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CABINET

EUROPEAN COMMUNITY FUTURE FINANCING

Memorandum by the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Minister of Agriculture, Fisheries and Food

As in Brussels in June, the question of European Community (EC) future financing will dominate the Copenhagen European Council on 4-5 December. The prospects for a settlement are poor; and the United Kingdom may be blamed if no agreement is reached. Cabinet may therefore wish to be aware in advance of the background, our objectives, the position reached in the negotiation, and points relevant to our presentation of the outcome.

BACKGROUND

2. The Community has been living beyond its means. It is funded by Customs Duties and agricultural levies, topped up by payments by each member state of up to 1.4 per cent of its (harmonised) Value Added Tax (VAT) base (equivalent to 1.02 per cent of Gross National Product (GNP)). But its spending is now running at some £29 billion a year, equivalent to 1.63 per cent VAT (1.17 per cent GNP). The Commission and most member states now wish to validate this by an increase in the "Own Resources" ceiling. The possibility of a further increase of 1.6 per cent VAT from January 1988 was foreseen in 1984, when the 1.4 per cent ceiling was set: the Commission wish to go further, and raise the ceiling to 1.4 per cent GNP (2.2 per cent VAT), though they envisage sub-ceilings to keep spending below 1.3 per cent GNP (1.9 per cent VAT) until 1992. All Southern member states, and the Irish, agree. Most Northern member states find the Commission's ideas over-ambitious. But all are anxious to secure some extra provision for agricultural spending. And it is clear that some increase in the ceiling is necessary if the Community is to get through 1988. The Commission's 1988 budget proposals, blocked by us (and - for different reasons - Greece and Spain) contain provision for £2.5 billion of spending above the ceiling. But to raise the ceiling requires unanimity. This gives us real leverage.

3. The runaway growth of Common Agricultural Policy (CAP) spending (up from £9 billion in 1983 to £19 billion this year) is the basic cause of the overspending. All member states accept, though some (eg the Dutch) more whole-heartedly than others (eg the Germans) that it must be reined in. All also accept in principle that it cannot be right that two-thirds of the agricultural budget and half of the total EC budget is now spent on the storage and disposal of surplus food. The French agree that the CAP

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has become an inefficient means of farm support, and needs reform, though they do not want to go as far as we think is right. But the Germans, unable to compete effectively with eg the French in a more competitive market, and anxious to maintain the structure of smallholdings in Southern Germany, want to slow the pace of reform.

4. Because our abatement forms part of the system of Own Resources it too is part of the negotiations. The mechanism secured by the Prime Minister at Fontainebleau in 1984, in the context of the last increase in Own Resources, ensures that two-thirds of the difference between our share of Community VAT and of Community spending is deducted. This has saved us over £2.8 billion in the last four years. Even so our annual net contribution after abatement has risen from £550 million in 1984 to £900 million now, and we remain the second largest contributor.

OBJECTIVES

5. In the negotiations over the last nine months our aims have been -
 - a. to secure a system of effective and binding control over Community spending;
 - b. to build support for keeping the necessary increase in Community resources to the lowest feasible level which will cover 1988 needs and credibly last through to 1992 and beyond; and
 - c. of unique importance to us, to maintain our Abatement.

PRESENT POSITION

6. The current position in the negotiations is described in UKREP telno 4094 (copy attached).

7. At the Prime Minister's insistence, the June European Council agreed to strengthen budget discipline, applying it to all Community expenditure. There now are proposals on the table for improved budget discipline; better monitoring of agricultural spending to permit a swifter response to threatened expenditure overshoots; and the introduction of "stabiliser" mechanisms for individual crops. These would bring prices down when excess production threatened, and would mark a real improvement on present arrangements. But the Commission also seek a substantial once-for-all increase in the provision for agricultural spending, already overshoot: and many member states want wide "exceptional circumstances" provisions which would permit further overshoots. Several, led by the Germans, wish to see weaker "stabilisers". We have made clear that without an effective control total, constraining spending through "stabilisers", we shall not agree to an increase in Own Resources.

8. The accusation most often levelled at us now is that we are holding out for an unrealistically rapid reform, and failing to take adequate account of the social consequences for small farmers in the Community. We consider it essential to use our current leverage to extract binding commitments to effective "stabilisers" and budgetary control procedures.

This is important also in the wider context of world agriculture and the General Agreement on Tariffs and Trade. If it proves impossible to complete the task at Copenhagen this week, we shall have to keep going, with the Dutch and the Commission. The logic of the case for CAP reform is strong, and increasingly widely recognised, and it must be in farmers' own interests that it is tackled now.

9. The pressure for increased EC resources also arises from a political link, made by Southern member states and the Irish, between increases in the Structural Funds (ie primarily the Regional and Social Funds) and their co-operation in the drive to complete the Single Market by 1992. Southern member states make the claim, economically tenuous but politically compelling, that they need assistance to help them prepare for the challenge of more open competition. The political reality is that they could block completion of the Single Market, which is a major United Kingdom interest. Some increase in the Structural Funds is also likely to be necessary in order to secure stringent control over agricultural spending. Our aim must be to contain the increase within the rates of growth of such spending which are laid down in the EC Treaty.

10. The Commission's proposal, backed by all Southern member states, is for a 100 per cent increase (in real terms) by 1992, ie an increase of some £5 billion. This would drive a coach and horses through all budget discipline. With the French, Germans and Dutch, we have campaigned for markedly lower numbers, and for offsetting savings, and the Prime Minister will continue to do so in Copenhagen. The odds are that we shall be the back-markers: if the Copenhagen meeting breaks down on this, we can accordingly expect criticism.

11. On the United Kingdom Abatement, the Commission propose a replacement for the Fontainebleau mechanism which - taken together with their proposals on the structure of Own Resources - would increase our annual net contribution by over £600 million on our estimates (£150/200 million on theirs). If all other issues are settled at Copenhagen, the negotiation is unlikely to break down over the Abatement: but if others cannot be settled we shall come under pressure. We have made clear that we will not accept any change to the Fontainebleau mechanism which would make our budget burden more onerous. What we have, we hold.

12. If an overall financing deal proves elusive at Copenhagen, several member states may argue that the Community must at least settle the 1988 budget problem. There will be calls for an interim increase in the 1.4 per cent VAT ceiling. We shall have to block this; for allowing it would significantly reduce our leverage to secure our first objective.

13. If at Copenhagen we can -

- a. secure measures ensuring effective and binding control of EC spending, particularly on the CAP;
- b. sufficiently scale down Southern aspirations for the Structural Funds and hence the increase in the overall ceiling; and

- c. maintain the Fontainebleau Abatement;

it would in our judgment be right to allow some increase in the ceiling. That increase should be sufficient to cover real 1988 requirements: and the new ceiling should be durable, lasting through and beyond this Parliament.

PRESENTATION

14. There will be no partial agreements at Copenhagen, for all member states link all the key issues (except the 1988 budget); and maintaining such linkage (including the 1988 budget) is essential to our strategy.

15. On most of the plausible scenarios for a breakdown, many of our partners will try to blame us. But this should not create serious difficulties: the essence of our position is that it is our duty to the tax-payer to ensure that the same disciplines which apply to other national public expenditure apply also to Community spending. We would as necessary stress that -

- a. excess CAP spending harms the Community's image, both in Europe and beyond, and is damaging to the long-term interests of farmers themselves;
- b. while some growth of the Structural Funds is desirable, uncontrolled growth would not be cost-effective;
- c. our EC budgetary burden, recognised as excessive in 1984, has since grown, making our case for an Abatement even stronger;
- d. the solution to the 1988 problem lies in real reform, not a fudge with hard decisions postponed;
- e. proper CAP spending control, if not achieved at Copenhagen, will come in the end, perhaps at the next European Council (in Hanover), for the need is increasingly recognised;
- f. our campaign for it has been in firm alliance with the Dutch and the Commission, and with some support from the French, Danes, Spanish and Portuguese.

Any more general criticism of us for concentrating on financing detail, and so producing a parochial and unproductive meeting in contrast to the Reagan/Gorbachev summit, should be rebutted similarly. Excessive agricultural surpluses and support are a worldwide problem; tackling it will cause difficulties elsewhere too, but the Community is making a serious effort, and some progress.

16. An overall agreement at Copenhagen, if available, could also be presented positively. There would be domestic criticism of increases in the resource ceiling and the budget discipline limit on agricultural expenditure. But we would stress that past budget discipline arrangements had proved an inadequate constraint, that expenditure was in effect

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already well above the ceiling, and that, while retaining the Abatement, we had secured real improvements in spending control for the future which should ensure that expenditure is held within the new ceiling for at least five years. Parliament would of course have to ratify the increase.

17. We accordingly invite Cabinet to note that -

a. Any agreement at Copenhagen would have to include unwelcome elements, notably additional Own Resources and agricultural expenditure.

b. But our negotiating objectives are important: securing them would represent a significant milestone for the Community, and a success for our policies.

c. The discussions in Copenhagen will be difficult. If no agreement is then reached, we shall stick to our guns, drawing attention to the progress already made, the underlying wide support for real CAP reform, and the likelihood that it will in the end be achieved. We should play down talk of 11:1 isolation, or of "crisis in the Community".

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G H N L J M

Foreign and Commonwealth Office
Treasury
Ministry of Agriculture, Fisheries and Food

2 December 1987

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FROM UKREP BRUSSELS

TO IMMEDIATE FCO

TELNO 4094

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INFO PRIORITY EUROPEAN COMMUNITY POSTS, WASHINGTON

FRAME GENERAL/FRAME ECONOMIC

SUBJECT: FUTURE FINANCING OF THE COMMUNITY : THE PROSPECTS FOR COPENHAGEN.

SUMMARY

1. LONG, PAINFUL PROCESS OF NEGOTIATION SINCE COMMISSION PACKAGE PUT ON TABLE LAST FEBRUARY HAS LEFT MUCH STILL UNDECIDED. AGRICULTURAL REFORM, BUDGET DISCIPLINE, STRUCTURAL FUNDS, OWN RESOURCE CEILING AND UK ABATEMENT STILL CONTAIN HOTLY DISPUTED POINTS. ALL MEMBER STATES RECOGNISE (GENUINELY) CASE FOR TAKING DECISIONS AT COPENHAGEN AND DIFFICULTIES THAT FURTHER DELAY IN DOING SO WILL IMPOSE, BUT MAY NOT HAVE WILL OR ROOM FOR MANOEUVRE TO MAKE THE NECESSARY CONCESSIONS. UK HAS WON THE ARGUMENT ON AGRICULTURAL REFORM BUT NOT YET THE MATCH: AND WE FACE A TORRID SESSION ON THE DEBATE, ALTHOUGH MOST PARTNERS PROBABLY RECOGNISE INEVITABILITY OF ITS CONTINUATION IN CLOSE TO ITS PRESENT FORM. WHILE THE ODDS AGAINST HAVE LENGTHENED, THE POSSIBILITY OF DECISIONS AT COPENHAGEN CONSISTENT WITH OUR OBJECTIVES REMAINS. PUBLIC PRESENTATION OF A FAILURE AT COPENHAGEN WILL AFFECT OUR ABILITY TO SECURE OUR OBJECTIVES THEREAFTER.

DETAIL

2. IT IS NOW OVER NINE MONTHS SINCE THE COMMISSION FIRST PUT FORWARD ITS PACKAGE OF PROPOSALS TO DEAL WITH THE COMMUNITY'S FINANCIAL PLIGHT. ONE EUROPEAN COUNCIL, TWO CONCLAVES, SEVEN FOREIGN AFFAIRS COUNCILS, NUMEROUS STERILE DAYS AND NIGHTS IN THE AGRICULTURE COUNCIL AND MORE THAN THIRTY-FIVE SPECIAL COREPERS LATER WE ARE STILL SHORT OF AGREED SOLUTIONS TO THE MAIN PROBLEMS.

3. THE COMMISSION HAVE FARED BETTER THAN WAS ORIGINALLY EXPECTED IN HOLDING THEIR PACKAGE TOGETHER. ALTHOUGH THIS CONTAINS ELEMENTS WE (AND OTHERS) CANNOT ACCEPT, SUCH AS DOUBLING OF THE STRUCTURAL FUNDS AND THE LEVEL OF THE NEW REVENUE CEILING, THE FACT THAT IT RETAINS CAP STABILISERS AT THE CENTRE OF THE NEGOTIATION AS AN ESSENTIAL PRE-CONDITION TO ANY DECISION TO RAISE THE REVENUE CEILING HAS BEEN, AND REMAINS, OF GREAT VALUE TO US. BUT THREE EGREGIOUS ERRORS WHICH THE COMMISSION MADE AT THE OUTSET (PROPOSING TO DOUBLE THE STRUCTURAL FUNDS, TO INTRODUCE AN OILS AND FATS TAX AND TO LET

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THE FOUR POOREST MEMBER STATES OFF PAYING FOR OUR ABATEMENT REMAIN TO HAUNT THE FINAL STAGES, ALTHOUGH THE TAX AT LEAST SEEMS TO BE LEADING.

4. IT IS NOW CERTAIN THAT THE EUROPEAN COUNCIL WILL HAVE TO GRAPPLE ITSELF WITH THE MAIN ELEMENTS OF AGRICULTURAL STABILISERS. COALITION POLITICS IN GERMANY, COHABITATION POLITICS IN FRANCE AND THE RELUCTANCE OF MOST AGRICULTURE MINISTERS TO GRASP NETTLES HAVE CONSPIRED TO BRING ABOUT THAT UNSATISFACTORY STATE OF AFFAIRS. PREVIOUS EXPERIENCE OF AGRICULTURAL NEGOTIATION AT EUROPEAN COUNCIL LEVEL IS NOT ENCOURAGING. BUT IF, A VERY BIG IF, WE, THE DUTCH AND THE COMMISSION CAN EXTRACT THE RIGHT DECISIONS ON CEREALS, OILSEEDS AND PROTEINS THEN THE REST OF THE PRESIDENCY STABILISER PROPOSALS COULD FALL INTO PLACE. THERE COULD HOWEVER BE CONSIDERABLE PRESSURE TO AVOID TAKING DECISIONS AT COPENHAGEN ON OTHER PRODUCTS.

5. BUDGET DISCIPLINE IS THE OTHER SIDE OF THE CAP REFORM COIN, AN ESSENTIAL COMPLEMENT TO IT BUT NOT, AS EXPERIENCE SINCE FONTAINEBLEAU HAS SHOWN, A SUBSTITUTE FOR IT. WE ARE NOT TOO FAR FROM AN ACCEPTABLE OUTCOME, WITH A TIGHTLY CIRCUMSCRIBED EXCEPTIONAL CIRCUMSTANCE PROVISION, BUT THE WATERS HAVE BEEN GREATLY MUDDIED BY DELORS' REVIVAL OF HIS PROPOSAL FOR A MONETARY RESERVE AND CONFUSED PRESENTATION OF IT. THE STOCK DISPOSAL ISSUE REMAINS OPEN, WITH CONSIDERABLE SUPPORT FOR AN OFF-GUIDELINE WIPING OF THE SLATE BUT NONE FOR DOING SO ON THE BASIS OF NATIONAL FINANCING. THE CHOICES ARE MORE POLITICAL THAN FINANCIAL HERE AND AN AGREED OUTCOME SHOULD BE ACHIEVABLE.

6. THE STRUCTURAL FUND ARGUMENT WILL BE PRETTY STRAIGHTFORWARD. HOW MUCH? FOR WHOM? BUT IT WILL NOT BE EASY TO RESOLVE, NOW THAT THE SOUTHERNERS' APPETITE HAS BEEN WHETTED BY THE DOUBLING PROPOSAL. THERE IS SOLID RESISTANCE TO THAT BY MOST OF THE NORTHERNERS (WHO STAND TO LOSE MORE RELATIVELY THAN WE DO, GIVEN THEIR GREATER PROSPERITY AND THE OPERATION OF THE ABATEMENT). AN AGREED OUTCOME IS LIKELY TO BE MORE COSTLY THAN WE WOULD WISH, BUT, A UK POSITION TOUGHER THAN THAT OF THE OTHER NORTHERNERS, PARTICULARLY THE FRENCH WOULD SEEM HARD TO JUSTIFY.

7. THAT LEAVES THE LEVEL OF OWN RESOURCES AND THE ABATEMENT. ON THE FORMER, RATCHETTING DOWN OF THE COMMISSION 1.4 PERCENT GNP PROPOSAL IS IN FULL SWING WITH FRENCH, GERMAN AND DUTCH SUPPORT. ON THE LATTER, THE PREDICTABLE ATTEMPT TO SQUEEZE US IS BEING MADE BUT MOST MEMBER STATES ARE DOING LITTLE MORE THAN GO THROUGH THE MOTIONS. THE CRUCIAL THING IS TO SWITCH THE FOCUS AWAY FROM THE SIZE

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F THE ABATEMENT TO THE SIZE OF OUR BUDGET BURDEN EVEN AFTER
BATEMENT. THE FACT THAT OUR BUDGET BURDEN HAS MORE THAN DOUBLED
INCE FONTAINEBLEAU AND IS SET TO GO ON INCREASING STEADILY (IF
LOWLY, AND CHANGING MORE SLOWLY THAN THAT OF OTHER MEMBER STATES)
F THE REVENUE CEILING IS RAISED, SHOULD BRING ACCEPTANCE THAT THE
ONTAINEBLEAU MECHANISM, TECHNICALLY ADAPTED AS NECESSARY TO FIT A
OUR RESOURCE COMMUNITY, IS THE ONLY POSSIBLE BASIS FOR A
ETTLEMENT.

8. SO MUCH FOR THE TREES, BUT WHAT ABOUT THE WOOD? I BELIEVE
HERE IS A GENUINE DESIRE ON ALL SIDES TO TAKE DECISIONS AT
OPENHAGEN. THE CONTRAST BETWEEN THE COPENHAGEN AND WASHINGTON
EETINGS IS THE FLAVOUR OF THE WEEK AMONGST COMMENTATORS AND
ARTICIPANTS ALIKE. IT IS A LITTLE FACILE, BUT IT MASKS REAL CONCERN
HAT, IF THE COMMUNITY CANNOT GET ITS FINANCIAL AND AGRICULTURAL ACT
OGETHER AFTER SO MANY MONTHS OF NEGOTIATION, THEN IT WILL BE UNABLE
O DEFEND AND TO FURTHER ITS COMMON INTERESTS IN THE INCREASINGLY
NCERTAIN WORLD THAT FACES IT. THE 1988 CALENDAR (FRENCH
RESIDENTIAL ELECTIONS, GREEK PRESIDENCY IN SECOND HALF OF THE YEAR,
OWER VACUUM IN WASHINGTON) REINFORCES THIS CONCERN.

9. NEVERTHELESS, IT WOULD BE FOOLISH TO REFUSE TO RECOGNISE THAT
HE ODDS HAVE RECENTLY LENGTHENED AGAINST A SUCCESSFUL OUTCOME AT
OPENHAGEN. CONCERN, AND INDEED A STRONG DESIRE, TO TAKE DECISIONS
HERE IS ONE THING: WILLINGNESS TO TAKE THE RIGHT ONES QUITE
NOTHER. AS YOU SAID YOURSELF THE OTHER DAY, WE NEED TO AVOID
'APOCALYPSE NOW'' INTERPRETATIONS OF FAILURE OR AN
VER-DRAMATISATION OF THE DIFFERENCES THAT LED TO IT. NOT ONLY IS
UCH AN APPROACH INVALID IN FACT BUT IT ALSO IN THE LONGER-TERM
ILITATES AGAINST THE ACHIEVEMENT OF OUR OBJECTIVES. THE MORE THE
EBATE IS POLARISED, THE LESS EASY IT IS FOR OTHERS TO CONCEDE THE
GROUND THEY MUST IF THERE IS TO BE AN AGREEMENT AT HANOVER OR
SOMEWHERE ELSE. IT IS PRECISELY BECAUSE OF THAT THAT SOME WILL WISH
O FOCUS ON THE ABATEMENT AND SEEK AN ALIBI FOR FAILURE THERE. OUR
INTEREST IS TO KEEP THE DEBATE FIRMLY FOCUSED ON AGRICULTURAL
REFORM.

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