E.R.

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PRIME MINISTER

MEETING WITH THE CONSERVATIVE EUROPEAN ~~DEFENCE~~ REFORM GROUP

You are to see this Group, led by Sir Edward du Cann, tomorrow. You read the briefs over the weekend but may like to glance at the attached note by Teddy Taylor setting out the sort of points which the Group are likely to raise in more detail.

You will see that Mr. Taylor asks whether the Group can bring two researchers along to the meeting, one of them an American graduate. I think this would not be a very happy precedent and suggest that you ask Michael Alison to explain to Mr. Taylor that it would not be appropriate. Agree?

C.D.P

CHARLES POWELL
7 April 1986

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Prime Minister

You may find it helpful to have these briefs over the week-end.

CDP 4/4

Qz.04956

MR POWELL

PRIME MINISTER'S MEETING WITH EUROPEAN REFORM GROUP, 8 APRIL

I attach, as requested in your minute of 24 March, briefs for the Prime Minister on the three points set out in Mr Taylor's letter of 13 March and in the short papers sent under cover of his letter to Mr Alison of 26 March. The briefs are divided into points to make and background. I have also placed in the folder separately, for background information, a memorandum submitted in February by the Treasury to the Treasury and Civil Service Select Committee of the House of Commons.

I am sending copies to Colin Budd (FCO), Rachel Lomax (Treasury), Ivor Llewelyn (MAFF) and to Sir Robert Armstrong.

D F Williamson

D F WILLIAMSON

4 April 1986

Item 1: budgetary discipline

Points to make

1. United Kingdom is most determined of all member states in tough approach to Community budget. Will continue to oppose misuse of resources (eg excessive production leading to stockpiles). Give assurance that defensible Community budget a major UK concern, but not, of course, only UK objective in Community. Strongly committed to early completion of common market of 320 million people to benefit of British manufacturing and service industries and improved competitive position vis à vis United States and Japan.

2. Budgetary discipline is underpinned by three elements:

(i) the requirements of the Treaty and of the Own Resources Decision (which includes the VAT ceiling and the Fontainebleau mechanism). Goes without saying that these must be respected. We are gaining real advantage from the Fontainebleau mechanism - our rebate for 1983 was 750 million ecu (about £440 million) and for 1984 1000 million ecu (about £590 million) but the abatement for 1985 (payable in 1986), the first year to which the Fontainebleau mechanism applies, should be at least 1800 million ecu (about £1050 million).

- We stand by the letter of the Fontainebleau agreement, including the current VAT ceiling. The Fontainebleau agreement states only that "the maximum rate may be increased to 1.6 per cent on 1 January 1988 by unanimous decision of the Council and after agreement has been given in accordance with national procedures". Premature to start commenting on new own resources when the 1.4% ceiling has only been in place for three months. Present need is to use available Community resources wisely.

- Although the formal ceiling on member states' VAT contributions to the Community is now 1.4 per cent, the ceiling for our contributions has not in practice been increased and remains below 1 per cent. In 1986, on the basis of the present budget and our best estimate of the abatement, we shall contribute about 0.61 per cent VAT while others pay at 1.29 per cent;

(ii) the reference framework for Community expenditure which is established by the Council of Ministers before the budget discussions. This was a French initiative (by M. Delors, as French Finance Minister) now included in the Council conclusions of 4 December 1984. It provides an extra element of discipline for the Council itself faced with the more spendthrift attitude of the European Parliament.

- It has strengthened the resolve of the Council to ensure that the Treaty requirement (Article 203(9) relating to the maximum rate for non-obligatory expenditure must be respected and that it can only be increased by agreement between the Council and the European Parliament. This greater resolve can be seen in the decision of the Council itself (and five member states, including the United Kingdom, separately) to challenge in the European Court of Justice the action of the European Parliament in increasing the maximum rate in the 1986 budget unilaterally.

- The United Kingdom has already won its case for interim measures resulting in an immediate rebate of £18 million which we have now received. We are pursuing the main case against the Parliament with equal vigour. If the Court's interim measures decision is confirmed in the substantive case, our contributions to the 1986 budget would be cut by over £70 million.

(iii) the agricultural expenditure guideline, which results from a British initiative, requires that the rate of increase in agricultural expenditure should not exceed the rate of the increase in the own resources base. The guideline was respected in the 1986 budget and would, of course, be respected by the Commission's current price proposals for 1986/87, since these proposals would reduce the budget by about 400 million ecu in 1986 and by about 800 million ecu in 1987 (or about 200 million ecu after the cost of the milk outgoers' scheme).

- Commission have indicated, however, that, because of fall in the dollar and other factors (the guideline does provide for some exceptional circumstances), they expect to propose a supplementary budget which would go above the guideline. UK has responded by asking for equivalent savings. This debate has only just begun and it is too early to speculate about the result. Some extra money will be needed, if only to provide our increased abatement.

- In any event, whether or not exceptional circumstances are invoked this year, essential to sustain the key role of the agricultural guideline in the budgetary process.

3. Thus:

- Britain now considerably protected by Fontainebleau mechanism. UK total contribution to Community budget about 0.24 per cent of our GDP, about same proportion as expenditure on arts and libraries

- nonetheless, strongly share view of European Reform Group that budgetary rigour and action to restrain misuse of resources essential

- demonstrated by our firm actions in the Council and in the European Court of Justice.

Item 1: budgetary discipline

Background

1. The two legs of the United Kingdom's budgetary crusade in the Community were, first, to get an automatic abatement of our contribution which could not be taken away without our agreement and, second, to establish more formal arrangements for stricter budgetary discipline. The first was achieved in a binding form by the Fontainebleau mechanism incorporated into the Own Resources Decision. The second was established, although in a somewhat weaker form than we would have wished, in the conclusions of the Council on budget discipline of 4 December 1984 (text attached).

2. It is assumed that the European Reform Group are concerned that:

(i) the budget discipline conclusions are respected, in particular the agricultural guideline and the reference framework constraints for non-obligatory spending through the maximum rate; and

(ii) there will be no new own resources for the Community;

On the 1986 budget the budgetary discipline procedures were substantially followed, until the European Parliament (which is not bound by the budgetary discipline conclusions) increased non-obligatory expenditure, mainly on the Regional and Social Funds, by about 560 million ecu without the agreement of the Council. In our view this was a clear breach of the Treaty (Article 203), in particular Article 203(9); and the Council and five member states, including the United Kingdom, have taken the European Parliament to the European Court of Justice. The United Kingdom also applied for interim measures and was successful, the European Court ruling that for the interim the lower expenditure level agreed by the Council at its second reading in November is to be applied. We hope that the Council will win the main case, probably in July.

3. The Commission have indicated that they expect to propose a supplementary budget for 1986. This would cover, inter alia, an increase of some 450 mecu in the United Kingdom's abatement, and an increase of about 790 mecu in agricultural expenditure and an extra 750 mecu for the structural funds. The agricultural figure would be the net effect of higher stock disposal; increased expenditure because of the fall in the dollar; some savings on Community agricultural expenditure; and the savings resulting from the price proposals. The amount available within the agricultural guideline is currently about 174 million ecu, so that the Commission's proposal would need to rely on the provision for exceptional circumstances.

But what is our total contribution?

4. The Prime Minister is recommended not to commit herself on the supplementary budget. The Commission will not publish it until May so it is too early to know what it may look like. A supplementary budget on the line s above would probably lead to a net fall in the UK's VAT contribution rate because of the extra abatement. We would also expect to be at least in balance on the increase in structural funds spending, though this would not be justified in terms of budget discipline. We wish to hold down agricultural expenditure but it is also an expensive nonsense to keep excessive quantities of agricultural products, particularly refrigerated products such as beef or butter, for long periods in public intervention stocks. We have also to bear in mind that some expenditure in 1986 might reduce pressure and debate in 1987 about a possible increase in the VAT ceiling and help to push this question off beyond the next general election.

5. The 1986 supplementary budget is likely to bring the Community close to the limit of own resources available under the 1.4% ceiling - the UK VAT rate will remain well below 1% thanks to the Fontainebleau mechanism. The Fontainebleau agreement provides for the Commission to produce a report on the operation of the own resources system and budget discipline one year before the ceiling is reached. The Commission have recently forecast that spending in 1988 may be slightly above the 1.4% limit. In

/our

our view it is unnecessary to comment on, still less negotiate about, these questions before the Commission report formally, and when the 1.4% ceiling has only been in place for three months. It is equally premature to consider future supplementary finance - whether through intergovernmental agreements (IGAs) or any other source - at this time. We have in any case yet to be convinced that any increase in Community resources is necessary, and that the additional pressures on agricultural spending cannot be offset elsewhere within the budget totals.

6. On the three specific points referred to in the last paragraph of the European Reform Group's paper:-

(1) the 1986 budget which the Council agreed last November assumed a rate of $1 = 1.20 ecu. Variations in this rate do of course influence the Community's agricultural budget but do not have an automatic effect. What counts is the actual level of world prices in surplus markets;

(2) in the view of the United Kingdom - and of the Budget Council as a whole - the 1986 budget does cover costs of Spanish and Portuguese accession; it is the European Parliament which disputed this;

(3) the Commission is now suggesting that an extra quantity of some surplus products should be disposed of but this suggestion has not yet been seriously discussed.

Cabinet Office
4 April 1986

Annex 1

The Community budget figures are:

million ecu

	1984	1985	1986'	
Community budget	27,249	28,433	33,315	'(established by European Parliament but challenged by Council)
of which agricultural guarantee	18,333 (67.3%)	19,955 (70.2%)	21,012 (63.1%)	
United Kingdom rebate/abatement (in respect of preceding year)	750	1,000	1,800(est)	

U.K. net contribution?

CONCLUSIONS OF THE COUNCIL
on the measures necessary to guarantee the effective implementation of the conclusions of the European Council on Budgetary Discipline

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaties establishing the European Communities,

.../...

Whereas at its meetings on 19 and 20 March and 25 and 26 June 1984, the European Council reached agreement on a series of decisions and guidelines to ensure the relaunch of the Community and establish a solid basis for its further development during the present decade;

Whereas principles of budgetary and financial discipline are specifically laid down;

Whereas the European Council considered it essential that the rigorous rules which at present govern budgetary policy in each Member State shall also apply to the budget of the Communities, and stated that the level of expenditure will be fixed on the basis of available revenue, and that budgetary discipline will apply to all budgetary expenditure;

Whereas the European Council invited the Council of Ministers to adopt the measures necessary to guarantee the effective application of the principles as set out in its conclusions,

HAS ADOPTED THE FOLLOWING CONCLUSIONS:

Article 1

1. At the beginning of the budgetary procedure each year, the Council shall fix a reference framework, i.e. the maximum level of expenditure which it considers it must adopt to finance Community policies during the following financial year in accordance with Articles 2 to 5 inclusive and Article 9.

.../..

2. In order to fix the reference framework, the Council shall act by qualified majority in accordance with Article 148(2), second indent of the EEC Treaty.

3. The relevant provisions of the financial guidelines concerning the Common Agricultural Policy, set out in the Annex to the Commission Communication of 6 March 1984, shall be implemented; these provisions are annexed to these conclusions.

Article 2

The Council shall ensure that the net expenditure relating to agricultural markets calculated in accordance with Article 4, will increase by less than the rate of growth of the own resources base. This development shall be assessed on comparable bases from one year to the next.

Account shall be taken of exceptional circumstances, in particular in connection with enlargement.

Article 3

The amounts to be taken into account for the application of Article 2 shall be:

(a) as regards expenditure:

- that chargeable to Section III, Part B, Titles 1 and 2 (EAGGF Guarantee) of the Budget. The calculation of agricultural expenditure for the purposes of the guideline referred to in Article 2 shall be this expenditure, reduced by the sum of amounts corresponding to the marketing of ACP sugar, refunds in connection with food aid and the payments by producers in respect of the sugar and isoglucose levies as well as the revenue from any future internal agricultural charges;

(b) as regards the own-resources base:

the potential revenue on the basis of which Titles 1 and 2 of the Revenue side of the Budget are determined. The calculation of the Community's own resources base for the purposes of the guideline referred to in Article 2 shall be the total VAT base upon which the VAT rate for the year in question is calculated, the amount of financial contributions (if any) included in the Budget of the year, together with the own resources, other than those derived from VAT, set out in Revenue Title 1, less the sugar and isoglucose levies as well as the revenue from any future internal agricultural charges.

When the potential revenue from VAT is changed following an alteration in the VAT ceiling, the guideline provided for in Article 2 shall thereafter be calculated as if the new maximum VAT rate had been applied in all the years relevant to the calculation of the guideline.

Article 4

The level of net expenditure relating to agricultural markets for a given financial year shall be calculated as follows:

(a) the level of expenditure, as defined in Article 3(a), shall be the average of the actual outturn expenditure for 1984, and the best estimate of the outturn for 1985.

(b) the own resources factor shall be established by dividing the forecast level of the own resources base for the financial year in question, as defined in Article 3(b), by the average own resources base for 1984 and 1985,

(c) the level of expenditure for the financial year in question shall be determined by multiplying the amounts obtained by the application of paragraphs (a) and (b), unless the Council acting by the majority defined in Article 1(2) decides otherwise;

(d) the method of calculation shall be re-examined in accordance with the Fontainebleau conclusions under the heading "budgetary imbalances" on the basis of the report to be presented by the Commission, one year before the 1,4% VAT ceiling is reached.

Article 5

In the event of failure to respect the qualitative guideline referred to in Article 2, the Council shall, during the following two financial years, ensure that, barring aberrant developments, agricultural expenditure is brought back within the limits imposed by this guideline. In so doing, the Council shall concentrate its activity primarily on the production sectors responsible for the failure to adhere to the guideline.

Article 6

1. The Council shall, when exercising its powers as legislative authority or branch of the budgetary authority, ensure that the reference framework is respected.

2. At the request of a member of the Council or the Commission, the Council, acting by the majority laid down in Article 1(2), may amend the reference framework.

Article 7

1. Except in the case of Decisions mentioned in paragraph 4, when the Council is on the point of adopting an act which appears likely to increase expenditure for a financial year beyond the reference framework applicable to that year, the adoption of that act shall, at the request of a member of the Council or the Commission, be suspended.

2. Within a period not exceeding one month, the Council, acting by the majority laid down in Article 1(2), shall determine whether the proposed act would, if adopted, lead to the reference framework being exceeded.

3. If the Council concludes that the proposed act would, if adopted, lead to the reference framework being exceeded, it shall reconsider the proposed act with a view to taking appropriate measures.

4. In the case of decisions affecting net expenditure relating to agricultural markets, the procedures laid down in paragraphs 5(c) and 6(b) of the Annex to the Commission's Communication of 6 March 1984 shall apply.

Article 8

When the Council is on the point of adopting an act which has considerable financial implications for several years, the Council shall, before taking the final decision, formulate an opinion on whether the financial implications of the proposed act are compatible with the principles and guidelines governing the Community's budgetary policy.

Article 9

1. The Council shall comply with the maximum rate provided for in Article 203(9) of the EEC Treaty throughout the budgetary procedure.

2. In order to achieve this:

- when establishing the Draft Budget, the Council shall keep the increase in expenditure other than that necessarily resulting from the Treaties or from acts adopted in accordance therewith to a level no higher than half the maximum rate provided for in Article 203(9);

- at the second reading, the Council shall adopt a position such that the maximum rate is not exceeded.

3. Paragraphs 1 and 2 of this Article are without prejudice to the provisions of Article 203 of the EEC Treaty, particularly those of the last subparagraph of paragraph 9.

Article 10

On the assumption that the 1986 budget will be prepared on the basis of own resources being increased in that year, these Conclusions shall first apply to the exercise of the Council's powers in 1985 concerning expenditure in the financial year 1986.

EUROPEAN COMMUNITY BUDGET :
BUDGET DISCIPLINE AND RELATED MATTERS

Memorandum by the Treasury

(for House of Commons Select Committee)

CONTENTS

785/24

EUROPEAN COMMUNITIES BUDGET : BUDGET DISCIPLINE AND RELATED MATTERS

Memorandum by the Treasury

1. This memorandum discusses various aspects of budget discipline in the Community, and related matters, in which members of the Committee have expressed interest.

Budget discipline

2. **December 1984 Agreement**. The Council's conclusions of 4 December 1984 on budgetary discipline, which were deposited in the Library of the House on 10 December 1984, comprise three elements:

(a) a reference framework for overall budget expenditure;

(b) a financial guideline on agricultural market support expenditure;

(c) a commitment to observe the maximum rate provisions of Article 203 on the rate of increase in non-obligatory expenditure.

3. The Council's conclusions provide that the ECOFIN Council should establish a reference framework each year at the beginning of the budgetary procedure. Since the framework is intended to be an integral part of the budgetary procedure, it is set and amended by qualified majority: this is the normal method of voting on budgetary matters. The framework can if necessary be amended. Other Councils are asked to ensure that their decisions respect the framework (Articles 1 and 6). If any decision appears to breach it, the ECOFIN Council can ask for the decision to be delayed for one month to consider appropriate measures (Article 7).

4. The financial guideline for agricultural spending provides that net expenditure on agricultural market support should increase by less than the rate of growth of the own resources base. The base-period for the comparison is the average of 1984 and 1985.

There is a special provision to ensure that changes in the VAT limit do not lead to a "step" increase in the guideline (Articles 2-4). Provision is made for account to be taken of exceptional circumstances, in particular enlargement. If the guideline should be exceeded, expenditure is to be brought back within the guideline, barring aberrant developments, over the two succeeding years (Article

5. The maximum rate provisions for non-obligatory expenditure are laid down in Article 203(9) of the EEC Treaty. The Council's conclusions (Article 9) provide for adherence to the maximum rate of growth set out in paragraph 2 of Article 203(9).

6. The Council's conclusions also include a provision (Article 8) for the ECOFIN Council to be consulted on the implications for budgetary discipline before any other Council takes a decision on multi-annual spending programmes.

7. **Legal status**. The budget discipline conclusions are a political agreement by the Council. They have no Treaty status. The United Kingdom would have preferred a legally binding agreement. But it was not possible to negotiate this.

8. **Commission undertakings**. The Commission have given certain undertakings with regard to the agricultural expenditure guideline, though not the other components of the agreement. Many elements of the guideline are in fact based on the Commission's own proposals. The Commission have undertaken to draw up their annual price fixing proposals in the light of the guideline; to provide early warning of possible excesses in agricultural spending; and to explore all possible means of reducing expenditure before seeking supplementa[illegible] budget provision. These undertakings are an integral part of the system. The text is annexed to the Council's conclusions.

9. **European Parliament's views**. The European Parliament have never accepted the Council's approach to budgetary discipline, which they see as a threat to their role in the budgetary process. The Parliament's Budgets Committee's report on budgetary discipline in the autumn of 1984 reiterated the Parliament's opposition to one branch of the budgetary authority deciding unilaterally on measures relating to budget discipline. It argued that all

measures of budget discipline, and notably the reference framework, should be agreed by both the Parliament and the Council on the basis of proposals from the Commission; that the distinction between obligatory and non-obligatory expenditure should be abolished; and that legislative acts authorising multi-annual programmes should be agreed jointly by the Parliament and the Council.

10. When the Council met the Parliament in a conciliation meeting before final adoption of the budgetary discipline conclusions, the Parliament claimed that a reference framework which was not fixed jointly by both parts of the budget authority was contrary to the Treaty and would sow the seeds of conflict between the Council and the Parliament. As a result of these representations, the Council agreed to invite a delegation of the Parliament to meet it shortly before the meeting at which the reference framework for the year was due to be fixed. The Council also reiterated an earlier undertaking to invite the Commission and the European Parliament to examine jointly ways in which the co-operation necessary for a budgetary discipline common to all three institutions could be brought about.

11. During the 1986 budgetary process, the Council indicated willingness to hold these discussions with the Parliament and invited a delegation from the Parliament to discuss the 1986 reference framework before it was established. The Parliament did not take up these invitations.

12. **Effectiveness**. The 1986 budget process was the first annual budget process to be governed by the new conclusions on budget discipline.

13. In accordance with Article 1 of these conclusions, the ECOFIN Council agreed a reference framework for 1986 by qualified majority on 8 July. This incorporated the agricultural expenditure guideline for the Community of Ten and a 7.1 per cent maximum rate of increase for non-obligatory expenditure (some 430 million ecu), calculated in accordance with paragraph 2 of Article 203(9) of the Treaty. The Council also made clear, however, that further consideration would have to be given to the twin issues of

enlargement and the so-called 'cost of the past' in the course of the budgetary procedure: the 'cost of the past' is a term used to describe the overhang of commitments from previous years, particularly in the Regional Development and Social Funds, requiring to be paid off. The Council emphasised that budget discipline applied to Community expenditure as a whole, irrespective of its nature and the countries concerned.

14. The agricultural expenditure guideline was fully respected throughout the budgetary process. The Commission's agricultural prices proposals in March 1985 were compatible with the guideline. In the 1986 budget as adopted, provision for net expenditure relating to agricultural markets in the Community of Ten was some 170 mecu within the guideline figure of 20,619 mecu. This represented an increase of 2.5 per cent over 1985 for the Community of Ten and only 5.3 per cent in total, including agricultural expenditure in Spain and Portugal estimated at 570 mecu.

15. With regard to non-obligatory expenditure, the budget discipline rules have not been properly applied. In the UK's view, the Council's 'first reading' of the budget on 26 September was satisfactory. The Draft Budget then established provided for the full maximum rate of increase in non-obligatory expenditure (some 430 million ecu), rather than half the maximum rate as envisaged in the budget discipline conclusions. But this excess seemed justified given the accession of Spain and Portugal.

16. The United Kingdom first expressed concern about a threat to budget discipline during the Budget Council's 'second reading' discussion on 26 and 27 November. On that occasion, the Council voted by qualified majority to increase non-obligatory expenditure by some 1.2 billion ecu over 1985. In the United Kingdom's view the largest increase that could be considered compatible with budget discipline was some 1 billion ecu, comprising 430 million ecu under the maximum rate plus the 550-600 million ecu earmarked for Spain and Portugal. The United Kingdom therefore voted against this increase and made clear its opposition to any special provision, outside the maximum rate, for the 'cost of the past'. However, the excess of 750-800 million ecu over

the levels implied by the budget discipline conclusions for the Community of Ten was more than covered by the net new own resources which Spain and Portugal will bring to the budget, even allowing for the estimated 570 million ecu of agricultural guarantee spending in Spain and Portugal during 1986.

17. At the December Budget Council the Council decided, with the United Kingdom voting against, to offer a further 242 million ecu of non-obligatory expenditure provided that the Parliament would agree to settle on that basis. This offer was rejected by the Parliament and subsequently withdrawn.

18. The budget as adopted by the Parliament contains an increase of some 1.8 billion ecu of non-obligatory expenditure over 1985. This is clearly incompatible with the non-obligatory expenditure provisions of the budget discipline agreement. In the view of the United Kingdom and other member states, the Parliament also exceeded its powers under the Treaty in adopting this budget. The Council and five member states, including the United Kingdom, have therefore instituted proceedings against the Parliament before the European Court.

19. The Commission published their CAP price proposals for 1986/87 on 5 February. They estimate that these proposals, taken by themselves, should reduce expenditure by some 408 mecu in 1986 and 786 mecu in 1987. Nevertheless, they have indicated their intention to propose a 1986 Supplementary Budget with additional provision of 790 mecu for agricultural guarantee expenditure, including 750 mecu for the fall in the value of the US dollar relative to the ecu (see Section 6 below) and substantial supplementary stock disposals, partly offset by the effects of the price fixing proposals themselves and management economies. This proposal, if accepted, would appear to result in the financial guideline for 1986 being exceeded by some 620 million ecu.

20. The Commission have calculated the 1987 agricultural expenditure guideline as 21,818 mecu on a Community of Ten basis and have indicated their intention of proposing expenditure consistent with the guideline (with an addition of 1,345 mecu for expenditure in Spain and Portugal) in the preliminary draft budget for

1987. The Commission have, however, noted that the objective of keeping the agricultural provision in the 1987 preliminary draft budget within the guideline can only be achieved if the Council adopts the entire price fixing package. There will undoubtedly therefore be pressures on the Council for extra agricultural provision during 1986. However, the Council and Commission are both committed by the budget discipline conclusions to take all possible measures to avoid the need for a supplementary budget for agriculture; and it will be a key UK objective to see that the financial guideline is respected.

21. **Implications of enlargement**. When the 1986 reference framework was set in July 1985, it was agreed that special consideration would need to be given to the effects of enlargement. The 1987 reference framework will likewise need to take account of the cost of enlargement. Provision will be needed, inter alia, for the Spanish and Portuguese transitional VAT rebate mechanism, which has been set at 87 per cent for 1986 and 70 per cent for 1987.

22. The agricultural expenditure guideline is set at present on the basis of the own resources provided by a Community of Ten member states. In November 1985, at the United Kingdom's request, the ECOFIN Council invited the Commission to propose methods whereby the guideline could be extended to cover agricultural spending in Spain and Portugal. The Commission are expected to come forward with a proposal shortly. It is hoped that a suitable basis can be agreed on which to extend the agricultural guideline to all twelve member states. The United Kingdom has suggested that this might be done by a simple extension of the existing guideline on the basis of the additional net own resources provided by Spain and Portugal during the transitional period. Such a system would allow for an appropriate increase in agricultural receipts to Spain and Portugal while reinforcing the overall discipline provided by the guideline.

23. With regard to non-obligatory expenditure, the United Kingdom and other member states took the view that some additional provision was justified for enlargement over and above application of the 7.1 per cent maximum rate of increase to the Community

of Ten expenditure base. The Council did not dissent during the 1986 budgetary procedure from the Commission proposal to allocate some 550-600 mecu to cover non-obligatory expenditure in Spain and Portugal during 1986. This figure will now form part of the non-obligatory expenditure base for future years. In the United Kingdom's view, there should be no need for further adjustment to the maximum rate provisions to cover non-obligatory expenditure in Spain and Portugal.

24. Ecu/US dollar exchange rate changes. Changes in the ecu/US dollar exchange rate affect EC budget expenditure and agricultural levy receipts by changing, at least in the shorter term, world prices denominated in ecus. An increase in the value of the dollar, by increasing world prices in ecu terms and thus reducing the gap between Community support prices and world prices, tends to reduce expenditure and receipts, while a reduction in its value tends to have the reverse effect. These effects apply principally to EC expenditure on export refunds for cereals and production subsidies for oilseeds, protein crops and cotton. World prices for these commodities are in general directly influenced by US prices. There can be a lesser and more indirect effect on other expenditure, notably on export refunds for other products. The effects on budget expenditure substantially exceed in aggregate the effects on levy receipts.

25. In February 1985, the Commission calculated that a 10 per cent change in the value of the US dollar against the ecu would other things being equal increase/decrease Community expenditure (net of receipts from agricultural levies) by approximately 1 billion ecu. The Commission made it clear at the time that this estimate was based on the conventional assumption that world prices in dollars would not change as a result of a change in the dollar exchange rate, whereas in practice one would expect that over a period an increase in the value of the dollar would be compensated for, at least in part, by a reduction in dollar prices, and vice versa.

26. More recently the Commission have indicated, in the context of their CAP price proposals for 1986/87, that in the current situation a 10 per cent change in the value of the dollar might

be expected to affect Community expenditure (net of levies) by some 750 mecu. As noted earlier, they have indicated their intention of proposing a Supplementary Budget in 1986 including additional provision of 750 million ecu of agricultural guarantee spending on account of the reduction in the value of the dollar. The assumption used in the main 1986 budget was that the dollar would on average equal 1.20 ecu over 1986 as a whole. The assumption in the Commission's price-fixing proposals is an average of 1.12 ecu to the dollar. So far this year, the dollar/ecu rate has been significantly below this level. In the week 29 January - 4 February, it averaged 1.04 ecu to the dollar. The average dollar/ecu rate in 1985, for comparison, was 1.31 ecu to the dollar.

27. **'Ex novo' review**. Section 1.4 of the Fontainebleau European Council conclusions states that:

> "one year before the new ceiling is reached, the Commission will present to the Council a report setting out the state of play on:
>
> - the result of budgetary discipline;
> - the Community's financial needs;
> - the breakdown of the budgetary costs among member states, having regard to their relative prosperity, and the consequences to be drawn from this for the application of the budgetary corrections.
>
> The Council will re-examine the question as a whole and will take the appropriate decisions ex novo."

In addition, Article 4(d) of the budgetary discipline conclusions provides with regard to the agricultural spending guideline that:

> "the method of calculation shall be re-examined in accordance with the Fontainebleau conclusions under the heading "budgetary imbalances" on the basis of the report to be presented by the Commission one year before the 1.4 per cent VAT ceiling is reached."

It was accepted by the Council of Ministers when they agreed to this text that the present method of calculation would continue to be applied as long as the 1.4 per cent ceiling remained in force.

Adoption and implementation of disputed 1986 budget

28. **Powers of European Parliament**. The respective roles of the Council of Ministers and the Parliament, as the two arms of the budgetary authority in the Community, are set out in Article 203 of the Treaty. Briefly, the Council has the last word on obligatory expenditure, including agricultural guarantee, while the Parliament has the last word on non-obligatory expenditure, including the Regional Development and Social Funds, subject to the constraints laid down in the maximum rate provisions of Article 203(9).

29. The problem in the 1986 budgetary process was that the budget as adopted by the Parliament provided for a rate of increase in non-obligatory expenditure which not only goes far beyond the maximum rate as provided in the second paragraph of Article 203(9) of the Treaty but also substantially exceeds the amounts in excess of that maximum rate which the Council was prepared to agree. The Treaty provides that, if the maximum rate in Article 203(9), second paragraph, is to be exceeded (as the Council was prepared to do on this occasion), the Council and the Parliament must reach agreement on a new maximum rate (Article 203(9), final paragraph). In the event, the Council's agreement was neither sought nor given.

30. The Parliament also has the power under Article 203(8) to reject the draft budget, acting by a majority of its members and two-thirds of the votes cast.

31. **Commission's execution of 1986 budget.** The Commission are responsible under Article 205 of the Treaty for implementation of the budget. The Commission take the view that they must implement the budget as adopted by the Parliament until the European Court rules otherwise. The United Kingdom has applied to the Court for an interim measures order suspending implementation by the Commission of the disputed elements in the budget pending substantive judgment by the Court on the cases brought by the Council and five member states.

32. **Escrow account**. The procedures for payments to the Community budget are governed by legislation made under the Treaty, in

36. **Interest.** Payments of traditional own resources are normally made two months after their collection. Advancing dates of payment simply reduces the period between collection and payment during which member states have use of the funds, and there is no provision in the Regulations for interest to be paid by the Commission in such cases. The governments of member states similarly have interest free use of the balances in the Commission's accounts with them.

Court of Auditors

37. **1984 budget discharge.** The Court of Auditors is required under Article 206a of the Treaty to submit a report on the accounts for each Community financial year to the Council and the European Parliament. A draft Council recommendation on the discharge to be given to the Commission in respect of the implementation of the Communities Budget for the relevant financial year is then prepared. Annexed to the recommendation is a list of comments which the Council considers should be brought to the attention of the European Parliament. The European Parliament, under Article 206b, has the final legal responsibility for granting the discharge to the Commission acting on the Council's recommendation.

38. The United Kingdom considers that the Court of Auditors has a key role to play in improving financial control within the European Community. The proposed discussion in the ECOFIN Council of the recommendation for discharge provides an opportunity to support the Court's work and to ensure that the Commission responds to the Council's comments.

39. At home, Parliament will have the opportunity to debate the Court of Auditors' report before the ECOFIN Council on 10 March.

40. **Opinion on inter-governmental agreements (IGAs).** The Governments of member states agreed to provide supplementary financing outside the own resources system for the 1984 and 1985 budgets. The background to this was that the 1 per cent VAT ceiling had been reached and there was no prospect of ratifying a new own resources decision in time to meet in full the expenditure requirements in the budgets for those years.

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particular the Financial Regulation of 21 December 1977 and Regulation 2891/77. These do not make any provision for payment into an escrow account in the event of a dispute. It would however be open to the Court, if it is so wished, to direct in an interim measures order that the disputed elements in the budget should be held in a special account and not spent until the Court has given judgment on the substantive cases brought by the Council and five member states.

Advance payments

33. **November 1985 advance payment**. Advance payments of own resources were made eleven times in 1985. The need arose from cash flow difficulties experienced by the Commission throughout the year, initially in the absence of an adopted budget mainly because a key element in the financing of the 1985 budget - special contributions approaching 2 billion ecu by member states in excess of the previous VAT ceiling under an inter-governmental agreement - was not received until the last few weeks of the year (or early January in two cases).

34. The advance payment of traditional own resources (agricultural levies and customs duties) which the Commission sought on 20 November 1985 would normally have been paid in December. The request was made under Article 10(2) of Community Regulation 2891/77. The UK contribution was some £134 million. Parliament was informed of the advance payment on 21 November. Since the amount remaining in the Vote was only some £16.1 million, the balance was paid by means of a drawing on the Contingencies Fund of £117.9 million. The Special Supplementary Estimate approved by Parliament on 3 February 1986 enabled reimbursement to the Contingencies Fund of this amount. The December payment of traditional own resources was reduced by the £134 million advanced to November.

35. **Prospects for 1986**. The possibility of requests for advance payments of own resources during 1986 cannot be ruled out. But the special circumstances relating to the timing of payments under the inter-governmental agreement which gave rise to the Commission's cash flow difficulties during 1985 no longer exist.

41. In its Annual Report on the 1984 financial year (paragraphs 1.10-1.13 and 3.6), the Court argues that, by using the 1984 inter-governmental agreement to provide some 1 billion ecu to finance inescapable financial commitments in 1984, member states had not fulfilled their Treaty obligation to ensure that revenue and expenditure balance.

42. The member states, including the United Kingdom, do not share this view. In their view, payments under the inter-governmental agreements were entirely consistent with Article 4 of the 1970 own resources decision. This referred to the budget as being financed out of own resources 'irrespective of other revenue' - in French 'sans prejudice des autres recettes'. The Community receives other revenue such as gifts and bequests. The Government considers that contributions under the intergovernmental agreements for 1984 and 1985 are likewise a form of 'other revenue', and are therefore available to balance the budget in accordance with Article 199 of the EEC Treaty.

Treasury Chambers
18 February 1986

Item 2: common agricultural policy

Points to make

1. Agree with the European Reform Group that operation of the common agricultural policy has been profoundly unsatisfactory. We must keep hammering away for changes. But still a fundamental part of the political contract which made the European Community and I do not expect it to collapse or to be "repatriated".

2. United Kingdom approach to the CAP this year is clear

- first priority should be price restraint. Least discriminatory way of tackling the imbalances in the markets, most in line with Conservative Party philosophy

- but farmers', including UK farmers', increases in productivity and in yields have been remarkable. In recent years Community support prices in national currencies have been steadily reduced in real terms (hence food prices in shops have risen less than inflation generally). Price restraint alone, given difficulties of negotiating in Community and needs of UK farmers, not going to do the job

- UK also favours some weakening of intervention, eg on beef and cereals. Greater market element makes sense

- UK also willing to consider more direct action, eg through taking some land out of production or moving it to forestry if this were cost-effective and on a Community-wide basis

- made clear in my NFU speech that we oppose discrimination against larger farms (eg 50 animal limit on proposed new direct payment on beef cattle).

3. Have noted with interest statements (eg by Herr Kiechle) that, if a price settlement were too tough for German farmers (who include many small or part-time farmers) some national aid should be given. Climate perhaps now more favourable for slightly greater national element but we would have to be satisfied that competitive situation of UK farmers was not distorted.

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4. Cannot pick and choose between our obligations. We have to negotiate for best possible CAP settlement, not with the idea that, in the last resort, we need not apply what is agreed.

5. Propose that we should concentrate, as far as possible, on objectives I have mentioned and on need to reduce misuse of resources. That is crux of the matter. British public particularly critical - and rightly - of surpluses in public stock. But problem of adapting agricultural policies is real problem world-wide. Expenditure from the Community budget on agricultural support, although far too high, probably represents only about 2 per cent of total public expenditure by the member states. The United States are spending over $20 billion on farm support in the current fiscal year-comparable to the cost of the CAP to the Community budget and a much higher cost per farmer. Despite this, many United States' farmers in dire financial trouble.

6. No realistic alternative to battling on to improve the working of the CAP, including measures (price restraint, weaker intervention, consideration of possible "set-aside") to reduce risk of stocks building up again after expensive disposal.

Item 2: common agricultural policy

Background

1. The Commission's proposals for prices and related measures for 1986/87 are tough. On support prices the package is effectively a price freeze, hence once again a significant reduction in real terms. There are some price cuts (eg intervention prices for butter and olive oil). The Commission proposes that intervention for beef should be considerably weakened next year to a fall-back arrangement and that intervention for cereals should be weakened by a reduction in the period, a discount for feed wheat and changes in quality standards. It is estimated that the cereals intervention changes would reduce producers' returns for feed wheat and barley by about 7 per cent. OD(E) has agreed that, on prices and intervention, we should support the general thrust of the Commission's package.

2. The Commission also proposes some supplementary measures in a form which discriminates against larger farmers: a coresponsibility levy of 3 per cent (next year 6 per cent) on cereals sold off the farm, with an exemption for the first 25 tonnes; a direct aid for beef animals which excludes milk producing farms and is restricted to the first 50 animals; and a limit on the ewe premium. We are opposing the discriminatory elements.

3. The Commission will also be bringing forward some more structural measures, and these will probably include some form of set-aside scheme.

4. The French election has delayed detailed negotiation on the agricultural package. A long haul seems probable.

5. Although the European Reform Group's paper emphasises that British agriculture "does not produce an overall surplus of food", the fact is that British farmers have expanded production very

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substantially in recent years and we do have considerable surpluses stored in the United Kingdom: for example, about 25 per cent of the Community's surplus stock of cereals is held here.

Cabinet Office
4 April 1986

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD 8085

PARLIAMENTARY QUESTION

Oral Question No: 39 **Date:** Thursday 6th March 1986

MR TEDDY TAYLOR (Conservative - Southend East): asked the Minister of Agriculture, Fisheries and Food, if he will propose at the next meeting of the Council of Ministers that the supplies of cheap food at present being sent to the Soviet Union and East Europe should be made available to pensioners and low income facilities in the United Kingdom; and if he will make a statement.

MR GUMMER

A major objective of Government policy towards the Common Agricultural Policy (CAP) is to tackle the problem of costly surpluses at source by bringing about a better market balance of supply and demand.

While surpluses continue to exist, howerver, the problem of their cost-effective disposal remains. Several Community schemes already exist which enable food supplies to be made available at reduced prices. In considering any extension account has to be taken of the likely cost and effectiveness. The most economical way of disposing of stocks is often to sell them on the world market with the benefit of export refunds to bridge the gap between Community and world prices. Where there are surpluses for export the Government remains opposed to singling out particular countries for special treatment.

Item 3: the Single European Act

Points to make

1. Important that we should use the momentum given by the agreement in Luxembourg to further our objectives in the Community, in particular the opening-up of the wider market to our manufacturing and service industries. But actual change in the role of the European Parliament very limited indeed.

2. On majority voting worth recalling that balance of original Treaty of Rome was not favourable to British interest: majority voting on agriculture and the budget, on which we have had difficulties, and unanimity on a number of important requirements for the internal market, on which we want to avoid blockages and to make progress. The changes we have now agreed (article 100A) introduce majority voting for the measures necessary to progressively establish the internal market by 31 December 1992 but maintain unanimity for fiscal provisions, those relating to the free movement of persons and those relating to the rights and interests of employees (a necessary safeguard against "social engineering"). We also negotiated arrangements to protect our high standards of human, animal and plant health: national provisions can still be applied on grounds of major needs referred to in article 36 of the Treaty. Practical effects of the changes, which are now being submitted to national parliaments for ratification, may not be great but at least some acceleration in decisions on those measures which the British Government and British industry want. I consider this a pro-British package. The Luxembourg compromise (the "veto") was never discussed in the Intergovernmental Conference and is not, of course, affected.

3. On role of the European Parliament, it soon became apparent that a number of member states - in particular, France - did not want to do anything significant. The new article 149 is simply a procedural change. For certain measures the Council will adopt a position on first reading, the European Parliament may propose amendments and the Commission will decide whether or not it supports them. The last word rests with the Council, as now.

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4. The last paragraph in the European Reform Group's paper, claiming that the European Parliament has acquired a new blocking power, is a partial misunderstanding. The sequence is:

(1) if European Parliament, by absolute majority of all its members, rejects the Council's position, Council can adopt the measure by unanimity. But, apart from some lesser articles, the main Treaty article to which this procedure applies is Article 100 (internal market) and this already requires unanimity. Thus, in the improbable event that the European Parliament can muster an absolute majority of its members to reject the Council's position, we would be back exactly where we are now on Article 100;

(2) if European Parliament, by absolute majority of all its members, proposes amendments and the Commission does not support them, the Council may adopt these amendments by unanimity but equally it need take no notice of them at all;

(3) if European Parliament, by absolute majority of all its members, proposes amendments and the Commission supports them, the Council may adopt the measure by qualified majority. It can also amend the measure (eg by throwing out the European Parliament's amendments) by unanimity: this is the present rule under article 149.

5. On Commission efforts to extend their competence (para 1 of the European Reform Group's note) we are taking a very vigilant attitude. This is shown by our greater activity in the European Court of Justice (UK has initiated nine cases in the last eighteen months - seven against the Commission, one against the European Parliament and one against the Council).

Item 3: the Single European Act

Background

1. The results of the Intergovernmental Conference, agreed in Luxembourg in December, have been accepted by the governments of all twelve member states (after a referendum in Denmark) and incorporated in a Single European Act. The text has been presented to Parliament as Cmnd. 9758 (attached). The Treaty changes require ratification by all twelve national parliaments. The Bill was presented to Parliament on 27 March 1986.

2. The main elements of the package of Treaty changes are -

(i) formal provision for the European Council (article 2), which will normally now meet twice a year;

(ii) a change (article 100A) from voting by unanimity to majority voting on some proposals necessary for completion of the internal market, for which a target date of 31 December 1992 is set (article 8A). Fiscal provisions, those relating to the free movement of persons and those relating to the rights and interests of employees remain subject to unanimity (article 100A.2) and there are safeguards for public, animal and plant health (article 100A.4);

(iii) for the first time, a Treaty base for measures on research and development (articles 130F-130Q) and environment (articles 130R-130T). Action has been undertaken in these sectors for some years under the basket article 235. We believe that the new articles are a far better base for British interests, eg they require a proper framework programme for R and D providing for consideration both of priorities and costs. On environment for the first time we have included the criteria of proper scientific assessment and of "the potential benefits and costs of action or lack of action". The framework programme for research and development requires unanimity (article 130I and 130Q). Decisions on the environment also require unanimity (unless the Council, acting unanimously, were to determine otherwise) (article 130S);

/(iv)

(iv) for the first time, a Treaty base, rather grandly described as economic and social cohesion, for the Regional Fund (articles 130A-130E), including a provision for better coordination of the various structural funds (article 130D);

(v) a statement on economic and monetary policy (article 102A) which does not go beyond present practice;

(vi) slightly revised articles on social policy (articles 118A and 118B) which, however, make clear that:

> "such directives shall avoid imposing administrative, financial and legal constraints in a way which would hold back the creation and development of small and medium-sized undertakings";

(vii) a so-called cooperation procedure with the European Parliament under which for certain measures the European Parliament can put forward amendments but the last word remains with the Council (new article 149). The assent of the European Parliament would now be required for applications for new accessions to the Community and for new association agreements (amended articles 237 and 238);

(viii) provision for a new court of first instance, to relieve the workload of the European Court of Justice;

(ix) separately from the changes in the Treaty of Rome, a new agreement on European Co-operation in the sphere of foreign policy. This is closely based on the British text.

3. The text of the Single European Act demonstrates how the United Kingdom ground down the unrealistic and unacceptable ideas which were given an airing at Milan and that the result should be a modest advantage for our objectives in the Community.

Cabinet Office

4 April 1986