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MR POWELL

EUROPEAN COMMUNITY: UNITED KINGDOM STRATEGY AND TACTICS ON
THE BUDGET

WITH COP?

The Cabinet Office supports the conclusions of the Chancellor of the Exchequer's minute of 21 May to the Prime Minister. The tactics and handling of the budgetary pressures this year and next are going to be very difficult and we need to think well ahead. In this forward planning the following points are crucial -

(i) the effective stopper on the Community budget in 1986 and 1987 is the 1.4 per cent VAT ceiling. We have not only to maintain this but to do everything we can to avoid a sapping movement under which others, claiming that the budgets are not sufficient, may be led to propose additional financing through an intergovernmental agreement (we should refuse: bad in principle; the budget controversy would have some fall-out) or a loan (we should refuse; there is no provision in the budget articles of the Treaty). Accordingly it is in our interest to minimise, preferably by genuine savings, any carry-over of expenditure from 1986 to 1987 and from 1987 to 1988, because such carry-overs will be quoted as justifying additional financing;

(ii) subject to (i), the effective stopper on our ^{net} contribution is the Fontainebleau mechanism. Even on the maximalist budgets proposed by the Commission the United Kingdom's VAT contribution after abatement is only 0.68 per cent in 1986 and 0.82 per cent in 1987. On the Fontainebleau mechanism what we have, we hold. Nonetheless it is tactically very important that we should handle the budget controversies in such a way as not to give other member states and the European Parliament leverage for attacking the Fontainebleau mechanism or seeking to weaken it indirectly. Over the next few years we want a Fontainebleau mechanism which delivers the goods (as it is doing) and which, as far as possible, is non-controversial;



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(iii) on the position after 1987 our present approach of resting precisely on the Fontainebleau text ("the maximum rate may [not will] 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") is very good. We should not abandon this line prematurely. It gives no-one any ground for complaining that we are either too lax or too mean. It should help us to get the best deal for the United Kingdom, both nationally and as Presidency, in putting through the 1986 supplementary and 1987 budgets within the 1.4 per cent ceiling during the rest of this year;

(iv) towards the end of this year and, more insistently, after the German elections at the beginning of 1987, there will be demands for a decision to increase the VAT ceiling to 1.6 per cent for 1988 and/or a fundamental review of Community financing. We should try to hold off becoming engaged in this debate as long as practicable. When we have to engage, it seems to us that the essential points for us are, first, that there should be no automatic assumption that the Community does need the 1.6 per cent; secondly, that in any event the United Kingdom must be as fully protected as it is now by the Fontainebleau mechanism; thirdly, that any serious German attempt to obtain a budget correction for themselves would almost certainly be against our interests and could be very costly (in 1986 estimated German VAT contribution 6154 mecu, United Kingdom VAT contribution after abatement 2240 mecu) because it would open up the Fontainebleau mechanism and would give us the seriously difficult task of negotiating to avoid contributing to the German correction; and, fourthly, that we do not have much leverage on the small increase from 1.4 to 1.6 per cent VAT because after abatement the net contribution of the United Kingdom would rise by only about £65 - £70 million a year. In equity, a fundamental review of Community financing will no doubt come in the future but on

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balance we do not think that this would be best launched in association with the pressure for an increase to 1.6 per cent VAT in 1988. The risk is that the demands for a much bigger increase would be generated, the Fontainebleau mechanism would be put in question and the Germans would get something partly at our expense. It seems to us that it is better to settle 1986 and 1987 within the 1.4 per cent ceiling, to work now on ways of bringing back the potential expenditure in 1988 to within the current ceiling and to recognise that, if later it were to become impossible to hold the ceiling, we should go for the smallest possible, ie the 0.2 per cent, increase. Bitter experience has shown within the Community that, after no increase, the next best option is a very small increase and that more ambitious plans can be more costly!

I am sending a copy to Sir Robert Armstrong.

D F WILLIAMSON

22 May 1986