Foreign and Commonwealth Office

London SW1A 2AH

18 January 1984

Dear John,

Visit of the Prime Minister to France: 23 January - Brief on the European Community

I enclose the brief on the European Community for the Prime Minister's discussion with President Mitterrand.

The speaking note is longer than usual. We have done it in this form because we believe the Prime Minister will need to give President Mitterrand a rather full account of our thinking. It was clear from the Athens European Council that there is a lot of genuine (as well, perhaps, as some deliberate) misunderstanding of our position on his part, and we think it important to try to get across to him, not just the detail of our negotiating position, but our overall approach to the Community which underlies it.

I am copying this letter and enclosure to Richard Hatfield.

Yours ever

Roger Bone

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VISIT OF THE PRIME MINISTER TO FRANCE: 23 JANUARY

EUROPEAN COMMUNITY: STEERING BRIEF

INTRODUCTION

1. The Prime Minister's visit to Paris for lunch with President Mitterrand on 23 January arises from her breakfast meeting with him at the European Council on 6 December. It was clear from that discussion, and from President Mitterrand's performance at the European Council, that there was a much wider gap between our position and his than had been apparent in the extensive discussions in the Special Councils in Brussels and in bilateral contacts. In particular, President Mitterrand was not prepared to contemplate a lasting mechanism for dealing with budget imbalances. Nor did he give any support to the ideas tabled by M. Delors for more effective control of overall expenditure although he did not disown them. Both the Prime Minister and President Mitterrand agreed at Athens that differences between us on Community issues should not be allowed to blow up as a major Anglo/French dispute and that they should have a meeting early in the French Presidency to try to establish a basis for the negotiations. President Mitterrand will be having a meeting with Chancellor Kohl in Bonn on 2 February. He plans a series of visits to other EC capitals.

French Attitudes

2. In his analysis of President Mitterrand's performance at the European Council Sir John Fretwell argued that, while the President was probably not well prepared on the detail of the issues under discussion, his unwillingness to negotiate was the result of his assessment at Athens that there was no real basis for a negotiation. While he might have been ready to move if a

real negotiation had got underway, and if he had judged that an outcome satisfactory to France was attainable, his political instincts told him that this was not on the cards. He therefore reverted to first principles as regards the negotiating issues of major concern to us, disregarding the work already done, including by his own Ministers and Officials.

3. President Mitterrand now faces a number of conflicting pressures. He will clearly wish the French Presidency to be a success and this implies presiding over agreement on the post-Stuttgart negotiations. At the same time, he will face strong domestic pressures, particularly as the European Parliament elections draw near. These are viewed in France, not least by the Government itself, as a referendum on M. Mitterrand's Administration. This means that President Mitterrand will continue to resist the kind of stringent control of agricultural spending which we have stressed. He will also continue to resist a longterm budget settlement at anything like an acceptable level to the UK. What is not clear is whether the French would be prepared to concede a satisfactory long-term budgetary arrangement at a price and, if so, what that price might be. The French would certainly seek concessions in the CAP package, eg some abatement of our stringent approach to price controls and guarantee thresholds and to the Community's external agricultural policy. While they seem prepared to move to a system for the overall control of Community expenditure, they are not prepared to accept a strict financial guideline for agricultural spending of the kind the UK has proposed, which would ensure a reduction in the rate of growth of agricultural spending.

French Tactics

4. The French have not yet made up their minds as to how to handle the negotiations though their initial comments suggest that they hope to conduct much of the negotiations on a bilateral basis, ie avoiding Special Councils such as were held before Athens. It is not yet clear to what extent they will make use of the Foreign Affairs Council (which meets on 23 January). However, at the one substantive Council so far under the French Presidency (Agriculture on 9/10 January) we were able to agree to the French suggestion that the bulk of CAP issues in the Post-Stuttgart negotiations should be discussed, and where possible decided, by Agriculture Ministers.

5. It is equally not yet clear to what extent the French Government are seriously aiming at decisions at the March European Council. Contrary to early indication after Athens they, are now expressing determination to make real progress by the end of March, but we do not know whether this is a genuine commitment or a tactical decision in the face of suggestions that the French Presidency were dragging their feet. On substance, there is also a division between those, including Cheysson and Delors, who appear to recognise that a successful negotiation can only be reached on the basis of a deal satisfactory to us and the Germans and others, including possibly the President himself, who still hope that Britain can be pressured by her nine partners into making substantial concessions. The tone of the French press, which suggested immediately after Athens that Britain's commitment to the Community was in doubt and that President Mitterrand would call Britain to account, has been much less combative in recent weeks. President Mitterrand's new Minister for European Affairs, M Roland Dumas, while sharing many of the

traditional French prejudices about Britain's attitudes, has expressed a strong desire to work closely with us.

UK Objectives

6. Against this background our objectives for the Prime Minister's meeting with President Mitterrand will be:

(i) To persuade the President that we are as deeply committed to the future development of the Community as any other Member, and that our approach to the negotiations is not one of standing in the way of the development of the Community but of seeking to establish a sound basis for that development.

(ii) To stress the importance of working for agreement at the March European Council and ironing out as many differences as possible before the Council.

(iii) To demonstrate to the President that, while the Community's original financial arrangements were satisfactory for the six, they must now reflect the realities of the Community of ten, and indeed of an eventual Community of twelve. This issue cannot be dealt with by tinkering on the margin, eg by Britain buying more from her Community partners. It requires objective analysis and a systematic long-term solution.

(iv) To make clear to the President that we have no interest in undermining the CAP but that, in seeking overall control of Community expenditure, as well as new areas of Community activity, it is vital to ensure that the Community's resources are not increasingly taken up by agricultural expenditure.

(v) To make clear that the Community's problems can only be resolved on the basis of an agreement capable of endorsement by national Parliaments, and

(vi) That such an agreement must involve resolution of the main issues confronting the Community, ie control of expenditure, particularly agricultural expenditure, and the problem of budget imbalances. These should be seen, not as particularly British problems, but as issues affecting the viability of the Community as a whole. It is right that, with other Member States seeking a major change in the Acquis Communautaire such a change should only take place on certain clear conditions.

(vii) To indicate our clear desire to promote the future development of the Community and in particular to work closely with the French on the development of New Policies including in the field of industrial collaboration.

(viii) To express appreciation of the support we have so far received over our 1983 refunds, but to leave the President in no doubt that the prospects for an overall agreement will be seriously jeopardised if this issue is dragged into the negotiations.

Briefing

6. The briefing takes the form of a speaking note and essential facts. Sir John Fretwell has advised that President Mitterrand is unlikely to go into detail at the meeting but rather to try to establish a basis of understanding and a framework for the negotiations. The speaking note reflects this advice but the essential facts contain detail on which the Prime Minister might draw as necessary.

VISIT OF THE PRIME MINISTER TO FRANCE: 23 JANUARY

EUROPEAN COMMUNITY:

POINTS TO MAKE

Need for an Early Agreement

1. Grateful to you for enabling this meeting to take place. We should be working hard to take decisions at the European Council in March. If we cannot do so, or cannot make really substantial progress, then the Community's difficulties will only increase. Apart from the obvious political repercussions, which would cast a pall over the European Parliamentary Election Campaign, there would be serious practical consequences for farmers and for governments as management of the CAP became more and more difficult. The Community as a whole would not be able to get on with the new policies which we all favour. The only people who would gain from seeing the Community in chaos would be the official opposition in all Member countries.

Procedure

2. A lot of urgent work needs to be done between now and the end of March. We welcomed the proposals made by M Rocard that the bulk of the agricultural issues should be dealt with in the Agricultural Council subject to the proviso that discussions of the overall control of expenditure will need to be handled in whatever forum is agreed for the negotiations on the central budget issues. There will also be a need for bilateral contacts. If France, Britain and Germany could see their way to solutions on the main issues that would help to unlock the negotiations. We need to work closely together on all this. Geoffrey Howe has invited Roland Dumas to visit London (8 February). I do not believe that our respective positions are as far apart as others may think. Hope we can resolve as many issues as possibly before the European Council rather than leaving them for the European Council itself.

Overall Approach to the Negotiations

3. UK's approach is often unrecognisable from the reports which appear both in our press and yours, and which tend to portray Community issues as some kind of private Anglo/French battle.

4. Britain's continuing commitment to the Community, which was resoundingly endorsed at the General Election, is based on our commitment to the Community as a major economical and political force in the world and as a viable and powerful instrument for democracy. We are as firmly committed as anyone to the ideals of the Treaty and have practical suggestions as to how the as yet unfulfilled aims of the Treaty can be met. We see the Community as a dynamic body. Like you we are not attracted by a supra national approach. Our approach is rather to focus on practical developments which are clearly in everyone's interest and in conformity with the Treaties, and to allow them to establish the future shape of the Community as a whole.

Nature of the Crisis

5. We all acknowledge that the Community is in crisis. But it is not a crisis which arises from the actions of any one Member State. It can only be resolved on the basis of an agreement among the Member States, capable of being endorsed by national Parliaments. The crisis has arisen because some Community policies have not worked as they were intended. The CAP, in particular, can be said to have over-fulfilled its original aims which did not include its growing absorption of budget resources at the cost of other Community policies or production of unmarketable surpluses. Nor do the Community financing arrangements provide a solid basis for the Community's future development in their present form.

6. Britain is not seeking to overthrow the basic tenets of the Community. We are not seeking a free trade area; nor are we insisting we get back every penny we put in. What we are seeking is a sound basis for the future development of the Community.

The Community has always had to adapt to reflect growing membership and changing circumstances. The present situation, with the Community on the verge of further enlargement and facing a financial crisis, demands new solutions.

Those who want an increase in Own Resources are themselves proposing a fundamental change in the Own Resources decision of 1970 and hence in the Acquis Communautaire. We are not saying that such an increase should never happen.

I said at Stuttgart in June that we would be prepared to consider an increase in Own Resources provided that we reached agreement on an effective control of the rate of increase of agricultural and other expenditure, and provided we secured a fair sharing of the budget burden.

DETAILED ASPECTS OF THE NEGOTIATIONS

Control of Expenditure

7. We both agree that the Community needs to control the growth of its expenditure. We share the approach outlined by the French Government in the run-up to Athens, namely that control of expenditure should cover all aspects and not just agriculture. Like you we are unhappy about the way the European Parliament is pushing all the time for higher spending.

8. As I indicated at Athens, we could accept an approach of the kind which France proposed. But it must be effective, not just a declaration of intent. This implies incorporating it as part of the Community's budgetary procedure. It also means we cannot avoid stringent steps to curb the growth of agricultural spending. Action is required to stop the growth of surpluses. I hope you will go along with our view that part of any agreement on Own Resources should include measures to ensure that agricultural spending should grow less rapidly than the Community's resources overall.

CAP

9. Recognise the crucial role which agriculture plays in France's economic and political life. Agriculture is of major significance economically and politically to us too. There is no doubt that all Community farmers, including British farmers, have benefitted from the CAP. But the CAP was intended to stabilise market conditions as well as create financial security for the farmer.

I recognise, and said so in the House of Commons, that France is prepared to take steps to cut down surpluses. We cannot avoid reducing our own surplus production. We need to take some account also of our trading relations with other countries. Concern for the overall balance of the Community's relationship with its trading partners is one of the reasons why I, Chancellor Kohl, and the Dutch and Danish Prime Ministers, opposed the Oils and Fats Tax when we discussed it at Athens.

You mentioned cereal substitutes to me at Athens as one of the key issues in the negotiations. We would be prepared to consider some arrangement negotiated with the Americans to curb the import of cereal substitutes as a counterpart to our closing the gap between Community and world grain prices. This is an issue which needs serious discussion with the Americans, and which will doubtless feature in your own forthcoming talks with President Reagan. We believe that it is essential to resolve the issue by agreement and to avoid retaliation which would quickly spread to the industrial sector, leaving us all worse off than before.

Budget Imbalances

(a) Nature of the problem

10. This is a problem that affects Britain acutely, but it is not a purely British problem. It is a problem that the Community has acknowledged and which can only be resolved by action by the Community as a whole.

We were given a commitment when we first entered the Community and foresaw this problem that, should an unacceptable situation arise, action would be taken to deal with it. The Community has acknowledged that commitment in the budget refunds.

It was recognised at Stuttgart that the time had come for a lasting solution to the problem. We agreed in the Stuttgart declaration that the objective of the negotiations would be "to agree measures which, taken as a whole, will avoid the constantly recurrent problems between the Member States over the financial consequences of the Community's budget and its financing". The aim was to ensure equitable financial situations for all Member States.

We are not looking for a special deal for Britain, but a recognition that a financial structure that worked for the Community of six does not work for the Community of nine or ten, and will not do so for the enlarged Community of twelve. The problem requires a systematic solution.

We all recognise that the Community budget entails transfers of real resources across national frontiers. In our case, this imposes an unjust and unbearable burden with a large transfer of resources from one of the less prosperous Member States to richer Member States. So far in the negotiations everyone has been calculating how much it would cost them if the burden on us were reduced to a reasonable level. We need an objective assessment. It should also be borne in mind that, under our proposal, we should still be a substantial contributor to the budget though less prosperous than most.

(b) Possible Solution

11. The Germans, as the wealthiest nation in the Community, are ready to make a larger overall contribution than at present. What they ask for in return is some kind of overall limit on their contribution.

I hope you can agree that what is now needed is a system which will ensure a fair sharing of financial burdens in relation to relative prosperity. This would put the Germans at a higher level than other Member States. It would reduce the existing burden on us, as one of the less prosperous Member States.

I recognise that a system of this kind would increase France's net contribution to the Community budget. We would be very willing to work with you to see that a system of the kind we have in mind would not put you in an unacceptable position.

We have consistently indicated our willingness to consider proposals other than our own provided that they genuinely measured the true burden, ie money which flows out from the UK to be spent in other Member States, and adequately corrected it. Ad hoc settlements of the kind that we have had in the past, are no longer satisfactory. They acknowledge that there is a problem, but do not take the next logical step which is to provide a mechanism which deals with the problem for as long as it lasts. They also create an annual haggle which distracts attention from other essential Community policies as well as creating difficulties with the European Parliament which are undesirable in themselves, and as we have seen over the 1984 budget, enable the Parliament to try to extend its powers at the expense of the Council. It was for this reason that we proposed a mechanism that should last for as long as the problem. In October last year, the French Government proposed that the mechanism which is agreed should be implemented on the revenue side of the budget. We welcomed this suggestion, from which it follows that the mechanism should form part of any new Own Resources system.

New Policies

12. We have clear ideas for the future development of the Community. These include proposals for completion of the internal market, in particular in goods and services such as

insurance, liberalisation of transport, including air transport, and development of a solid fuels policy.

Your officials and mine had useful discussions before Athens on how French ideas for industrial cooperation could also be taken forward. I am only sorry that this whole area was hardly discussed at Athens. While our approaches are not the same in every way there is a lot of common ground and your concept of industrial cooperation whether under a Community or bilateral umbrella is one that we are keen to develop.

There are a number of bilateral objectives where we already cooperate closely and others where cooperation can be developed. This cooperation helps to strengthen the cohesian of the Community as a whole. I therefore hope that you will continue to give a lead on this under your Chairmanship of the Community. The opportunities that exist for the Community only help to emphasise how vital it is that we do get to grips with these issues which are now holding up progress. I want to see the Community on a sound basis so that it can devote itself to the development of new policies.

1983 Refunds

13. We were grateful for the attitude which Member States took to the Parliament's action on the 1983 refunds, which reflected the general realisation that important issues of the relative powers of the Council and the Parliament were at stake. We are looking for early agreement on the Regulations for the 1983 refunds. We hope that a transfer to the line of money now in the reserve chapter of the budget can be made before the end of March or, if not, that it should be clear that only the Parliament, and not our partners, are standing in the way of implementation of the agreement. This is a politically sensitive issue in the United Kingdom. I have consistently argued, against those in the UK who wish to take drastic action on the budget, that the Community is not in default on its obligations on the 1983 refund. I hope we can continue to count on the support of our

partners for implementation of what was agreed at Stuttgart. It would make an overall settlement more, rather than less, difficult if this question were now linked to the outcome of the negotiations overall.

1982 Refunds

14. We also look to the Community to meet its remaining obligations on the outstanding element of our 1982 risk sharing refunds, which should have been paid to us in 1983. As you may know, we have taken this up formally with the Commission and look to them to propose remedial action.

Conclusion

15. Agreement can only be reached on the basis of a package which will need to cover the control of expenditure and a lasting solution for budget imbalances. Only in the light of agreement on that package can we take decisions about the future level of the Community's Own Resources. We now have less than 2 months to the next European Council, and it is vital that we keep in close touch if we are to iron out some of the major differences and be able to make substantive progress in March.

PRIME MINISTER'S MEETING WITH PRESIDENT MITTERRAND

ENLARGEMENT

POINTS TO MAKE

1. French can have been left in no doubt about Spanish and Portuguese concerns and the importance both countries attach to major progress during the French Presidency.

2. Hope it will prove possible to complete substantive part of the accession negotiations by the summer break. Will give full support to French Presidency efforts to achieve this.

BACKGROUND

3. Informal working date for Spanish and Portuguese accession of 1 January 1986 depends very much on progress under French Presidency. Unless the French made a major effort, the deadline is likely to slip again and create real political difficulties domestically for both applicant states.

4. French intentions are still opaque. During Prime MInister Gonzalez' visit to Paris on 20 December, the French and Spaniards appear to have agreed on the political context for bilateral work with the aim of reducing as far as possible the element of political controversy from difficult dossiers (ie mainly agriculture). There has been no subsequent feedback and President Mitterrand is still avoiding committing himself to specific deadlines. Meanwhile, the French are focussing work in the Community on less sensitive dossiers.

VISIT OF THE PRIME MINISTER TO FRANCE: 23 JANUARY

EUROPEAN COMMUNITY

ESSENTIAL FACTS

(a) CONTROL OF COMMUNITY EXPENDITURE

1. The Stuttgart European Council recognised in its conclusions the need for greater budgetary discipline. One of our own conditions for considering any increase in Own Resources is effective control of agriculture and other expenditure.

UK Proposal for a Strict Financial Guideline

2. At an early stage in the negotiations we therefore proposed a strict and legally binding financial guidline for agricultural expenditure which would hold the rate of growth of agricultural expenditure to a specified fraction of the rate of growth of Own Resources. Each year the Budget Council would set a permitted rate of increase which would not be greater than, but could be less than, the 'given fraction'. The Commission's proposals and the Council's decisions on CAP prices and the budget would have to be consistent with the guideline.

3. In our view the essential elements of an effective guideline are that:

(i) the basic principle must be to hold the rate of growth of CAP guarantee expenditure "markedly below" or to a given fraction of the rate of growth of the Own Resources base;

(ii) the guideline must be in a legally binding form;

(iii) it must be precisely defined;

(iv) there should be arrangements for "clawing back" any amount by which expenditure exceeds the guideline.

Commission Proposals

4. Most Member States are prepared to accept the ideas put forward by the Commission for a financial guideline to ensure that agricultural expenditure would grow at a rate less than that of Own Resources. According to the Commission's proposals if in the

Commission's view the Agriculture Ministers appeared likely to decide on price increases, whose costs would exceed that of the Commission's proposals, there would be a joint Council of Budget and Agriculture Ministers; the Commission and the Council would take all possible steps to keep expenditure within the budget during the year; supplementary budgets would be used only as a last resort, but voting would be by qualified majority, as at present; expenditure over the guideline would be clawed back over the following 2 years; and the Commission would bind itself formally to take account of the guideline. In our view, the main drawbacks of the Commission's proposed guideline are that it is not legally binding and could not therefore constitute an effective control on CAP expenditure; and that the basic principle of a rate of growth of agricultural expenditure merely 'below' (not markedly below) that of Own Resources is weaker than our own approach.

Dutch Amendments to Commission Proposals

5. The Dutch amendments to the Commission proposal, tabled at the 28 November Special Council which M Thorn has said he could accept, involve one important improvement: the Commission would undertake to draw up annual proposals for CAP prices which accorded with the guideline and the Council of Ministers could only agree on an amended proposal by unanimity. This provision would significantly strengthen the force of the guideline even if it was not embodied in a legally binding form.

French Proposals

6. At the 28 November Special Council, M Delors tabled French proposals for greater budgetary discipline on all expenditure. These were subsequently watered down in a second, shorter French paper tabled on 29 November. The second French paper envisages that at the start of the budget procedure the Finance Council would fix a 'reference framework' ie the maximum amount of resources to be used for the following budget year. The reference framework would be determined in consultation with the Parliament. Within this reference framework the Council would set itself two

guidelines, one for total expenditure and the other for agricultural expenditure, the latter cast in terms of a 3-year moving average.

7. We have welcomed the French proposals as a basis on which to build our own ideas. The amendments which the Prime Minister tabled at Athens were intended to establish:

a) that Finance Ministers should work out in detail the general principles in the French proposals;

b) that the resulting detailed arrangements should be embodied in a legal form as part of the Community's budgetary procedures;

c) the "markedly below" formula;

d) that there should be clawback of any expenditure above the guideline (as was envisaged in the earlier, longer version of the French ideas which Delors put forward at the Special Council on 28 November).

8. President Mitterrand's performance at Athens, however, casts doubt on whether he will support the Delors proposal. President Mitterrand not only failed to speak up for the proposal but at his breakfast meeting with the Prime Minister on 6 December appeared to know nothing about it. M Cheysson's intervention also suggested that the French are hesitating about pressing for a legally binding guideline. M Cheysson said that the French paper respected the role of the European Parliament and existing institutional arrangements and was in line with but 'upstream' from the Commission's proposal. He added that France opposed legally binding rules.

9. The revised Presidency text tabled at the Athens European Council on 5 December combines the Commission/Dutch proposals and the French proposal. It contains a number of useful points on which we could build but is still unsatisfactory in its present form, particularly in so far as it does not provide for changes in the legal basis of the budgetary procedures and does not include the "markedly below" formula.

10. The UK objective is to build on the progress made during the autumn by encouraging the French to keep their ideas on the table and not to shy away from the need for legally binding arrangements.

(b) CAP

French and British Positions on CAP up to Athens

1. France generates some 26% of CAP production, about double the British figure, and France has about five times more agricultural holdings than the UK . Farmers and farm workers represent 8.5% of the working population (many part-time), compared to 2.8% in the UK, and they carry disproportionate political weight. Over the years, however, high CAP prices have had the effect of bringing member states closer to self-sufficiency and limiting the outlets for French food exports within the Community. The French reaction to this is not to limit CAP production but to seek to reduce agricultural imports into the Community (enforcing "Community preference" by limiting New Zealand's access for example) and to pursue a vigorous "vocation exportatrice", supplying subsidised production to world markets.

2. France and UK's very different perspectives on the CAP have led to some sharp differences over the key agricultural issues in the Post-Stuttgart negotiation. Broadly:

STRICT FINANCIAL GUIDELINE

UK Position

A necessary condition for sustained control of agricultural spending (and, by implication, for UK consideration of new own resources)

French Position

Incompatible with the CAP which is based on individual market mechanisms. {Possibly acceptable, however, as part of a package of budgetary discipline over the whole budget (Delors paper etc)}.

PRICES/GUARANTEE THRESHOLDS

UK Position

Price restraint, and the setting of limits on how much support can be unconditionally guaranteed for commodities for which economic outlets are limited, are crucial elements of CAP reform.

French Position

Could accept some price restraint (eg on cereals) and guarantee thresholds, but this is not the key to the future of the CAP. The CAP objective of increasing farming incomes is sacrosanct. [The CAP in fact talks only of ensuring a fair standard of living for farmers.]

EXTERNAL TRADE

UK Position

EC is high cost producer and does not have a future as a major world supplier. Agricultural trade must not be allowed to jeopardise the EC's much more important industrial trade. Present policies are increasing tensions with major trading partners and (by reducing the value of local production) hindering development in many LDCs.

French Position

EC has a "vocation exportatrice" and France favours a vigorous Community export policy including long-term supply contracts. Any reduction in EC production must be matched by exercise of GATT rights in relevant sectors (eg cereals substitutes). No capitulation to US.

MILK

UK Position

The milk sector accounts for about a third of CAP spending. Action is urgently needed to reduce the current level of surplus. We favour action on price in the first instance to discourage production, increase consumption and reduce the cost of disposing of the surplus.

We are examining the proposal for a super-levy. As a complementary policy it would be acceptable only on certain strict conditions, and provided that it applied to everyone on broadly the same terms. In any case, the super-levy is no substitute for action on price: it could only be effective if harnessed to a rigorous price policy.

There was pressure at Athens to increase the co-responsibility levy. This would be the wrong approach. Instead of limiting production, the effect of the levy is to raise revenue to finance surplus production.

French Position

Could accept super-levy provided it had sufficient flexibility to allow transfer of quotas on national basis with differential element to favour small and hill farms. French also favour a progressive co-responsibility levy on milk and a levy on intensive producers: (both would hit UK disproportionately). The UK butter subsidy should be abolished.

CEREALS

UK Positon

Price restraint is the key, and we favour a systematic narrowing of the gap between EC and world prices.

As for substitutes, we are not convinced of the case for further EC restrictions on the import of cereals substitutes which could have damaging consequences for world trade. A lower price for cereals would help to reduce the demand for imports of substitutes.

French Position

Agree, broadly, on prices. But stongly believe that price restraint must be contingent on action to reduce cereal substitute imports.

OILS AND FATS TAX

UK Position

We strongly oppose this proposed tax which would bear particularly hard on the poorest EC consumers. Whatever the legal niceties, overseas suppliers would see the tax as contrary to GATT bindings, and would be likely to seek compensation or to retaliate. The Commission were asked to make proposals for controlling CAP expenditure, not for raising new revenues.

French Position

Agree the proposal, which is a necessary complement to a more rigorous milk regime.

MCAs

UK Position

This subject is of great importance to some Member States. It is not clear, even now, how the Commission's ideas for dismantling MCAs would apply to a floating currency like sterling. Our main concern is that the solution agreed should be neither inflationary nor weigh heavily on the Community budget.

French Position

It is essential to find a way of dismantling MCAs as soon as possible . FRG positive MCAs are intolerable to France. Could not accept proposed FRG solution which would create a DM zone. (M. Mitterrand has twice used the analogy of the Israeli sheckel and the US dollar).

OTHER PRODUCTS (ie Mediterranean)

UK Position

Economies must be found in the regimes for all products, including those not produced in the UK. There must be a balanced package.

French Position

{Substantial Mediterranean production in the South of France}. A balanced package, yes, but not too much zeal. The way to achieve outlets for fruit and vegetables, for example, is to increase protection against imports - not to cut EC prices, or discontinue aids.

RECENT DEVELOPMENTS

Future Work Programme

3. At the Agriculture Council on 9/10 January it was agreed that Farm Ministers would take over all work on the post-Stuttgart agricultural issues and 1984 price fixing. (Supported by high-level official group) M. Rocard (Presidency) maintained that only milk and MCAs would need to go to the European Council. Other decisions could be taken at the level of Agricultural Council, (and the Commission maintained that many of these were 'technically prepared' before Athens and ready for political decision). The linkage with a Financial Guideline was not clear, but it was agreed that this question should be pursued outside the Agriculture Council.

Market Management Measures

4. On 22 December 1983 the Commission announced decisions within its competence to achieve economies of 165 mecu, primarily by introducing a standard delay of 4 months for most intervention payments. UK, almost alone amongst Member States, has welcomed this move. France has echoed FRG complaints that the Commission should not have pre-empted decisions of the Agriculture Council.

1984/85 Price Fixing

5. The Commission 1984/85 price proposals agreed on 12 January contain only modest price changes. Zero increases are proposed for milk, wine and cereals. The weighted average price change in ECU terms is claimed to be 0.8%, and in national currency terms - 0.5%. For UK (assuming the proposed revaluation of 4% in the green pound is agreed), the proposals would give rise to a net price cut in sterling terms of 3.2%. For France, the proposals

represent a price increase of 3.2%.

6. In general, the proposals are less radical than we advocated (eg we would have like price cuts for milk and cereals). But we have no major complaints.

7. In addition to suggested price decisions, the Commission have maintained in full their reform proposals of July 1983 (Com 500) including such objectionable, or at least unwelcome, proposals as that for an oils and fats tax, action against cereals substitutes, a milk intensive levy, and elimination of the UK butter subsidy.

State of CAP finances

8. The CAP budget for 1984 is 16.5 becu. Current estimates are of claims of up to 19 becu this year. On 10 January Mr Dalsager warned the Agriculture Council that the Community would only have an average of 1207 mecu to spend in each full month this year compared with 1330 mecu in 1983. The money is likely to run out in the autumn unless either the Council agrees a CAP reform package or the Commission takes drastic action to suspend intervention buying for some commodities.

LINE TO TAKE ON "COMMUNITY PREFERENCE" AND FRENCH CHARGES THAT UK'S PROBLEMS ARE PRIMARILY SELF-INFLICTED BY OUR LEVEL OF AGRICULTURAL IMPORTS

(a) UK agricultural imports are no longer particularly high. Current estimates are that the UK share of agricultural levies in 1984, at 22%, will be exactly in line with the share of our contribution to the Community's own resources as a whole. About half of the UK's agricultural imports are now from the EC, compared with 31% in 1972.

(b) Concessions made by the whole of the EC to some former British colonial territories: (NZ butter, ACP sugar etc) are equivalent to provisions in the original Treaties for all France's former colonial territories.

(c) The slogan of "Community preference" is all too often used in France to argue for protectionism to a degree which is not reconcilable with the EEC Treaty. The Treaty speaks of "progressive abolition of restrictions on international trade." The Community depends for its prosperity more than any of the other world economic powers on international trade, and its external trade policy must reflect this.

(d) The inequitably high level of the UK's net contribution to the Community budget does not derive from our patterns of trade, which have shifted dramatically towards Europe (more than 44.5% of British exports went to other Community countries in November 1983 compared with about 30% before accession). Rather, it derives from the massive two-thirds share of the budget taken up by agriculture, and Britain's relatively small agricultural sector (about half the level of France's production). Do the French want us to redress the balance by increasing our agricultural production?

(c) BUDGET IMBALANCES

French Position

1. In the pre-Athens negotiations, the French gave some support to the Danish proposal for a convergence fund which provided that Member States of below average prosperity whose share of Community expenditure was below their GDP share would receive compensation for part of the gap between their expenditure and GDP shares. The French suggested three specific amendments to the Danish proposal:

(a) Corrections should be made on the revenue side rather than on the expenditure side;

(b) reallocation of administration expenditure which would reduce the size of the Community's allocated budget and hence the apparent size of the UK's budgetary burden;

(c) financing by a special key so that financing reliefs would lean more heavily on the richer net recipients (Benelux and Denmark) and less heavily on France;

2. The French strongly opposed the Commission's proposal for modulated VAT whereby CAP expenditure above 33% of the total budget would be financed by a special key based on relative prosperity, agricultural production shares and shares of net operating surplus. They rejected the first German proposal tabled in November for combining the Danish proposal with the Commission's ideas for modulated VAT.

3. The French are also firmly opposed to the UK safety net proposal on the grounds that it would institutionalise the concept of 'net contributions'. Their objection to net contributions is rooted in the argument that comparison of national contributions to and receipts from the Community budget would raise the demand for juste retour. Before taking office, President Mitterrand himself was critical of his predecessor for acquiescing in the May

1980 Agreement whereby refunds to the UK were to be calculated on the basis of net contributions. The French particularly dislike the inclusion of levies and duties in the calculation of net contributions which they argue is contrary to the principles of Community preference in trade. They sometimes claim that the UK should solve the problem of its disproportionate contribution of Own Resources to the Community budget by importing more from its Community partners.

4. There were some signs of flexibility by the French during the pre-Athens negotiations, eg willingness to discuss proposals for a durable system; acceptance that compensation should be implemented on the revenue side of the budget; and M Morel's discussions with Mr Williamson in November which indicated that the French might accept a solution based on measurement of the VAT/expenditure shares gap. But at the Athens European Council President Mitterrand reverted to the French position before Stuttgart that he would only consider a short-term ad hoc arrangement, modest in size, to relieve the British burden. On the second day of the Athens European Council, President Mitterrand said that he could not accept any of the proposals on the table for correcting budget imbalances (presumably including even the Danish proposal which the French had previously supported); the most he would agree for the UK was a refund of 500 mecu per year for 3 years. He did not respond either to the new German proposal tabled at Athens for a solution based on the VAT/expenditure shares gap or to the Prime Minister's suggestion for working out a solution which would leave the UK making a net contribution broadly similar to that of France in the range of 400-500 mecus in the first year of operation of the new system.

5. Given the fundamentalist approach taken by President Mitterrand at Athens in advocating a temporary ad hoc arrangement and M Mauroy's belief (reported by M Thorn in his discussions with Sir G Howe on 6/7 January) that the UK would in the last resort be prepared to accept a digressive 5 year arrangement to correct their budgetary imbalance, the key UK objective is to convince

President Mitterrand that whatever solution is decided must be neither ad hoc nor arbitrary.

6. The essential elements for us in any package are:

(a) A Lasting Solution

The new system, like any increase in the 1% VAT ceiling, will have to be included in a revised Own Resources Decision agreed by the governments of all Member States and ratified by all ten Parliaments. The following arguments could be deployed:

(i) During our accession negotiations we were given an assurance that 'should unacceptable situations arise within the present Community or an enlarged Community, the very survival of the Community would demand that the institution find equitable solutions'. This assurance has been repeated several times over the last decade culminating in the Stuttgart Declaration which stated that 'the negotiation will aim at a more balanced and equitable situation in financial terms from the point of view of the interests of the different Member States and the Community as a whole' and 'will agree measures which, taken as a whole, will avoid the constantly recurrent problems between the Member States over the financial consequences of the Community's budget'. A temporary ad hoc arrangement would not meet this requirement.

(ii) Ad hoc arrangements are likely to result in annual wrangles with the European Parliament which not only take up valuable time but enable the Parliament to try to extend its powers at the expense of the Council. President Mitterrand is likely to be particularly susceptible to this argument since the French have recently taken a firm line over the 1984 budget in opposing any extension of the Parliament's budgetary powers.

(iii) The present budgetary arrangements were designed to work for a Community of Six. They do not work in a Community of Ten. A broad economic balance was intended by those who founded the Community. This has manifestly ceased to exist. The UK not only bears an ineqitable budgetary burden but a large non-budgetary burden as well. Lack of economic balance has led to the paralysis of Community decision making. Member States are inclined to consider all new Community spending programmes in terms of their budgetary impact on themselves rather than on their merits.

(iv) This problem would become even worse in a Community of Twelve. Spain and Portugal would for some years have to be net recipients from the budget and the costs of their membership would have to be shared out among the existing Member States. It is therefore in French interests that lasting and equitable budgetary arrangements should apply after enlargement.

(b) Adequate Measurement of the Budgetary Burden

The UK argues for relief related to the whole net contribution to take account of the effect of our disproportionately high contribution of Own Resources as well as our low receipts from the Community budget. France is strongly opposed to the inclusion of customs duties and general agricultural levies in the calculation of contributions to the Community budget for theological reasons and partly form calculation of national financial advantages. Without going back on our position that that the gap between own resources share and expenditure share is the right way to measure the problem, we have said that we are prepared to look at different ways of dealing with the problem provided both sides of the gap are adequately covered.

7. There is no foundation in the argument that the UK could solve the problem of its disproportionate payments of levies and duties

by importing more from its Community partners. UK imports from the Community have increased from 32% in 1972 to 46% in 1983 but the size of our unadjusted net contribution has steadily grown over that time. The most important single cause of the British budget problem is the low level of our CAP receipts.

8. The Commission and some Member States, including France, have tried to reduce the size of the gap between expenditure and GDP shares by excluding or redistributing some items in the allocated budget. We cannot accept arbitary and mistaken changes to the definition of allocated Community expenditure which the Commission has always used hitherto. We believe the existing practice of attributing the bulk of administrative expenditure to Belgium and Luxembourg fairly represents the costs and benefits involved.

(c) Adequate Correction of the Measured Burden

9. The UK Safety net proposal sets a maximum limit or threshold on a Member State's contribution related to ability to pay. The limit is expressed as a percentage of the Member State's GDP expressed as a function of relative prosperity. There is now a wide measure of agreement that compensation should be related to ability to pay. The Federal Republic and the Commission have also adopted the Safety Net 'threshold' formula. The UK could not accept a system under which the limit is expressed as a percentage of the measured burden (not of GDP) as in the Danish scheme since this would not guarantee adequate protection against increases in our uncorrected net contribution.

(d) Compensation should be implemented on the revenue side of the budget

10. We welcome the fact that the French themselves proposed that compensation should be implemented on the revenue side of the budget in their amendments to the Danish proposal which were tabled in October. If implementation is on the revenue side, it follows that the new arrangements will have to be included in a revised Own Resources Decision.

Financing of Compensation

11. One of the reasons why the negotiations have been so difficult is that other Member States have been calculating what it would cost them if the budgetary burden on the UK was reduced. We recognise that a system of financing reliefs in accordance with normal VAT shares would leave France with a large net contribution. It is possible to produce a different result by making the financing of relief related to a special key. In our Safety Net proposal we deliberately left open this possibility. It is also why the Prime Minister suggested at Athens that in working out the details of a system of the kind we proposed, we should aim for an outcome whereby France and the UK would have approximately equivalent net contributions (400-500 mecu) in the first year of the system.

(d) NEW POLICIES

1. In the course of the negotiations leading up to the Athens European Council a number of Member States, including France and the UK, tabled papers setting out ideas on the future development of the Community. Our own contribution, while stressing the need for cost effectiveness and for action to be taken within the framework of the finance available, sought to demonstrate that much could be done which would be of immediate and tangible benefit to the Community and its inhabitants in ways which cost little. We concentrated our fire on policies which are considered genuinely "communautaire", on which specific Commission proposals are already on the table, and above all on which early decisions would be in the UK interest.

2. Our priorities are:

<u>Internal Market</u>

- Removal of barriers to intra Community trade in goods <u>and</u> services (ie renewed impetus to the Community's standards harmonisation programme; early and genuine liberalisation of non-life insurance services in line with Treaty requirements).
- Adoption before 1 July 1984 of a single administrative document to simplify customs formalities.

<u>Transport</u>

- Free lorry movement by (a) increasing the EC road haulage permit quota and (b) deciding during the French Presidency on a timetable for the abolition of <u>all</u> road haulage quotas.
- Early liberalisation of air transport services: French Presidency to arrange a special Transport Council to discuss air transport policy and report back to the March European Council.

<u>Environment</u>

- A firm deadline (no later than 1990) for the introduction of unleaded petrol.

Energy

-A solid fuels policy to promote the economic production and use of coal.

3. The French do not share our enthusiasm for the completion of the internal market or for the liberalisation of transport services (on which Mr Ridley is seeking an early meeting with his French opposite number, M. Fiterman). So far, they have scheduled no Internal Market Councils for their Presidency in contrast to the Germans, (who held four). The French represent a major obstacle to freedom of insurance services - of particular importance to Lloyds - and face legal proceedings brought by the Commission.

4. French ideas on new policies have stimulated much interest. They argue that Europe faces a historic challenge in the new technologies; that the Community will fail if it cannot mobilise its resources to compete with its rivals in the US and Japan; and that the price of failure will be increasing technological dependence. To meet this challenge the French advocate a number of measures designed to enhance the Community's research effort and to create a better environment for co-operation between European enterprises. There is much in this analysis with which we agree and we can support many of their ideas for action (eg more priority for R&D, work on standards, competition policy geared to industrial development). We and other Member States have made it clear that we cannot go along with some specific ideas (eg temporary tariff protection for industries of the future; tighter definitions of EC origin rules for Community products; Commmunity rules for inward investment). The French for their part have been at pains to state that their intention is not to erect a protectionist wall around Europe and have indicated that they are prepared to be flexible over points of difficulty for other Member States. But they will be looking very hard for concrete examples of inter-European co-operation over large scale projects and high technology, whether in a strictly Community framework or on a bilateral or multilateral basis. The Airbus A

320 is one such project (see brief no 6). The Channel Fixed Link is potentially one such bilateral project. The report of the Anglo-French Banking Group is likely to be submitted to the two Governments at the end of January. It will receive careful study: we are ready to consider any proposals provided they meet our stated requirement that any link should be financed privately (NB the French may be willing to provide some public financial support).

5. As part of their concern on this front the French Presidency have made clear that they intend to make employment and social policy consequences of their technology developments a priority of their work programme. As well as the Social Affairs Council, they are planning three informal Ministers' meetings, in order to pursue specific proposals (recommendation on working time, resolution on local employment initiatives {ie small firms}, noise directive, Vredeling directive on employee participation, women's employment problems, social effects of new technology, among others); as well as to relaunch a general Community social affairs initiative based on their (unsuccessful) 1981 proposals for a "European social zone".

The UK does not, as a matter of tradition and principle, favour proposals for binding Community legislation in the field of social affairs; we take the view that such matters are more appropriate for action by the social partners without Government interference. However, we are prepared to consider non binding recommendations so long as these do not compromise the established UK line.

(e) STRUCTURAL FUNDS

4. The Stuttgart European Council stressed the need for control of expenditure in areas other than agriculture and called for the development of policies within the bounds of financial feasibility. In response to this, the Commission produced proposals on ways to increase the cost effectiveness of the structural funds (ERDF, Social Fund and the FEOGA Guidance section) by avoiding duplication of effort and expenditure principally through better co-ordination between the various funds and more concentration of the funds resources, in the sense of concentration on areas of need and higher rates of intervention.

5. Agreement on almost all points was reached before the Athens Summit. The only outstanding issues were whether there should be commitments to a substantial increase in the size of funds and to the introduction of Integrated Mediterranean Programmes (see below).

6. In the meantime, negotiations on a new ERDF Regulation which had become bogged down, mainly over the question of full quota shares, resumed at the end of 1983. Discussions are continuing but early agreement is unlikely. Although nominally part of the structural funds review, the Social Fund has not featured in the current discussion: all Member States and the Commission have been content to proceed on the basis of the Regulation agreed earlier in 1983. Discussions of new proposals for the FEOGA Guidance Section have just begun but are at a very preliminary stage.

Integrated Mediterranean Programmes

7. The Commission's proposal for IMPs would involve expenditure of some $6\frac{1}{2}$ billion ecu of Community money over 6 years, starting in 1985, on backward rural areas of Italy (45% of the funds), Greece (38%) and France (17%). The money would go primarily to agricultural structural programmes as well as to infastructure projects, industrial development and job creation.

8. The proposals started life as a pay-off to the Italians in the abortive 30 May 1980 mandate negotiations. They now tend to be seen, rather, as a pay-off to the Greeks in the context of the Greek Memorandum.

9. The northern Member States are united in opposing these proposals, though Britain is most outspoken in its criticism. The Commission is pushing them hard through Natali, the Italian Commissioner for Mediterranean Policy and Enlargement, who is their chief architect. The French, though they stand to benefit, are ambivalent because of costs of national matching funds which would be required, and because of the implications of enlargement.

10. The Commission's proposals are currently bogged down in a Working Group established to discuss them. The Greeks and Italians were unsuccessful in their aim for a commitment to IMPs at Athens and, because of the extent of disagreement between Member States both about the details of the proposals and, in Britain's case, the very principle of IMPs as a vehicle for additional expenditure outside the existing Structural Funds, decisions are not likely to be taken for some time. There is no sign yet that the French intend to push IMPs hard during their Presidency.

Measurement of the Budgetary Burden

9. The main French objection to a safety net solution based on net contributions is rooted in their objection to the inclusion of levies and duties in the calculation of national contributions. They therefore argue that;

(a) only the expenditure gap should be taken into account and

(b) the UK should solve the problem of excessive contributions by importing more from its Community partners.

(iv) It is not true to suggest that the UK could solve its budgetary problem by importing more from its Community partners. UK imports from the Community have increased from 32% in 1972 to 46% in 1983 but the size of our unadjusted net contribution has steadily grown over that time. The most important cause of the British budget problems is our low leverl of CAP receipts not the problems of levies and duties.

(v) We cannot accept arbitary and mistaken changes to the definition of allocated Community expenditure which the Commission has always used hitherto. We believe the existing practice of attributing the bulk of administration expenditure to Belgium and Luxembourg fairly represents the costs and benefits involved.

Financing of Compensation

11. Financial reliefs in accordance with normal VAT shares would leave France with a large net contribution. Applied to 1982 the Safety Net would give corrected net contributions of 2107 mecu for Germany, 763 mecu for France and 440 mecu for the UK. It is for this reason that we referred in our Safety Net proposal to the possiblity of a special financing key and that the Prime Minister proposed at Athens in working in detail on a system of the kind we proposed, we should aim for na outcome whereby France and the UK would have approximately equivalent net contributions (400-500) mecu.