Subject Euro Pol Budget Pt 23

OPS

10 DOWNING STREET

THE PRIME MINISTER

9 March 1984

PRIME MINISTER'S PERSONAL MESSAGE SERIAL No. T38/84

Dear Mr. President.

When we met on Monday, I promised to let you have a paper about the problem of the imbalance in the Community Budget. The paper would be designed to describe a lasting and systematic solution to this problem and explain how a net transfer of resources of 400-500 million ecu by the United Kingdom in a 12 Member Community could be achieved on a sustainable basis.

I now enclose this paper and hope it will be of use to you as you prepare the March meeting of the European Council.

I much valued the opportunity we had at Chequers to discuss the whole range of European Community problems that confront us. Like you, I hope that we shall be able to make decisive progress at our meeting later this month. I am sure that it will be important for Geoffrey Howe and Roland Dumas to keep in close touch over the next two weeks.

Yours sincerely

Margaret Thatcher

His Excellency Monsieur Francois Mitterrand

FUTURE FINANCING OF THE COMMUNITY

The EC Treaty established in Article 200 a first system for financing the Community which was replaced in 1970 by the Own Resources Decision. That Decision was based on two main principles

- the Community's Own Resources were to consist of the customs duties, agricultural levies and a proportion of VAT revenue on a standard basis

- there was to be an upper limit on Own Resources, in the form of the 1% VAT ceiling.

2. Before the United Kingdom joined the Community, a solemn assurance was given to us that "should unacceptable situations arise within the present Community or an enlarged Community, the very survival of the Community would demand that the institutions find equitable solutions". Events have shown that the Own Resources Decision does produce an unacceptable situation for the United Kingdom. It is ill-adapted to a Community of 10 and will be even more unsatisfactory for a Community of 12. It will increasingly jeopardise the Community's development unless it is corrected. The Community is now at a critical stage in its history, at which it will either demonstrate the capacity to adapt its priorities and enlarge its objectives, including its ability to meet the social, industrial and technological challenges it faces or it will cling on to old decisions.

3. In recent years ad hoc solutions to the budget problem have been found. The Stuttgart Declaration set the objective of avoiding "the constantly recurrent problems between the Member States over the financial consequences of the Community's budget and its financing" and to this end "ensuring equitable financial situations for all Member States". The underlying problem remains. In the period 1980-82 the United Kingdom whose gross domestic product per head was only 95% of the Community average

/during

6

during this period would have contributed about 50% of the resources transferred to other member states through the Community budget if there had not been corrective adjustments on an ad hoc basis. The United Kingdom's net budgetary burden, without taking account of ad hoc refunds negotiated from 1980, rose as follows -

million ecu

1978	1979	1980	1981	1982
228	849	1512	1419	2036

If the Own Resources ceiling were raised and no corrective system were in place, this burden would rise substantially.

4. The United Kingdom has made clear that it is only prepared to consider an increase in the VAT ceiling if there is effective control of agricultural and other spending ("budget discipline") and if the financing system is put on to an equitable basis ("budget imbalance").

5. There is now an emerging consensus that a reformed system must -

(i) be lasting and be included in a revised Own Resources Decision;

(ii) involve a correction on the revenue side by reducing a member state's VAT contribution in the following year;

(iii) be based on a member state's relative prosperity, limits being expressed as a percentage of a member state's gross domestic product;

(iv) come into effect in 1985, so that it can operate in respect of 1984 and subsequent years.

6. The reformed system should be so designed as to leave the United Kingdom at the outset with a net transfer of resources through the Community budget to other member states in a 12 member Community of 400-500 million ecu per year.

/7.

6.

7. The United Kingdom has proposed a system based on measuring the actual net transfers of resources through the Community budget. This is the best way of dealing with the problem. In the illustrative example put forward by the United Kingdom a member state whose relative prosperity was at or below 90% of the Community average would not make any net contribution. Above this level, there would be a limit expressed as a percentage of a member state's gross domestic product. It would rise by 0.007% of the member state's gross domestic product for each percentage point increase in its relative prosperity. The member state would receive relief for the excess of its net contribution above its limit. No member state would be expected to contribute to its own relief or to the relief of another member state if by so doing it would increase its net contribution above its limit. Applying this system to the 1982 figures and using a relative prosperity index for a Community of 12, the United Kingdom's adjusted net contribution would be 437 million ecu.

8. A number of other delegations have supported a system based on the VAT share/expenditure share gap. This formula treats the customs duties and levies as though they were VAT. For some member states, including France and Germany, this would be an advantage, because it overstates their contribution. But for the United Kingdom it would produce a measured gap which would have been 350 million ecu a year lower than the actual transfer of resources through the budget. In order to keep the United Kingdom's transfer of resources through the Community budget after adjustment within 400-500 million ecu, the limit would have to be very low. This result could be achieved by technical adjustments in the system. If, for example, it were decided that a member state whose gross domestic product per head was below the Community average made no net contribution and the limit rose by 0.01% of the member state's

/gross

6.

gross domestic product for each percentage point increase in its relative prosperity, the United Kingdom's actual net contribution after adjustment would have been about 400 million ecu (1982 figures, using a relative prosperity index for a Community of 12). Alternatively, a member state whose gross domestic product per head was at or below 97½% of the Community average could make no net contribution, with the limit rising by 0.008% of the member state's gross domestic product for each percentage point increase in its relative prosperity. This would have given on the same assumptions a United Kingdom actual net contribution after adjustment of about 460 million ecu.

9. Each of the systems described above is based on a single method of correcting the budget imbalance. However, if this result were achieved by the VAT share/expenditure share gap, it would not provide the necessary assurance against the risk of arbitrary fluctuations in the size of the gap. One way of providing this protection would be by allowing any member state benefitting from the system described in paragraph 8 and whose share of levies and duties was larger than its VAT share to have a correction to the latter gap as well.

10. The United Kingdom accepts that, if its relative prosperity were to improve, its net contribution to the Community budget would rise.

Margaret Thatcher