

TREASURY

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Visit of Mr Tugenhat

15/5/81

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CONFIDENTIAL

1. MR HANCOCK ^{D.H. 13/5.}
2. CHANCELLOR

cc Financial Secretary
Minister of State (C)
Sir K Couzens
Mrs Hedley-Miller
Mr Edwards
Mr Fitchew
Mr Scholes

VISIT OF MR TUGENDHAT, 15 MAY

You are seeing Mr Tugendhat at 12 noon tomorrow, Friday 15 May. He is staying to lunch with you and the Minister of State (Commons).

2. The objectives of the meeting are set out in paragraphs 4-8 of Mr Hancock's minute of 24 April, which you might like to re-read. I attach a copy.

3. I also attach:

- a. some suggested speaking notes on restructuring, and
- b. a self-contained brief by Mr Donovan on Community budget nomenclature.

4. Over lunch, you might put a more political slant on the restructuring points, stressing their importance to the whole government. In particular, you might pursue point 5 of the speaking notes. As drafted, this is ultra tactful. But we know privately that Mr Tugendhat has circulated a paper to the Commission which states that "there should be no fixed budgetary guarantees for member states rendering them uninterested in the development of Community policy". The paper accepts the need to agree "principles governing the Community budget", but rules out "any system founded on prefixed corrected net budget positions for member states". This can only damage our case.

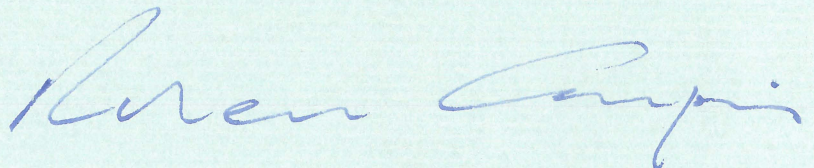
5. You might put to Mr Tugendhat the following arguments:-

- i. Because it has no "budgetary guarantees", the present system is a recipe for the squabbling

and deadlock which does the Community such injury. Every policy has to be considered in terms of its budgetary effects on member states. Successive British governments have been forced to dwell on our net contributions.

- ii. If the sharing of the budget could be decided consciously and equitably, member states would be free to consider policies on their merits.
- iii. Without "budgetary guarantees", member states are bound to balk at the costs of enlargement. With such guarantees, the budgetary consequences would be more manageable, and the present and future members of the Community would know where they stood.
- iv. In any case, the Commission cannot ignore Chancellor Schmidt's insistence that the Community should consider limiting net contributions and receipts.

6. Mr Tugendhat may say that he cannot advocate direct adjustments to net positions, precisely because he is British. He has to advocate more roundabout solutions. However, this would be an odd judgment. You might ask - if he as Budget Commissioner does not give a lead, who will? In any case, he does not have to damn the direct approach to avoid advocating it.



R P CULPIN

14 May 1981

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

- cc Chief Secretary
- Financial Secretary
- Sir D Wass
- Sir K Couzens
- Mr Ryrie
- Mrs Hedley-Miller
- Mr Lovell
- Mr Unwin
- Mr Ashford
- Mr Edwards
- Mrs Gilmore
- Mr Aaronson
- Mr Culpin
- Mr Ridley

COMMUNITY BUDGET RESTRUCTURING

1. The Foreign Secretary minuted the Prime Minister of 14 April to call the attention of members of OD to two papers written by officials under Cabinet Office chairmanship on the following subjects:-

- (i) Handling the European Community Budget restructuring negotiations between now and the start of our Presidency on 1 July.
- (ii) At what point we should precipitate a negotiation about the size of our refund in respect of the 1982 Budget.

2. The Treasury were consulted in the preparation of these papers - the second is a summary of one that we wrote. We agree with the recommendations and with the Foreign Secretary's conclusion that collective Ministerial discussion is not necessary at this stage. I see no need for you to intervene in the correspondence and have no comments on the second paper. But I have one or two comments on the first paper and two specific suggestions to put to you about your own role in these negotiations.

The meeting with Schmidt

3. The Foreign Secretary is right to stress the importance of the Prime Minister's meeting with Schmidt on 11-12 May. The interdepartmental briefs for that meeting will be circulated on Friday, 1 May, and we shall subsequently brief you on the way you might handle your preliminary bilateral talks with Schulmann (who is representing Matthöfer, we understand, at both the Finance Council and the bilateral discussion on 11 May).

The Commission Report

4. Paragraphs 7-8 of the paper on the next phase of the negotiations deal with the other major event between now and our Presidency, namely the writing of the Commission's report. It is extremely important to us that this report should provide the basis for a successful negotiation. Obviously we cannot dictate to the Commissioners what they say but, by exploiting all our various contacts within the Commission, we can reasonably hope to have some influence on the drafting. The Commission have left the work exceedingly late and the whole task of writing and agreeing the report will be compressed into the six week period between their next meeting on 30 April and their target date for delivery which is 15 June. Judging from the way that the internal Commission discussions have been going, the report will not be at all detailed and specific - but it would not necessarily help us if it were. Our aim must be to get a sensible structure which will provide the framework for the subsequent negotiations, plus a series of useful statements which we can subsequently quote in our own cause. It would be a big help if the report endorsed in terms our thesis that the distributive effects of the budget should in future be a matter of conscious decision. Even if we do not get that, I would at least hope that Mr Tugendhat will be able to persuade the Commission to include the following two statements:-

- (i) An acknowledgement that no conceivable reform of the CAP or development of the non-agricultural expenditure is going to solve the British problem, so that
- (ii) Some form of residual financial adjustment mechanism will be needed as part of the process of restructuring in order to prevent the recurrence of an "unacceptable situation".

5. We understand that, at the last Commission discussion before Easter, Mr Tugendhat had some success in getting his colleagues to acknowledge that both these statements were true. His next task will be to get them into the report. To keep him up to the mark it is suggested, in paragraph 8 of the paper by officials, that you should see him yourself.

6. Establishing the right relationship with Mr Tugendhat will require some care and tact. He has recently been showing signs of resistance to the pressure being put on him by H.M.G. At one stage he appeared to be demonstrating his independence by arguing that proposals for new forms of own resources would be an essential part of the Commission's report. Recently he has been making more realistic comments on the 1% ceiling; but the earlier episode shows the importance of staying in touch with him during the next critical six weeks.

7. In the negotiations that follow the Commission's report, Mr Tugendhat's help will also be essential. If we are to secure agreement to some form of direct adjustment system, then a working party of the member states and the Commission will have to be set up at some stage to examine the possibilities. We shall be in the chair which will give us an opportunity of proposing "compromise" solutions after discussion. But we can scarcely start the ball rolling by circulating the initial working papers. The only feasible source of such papers will be DG XIX of the Commission who report to Mr Tugendhat. It will therefore lie within his power to ensure that they are not unhelpful to us, even if he cannot make them include our ideas.

8. I think it would be too early to talk to him about such matters until after the Commission have reported. His attention is bound to be focussed, during the next six weeks, on the problem of getting the Commission to agree a text. If you decide to meet him in May, as I hope you will, I suggest that your objectives should be:-

- (i) to make him feel that his own views are respected by HMG, and
- (ii) to ensure that he appreciates how essential it is that the Commission report should contain propositions, such as those in paragraph 4 above, on which we can build in subsequent negotiations.

(The report by officials implies in paragraph 8 that you should not see Mr Tugendhat until June. This was not intended - what was meant was "not before Easter". The first half of May would be appropriate.)

A speech in the Hague

9. In a submission made just before Easter, I recommended that you should go to the Hague to talk to Mr Van der Stee about the handover of the Presidency of the Finance Council. Your Private Office tell me that you could get away for 24 hours between lunch-time on Wednesday, 3 June and lunchtime on Thursday, 4 June. (On Wednesday morning is NEDC and on Thursday afternoon First Order Questions.) If you felt able to make such a visit, you could take the opportunity to deliver a speech to a Dutch audience about our attitude to the Community and to Budget restructuring. I have consulted our Embassy informally and they tell me that they see no difficulty about persuading a Dutch organisation to invite you to deliver a speech to a suitable audience. FCO officials favour the plan.

10. There are a number of reasons why the Netherlands is a good choice:-

- (i) You have already made speeches about the Community in Bonn and Paris. The Hague would be a natural third choice.
- (ii) The Dutch usually listen with sympathy to us. They do not indulge in outbreaks of moral indignation such as have characterised recent comments on UK attitudes by the French and German governments.
- (iii) The Dutch are one of the small rich countries who are net beneficiaries from the Community Budget. If the Community Budget is to be restructured in the way that we want, then they are bound to lose out. There is evidence that they appreciate that their position, as a relatively rich country and a major beneficiary from the Budget, is anomalous. If we cannot persuade the Dutch to accept change, then we have no hope of achieving our objectives, because the Dutch are more likely to be persuaded of the need than the other small rich countries.

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11. Attached as the Annex is an outline of the sort of speech that I would consider it helpful to make as the Treasury's contribution to process of persuading the rest of the Community to accept the case for changes in the Budget favourable to us. I have incorporated in the outline one suggestion by Mr Aaronson. But I have not followed him in proposing that the speech should include a substantive passage of economic policy. I do not think there would be time both to do that and make an effective speech about our approach to restructuring. We need a text, setting out a coherent and persuasive case, that can be put out to the press, not only in the Hague and London, but in all Community capitals.

12. To ensure that we do not waste time drafting a speech that you do not want to deliver, I should be glad to know whether you wish the speech to cover the subjects summarised in the Annex or whether you would prefer to omit topics from it or add topics to it.

13. If we have your answer next week, we shall be able to let you have a complete draft, incorporating advice from the FCO, Cabinet Office and our Hague Embassy, for you to look at after you get back from Libreville on Friday, 22 May.

Recommendation

14. I recommend that:-

- (i) You invite Mr Tugendhat to visit you in London in the first half of May.
- (ii) We ask the Embassy to secure an invitation for you to address a suitable audience in the Hague on the evening of Wednesday, 3 June.
- (iii) We try to arrange for you to call on Mr Van der Stee while you are there.

15. I seek your instructions on the content of the draft that we should now prepare - see paragraphs 11-12 and the Annex.

D.H.

D J S HANCOCK

24 April 1981

BUDGET RESTRUCTURING : POINTS TO MAKE

1. Commission's June report will be terribly important in getting discussion off to a good start. Tugendhat, as Budget Commissioner, has a crucial role to play. How does he see it going? What can we do to help each other?

2. Hope that between us - Commission and Presidency - we can lift the level of discussion. Encouraged by increasing recognition that Community must decide how to share its budget burdens and benefits: Germans shared this approach at bilaterals this week. Does Tugendhat think Commission could include this thought explicitly in its report??

3. We'll have the job of using the report in our Presidency. Could be a bit difficult as we are still suspicious on the budget. Would help us no end if Commission report could provide an agenda around which to organise work - setting out the scale of the problem and a range of options for solving it, including direct adjustment of net contributions and receipts. Does Tugendhat see any difficulty about this?

4. From our national point of view, the most important point we hope Tugendhat will help to get across is that no conceivable switch from agricultural to non-agricultural spending will be sufficient to solve British budget problem, so something more will be needed. Is that now accepted in Commission?

5. Know some fear that if Community opts for direct adjustment of contributions and receipts, countries will lose all interest in policies. How can we best rebut this? Surely policy discussion would be better if countries were not always worrying what it would do to their net budgetary positions? And surely a country like the UK is bound to stay interested in a policy like the CAP? Even if we could negotiate refunds of our entire net contribution, that wouldn't stop the CAP from generating food which no-one wants to eat. Nor would it stop us from paying too much for our food. How could we not care about such things?

IF TUGENDHAT RAISES 1 PER CENT CEILING

Understand misgivings about a "1 per cent Europe".

But

- i. must be realistic. Even if we wanted to raise the ceiling, Parliament would probably not pass the necessary legislation; and the Germans are not budging.
- ii. The 1 per cent ceiling is the only real constraint we have on the CAP. In part, it's because we care about reforming the policy, and don't just want our money back, that we need to keep the 1 per cent constraint in place.

IF TUGENDHAT SUGGESTS A NEW CONTRIBUTION KEY FOR FINANCING THE CAP

Certainly worth considering. But wouldn't this require a radical assault on the own resources system? And wouldn't it be a rather roundabout way of achieving an equitable pattern of net contributions and receipts? On the face of it, some direct adjustment of net positions would be simpler and more reliable.

IF TUGENDHAT SUGGESTS NATIONAL FINANCING OF THE CAP

Again, certainly worth considering. But presumably this would not limit total spending by member states on agricultural support - so it might not limit the incentive to surplus production. On the face of it, unlikely to be enough to solve British budget problem. But perhaps Tugendhat has some figures?

BUDGET NOMENCLATURE

The Commission will use a revised nomenclature for the 1982 preliminary draft budget (PDB). They have justified their proposed changes on the grounds that they will rationalise the budget layout. The Commission have not consulted the Council in advance and this has created considerable suspicion on the part of all member states. We have now learnt that this lack of consultation was due to a desire by the Commission to avoid involving the European Parliament.

2. Our main concern about the changes was at suggestions that, in the new presentation, "refunds" (export subsidies) in respect of ACP sugar (cane sugar imported from Commonwealth countries and former French colonies) and New Zealand butter should be moved out of the agriculture section of the budget. There were also suggestions that refunds in respect of food aid would be moved from the agriculture to the aid section.

3. These changes would have made comparisons with agriculture expenditure in previous years difficult. This would have been serious because of the Council's commitment to contain the growth of agricultural expenditure either to the rate of growth of own resources or (the UK, German and Dutch position) to a rate "markedly lower" than that. Reducing the apparent size of agricultural expenditure by changing the definition would have allowed higher levels of expenditure in total.

4. We learnt, during discussions between the Financial Secretary and Mr Tugendhat this week, that the Commission have decided against the changes in coverage and that the agriculture section in the 1982 PDB will have the same coverage as in 1981.

5. The other aspect of this subject is that the change in order is likely to cause confusion, at least initially. While this is tedious, we could probably have accepted it, but other member states are likely to be more difficult. It is also quite likely that the Council and the European Parliament will take different positions on the changes; since

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the budget nomenclature is settled as part of the budget procedure the Parliament has the last word. The proposed changes will also require amendment to the Financial Regulation. We would have preferred to have avoided this complication during our Presidency.

Points to make

1. We are reassured that the Commission have decided against moving part of the expenditure previously included with the EAGGF to a separate part of the budget. Such a change would have made the task of containing agricultural expenditure more difficult because of the difficulty of comparing expenditure with earlier years.

2. There is a real risk that the proposed changes will result in disagreements between member states and the Commission and later between the Council and the European Parliament; there are more than enough of these already .

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PS/LORD PRIVY SEAL
PS/MR RIDLEY
MR BULLARD
MR HANNAY
LORD BRIDGES

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HD/ERD
HD/.....
HD/.....

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M' de Koublanque

CABINET OFFICE

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MR D M ELLIOTT
MR RHODES
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~~MR WENTWORTH~~

D.O.T.

PLUS OGDS

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COMMISSION MEETING ON THE MANDATE ON 13 MAY

SUMMARY

1. THE COMMISSION APPROVED AN OUTLINE OF ITS REPORT. THE DISCUSSION ON SUBSTANCE WAS GOOD TEMPERED, NO ONE TRIED TO ERECT MAJOR ROAD BLOCKS AND A NUMBER OF IMPORTANT PROPOSITIONS APPEARED TO BE ACCEPTED; NET SOLDES WERE THE PRINCIPAL MEASURE OF UNACCEPTABLE SITUATIONS, THE BUDGET SHOULD TRANSFER RESOURCES FROM RICHER TO POORER COUNTRIES, MEMBER STATES RECEIVING INADEQUATE BENEFITS SHOULD BE COMPENSATED AND THE BUDGET PROBLEM AND CAP REFORM WERE MAIN ISSUES WHICH HAD TO BE ADDRESSED IN THE REPORT. BUT THE COMMISSION DID NOT HAVE A DETAILED DISCUSSION ON THE CAP AS

MAIN ISSUES WHICH HAD TO BE ADDRESSED IN THE REPORT. BUT THE COMMISSION DID NOT HAVE A DETAILED DISCUSSION ON THE CAP AS INTENDED; AND THEY REMAIN SOME WAY FROM CONCLUSIONS ON ALL THREE MAIN STRANDS OF THEIR WORK. THORN COMMISSIONED DRAFTS OF THE VARIOUS SECTIONS OF THE REPORT FOR THE 25 MAY MEETING.

DETAIL

2. THE COMMISSION'S DAY-LONG MEETING ON THE MANDATE, PARTIALLY ERODED BY OTHER BUSINESS, WAS MAINLY OCCUPIED BY A TOUR DE TABLE ON THE BASIS OF A DRAFT OUTLINE REPORT CIRCULATED BY THORN AND PREPARED BY JENKINS. SEVERAL COMMISSIONERS SPOKE ON THE LINES OF PAPERS WHICH HAD BEEN CIRCULATED (COPIED BY BAG TO EDWARDS - TREASURY - AND OTHERS ON 12 MAY).

3. ANDRIESEN AGREED WITH THORN'S DRAFT. THE REPORT SHOULD COVER INSTITUTIONAL DEVELOPMENTS. A PRAGMATIC SOLUTION TO UNACCEPTABLE SITUATIONS WOULD BE NECESSARY IN THE SHORT TERM, AND IT WOULD HAVE TO INCLUDE A FINANCIAL MECHANISM. NEW OWN RESOURCES WERE AN ESSENTIAL PART OF THE LONGER TERM SOLUTION AND THE COMMISSION SHOULD MAKE FIRM PROPOSALS ON THIS IN THEIR REPORT.

4. NATALI SAID UNACCEPTABLE SITUATIONS COULD BE DEFINED IN THREE WAYS - IN BROAD ECONOMIC AND POLITICAL TERMS; IN TERMS OF NET BUDGETARY POSITIONS QUALIFIED BY THE RESOURCE EFFECTS OF EC POLICIES; AND AS PROBLEMS PECULIAR TO THE SITUATION OF A FEW MEMBER STATES (MEANING OBSCURE). HE DID NOT EXCLUDE THE NEED FOR BUDGETARY MECHANISMS. HE REITERATED HIS EARLIER REQUESTS FOR FIGURES ON WIDER RESOURCE FLOWS.

5. ORTOLI REGRETTED THAT THE UK SETTLEMENT HAD GIVEN TOO MUCH EMPHASIS TO NET BUDGETARY POSITIONS. ON THE OTHER HAND, IT WAS NOT POSSIBLE FOR DG II TO QUANTIFY THE WIDER RESOURCE EFFECTS OF COMMUNITY POLICIES. HE STRESSED AGAIN THE NEED TO REVIEW INDIVIDUAL PRODUCT REGIMES IN THE CAP.

6. GIOLITTI LABOURED CONVERGENCE. THE REPORT SHOULD MAKE PROPOSALS ON ENERGY AND INDUSTRY.

7. RICHARD THOUGHT UNACCEPTABLE SITUATIONS WERE AS DIFFICULT TO DEFINE AS ELEPHANTS, BUT EASY ENOUGH TO RECOGNISE. THE BUDGETARY MEASURE WAS BEST. THE SOLUTION, INCLUDING A BUDGETARY MECHANISM, MUST BE ABLE TO DEAL WITH CURRENT AND FUTURE PROBLEMS.

8. CONTOGEOORGIS ENDORSED THORN'S OUTLINE. A BETTER MEANS OF DETERMINING THE INCIDENCE OF ECONOMIC AND FINANCIAL COSTS AND BENEFITS IN THE COMMUNITY WAS NEEDED. THE OUTCOME SHOULD ASSIST CONVERGENCE.

9. TUGENDHAT SPOKE ON THE LINES OF HIS PAPER. THE COMMUNITY NEEDED A POLICY ON THE BUDGET AS ON OTHER THINGS. OTHER POLICIES SHOULD NOT BE WIDELY DISTORTED FOR BUDGETARY REASONS, BUT THE BUDGET OUTCOME DID MATTER. THE COMMISSION'S REPORT SHOULD SURVEY A FULL RANGE OF OPTIONS SO THAT ALL MEMBER STATES' INTERESTS WOULD BE SEEN TO HAVE BEEN CONSIDERED. THORN'S NOTE RIGHTLY POSED THE KEY QUESTION WHETHER THE UNACCEPTABLE SITUATION ^{WAS A} ~~OR~~ LIMITED PROBLEM REQUIRING A TEMPORARY SOLUTION OR A STRUCTURAL PROBLEM CALLING FOR A GLOBAL AND PERMANENT SOLUTION. THE FIGURES ON NET SOLDES HE HAD PRESENTED PREVIOUSLY SHOWED IT WAS THE LATTER.

10. NARJES DWELT ON THE LIMITED POWERS OF THE COMMISSION

11. O'KENNEDY SAID THE REPORT SHOULD POINT OUT THE BENEFITS OF MEMBERSHIP AND THAT MEMBER STATES' OWN POLICIES COULD AGGRAVATE UNACCEPTABLE SITUATIONS (PRESUMED TO BE A REFERENCE TO EXCHANGE RATES, MCAS ETC). THE 1 PER CENT CEILING SHOULD BE RAISED.

12. DALSAGER ALSO HARPED ON MCAS. HE ATTACKED CO-FINANCING OF THE CAP AND POINTED OUT THAT ITS SHARE OF THE BUDGET WAS NOW MUCH LOWER THAN 20 YEARS AGO.

13. DAVIGNON ARGUED THAT GOVERNMENTS WOULD NOT DISCUSS THE REPORT SERIOUSLY UNTIL THE AUTUMN BECAUSE OF THE NEW FRENCH GOVERNMENT AND SO IT MUST BE SOLID ENOUGH TO WITHSTAND NATIONAL SCRUTINY IN THE INTERIM. HE SUGGESTED THAT RICHARD AND GIOLITTI SHOULD WORK UP THE SECTION ON STRUCTURAL POLICIES, TUGENDHAT SHOULD DEVELOP IDEAS ON GLOBAL FINANCIAL MECHANISMS AND OPTIONS ON THE CAP SHOULD BE DEVELOPED. SOME MEMBER STATES DID NOT RECEIVE A FAIR SHARE OF BENEFITS AND MUST BE COMPENSATED. THE ISSUES TO BE ADDRESSED WERE THE VOLUME, NATURE AND MEANS OF COMPENSATION.

14. HAFERKAMP (WHO WE LEARN CONFIDENTIALLY HAD RECEIVED DETAILED BRIEFING FROM BONN) SPOKE OF THE NEED FOR, AND THE EMERGING CONSENSUS IN THE COMMISSION ON, A COMMITMENT TO ENSURE THAT THE BUDGET TRANSFERRED RESOURCES FROM RICHER TO POORER MEMBER

14. HAFERKAMP (WHO WE LEARN CONFIDENTIALLY HAD RECEIVED DETAILED BRIEFING FROM BONN) SPOKE OF THE NEED FOR, AND THE EMERGING CONSENSUS IN THE COMMISSION ON, A COMMITMENT TO ENSURE THAT THE BUDGET TRANSFERRED RESOURCES FROM RICHER TO POORER MEMBER STATES IN A PLANNED MANNER.

15. SUMMING UP, THORN SAID THERE WAS AGREEMENT ON THE STRUCTURE OF THE REPORT. RICHARD AND GIOLITTI SHOULD DEVELOP THE SECTION ON THE STRUCTURAL FUNDS AND DAVIGNON PROVIDE SOMETHING ON INDUSTRY AND ENERGY. THE MAIN AIM OF THE REPORT SHOULD BE TO INDICATE MAJOR INITIATIVES ON THE BUDGET AND THE CAP. HE WAS DISAPPOINTED BY DALSAGER'S PAPER ON THE CAP AND THE NOEL GROUP SHOULD CARRY FORWARD EXAMINATION OF PRODUCT REGIMES, INCOME AIDS AND NATIONAL FINANCING. "SOMEONE ELSE" SHOULD WORK ON THE BUDGETARY ASPECTS. HE WOULD DO THE REST.

16. NEVILLE-JONES AND JENKINS HAVE DISCUSSED THE HANDLING OF THE CAP REMIT, JENKINS DOUBTS IF HE WILL HAVE TIME TO WRITE THE PAPER AND THEY AGREE THORN'S CABINET SHOULD NOT DO IT. NEVILLE-JONES HAS THEREFORE ASKED ALAN WILKINSON TO PREPARE A DRAFT. IT IS ASSUMED THAT THE TUGENDHAT CABINET WILL PROVIDE THE SECTION ON BUDGETARY ISSUES.

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Financial Secretary
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Sir K Couzens
Mr Hancock
Mrs Hedley-Miller
Mr Battishill
Mr Ashford
Mr Edwards
Mr Culpin
Mr Griffiths
Mr Cropper
Mr Parker (UKREP Brussels)

Minister of State (Commons)

11 May 1981

MEETING WITH COMMISSIONER TUGENDHAT : 15 MAY 1981

BACKGROUND

1. Mr Tugendhat wants to discuss the current proposals for the harmonisation of excise duties on alcoholic drinks, prior to the Fiscal Council proposed by the Dutch Presidency for 4 June.
2. This Council is an attempt by the Presidency to pick up the package prepared by their Luxembourg predecessors for the Council arranged for last December, which was abandoned at the last minute. Apart from a few possible changes, to take account of the accession of Greece in January, it is therefore expected that the package presented at the June Council will be the same as prepared for the December Council. This was set out in document 12009/80 (copy attached) and its essential elements were as follows:

Internal circulation: CPS
Mr Phelps
Mr Freedman
Mr Howard
Mr Rawlinson

- a. Compulsory duties on beer, fortified wine and spirits; with a statement in the minutes to the effect that this was without prejudice to the question of whether ultimately there should be a compulsory table wine duty. Member States with a table wine duty could apply a reduced rate to a small quantity (no more than 20,000 hectolitres) of wine produced 'under difficult climatological conditions'. (eg English wine)
- b. In Member States applying duty to both table wine and beer, the duty ratio to be no more than 3 to 1. Where it is currently higher, a Member State would have until the end of 1986 to adjust it, with half the necessary adjustment being made by 30 April 1984.
- c. The duty on fortified wine to stay within a range of 20% to 65% of the rate of duty applied to spirits according to alcoholic strength.
- d. Certain other fermented beverages, eg made-wine, to be covered by the same Directive as fortified wines.
- e. Provision for Member States to apply a reduced rate to certain liqueur wines 'produced in specified regions under special conditions' (eg French vins doux naturels).
- f. A single specific rate of spirits duty, but Denmark would be allowed to retain its ad valorem element until the end of 1987 and France could apply a reduced rate to a quota of traditional rum from the overseas Departments (FOD or DOM rum).
- g. Beer to be charged on an 'end product' basis by the end of 1987.
- h. Wine and beer to be subject to the same VAT rate by the end of 1986.
- i. All spirits to be subject to the same VAT rate by the end of 1983.
- j. The question as to whether all alcoholic drinks should be subject to the same VAT rate to be decided by the end of 1985. Pending that decision, existing differentials could be retained or changed only to bring them closer together. No new differentials could be created.
- k. Denmark to be allowed to continue the existing derogation under which travel allowances for excise duty goods are reduced.

3. As regards changes to accommodate Greece, the only point of substance to arise so far has been the treatment of the spirits drink ouzo. Greek representatives have made it clear they wish to retain a duty structure which discriminates in favour of ouzo and this could be a sticking point. It is unlikely to secure general acceptance and we understand the Commission will oppose it. This is of a different order from the other special provisions proposed (eg VDN, DOM rum and English wine). According to a note circulated by Greece, ouzo represents 80 - 85% of spirits production in Greece and 93% of it is consumed there. Any relief would therefore apply to Greece's major spirits industry and be intended to discriminate against imports to the Greek market.

UK POSITION

4. We have a number of objections to the proposals as they stand which should all be well-known to Mr Tugendhat. They are as follows:
- a. The wine/beer ratio of 3 : 1 is too low, having regard to the typical alcoholic strength of the products consumed here, and should not be less than $3\frac{1}{2}$: 1.
 - b. There should be a definitive decision now that all alcoholic drinks in a Member State should be subject to the same rate of VAT. It is wrong to achieve a harmonised excise duty structure which includes measures designed to limit differentials between certain drinks and then allow this to be undermined by differential VAT rates.
 - c. The proposal to include made-wines in the fortified wine Directive is unclear as it does not specify which ones. In an earlier version of the package it was clear that only made-wines of a comparable strength to fortified wines would be included. From the UK point of view, although we are prepared to discuss the technical issues involved, only such drinks should be included (ie exceeding an actual alcoholic strength of 15%). We would wish it to be made clear at the Council therefore, firstly, that strong cider (scrumpy) is not covered by the proposed Directive and, secondly, that made-wines of a strength comparable to table wine (which is not to be subject to a mandatory duty) are also not covered by the Directive.

- 5. The package does, of course, include the politically important concession for English wine (wine from grapes grown here) and it is understood the Commission has reservations about this. As regards the Greek request on ouzo, if this were to be taken up by the Presidency it would also be among the points objectionable to the UK.

INFRACTION PROCEEDINGS

- 6. The wine/beer Infraction Proceedings still overhang all this. At the request of the Presidency, the Commission and ourselves have applied to the European Court for a final extension of the time limit until after the projected June Council. Because of internal dissension within the Commission, the request was for a maximum of five months extension - to the end of September. As yet we do not know the Court's reaction, but it is likely that an extension will be agreed to beyond the June Council.
- 7. The significance of the Budget change in removing the 'protective trend' identified in the Court's Interim Judgment, by returning to the wine/beer duty ratio existing at Accession, has been drawn to the Commission's attention. The reaction however has been that, while they appreciate we have made a very considerable move in the right direction, this does not remove the alleged breach of Article 95 of the Treaty. At present the Commission clearly feel unable (largely because of Italian pressure) to think in terms of anything higher than a 3 : 1 ratio.

UK PRESIDENCY

- 8. The Commission is thought to feel that another Council after June will be required in order to achieve the necessary agreement in principle to remove the Infraction Proceedings and to pave the way for final agreement on Directives. This would involve the UK in holding a Council before the end of September, unless progress in June was sufficient for the Commission to suspend action on the Infraction Proceedings. Such a Council, of course, would only be a proposition if real progress was made in June.

LINE TO TAKE

- 9. The strength with which we should pursue the points in paragraph 4 above is currently under consideration inter-Departmentally, through the EQO machinery,

and this will not be complete before the meeting with Mr Tugendhat. We envisage that we should press strongly for all the points, probably to the extent of making them sticking points, in the belief that the Chancellor will want us to do this. We would, however, suggest that there should be flexibility to make minor concessions at the Council if that achieves an agreed package; but certainly there is no advantage in withdrawing or softening any of our objections now if Mr Tugendhat refers to them. It should be pointed out that the package includes no table wine duty, which is important to us, but we have been willing to go along with the omission on the basis proposed. It would also involve us in the upheaval of a change to the basis of our beer duty charge. We see no advantage in this, but again would go along with it as part of the package. We have, therefore, already given a great deal for little demonstrable advantage. It would, however, be appropriate to emphasise to Mr Tugendhat that, despite our objections to the proposed package, we are keen to make progress on harmonisation and will approach the Council in a constructive way.

10. On the question of Infraction Proceedings, there is nothing that can now usefully be discussed in advance of the Fiscal Council. If the subject is raised however, it would be appropriate to emphasise the significance of the moves made in the 1980 and 1981 Budgets. It would be a mistake to give any indication of a willingness to make further reductions in the ratio, other than in the context of agreement on an acceptable harmonisation package. It would also be appropriate to point out that, in the event of an agreement at the Council, it must be clearly understood that the Commission will then request the European Court to suspend the Infraction Proceedings and thereafter take no unilateral action against us while we act in accordance with any such agreement at the Council. This was firmly understood before the abandoned December Council and would have been confirmed in an exchange of letters in Brussels. Our representative in Brussels will be arranging for this to be done before the June Council.

11. As regards the possibility of a Fiscal Council early in our Presidency, you should say that this can only be considered in the light of progress at the June Council. It would clearly be appropriate to express a willingness to do all in our power to build upon realistic progress in June, but it would also be fair to point out that the end of September deadline raises formidable problems in preparing for an effective meeting.

12. Mr Phelps and Mr Freedman, with whom this brief has been discussed, will provide support from here at the meeting, together with Mr Parker from UKREP in Brussels.

CJP

NOTE FOR THE RECORD

COMMUNITY BUDGET RESTRUCTURING : VISIT OF MR TUGENDHAT ON 15 MAYDiscussion with the Chancellor

Mr Tugendhat called on the Chancellor at 12 noon on 15 May. He was accompanied by Miss Neville-Jones and Mr Lever of his Cabinet. Also present were Mr Hancock, Mr Edwards, Mr Wiggins and Mr Culpin.

2. Mr Tugendhat first discussed the range of options likely to be included in the Commission's June report. He hoped the report would contain "the basis on which an answer should be found". But it would also mention a number of options which a majority would probably want to rule out. It would, for example, almost certainly refer to partial national financing of the CAP as one possibility, even though a clear majority of the Commission would be opposed to its adoption. (The press had attributed the idea of partial national financing to Mr Tugendhat. This was wrong, but he had decided against trying to correct the story.)

3. Mr Tugendhat said that the Commission had talked a little about direct adjustment mechanisms. The report was likely to include something on these. But discussion within the Commission had not yet gone far. Mr Tugendhat could not be sure, therefore, what others took 'direct adjustment mechanisms' to mean. Some Commission officials - including Noel, the Secretary General - were still inclined to argue that, given a will to make policy adjustments, only temporary mechanisms would be needed, limited to the UK. However, this did not seem to be the consensus in the Commission itself.

4. Mr Tugendhat said that there had been no resistance in the Commission to the proposition that three principles should govern restructuring:-

- i. there should be no distortion of policy for budgetary reasons;
- ii. conversely, there should be no fixed budgetary guarantees for member states rendering them uninterested in the development of Community policy; and
- iii. resource flows should take place from more prosperous to less prosperous member states.

5. As an example of a policy distortion which violated the first principle, he cited the twisting of the CAP regime for Mediterranean products to give Italy a financial benefit. This would store up terrible problems for the future.

6. As an example of a danger against which the second principle was meant to guard, Mr Tugendhat cited the charge that the UK was able to maintain high positive MCAs because it did not have to worry about the budgetary cost. He acknowledged that there was a good answer to this, but said the charge was commonly advanced in the Community

7. In further discussion of the second principle, Mr Hancock suggested that far from rendering member states uninterested in the development of Community policy, "budgetary guarantees" could free the Community to consider policy issues on their merits. Miss Neville-Jones suggested, however, that an adjustment mechanism which moved countries in the right direction would be more acceptable than one which guaranteed that they would arrive at a given end point. Officials pointed out that aspirations would not be enough. The net contributor countries would need an assurance that they would arrive at an acceptable point. The Chancellor concluded that, whatever view one might take on absolute "budgetary guarantees", cast iron guarantees against budgetary fleecing were essential.

8. Mr Tugendhat added that the three principles had to be taken together, and the third principle set limits on the second. Resources should certainly not be flowing from less to more

prosperous member states. He mentioned in passing that the third principle had been suggested by Haferkamp, apparently on briefing from Bonn.

9. In discussion of opportunities for further lobbying, Mr Tugendhat mentioned that Mr Narjes would soon be in London to see the Trade Secretary, and it might be worth arranging a short talk on restructuring while he was here.

Discussion between officials

10. In subsequent discussion with Miss Neville-Jones, officials again expressed concern about Mr Tugendhat's second principle, which seemed to conflict with the UK and German approaches. If the budget problem was to be solved, the Community would have to take a view on what the net positions of individual member states should be, and then take the action needed to produce the intended results. It would, however, be possible to introduce some uncertainty into the schemes which had been discussed interdepartmentally. If, for example, the Community were to decide on an 'objective' distribution of net contributions and receipts at the beginning of each year, on the basis of estimates then available, member states might make appropriate transfers throughout the year, but dispense with the final end-year adjustments to bring actual outturns into line with "objective" plans.

Miss Neville-Jones

11. Enlarging on Mr Tugendhat's approach, /suggested that it would be possible for the Community to adopt a three-stage determination of net contributions and receipts, broadly as follows:-

- i. given policies would determine unadjusted net contributions and receipts;
- ii. guarantee spending would then be refinanced, so as to neutralise its distributional effect between countries: contribution shares would be set roughly equal to receipts shares;
- iii. some form of financial mechanism would be applied to the results of ii.

12. We promised to send Miss Neville-Jones a summary of our own latest thinking.



R P CULPIN
19 May 1981

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