Ref. A084/1988

PRIME MINISTER

Cabinet: Community Affairs

The Foreign and Commonwealth Secretary may comment on the debate in the House of Commons on 10 July about the outcome of the European Council at Fontainebleau. The Government's majority was substantial (165) and only a small number of Government backbenchers (about 18) abstained in the final vote.

2. The Foreign and Commonwealth Secretary may also report on his meeting on 11 July with the President of the European Parliament, Mr Dankert, whose visit was mainly to hand over the text of the draft Spinelli Treaty on European Union, which he was asked by the European Parliament to present to each member state. This draft Treaty has no chance of progressing further, but some of the ideas may be discussed in the high-level group on Community institutions which will be set up following President Mitterrand's proposal at the last European Council.

3. The Chancellor of the Exchequer will report on the Finance Council on 9 July. The result on budget discipline was reasonable: the Council agreed that in order to carry forward the discussions on the measures necessary to guarantee the effective application of the principles of budget discipline, the existing ad hoc group will prepare a report for a substantial discussion at the informal Finance Council on 15-16 September. The Council also approved the Commission's proposal to transfer the provision for the 1983 refund (750 million ecu net) from the reserve chapter of the budget to the operational budget lines (you will recall that the regulations themselves were approved by the Foreign Affairs Ministers immediately after the Fontainebleau European Council). No more action is required by member states. It is now for the European Parliament to make the transfer. We do not yet know when they will do so. The bulk of the refunds will actually be paid within about a month of the European Parliament's decision.

4. The Agriculture Council meets on 16-17 July. The Budget Council on 18-19 July will be discussing the Commission's proposals for a supplementary budget for 1984 and for the Community's preliminary draft budget for 1985. Both proposals are in excess of the revenue available under the 1 per cent VAT ceiling. You are discussing the attitude the United Kingdom should take with the other Ministers most directly concerned on 13 July.

approved by ROBERT ARMSTRONG
and signed in his absence.

Lindsay Wilkinson.

11 July 1984

[Sir Geoffrey Howe]

historic place in the reconstruction of our continent in a way which excludes the possibility of another European war.

Britain has always been a major contributor to the defence and security of Europe. We form a key element in the European pillar of the Atlantic Alliance. We were not present at the birth of the European economic community. Even so, we played a key part in the post-war construction of European co-operation in many fields: and in due course it became evident that our economic and political well-being lay in closer links with our nearest neighbours, with whom we already share so much, and with whom we could develop the enormous potential of the largest single market of the industrialised world.

The European Community is of course still very young. Inevitably it has experienced growing pains but now, with the agreement at Fontainebleau, we have the chance to move into a new phase.

Europe has the chance now to work at creating the conditions for sustained economic growth which should, in time, enable it to match the United States and Japanese performance in creating jobs. Europe has the chance now to strengthen the European pillar of the Alliance and thus make its voice more widely heard on foreign policy. If we, are to achieve those aims we must now make a reality of the treaty of Rome, beginning with the establishment of a true common market in goods and services.

Mr. Teddy Taylor (Southend, East): As my right hon. and learned Friend has mentioned the great potential for jobs, could he tell us what has been the net increase in jobs during the past 10 years in the Common Market, America and Japan—the three areas that he mentioned?

Sir Geoffrey Howe: The argument is one with which I am familiar and which I often advance. One of the most important reasons for pressing ahead with the establishment of a true Common Market in goods and services in the EC is to create precisely that unity which has led to the creation of 12 million jobs in the United States. To achieve, that, we need the EC and the full implementation of the Common Market.

Mr. Nicholas Budgen (Wolverhampton, South-West): Will my right hon. and learned Friend give way?

Sir Geoffrey Howe: No.

The importance of Fontainebleau is that it provides a much sounder financial basis on which to tackle precisely those tasks.

Mr. Budgen *rose*——

Sir Geoffrey Howe: I know that my hon. Friend is always anxious to make a point during my speeches. I might give way to him later but I do not wish to do so so soon after giving way to my hon. Friend the Member for Southend, East (Mr. Taylor).

Fontainebleau provides a sounder financial basis on which to tackle the tasks that I have outlined. That is the measure of what was achieved last month. The budget settlement was a means to those ends. I shall say more about that in a few minutes. Let me first say something about the budget.

When the Government took office, we made two things crystal clear to our partners. First, Britain would once again adopt a positive attitude to Community membership—that was an important commitment—and secondly, that we were determined to secure reform of the unfair budgetary arrangements.

It is no secret that our task was not easy. Some of our partners suggested that increased expenditure on industry, on regions, and on social funds would take care of the problem. Meanwhile, we were offered a series of decreasing annual refunds.

There were three good reasons why we rejected that approach. First, the prospect of a spontaneous and significant change in our favour in the balance of Community spending was not a real one; secondly, our case could not be met by declining annual refunds, but only by a fair and lasting system; and thirdly, there was an overriding need to bring Community spending under control.

As I said in a speech at The Hague three years ago, conscious decisions needed to be taken on the size and direction of financial transfers. Those decisions needed to be based on objective criteria reflecting member states' ability to pay. Beginning in May 1980 our partners agreed to the first of a series of annual refunds. Those refunds have already brought us £2 billion—£2 billion more than the Labour Government ever got back, for all their negotiations.

Mr. Alan Howarth (Stratford-on-Avon): My right hon. and learned Friend has just referred to the regions, the social fund and the need for objective criteria. Does he agree that there is a real problem associated with the attitudes that are apparent in the Commission? For example, it has proposed for 1985 increases in those two items in the budget of more than 16 per cent. apiece. Such increases bear no relation to the rate of inflation in any of the member countries or to the capacity of those countries to pay. Will my right hon. and learned Friend therefore not have to devise hoops of steel to contain the Commission's aspirations?

Sir Geoffrey Howe: I am grateful to my hon. Friend for drawing attention to the 1985 budget proposal of the Commission, which has yet to be scrutinised by the Council and which certainly does not represent the council's conclusions. I agree with him about the importance of the need for a financial disciplinary framework. The annual refunds did not produce a lasting settlement. Moreover, they have become progressively harder to negotiate at an acceptable rate.

For 1982, for example, our refunds amounted to some £660 million, including a so-called risk-sharing element of £176 million. As the House well knows, there has been continuing disagreement between the Council and ourselves over a part of that risk-sharing element, amounting to £42 million. We took that factor into account in coming to an agreement at Fontainebleau. Given the generally satisfactory nature of that agreement, the Government have decided not to pursue that outstanding claim.

For 1983, as hon. Members will know, the total agreed refund amounted to only £440 million. Taken over the four years, the total refund agreed to be paid amounted to £2·5 billion. That was a very substantial achievement, but over the longer term these ad hoc refunds were on a declining path. They did not provide a systematic correction of the budgetary burden and they provided no answer to the fundamental problem of structural imbalance in the Community's finances.

WHAT ABOUT 1982 REFUNDS

This diagreement was of a quite different order than the 1983 refunds. There was no dispute about our basic refund, all of which has been paid, but about a small element of the so called risk sharing payment. The disagreement arose over the calculation of the amount due. We took this into account in negotiating the agreement at Fontainebleau. Given the satisfactory settlement that was agreed, the Government have decided not to pursue the outstanding claim.

GOVERNMENT LIGHTLY ABANDONING UK INTEREST OVER 1982 REFUNDS

We have already secured a refund for 1982 worth £624 million. We took a decision in the context of the overall agreement reached at Fontainebleau, which sets the £42 million in dispute against the longer term benefits we have secured under the system.

WHY NOT GO TO THE ECJ OVER 1982 REFUNDS?

Because the national interest lies in reaching an overall settlement of lasting benefit to the UK, not in prolonging this particular disputed aspect of our refunds. In a complex issue of this kind, there would be difficulties, both of procedure and substance, in establishing a case before the European Court.

EC CP

CONFIDENTIAL

Ref. No: EU(84)6
Date: 9th July 1984

A BRIEF FOR THE DEBATE ON
EUROPEAN COMMUNITY AFFAIRS

HOUSE OF COMMONS
TUESDAY, 10TH JULY 1984

This brief is to be read in conjunction with Members Brief No. FA(84)4, the Briefing Note, No. 23, 28th June 1984, and the text of the conclusions of the Presidency following the Fontainebleau Summit of 25th/26th June 1984.

CONTENTS

		Page
1.	The Advantages of the System	1
2.	The Size of the Refund	1
3.	Budget Discipline	2
4.	The increase in Own Resources and procedures for ratification	2
5.	Labour's Line	3

Conservative Research Department,
32 Smith Square,
London SW1
Tel. 222 9000

Enquiries on this brief to:
Andrew Tyrie Ext. 2519

SOME KEY POINTS

1. The advantages of the System

The agreement reached at Fontainebleau* is durable, equitable and immutable.

a) Durability. The duration of the budgetary corrective mechanism is linked to the duration of the new own resources (See 4). It will be incorporated into the new own resources decision. Any changes to the new own resources decision will require unanimity. It will therefore not be possible to suspend the operation of the budget corrective mechanism without the United Kingdom's agreement.

b) Equity. Section I of the Presidency text at Fontainebleau reads:

'it has been decided that any member state sustaining a budgetary burden which it excessive in relation to its relative prosperity may benefit from a correction at the appropriate time.'

The European Council went on to agree that the United Kingdom was in this position and should accordingly benefit from a correction. From the wording of the text it is clear that other member states can also benefit at the appropriate time if they fulfil the condition of sustaining an excessive budgetary burden in relation to their relative prosperity.

c) Immutability. The system works by reducing VAT contributions by the given amount one year in arrears. This contrasts with the previous arrangement for ad hoc refunds of expenditure. The system of reduced VAT contributions will give us protection against interference by other member states or by the Parliament. Moreover, the system could only be changed by unanimous agreement of all member states.

2. The Size of the Refund

It is very difficult to forecast movements in our net contribution since these would depend on the size and composition of the Community budget and changes in our share of Community expenditure. However, it can be said that even with an increased VAT ceiling, we shall be paying around half of what we would have had to pay with no increase in the VAT ceiling and no agreement on refunds. Without the Fontainebleau settlement we would probably have paid around £1.2 billion to the Community in 1984, and this could have risen to £1.5 billion or more in later years.

The system used to measure our excess contribution, the so-called VAT expenditure share gap, does not exclude from consideration all customs levies and agricultural duties that we contribute. It only excludes those which are notionally in excess of the share of our VAT base in VAT own resources. To illustrate, if the UK's duties and levies share is 25 per cent of European Community revenue from all partners' customs receipts and the UK VAT share is 21 per cent, only the 'excess' (25 minus 21 per cent) of the levies and duties is not taken into account. For 1983 this amounts to about 300 million ecu or £170 million.

*NB: Only items 1,2 and 4 of the Presidency conclusions were fully discussed and agreed.

Marginal Contributions. An important consequence of the system is that our marginal contribution to new spending (which is financed by VAT contributions), will be one-third of 21 per cent, i.e. 7 per cent. By contrast Italy is likely to contribute at more than twice that rate, and West Germany and France at an even greater rate. This is a powerful incentive to economy and prudent financial discipline on the part of these countries.

3. Budget Discipline

On Budget discipline the Prime Minister made it clear in the House on 27th June that:

> 'The Government will be prepared in due course, and when the arrangements are in place on budget discipline, to recommend to the House that the own resources ceiling should be increased to 1.4 per cent of VAT' (Hansard, 27th June 1984, col. 993).

The Council of Ministers will now work on how best to achieve arrangements to guarantee budgetary discipline, both for agriculture and other expenditure. The basis for these discussions reflects the United Kingdom's position put in discussions before and after the Stuttgart Summit last June. The UK has stressed the need to keep the rate of growth of CAP market support expenditure below the rate of growth of own resources base, and the need to implement that principle in annual price fixing, in the Budget, and in the Commission's management of agricultural expenditure.

Progress has already been made in curbing CAP expenditure. CAP common prices were reduced throughout the Community and prices expressed in terms of their national currencies fell significantly in all member states. Expenditure on the milk sector has been curbed. This was absorbing about one third of FEOGA guarantee expenditure and production was increasing rapidly. These were difficult decisions but they are only the first step. We shall continue to press for restraint in CAP support levels and expenditure.

4. The increase in Own Resources and procedures for ratification

The European Council agreed to increase the VAT own resources ceiling from 1 per cent to 1.4 per cent no later than 1st January 1986. The new rate will come into force as soon as the ratification procedures are completed. The UK believes that with prudence and firm financial control this increase will be sufficient for the Community for some years to come. Any further increase would require unanimity as well as ratification by the Parliaments of all member states. No further increase beyond 1.4 per cent was agreed. The increase in own resources relates to the maximum rate of VAT which the Community can call up. The actual rate of VAT called up would depend upon the size of the Community Budget for any given year.

Article 201 of the Rome Treaty lays down the procedure for increasing the VAT own resources ceiling. After consulting the European Parliament, the Council, acting unanimously, lays down the appropriate provisions - which in this case will be a revised version of the own resources decision of 21st April 1970. The provisions are then 'adopted' by the member states in accordance with their respective constitutional requirements. The increase cannot come into force until all member states have adopted the appropriate provisions. In the United Kingdom the draft proposal from the Commission to increase the VAT ceiling will be deposited in the House and examined by the Scrutiny Committee. When the Council has agreed the proposal the final text will also be deposited for examination by the Scrutiny Committee, which may recommend either or both for debate in the House. The Government would then lay a draft order in Council under Section I (III) of the European Communities Act, and this draft order would need to be approved by an affirmative resolution in each House of Parliament before ratification was complete.

The exact timing of the above will depend upon when the texts are agreed and adopted by the Council. The European Council concluded that the increase should be ratified at the latest by 1st January 1986.

5. Labour's line (See also Briefing Note No. 23)

a. Labour have stated that they would not have agreed to such a deal. It is important to realise that non-agreement would have meant:

- no receipt of our 1983 refunds (worth about £450 million).

- no receipt of the agreed 1984 refund of 1,000 million ecu (about £600 million).

- no protection from excess contributions in 1985 and beyond. These could easily have risen to £1.5 billion.

- no systematic reform of the Community's financial arrangements and no progress towards the achievement of greater budget discipline. Agricultural expenditure could well have continued to rise within the 1 per cent ceiling and further squeese out other policies.

- that there would have been delay in the enlargement negotiations for Spain and Portugal.

- that there would have been no money available for new policies of potential benefit to the United Kingdom.

b. Their renegotiation failed to secure any refunds whatsoever. Net contributions for the last two years for which they were responsible (the only two years not protected by transitional arrangements, negotiated by a Conservative Government) were out of all control. At 1983 prices Labour's net contribution to the Community exceeded £1.41 billion per annum for 1978 and 1979, compared with an average of £655 million for the following four years under the Conservatives. See table overleaf.

EC Budget (Contributions)

Mr. Haselhurst asked the Chancellor of the Exchequer what have been the amounts paid net to the European Economic budget during each of the years of the United Kingdom's membership, at constant 1983 prices.

Mr. Ian Stewart: The information requested is set out in the following table:

	£ million
1973	374
1974	93
1975	*−141
1976	365
1977	708
1978	1,420
1979	1,431
1980	890
1981	448
1982	638
1983	647

* Negative sign denotes a net receipt.

The figures given in the reply have been calculated to constant prices by use of the GDP deflator based on GDP in pounds sterling at 1983 average market prices. These figures are published in Economic Trends.

(Source: Hansard, 27th June 1984, WA, col. 458)