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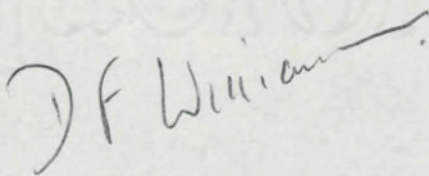
Qz.03662

MR COLES

REFORM OF THE COMMUNITY'S FINANCING

--- As the attached telegrams from our Permanent Representative in Brussels are very relevant to the meeting of Ministers at 4.45pm this afternoon, I annex the texts for the information of those who will be present.

I am sending copies to Janet Lewis-Jones (Lord President of the Council's Office), Roger Bone (FCO), John Kerr (Treasury), Murdo Maclean (Chief Whip's Office) and to Sir Robert Armstrong.


D F WILLIAMSON

5 April 1984

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DESKBY 050800Z FCO

FM UKREP BRUSSELS 041845Z APR 84

TO IMMEDIATE FCO

TELEGRAM NUMBER 1247 OF 04 APRIL 1984

INFO PRIORITY (PERSONAL FOR AMBASSADORS) BRUSSELS COPENHAGEN
THE HAGUE ROME DUBLIN PARIS BONN LUXEMBOURG ATHENS

MY TELNO 1210

BUDGET IMBALANCES

1. I SAW DAVIGNON THIS EVENING. I SAID THAT THE PROCEDURE HE HAD ENVISAGED OF US TELLING HIM THAT WE COULD LIVE WITH A CERTAIN SOLUTION AND HIM THEN GOING TO THE FRENCH ON THAT BASIS WOULD NOT DO. BRITISH MINISTERS COULD NOT MOVE FROM THE PRIME MINISTER'S POSITION AT THE EUROPEAN COUNCIL WITHOUT KNOWING WHERE THE FRENCH AND GERMANS WERE READY TO MOVE TO. MOREOVER, THE PRIME MINISTER, ON HEARING OF THE IDEAS HE HAD PUT TO ME ON MONDAY, HAD INSTRUCTED ME TO SAY THAT WHILE SHE CONSIDERED THAT SOME PROGRESS HAD BEEN MADE, SHE FELT VERY STRONGLY THAT MORE WAS REQUIRED. THIS WAS PARTICULARLY THE CASE WITH THE BASE AMOUNT, IE 1100, WHICH SHE DID NOT CONSIDER A REASONABLE FIGURE.

2. DAVIGNON SAID THAT THIS WAS EXTREMELY DISAPPOINTING. IN THE PAST 36 HOURS HE HAD HAD AN OPPORTUNITY TO TALK TO KOHL AND LUBBERS. ITS WAS HIS IMPRESSION THAT THEY MIGHT BE BROUGHT UP TO A FIGURE OF 1100 WITH SOME DIFFICULTY, BUT HE SAW NO POSSIBILITY OF THEM GOING BEYOND AND THE COMMISSION WOULD NOT AGREE TO PROPOSE IT. LESS AUTHORITATIVE REACTIONS FROM PARIS (HE HAD NOT INFORMED THE FRENCH OF HIS CONVERSATIONS WITH US) SUGGESTED SOME READINESS TO MOVE THERE TOO, BUT RELUCTANCE TO GO TO 1100 AND GREAT DETERMINATION NOT TO GO BEYOND A COMPENSATION RATE OF TWO THIRDS OF THE VAT SHARE/EXPENDITURE SHARE GAP.

3. DAVIGNON THEN ASKED ABOUT THE OTHER ELEMENTS IN HIS IDEAS. I EXPLAINED THAT HIS IDEAS ABOUT ENLARGEMENT WERE NOT ACCEPTABLE. HE DID NOT PURSUE THEM. I SAID THAT WE MIGHT BE PREPARED TO CONSIDER A FRANCHISE PROVIDED THAT IT WAS ABSOLUTELY CLEAR THAT ITS ONLY SIGNIFICANCE WAS AS A TRIGGER FOR BRINGING THE SYSTEM INTO OPERATION AND THAT THE WORKING OF THE SYSTEM WOULD NOT BE AFFECTED IN ANY WAY ONCE IT WAS TRIGGERED. IF THERE WAS TO BE A FRANCHISE WE THOUGHT THAT 0.075 PER CENT OF GDP WOULD BE MORE APPROPRIATE THAN 0.1 PER CENT. DAVIGNON CONFIRMED OUR INTERPRETATION OF THE FRANCHISE'S EFFECT AND SEEMED READY TO CONSIDER 0.075 PER CENT.

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4. AT THIS POINT DAVIGNON SAID THAT HE HAD JUST HEARD THAT PRESIDENT MITTERRAND AND THE PRIME MINISTER WOULD BE MEETING ON MONDAY. HE THOUGHT IT ESSENTIAL TO FIND SOME BASIS ON WHICH THEY COULD DISCUSS THE SUBJECT CONSTRUCTIVELY. IF THEY CONFRONTED EACH OTHER FROM ENTRENCHED POSITIONS OF 1000 AND 1250 MILLION ON THE BASIS OF THE 1983 FIGURES THEY WOULD GET NOWHERE. HE WAS INCLINED TO RECOMMEND THAT THE BASIS FOR DISCUSSION SHOULD NO LONGER BE THE REFUND ON THE BASIS OF 1983 FIGURES BUT THE PARAMETERS OF THE SYSTEM IN ITS FIRST YEAR OF OPERATION, IE:-

- A. THE THRESHOLD;
 - B. THE FRANCHISE;
 - C. THE COMPENSATION RATE;
 - D. THE POINT AT WHICH THERE WOULD BE A MOVE TO A HIGHER COMPENSATION RATE (THE STEP), AND
 - E. WHAT THE HIGHER PERCENTAGE SHOULD BE.
- HE ASKED WHAT OUR POSITION WOULD BE ON THESE MATTERS.

5. I SAID THAT I WOULD ENQUIRE WHETHER THE PRIME MINISTER WOULD BE READY TO MOVE TO THIS BASIS. IT FOLLOWED FROM MY INSTRUCTIONS THAT:-

- A. WE WOULD WANT A LOWER THRESHOLD THAN 0.05 PER CENT OF GDP. DAVIGNON NOTED THAT THIS RAISED THE 1100M QUESTION.
- B. WE WOULD WANT A COMPENSATION RATE BETWEEN THE THRESHOLD AND THE STEP OF 80 PER CENT. DAVIGNON SAID THAT THIS WOULD BE VERY DIFFICULT. IT WOULD BE HARD TO GET 77 PER CENT.
- C. HIS FIGURE OF 2,300 MECU FOR OUR 1985 GAP WAS UNREALISTICALLY HIGH AND WE COULD NOT ACCEPT IT. OUR BEST ESTIMATE, GIVEN THAT OWN RESOURCES WOULD NOT HAVE BEEN INCREASED IN 1985, WAS 2,000 MECUS. HE SAID THAT HE COULD COME DOWN A BIT. HE HAD MENTIONED 2,300 MECUS BECAUSE IT WAS NECESSARY TO EXPRESS THE STEP IN TERMS OF A PERCENTAGE OF GDP AND .4 PER CENT WAS ABOUT 2,300. AFTER SOME DISCUSSION, IN WHICH HE REFUSED TO ENVISAGE SETTING A FIGURE RATHER THAN A PERCENTAGE SINCE THIS WOULD COMPLICATE THE SYSTEM AS FAR AS OTHERS WERE CONCERNED, HE SAID THAT .35 PER CENT OF GDP (2030 MECUS ON THE COMMISSION'S ESTIMATE) MIGHT JUST BE POSSIBLE. HE WOULD HAVE TO THINK ABOUT IT.
- D. I THOUGHT THAT WE WOULD PROBABLY BE ABLE TO ACCEPT A MARGINAL RATE OF COMPENSATION OF 90 PER CENT PROVIDED THAT IT BEGAN AT 2030.

6. DAVIGNON SAID THAT HE WOULD HAVE TO REFLECT OVERNIGHT AND TO TALK TO ORTOLI AND THORN. HE THOUGHT THAT THEY WOULD AGREE THAT THE ONLY WAY FORWARD NOW WAS TO REPLACE THE LAST PARAGRAPH OF PAGE 12 OF THE PRESIDENCY CONCLUSIONS WITH A NEW PARAGRAPH SETTING OUT THE PARAMETERS OF THE SYSTEM. HE WOULD BE VERY GRATEFUL TO KNOW WHETHER THE COMMISSION COULD RECOMMEND TO PRESIDENT MITTERRAND THAT HE SHOULD DISCUSS THE MATTER WITH MRS THATCHER ON THIS BASIS.

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7. GRATEFUL FOR INSTRUCTIONS.

8. FCO PLEASE DISTRIBUTE TO NAMED ADVANCE ADDRESSEES ONLY.

FCO ADVANCE TO:

FCO - PS: PS/MR RIFKIND: PS/PUS: TICKELL: HANNAY: FAIRWEATHER: WALL

CAB - WILLIAMSON: STAPLETON: DURIE

TSY - UNWIN: FITCHEW: MORTIMER

NO.10 - COLES

BUTLER

LIMITED

HD|ECD(1) (2)

PS

PS|MR RIFKIND

PS|PUS

SIR C. TICKELL

MR HANNAY

COPIES TO
COPY ADDRESSEES

PP COPENHAGEN

THE HAGUE

PP ROME

PP DUBLIN

PP PARIS

PP BONN

PP LUXEMBOURG

PP ATHENS

GRS 700

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DEDIP

DESKBY 051200Z

FM UKREP BRUSSELS 051045Z APR 84

TO IMMEDIATE FCO

TELEGRAM NUMBER 1253 OF 5 APRIL

AND TO PRIORITY (PERSONAL FOR AMBASSADORS) BRUSSELS, COPENHAGEN, THE HAGUE, ROME, DUBLIN, PARIS, BONN, LUXEMBOURG, ATHENS.

MY TELNO 1247: BUDGET IMPBALANCES.

1. AS REPORTED BY TELEPHONE TO HANNAY, I SPOKE TO DAVIGNON AGAIN THIS MORNING. HE SAID THAT HE WAS GLOOMY AS A RESULT OF OUR CONVERSATION LAST NIGHT. HE WAS STILL CONVINCED THAT EVERY POSSIBLE NERVE SHOULD BE STRAINED IN ORDER TO GET AN AGREEMENT ON MONDAY/TUESDAY. BUT THIS WOULD NOT WORK UNLESS PEOPLE KNEW BEFOREHAND WHAT WAS GOING TO HAPPEN. TO HAVE A BAD DISCUSSION IN THE COUNCIL WOULD BE THE WORST THING. ON THE OTHER HAND, TO POSTPONE AN ATTEMPT TO SETTLE TO SETTLE WOULD BE VERY DANGEROUS. THE GERMANS WOULD THEN INSIST ON FIXING THE ARRANGEMENTS FOR THEM AT THE SAME TIME. DISCUSSION ON THE HUMP WOULD HAVE BEGUN. EVERYBODY WOULD HAVE DONE THEIR SUNS. HE REMAINED CONVINCED THAT THE TIME TO CONCLUDE WAS NOW. SO WE MUST TRY TO SET UP A SITUATION IN WHICH A CONVERSATION BETWEEN THE PRIME MINISTER AND PRESIDENT

DEDIP.

PS / Mr Hoffmeyer

PS / PUS

Mr C. Dickel

Mr Hannay

Hd / ECD (i) (2)

Mr Wall / ECD (I) FCO

Mr Williamson } Cabinet
 Mr Stapleton } Office
 Mr Durrant } Office

Mr Moran } H.M.

Mr Fitzhew } Treasury

Mr Croston } Treasury

Mr Coles / Ho 10. D.S.

CONVERSATION BETWEEN THE PRIME MINISTER AND PRESIDENT
MITTERRAND ON MONDAY COULD BE DECISIVE.

2. I EXPLAINED THAT NO MEETING HAD BEEN PLANNED AND THAT PRESIDENT MITTERRAND HAD NOT ASKED FOR ONE; THAT THE PRIME MINISTER HAD A HEAVY PROGRAMME IN LONDON AND COULD NOT THEREFORE GO TO CULHAM; AND THAT MY UNDERSTANDING WAS THAT NO. 10 AND THE ELYSEE WERE PROBABLY ABOUT TO AGREE THAT NO MEETING WOULD TAKE PLACE. DAVIGNON SAID THAT THIS WAS NOT THE STORY HE HAD HAD FROM THE ELYSEE WHICH WAS THAT THE PRESIDENT WOULD RATHER LIKE A MEETING BUT DID NOT WISH TO BE 'DEMANDEUR' FOR IT. HE APPEALED TO ME TO TRY TO MOVE THINGS TOWARDS A MEETING TAKING PLACE.

3. DAVIGNON SAID THAT HE HAD DISCUSSED THE SITUATION WITH ORTOLI AND THORN. THEY CONCLUDED THAT IT WAS NOT POSSIBLE FOR COMMISSIONERS TO GO TO MITTERRAND IN THE LIGHT OF OUR CONVERSATION LAST NIGHT. BUT THE COMMISSION WOULD RECOMMEND THAT WE SHOULD PROCEED ON THE BASIS IN PARAGRAPH 4 OF MY TELEGRAM UNDER REFERENCE. I INTERJECTED THAT WE HAD NOT YET GIVEN OUR VIEWS ON THIS IDEA. NOEL WOULD GO TO SEE BIANCO TOMORROW TO EXPLAIN THE POSITION. HE WOULD GIVE NOEL PRECISE INSTRUCTIONS. I SAID THAT I HOPED HE WOULD EXPLAIN TO NOEL THAT IT WAS VERY IMPORTANT TO MOVE THE THRESHOLD DOWN FROM .05 AS WELL AS GETTING THE OTHER POINTS WE HAD DISCUSSED RIGHT. DAVIGNON SAID THAT WE SEEMED TO BE DETERMINED IN EFFECT TO KEEP RAISING THE 1100M FIGURE. THE DEAL COULD ONLY BE DONE IF NONE OF THE PARTIES EVER BROUGHT IT UP AGAIN. HE ASKED ME TO STRESS JUST HOW CRUCIAL IT WAS NOT TO PUSH THE OTHERS TO THE POINT OF EXASPERATION BY DISCUSSING THE 1000/1100/1250M QUESTION. THE COMMISSION WERE WORKING VERY HARD AND BELIEVED THAT EVERYBODY WOULD FOLLOW A PRESIDENCY PROPOSAL ON MONDAY/TUESDAY IF ONE WERE MADE. BUT THE FRENCH WOULD NOT MAKE ONE AND THEN HAVE US REJECT IT AND RATCHET THEM UP FURTHER. FRENCH AND BRITISH LEADERS MUST NOW REACH AN UNDERSTANDING.

4. DAVIGNON HAS NOW LEFT BRUSSELS TILL LUNCH-TIME TOMORROW, THOUGH I CAN IF NECESSARY CONTACT HIM BY TELEPHONE. HE AND THORN WILL BE AT JET ON MONDAY, RETURNING TO LUXEMBOURG BY 1700H. HE SAID THAT IF IT WOULD HELP, THOUGH HE COULD NOT SEE HOW IT COULD, HE WOULD BE READY TO COME TO LONDON ON SUNDAY NIGHT.

FCC ADVANCE TO:



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Qz.03661

MR COLES

REFORM OF THE COMMUNITY'S FINANCING: COMMISSIONER DAVIGNON'S
MODIFIED PROPOSALS

We have received a further telegram from Sir Michael Butler this morning. In the light of this I attach, for the meeting of Ministers at 4.45pm this afternoon, a short explanatory note on Commissioner Davignon's possible modified proposals.

I am sending copies to Janet Lewis-Jones (Lord President of the Council's Office), Roger Bone (FCO), John Kerr (Treasury), Murdo Maclean (Chief Whip's Office) and to Sir Robert Armstrong.

D F WILLIAMSON

5 April 1984

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REFORM OF THE COMMUNITY'S FINANCING: COMMISSIONER DAVIGNON'S
MODIFIED PROPOSALS

Note by the Cabinet Office

1. Commissioner Davignon has been working to find a solution to the outstanding problem of reform of the Community's financing. He has based himself on the French Presidency text which, apart from the crucial question of the figures, is acceptable to the United Kingdom and has been largely agreed. The proposals he is now considering concern only the figures and the means of arriving at them.

2. As a result of the Foreign Affairs Council on 27 March, the following elements may be considered to be agreed, and are not affected by the latest proposals:-

- (i) The system for correcting imbalances is to be incorporated into a revised Own Resources Decision, which is equivalent to a Treaty and can only be changed by unanimous agreement of member states and their national parliaments.
- (ii) The correction of a member state's contribution is to be made by reducing the member state's VAT contribution in the following year. This removes the difficulties associated with ad hoc refunds which were implemented through extra payments and can be blocked by both the European Parliament and other member states.
- (iii) The system is to come fully into operation in respect of 1985 after a transitional year in which the United Kingdom would receive refunds of 1000 million ecu in respect of 1984.

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(iv) The system would be based on the difference between a member state's share of VAT payments to and its share of receipts of Community expenditure from the Community's allocated budget. This is known as the VAT share/expenditure share gap.

3. On the figures to form the basis of the permanent correcting mechanism, the United Kingdom was arguing in the final stages of the European Council for a system which would have produced a rebate in reference to 1983 of 1250 million ecu. The other member states would not consider a figure higher than 1000 million ecu.

4. The significance of these figures was only that they would set the limits within which the threshold and the rate of compensation to the United Kingdom above the threshold would be determined. Commissioner Davignon intends to cut through this argument by moving straightaway to an agreement on the threshold and the rate of compensation. The two important points are:-

(i) the threshold above which compensation is paid;

(ii) the rate of the compensation to a member state whose VAT share/expenditure share gap exceeds its threshold (the so-called "ticket modérateur" element).

If the trade-off between the threshold and the compensation rate is agreed at the outset, this will limit the ability of other member states to try to fix the details of the system in a way which will work to the disadvantage of the United Kingdom.

5. Commissioner Davignon's modified proposal is expected to contain these elements:-

(i) a threshold which would be set [redacted] at 0.05% of GDP (ie 250 million ecu). This is lower (ie more favourable) than the United Kingdom itself proposed but it must of course be seen in conjunction with the other elements of the proposal;



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- (ii) a compensation rate of 80% up to a VAT share/expenditure share gap of 0.35% of GDP (2030 million ecu) and a rate of 90% for any remaining gap above that figure. This means that, on the first band, the United Kingdom would contribute 20% of its normal share (ie it would be paying about 4% of the Community expenditure) and on the second band (all the increasing Community expenditure) the United Kingdom would contribute 10% of its normal share (ie it would pay about 2% of the Community expenditure);
- (iii) there would be a qualifying condition (the "franchise"): in order to benefit from compensation a member state would have to have a VAT share/expenditure share gap at least equivalent to 0.075% of its gross domestic product (ie about 375 million ecu for the United Kingdom in 1983). At this level this condition would not be likely to affect the operation of the system for the United Kingdom. It would, however, benefit us by ensuring that the German limit was high.
6. The estimated effect of Commissioner Davignon's probable modified proposal is shown in the attached tables.

Cabinet Office

5 April 1984

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REBATES AND NET CONTRIBUTIONS 1985-1988
 SITUATION UNDER COMMISSIONER DAVIGNON'S LATEST PROPOSAL
 (Threshold 0.05% of GDP; Compensation rate of 80% up to
 0.35% of GDP, and 90% thereafter)

0.04

1. Figures in million ecu

(i) Treasury figures*

Year	Unadjusted Net Contribution	Rebate	% Rebate	Adjusted Net Contribution
1985	2310	1334	58	976
1986	3090	1964	64	1126
1987	3390	2170	64	1220
1988	<u>3530</u>	<u>2223</u>	<u>63</u>	<u>1307</u>
Total	12320	7691	62	<u>4629</u>

(ii) Cabinet Office figures*

1985	2310	1346	58	964
1986	3090	2003	65	1087
1987	3390	2237	66	1153
1988	<u>3530</u>	<u>2319</u>	<u>66</u>	<u>1211</u>
Total	12320	7905	64	4415

2. Figures in £ million

(i) Treasury figures*

Year	Unadjusted Net Contribution	Rebate	% Rebate	Adjusted Net Contribution
1985	1363	787	58	576
1986	1823	1159	64	664
1987	2000	1280	64	720
1988	<u>2083</u>	<u>1312</u>	<u>63</u>	<u>771</u>
Total	7269	4538	62	2731

(ii) Cabinet Office figures*

1985	1363	794	58	569
1986	1823	1182	65	641
1987	2000	1320	66	680
1988	<u>2083</u>	<u>1368</u>	<u>66</u>	<u>715</u>
Total	7269	4664	64	2605

*The "Treasury figures" assume that levies and duties grow in line with GDP while the "Cabinet Office figures" assume that they remain at the average level of the last 5 years.

European Budget



10 DOWNING STREET

AJZ - 11/2/84.

the Chancellors will be accompanied at the 16.45 meeting by Geoffrey Fitchew.

CST 5/4/84.