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16 March 1984

EUROPEAN COUNCIL, BRUSSELS

19/20 MARCH 1984

COMMISSION TEXT ON BUDGETARY IMBALANCES

Brief by Foreign and Commonwealth Office

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COMMISSION PAPER ON BUDGET IMBALANCES

BACKGROUND

1. The main points in the Commission paper are as follows:

(a) Establishment of a limit (which the paper calls a threshold) related to relative prosperity. This limit is adjusted each year on the basis of linear growth as a function of relative prosperity.

(b) Financing on the revenue side.

These points are satisfactory. Other points are less satisfactory:

(a) Takes as measurement of the imbalances the VAT share/-expenditure share gap and thus excludes our "excess" levies and duties.

(b) Duration ("the same as that of the new own resources"). This needs amendment.

(c) Compensation above the limit is of only a part of the excess burden.

(d) The financing arrangements appear to imply that the UK might have to contribute to other people's refunds (eg German refunds, if they were to qualify). This is not acceptable.

(e) Redefinition of administrative expenditure to exclude a part of it from the allocated budget (thereby reducing the UK's apparent burden).

(f) An obscure reference to transitional arrangements during enlargement but which again implies some attempt to reduce the real burden and hence our compensation.

(g) Para 4 (Financing) implies that if a Member State has to contribute to reliefs of others it must do so at its full financing share vote. If the scheme relates only to the British budget imbalance (ie excludes relief to the FRG and others) this does not create problems. But if the system applies to eg FRG we could find ourselves paying a large sum to German reliefs once they reached their limit. There are two possible ways of dealing with this depending on whether we decide to go for full net financing, ie our reliefs would be net of our contribution to our own reliefs and that of others or simple net financing, ie our reliefs would be net of any contribution to our own relief. Which system is preferable depends in large measure on whether the Germàns insist on having a lijmit which they are likely to reach (in which case we should want full net financing) or one which is so high they are unlikely to reach it, in which case we should be protected. In the latter circumstances, we would wish to ensure that Germany contributed to our reliefs and would therefore wish any system to be "net" only.

Possible textúal amendments are given below:

(i) fully net: add to end of part 4: "No Member State in receipt of compensation should contribute to any other Member State's compensation".

(ii) net: add to end of part 4: "These contributions will be taken into account when calculating the gap mentioned in point 1".

POINTS TO MAKE

2. Have had a valuable opportunity to discuss text last Friday with President Thorn and received from him useful clarification of a number of points. Glad to note that Commission text approaches the problem in the way we have been discussing it for almost a year ie establishment of a threshold based on relative prosperity and with an upper limit on a Member States' contribution expressed as a percentage of GDP.

3. Also pleased to note proposal for financing on revenue side of the budget.

4. Commission text therefore provides a basis for negotiation but there are a number of aspects which are not satisfactory from our point of view.

(a) Treats levies and duties as if they were VAT and therefore, leaves uncovered an element in our true budget burden averaging 330 mecu over the last 5 years. Need a system which covers the full burden. Recognise that it is possible to draw parameters of a VAT share/expenditure share scheme tightly so that, in the first year (1982 figures/relative prosperity in the enlarged Community), it could leave UK with a net contribution in the region of the 400-500 mecu of which I spoke at Athens. But there will be no guarantee that this could be sustained given possible fluctuations in levies and duties element. Must have system which leaves us with net contribution of the order of which I spoke in year one and provides sustainable, predictable results.

(b) Once we have a system which defines what the limit of a Member State's net contribution should be, in relation to its relative prosperity, there is no reason why compensation above the limit should not be 100%. Text as drafted suggests a surcharge or ticket moderateur and thus catches the UK twice, first in its initial definition of its burden and the second time by not providing full compensation above the limit.

(c) Definition of VAT share is difficult to follow. I understand that the Commission will kindly be letting us have some illustrative figures to make clear the basis of calculation.

(d) Commission proposal to change allocation of administrative expenditure is arbitrary. 15% of administrative expenditure is already excluded from the allocated budget. Benefits to Belgium and Luxembourg of having EC institutions are clear and greatly valued by them. In any case, Belgium and Luxembourg are highly unlikely to be affected by the limit so no advantage to them in reallocation. Sole purpose is to minimise apparent burden on UK.

(e) Period of validity as defined in the Commission paper is not clear. The scheme must form part of the revised own resources decision and should last as long as that decision. Simple amendment could make text satisfactory on this score, namely addition of word "decision" at end of para 5.

(f) Scheme should come into effect in respect of 1984 and subsequent years.

(g) Reference to transitional arrangements during enlargement. If, as we think, this passage is designed to make the UK pay extra for the costs of enlargement. At Athens, I said UK would be prepared to pay 4-500 mecu net contribution (based on 1982 figures). This was on the assumption of an enlarged Community, and would involve us contributing to costs of enlargement.

(h) Some way to go before Commission text could be made satisfactory. Provides a basis for negotiation.

FOREIGN AND COMMONWEALTH OFFICE
16 MARCH 1984

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GERMAN TEXT ON BUDGETARY IMBALANCES

Brief by Foreign and Commonwealth Office

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BRIEF ON GERMAN TEXT ON BUDGETARY IMBALANCES

BACKGROUND

The German text includes the following features from their text tabled at Athens:
(i) Measurement of the imbalance by the VAT/expenditure gap;
(ii) Definition of an upper limit as a percentage of GDP, related to relative prosperity;
(iii) partial compensation for the resulting imbalance, the rate to be determined in inverse relation to relative prosperity; and
(iv) refund payments to be made by deduction from the following year's VAT payments.

Two additional elements are involved:
(v) financing will be according to the French proposal for modulating VAT shares advanced in their amendments to the Danish convergence fund scheme, and
(vi) the scheme will be subject to review after five years in response to a Commission proposal; it would continue in the absence of unanimous Council agreement.

The fundamental departure is that no parameters are supplied. The Germans suggest that these will be set to ensure that compensation to the UK in the first year of operation amounts to a certain figure which will be determined as the first stage in the political negotiation at the European Council. Refunds in subsequent years would be generated automatically by changing expenditure burdens according to the parameters determined for year one.

POINTS TO MAKE

1. The German text of draft conclusions has a number of positive points: it determines an upper limit on a Member State's financial burden based on relative prosperity, and it includes a

satisfactory formula on the duration of the system. Text is certainly a basis for futher work and discussion. It is less satisfactory when read in conjunction with the Explanatory Memorandum. I have the following comments:

(i) Fixing the compensation for the first year without agreeing details of the refund mechanism in advance runs against the logic of the procedure which we have consistently tried to follow, ie that we should first determine the extent of the burden and the proportion of it which the Member State concerned might reasonably be expected to bear given its relative prosperity. The amount of the compensation is clearly of crucial importance but it should be the outcome of this calculation, not the point of departure for it.

(ii) The paper provides for only partial compensation above the Member State's agreed limit. This proposal is based on the mistaken belief that a Member State which has a limit on its net contribution will not continue to have an interest in an economical financing policy. On the contrary, a fair distribution of burdens and an assurance that a Member State would not pay more than its due would ensure that it can consider all proposals on their merits.

(iii) By taking as the measure of the budget burden the VAT share/expenditure share gap, ie by treating as if they were VAT our share of levies and duties, the German proposal leaves uncovered a portion of our burden averaging 330 mecu over the last five years. This weakness is further compounded by the proposal that if the financial burden on a Member State exceeds its upper limit only partial compensation is made. There is no reason why, once a fair share of budget burdens has been defined, a Member State should pay over its agreed limit. Any scheme in which the limit varies in accordance with relative prosperity will ensure that a Member State which benefits will contribute to Community costs, including those of enlargement, since its limit will rise in accordance with relative prosperity.

(iv) Paper does not specify on what basis of relative prosperity a scheme would be established. Must bear in mind that we are dealing with a system which must apply in a Community of 12 and should, therefore, be based on relative prosperity in a Community of 12. Under such a scheme, UK would be making a net contribution in period before enlargement considerably greater than justified by our relative prosperity in Community of 10. This itself would be a major contribution to costs of enlargement.

(v) Paper is reticent about financing of reliefs. Paper refers to use of financing key proposed by France last year. This was designed to pass a burden of financing reliefs to the wealthy smaller countries. They will no doubt have their own views. It is anyway important that reliefs for UK should be fully net.

FOREIGN AND COMMONWEALTH OFFICE
16 MARCH 1984

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TRANSLATION OF LETTER

from : Permanent Representation of the Federal Republic of Germany to the European Communities

dated: 13 March 1984

to : Secretary-General of the Council of the European Communities

Subject: Proposed text for the conclusions of the European Council on the question of more equitable financial burden-sharing in the EEC

Sir,

I enclose the proposed text for the conclusions of the European Council on the question of more equitable financial burden-sharing in the European Community which the Federal Minister for Foreign Affairs promised his colleagues at their informal meeting at Val Duchesse yesterday. The text includes explanations relating to the German upper limit arrangement (10281/1/83 REV 1 of 31 October 1983). The explanations and the text of the conclusions take account of several remarks made by other delegations during discussion of the arrangement.

I should be grateful if you would make the attached text available to all delegations forthwith.

(Complimentary close).

Prop ed text for the conclusions of the European Council on the question of more equitable burden-sharing in the European Community

A burden-limitation system applicable to all Member States will be introduced so as to ensure improved balance in the Community budget. Member States whose financial burden exceeds an upper limit determined on the basis of their economic capacity will be granted a partial equalization amount calculated in accordance with their relative prosperity vis-à-vis the rest of the Community. This equalization will take place when VAT payments are made for the following year.

The system will be designed in such a way that, in the first year of its application, the United Kingdom receives an equalization amount totalling ECU net, while the other Member States' financial burdens are not increased over their upper limits.

After five years, this system may be amended on a Commission proposal by means of a unanimous Council decision.

Explanations concerning the German upper limit arrangement

1. The German upper limit arrangement, as it was presented at the European Council meeting in Athens, has two aims:

- on the one hand, it is intended to correct the disproportionate burdens which already exist (United Kingdom problem);

- on the other hand, it is intended at the same time to provide a permanent assurance against excessive unilateral burdens.

2. This arrangement thus takes into account the requirements of progressive integration since

- the burden exceeding the upper limit is compensated for only partially, and

- the proportion to be compensated for is reduced as the prosperity of a Member State increases.

This merely partial compensation ensures that, as opposed to the United Kingdom safety net system, those Member States which are entitled to compensation also continue to participate in the financing of the further development of the Community and thus continue to have an interest in an economical financing policy.

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3. The meeting of the European Council on 19 and 20 March 1984 can confine itself to approving the main principles of the upper limit arrangement (perhaps on the basis of the attached draft conclusions). The detailed formulation of the arrangement could then be worked out in follow-up meetings by the Council of Ministers within a period still to be laid down (by the next European Council meeting at the end of June at the latest).

4. In the context of the German upper limit system the amounts of relief for the first year of its application could be determined by political agreement. In subsequent years the amounts of relief would then fluctuate within a certain range according to budgetary developments. This variation in relief (upwards or downwards) would be the result of Member States' changing expenditure burdens, which fluctuate from year to year.

5. The broad outlines of the upper limit system are as follows:

- The yardstick for measuring a Member State's financial burden will be the difference between its share in the value-added tax revenue payable to the Community and its share of total return flows from the Community budget.

- An upper limit will be set on the financial burden of a Member State thus calculated. This upper limit will be expressed as a percentage of a Member State's gross domestic product, this percentage rising to a maximum figure according to its relative prosperity.

- Where the financial burden on a Member State exceeds the upper limit, partial compensation will be made, with the amount of compensation declining in inverse relation

.../...

to the degree of prosperity of the country.

- Compensation payments will be deducted from the following year's VAT payments. They will be financed by all Member States using the scale proposed by the French delegation in September 1983.

The standard values for the upper limit system (e.g. percentage of GDP, percentage for calculating compensation claim) can only be laid down when a decision has been taken on the size of relief claims for the first year.
