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CONFIDENTIAL

Prime Minister
A useful summary of where we stand. Budget discipline may come up in PM's Questions this week.
CDP 12/xi

Qz.04030

MR POWELL

EUROPEAN COMMUNITY: BUDGETARY ISSUES IN THE EUROPEAN PARLIAMENT

There is a plenary session of the European Parliament this week and there may be publicity about their views on a number of budgetary questions. It may be helpful, therefore, to set out where we stand on the following points -

(1) the revised Decision on Own Resources. This text will put into effect the Fontainebleau agreement on the budget correction (both the lasting system of abatements of the United Kingdom VAT contribution and the ad hoc abatement of 1000 million ecu in 1985 in respect of 1984) and the increase in the VAT ceiling on Own Resources to 1.4 per cent. The text is agreed in all substantive respects by all member states, except for a German reserve on the date of entry into effect. All member states other than Germany are prepared to see some new finance made available under the revised Own Resources Decision in 1985 (either by setting an interim rate for 1985 or by fixing the month of entry into effect of the additional 0.4 per cent VAT with no retroactivity). This is necessary as the authority for the 1000 million ecu abatement of the United Kingdom's VAT contribution and in order to finance any irreducible budget overrun in 1985. The Germans argue for 1 January 1986 as the date of entry into effect and make a link with the enlargement of the Community. When the main difficulties over enlargement are settled, the Germans may reconsider their position and come into line with the Nine on the revised Own Resources Decision.

The European Parliament has to give an Opinion on the revised Own Resources Decision. It has no power to

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change the text. There is little doubt, however, that the European Parliament will press its wholesale changes in the text (eg separating the budget correction mechanism from the increase in the VAT ceiling, the introduction of a terminal date, correction on the expenditure side) which are wholly inconsistent with the Fontainebleau agreement. They must be rejected by the Council. We believe that they will be. The United Kingdom's task is to make sure that the Council does not deviate in any way from the Fontainebleau agreement.

Line to take. There are no significant difficulties over the revised Own Resources Decision in the Council. There is only a German reserve on the date of entry into effect. We understand the German wish to move in parallel on the Community's Own Resources and on the enlargement negotiations with Spain and Portugal. We hope that sufficient progress will have been made shortly in those negotiations so that the Germans can review their position on the date of entry into effect of the revised Own Resources Decision. The revised Own Resources Decision will then be submitted to national parliaments for ratification.

The European Parliament has the right to express an Opinion on the revised Own Resources Decision but cannot unilaterally change the text.

(2) budget discipline. The text on Community budget discipline has now been agreed by the Council of Ministers (Finance). It contains the two main elements: setting a reference framework for all Community expenditure and establishing the strict financial guideline for agricultural support expenditure. The text will be formally included in the conclusions of the Council on the measures necessary to guarantee the effective implementation of budgetary discipline in accordance with the Fontainebleau agreement (there is a Greek reserve on the status of the text but it will probably fall). It will be binding on the Council

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in all its forms. The text will not be finally adopted until there has been a meeting between the Council, European Parliament and Commission. Although the wording is the responsibility of the Council itself, the European Parliament has expressed a strong interest.

Line to take. We are satisfied that an important step forward has been taken, since the Council of Ministers (Finance) has reached agreement on the measures necessary to guarantee the effective implementation of budgetary discipline, in accordance with the Fontainebleau agreement. These measures include a reference framework for all Community expenditure and a strict financial guideline for agricultural support expenditure, which would be formally included in the conclusions of the Council. We also accept that the European Parliament should be given an opportunity to express its views before the measures are finalised. I understand that a meeting between the Council, European Parliament and Commission is being arranged shortly.

(3) the 1985 budget. It seems very probable that the European Parliament this week will propose increases in the Community's 1985 draft budget (the Council sent this forward within the 1 per cent VAT limit) so that it exceeds the available revenue. This would not be legal. The Council will not agree to a budget for which revenue is not available. A conflict between the European Parliament and the Council is to be expected. It is too early to forecast the result. There may be no agreement on a budget (in those circumstances the financial rules would provide that monthly expenditure has to be restricted to a provisional twelfth of the annual amount). It is also possible that before the 1985 budget has to be adopted the Germans may lift their reserve on the provision of some new finance in 1985 through the proper procedure of the revised Own Resources Decision.

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It is also probable that in revising the draft 1985 budget the European Parliament will make provision for the United Kingdom's 1000 million ecu not by a rebate of VAT contribution (as it should be) but by providing for expenditure in the United Kingdom. Thus the money would be available but by the wrong method. We shall look to the Council to reject this and to respect the Fontainebleau agreement to the letter. I recommend, however, that we should not highlight the question of the 1000 million ecu, which is at this stage likely to be only one element in a much wider and continuing disagreement between the Council and the European Parliament on the 1985 draft budget.

Line to take. The Treaty is quite explicit (article 199) in stating that "the revenue and expenditure shown in the budget shall be in balance". This means that at present the 1985 draft budget of the Community must be within the 1 per cent VAT ceiling. We have made clear that we can accept that, subject to Parliamentary ratification, the revised Decision on Own Resources should come into effect during 1985 and thus provide some extra finance to meet any irreducible budget needs by the proper legal procedures. It is too early to comment on the details of any differences between the Council and the European Parliament on the 1985 draft budget, as the discussions are only just beginning.

I am sending copies to Colin Budd (FCO), David Peretz (Treasury) and to Sir Robert Armstrong.

D F Williamson

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