

PRIME MINISTER

EUROPEAN COMMUNITY BUDGET

You have a meeting tomorrow morning with the Foreign Secretary, the Chancellor, the Minister of Agriculture, David Hannay and David Williamson to consider the EC Budget. The basic document is the Chancellor's minute of 21 May (in the folder). Mr. Williamson has also done a note to steer discussion.

There will be no difficulty about endorsing the conclusions in paragraph 42 of the paper attached to the Chancellor's minute, ie. We must:

- keep expenditure within the 1.4 per cent VAT ceiling in 1986 and 1987;
- galvanise the Community to seek real savings, not just roll over expenditure into future years;
- secure our abatement;
- preserve the 1.4 per cent ceiling for as long as possible.

There is one very important tactical point to be borne in mind on the 1.4 per cent ceiling. We are on very strong ground in the Community while we stick to the letter of Fontainebleau. It is quite clear that the ceiling cannot be raised before 1988; and 'may' - but not 'will' - be raised then, though only by unanimous consent. Where we would risk serious trouble would be if we tried to go beyond that - for instance by saying now that we would definitely rule out now an increase in 1988. Once we move away from Fontainebleau in one direction, the others will move off it in the other. The most damaging outcome for us would surely be one in which the Fontainebleau mechanism comes apart before the election.

It is important therefore to get firmly established at tomorrow's meeting that we stick absolutely to Fontainebleau, and do not make the tactical error of trying to pull the blanket even further to our side of the bed. (Whether or not we would agree to increase the ceiling in 1988 remains absolutely open.)

The general issue of Community spending is likely to come up at the European Council in a fortnight's time. You will want to discuss the line to be taken then.

You shall also want to direct serious thought to be given to measures to produce real savings in the Community budget.

C D POWELL

11 June 1986

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MR POWELL

EUROPEAN COMMUNITY: UNITED KINGDOM STRATEGY AND TACTICS ON
THE BUDGET

The Prime Minister has a meeting at 9.30 am on 12 June in order to discuss with her colleagues principally concerned the United Kingdom's strategy and tactics on the Community budget. The Chancellor of the Exchequer minuted the Prime Minister on 21 May. I minuted you on 22 May. In the light of some further Ministerial discussion since then, you may find it helpful to recommend that the meeting on 12 June should deal with these questions:-

- (1) is it agreed that the United Kingdom's objective is to camp on the 1.4 per cent VAT ceiling for as long as practicable, it being in any event politically impossible to agree to raise the ceiling before the Election (Chancellor of the Exchequer's conclusion on page 3 of his minute)?
- (2) if so, how do we handle the difficult tactical situation over the next year or two (including our Presidency) and not prejudice what we have gained at Fontainebleau?
- (3) these tactical elements might be:
 - (a) no premature discussion of the 1.4 per cent VAT ceiling. The earlier the discussion, the more the bandwagon effect of other member states wanting an increase. We are on good ground in 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). We do not have now to declare our hand beyond this;

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(b) handling the revised 1986 and the 1987 budgets strictly within the rules ie respecting the 1.4 per cent VAT limit but recognising that the budgets will be close to that limit. In return, we shall want no tampering with our abatement and to make clear that we shall not agree to circumventing the 1.4 per cent VAT limit by an intergovernmental agreement (this idea is already being floated and needs to be scotched);

(c) avoiding German pressure for a budget correction for themselves, which could be costly for us;

(4) if we are to succeed in our objective and the tactical handling, we have to tackle an immediate problem, which is the Commission's assertion that the proposed 1986 (revised) and 1987 budgets within the 1.4 per cent VAT ceiling will not be sufficient to finance all requirements. It is this assertion which is stirring up the talk of budget crisis and of a higher ceiling. In the 1986 draft budget (revised) the Commission claims that an extra 400 million ecu is needed for structural fund expenditure and about an extra 500 million ecu for agriculture. In the 1987 draft budget the Commission makes large provision for the "cost of the past" on the structural funds and also claims that an extra 1200 million ecu is needed for agriculture if on average \$1 = 1.1 ecu or 2500 million ecu if \$1 = 1.02 ecu. We should not tamely accept the possibility of substantial carry-overs but must actively look in the budgetary discussions for savings to minimise them (eg wiping off the books structural fund commitments which will never be implemented, ceasing to pay advances on agricultural expenditure, transferring more of the cost of storage to national budgets, revising the beef intervention system etc).



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The Prime Minister may be able to conclude that the conclusions of the Treasury paper, para 42, are broadly endorsed but that we must make a specific effort to reduce the threatened budget carry-overs, which are fuelling the early pressure for a VAT ceiling increase.

I am sending a copy to Sir Robert Armstrong.

D F Williamson

D F WILLIAMSON

9 June 1986