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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

19 December 1984

Charles Powell Esq
10 Downing Street
LONDON SW1

Prime Minister (2)

Dear Charles,

**1985 COMMUNITY BUDGET : PROVISIONAL TWELFTHS REGIME**

As you will be aware, the European Parliament voted on 13 December to reject the Draft 1985 EC Budget. Accordingly from 1 January the Community's finances will, as also happened in 1980, function under the "provisional twelfths" regime laid down in Article 204 of the EC Treaty.

The Chancellor has suggested that the Prime Minister might find it helpful to have the attached note, prepared in the Treasury, describing how the system is likely to work over the coming months. The Chancellor has asked me to draw attention to three main consequences arising from the application of the "provisional twelfths" regime.

First, the main impact of the regime will be on agricultural guarantee spending. The Commission's original estimate was that the total required for guarantee spending in 1985 was 19.3 becu ie 1.6 becu per month. The provision in the draft 1985 Budget was cut back by the Council to 18 becu, because of the need to keep within the 1% VAT ceiling. However, under the provisional twelfths regime the total available will be only 16.1 becu - just over 1.3 becu per month. If, as seems probable, the Commission is unable as well as unwilling to hold down agricultural spending much below 1.6 becu, it will be necessary for the Council - as is permitted under the rules - to bring forward extra twelfths within the 16.1 becu total. The probable result is that, in the absence of a supplementary budget going above the 1% ceiling, the appropriations available for CAP spending will be exhausted by early October.

Second, because of the seasonal pattern of CAP spending, the Community will face a cash shortfall early next year. To forestall this, the Commission is likely to request advances under the own resources regime fairly quickly. Though this step would be unpopular with Member States there are precedents for such a request and the Commission would be acting within its legal rights. A supplementary estimate would be necessary for us to comply. The Chancellor's view is that we should go along with any such request for advances, as we did in both 1983 and 1984.

Third, we will need to keep a close watch on the residue of the UK's 1983 refunds. Payment of the final 10% of the 1983 refund - some £59 million - cannot take place until the Commission's audit checks have been completed. Part of the 10% may still be paid before the end of the year. But the remainder will be carried over into 1985. Given the expected cash shortfall (see paragraph 5 above), it may be necessary to put strong pressure on the Commission to ensure that the rest of the refund is paid before the end of our current financial year.

The Chancellor sees no need for any Ministerial discussion of these issues at this stage. It seems probable, however, that the difficulties caused by the provisional twelfths system, particularly for CAP spending, will lead other Member States to start pressing early next year for a rapid agreement on how to provide extra financing to cover Community spending in excess of the 1% limit in 1985. Our aim must be to ensure that this pressure is directed at making the Germans agree to bring forward new own resources into 1985. The Chancellor suggests, however, that a meeting may be necessary to discuss the options and tactics before the 28-29 January Foreign Affairs Council.

I am sending copies of this letter to the Private Secretaries to Members of OD(E) and to Sir Robert Armstrong.

Yours ever
David

D L C PERETZ
Principal Private Secretary

# THE PROVISIONAL TWELFTH BUDGETARY REGIME

On 13 December the European Parliament rejected the draft 1985 Budget by 390 votes to 5 with 16 abstentions. Consequently from 1 January 1985 the Community will have no agreed Budget covering its revenue and expenditure. This note is a preliminary commentary on the consequences of the Parliament's action.

## Legal position

2. (i) **Expenditure**

Article 204 of the Treaty of Rome lays down the basis of the so called "provisional twelfth regime" which comes into force in the event of the Community institutions not having adopted an annual Budget. Payments appropriations in each month are limited to one twelfth of the total appropriations available, chapter by chapter, in either the 1984 Budget or the 1985 draft Budget, whichever is the lower. Since the twelfth regime makes no allowance for inflation, nor for planned increases in spending provisions, its overall effect is to restrain expenditure.

Commitment appropriations are similarly limited in total; but an advance of one-quarter of commitment appropriations can be made.

If the Commission considers that it cannot meet its commitments in any spending chapter without more funds it can ask for payment of two or more twelfths in any month. Additional twelfths are authorised by a qualified majority of votes in the Council of Ministers. Non-obligatory expenditure decisions are subject to change by the European Parliament within 30 days of their adoption.

(ii) **Revenue**

Traditional Own Resources - agricultural levies and customs duties - are paid as normal to the Community. There is uncertainty over the precise level of VAT to be paid. The 1970 Own Resources Decision states that if a budget has not been adopted at the beginning of the financial year, the rate previously fixed should remain applicable. But during the 1980 provisional twelfth regime Member States insisted on paying only the (lower) VAT figure which they had paid in the previous year's Budget and not the same proportion of a larger VAT base. Assuming the 1980 precedent is followed, the UK would pay only the VAT amounts paid under the 1984 Budget (and excluding the Inter-Governmental Agreement totals from the calculation). Total monthly VAT payments to the Community would be 1.2 billion ecu, and the UK's share would be some 240 mecu.

**Problem areas**

3. In 1980 the Community functioned fairly smoothly under a provisional twelfth regime for almost six months, following the Parliament's first rejection of an annual budget. But with the Community already up against its revenue ceiling, in 1985 financial pressures will become intense more quickly.

4. The likely major difficulties are as follows:

(i) **Obligatory expenditure**

EAGGF agricultural guaranteed expenditure will on the Commission's forecast that 19.3 billion ecu are required during 1985 cost on average roughly 1.6 billion ecu per month. There is traditionally a higher level of payments during the first two or three months of the year, perhaps as much as 2 billion ecu per month. The Commission estimate however is that the twelfth regime will permit total guarantee appropriations of 16.1 billion ecu, ie about 1.3 billion ecu per month. Meeting Member States requirements for EAGGF advances will therefore require higher monthly amounts than will be available under the twelfths regime. The Commission could either ask for supplementary twelfths to be provided; or - following a precedent set in 1980 - treat guarantee sector advances as being equal to commitments, thus allowing for a three month advance of funds immediately. Despite the dubious legality of this latter course Member States are likely to accept it as the simplest way of avoiding major agricultural disruption. Even so, the Commission estimate that all appropriations for agriculture will be exhausted by September 1985.

(ii) **Non-obligatory expenditure**

Where insufficient expenditure was provided for in the 1984 Budget, or a new programme is due to begin, the twelfth regime does not provide sufficient basis for starting payments. The ESPRIT programme, food aid and fisheries structures measures will therefore be restricted.

The Social Fund Regulations lay down that 50 per cent of commitments should be paid before 31 March. Additional twelfths will therefore quickly be needed; or the Regulations temporarily amended. Agricultural guidance expenditure twelfths are likely to cover less than 75 per cent of the planned 1985 expenditure.

The provisional twelfths regime does not allow for transfers from the Reserve (Chapter 100) thereby limiting the Commission's scope for financial management during the year.

(iii) **Cash flow**

The Commission normally start the year with a substantial unspent balance from the previous year. The position at the end of 1984 is likely to be extremely tight financially, with more commitments carried over to 1985 than credits to cover them. In addition the agreed contribution under the Inter-Governmental Agreement will not have been paid by the United Kingdom nor (probably) by Italy. Since EAGGF expenditure will require significantly more than the revenue available under the provisional twelfth regime the Commission will quickly face a serious cash flow problem. Member States would then be likely to receive demands for advance payments of traditional Own Resources and perhaps also for overdraft facilities on VAT Own Resources payments (Articles 10(2) and 12(2) Treaty of Rome). Article 10(2) advances have been made available by the UK over the last two years, in the first instance by drawing on the Contingencies Fund, with Parliamentary authority subsequently sought through a Parliamentary Estimate.

A further expedient to relieve the Commission's financial pressures would be to refuse to fund expenditure in the dairy sector while the milk super levy is not being paid to Brussels. This step would perhaps save the Commission some 400 mecu per month and cost the UK some 70 mecu per month.

<u>Conclusion</u>

5. Several important legal disputes over the Commission's scope for interpretation of the provisional twelfth regime remain unsettled. In addition provisional twelfths have never operated against the background of exhaustion of the Community's financial resources. The practical implications of the regime will depend on the level of agricultural expenditure during the early months of 1985; and on the approach taken by the incoming Commission which formally takes office on 1 January.

HM TREASURY
17 December 1984

Annie Budgett

Flee

c FCO.
DTI.
MAFF
LOD
MIS, FCO.
CO.
Percy Cradock

10 DOWNING STREET

*From the Private Secretary*

23 December 1984

Dear David,

1985 COMMUNITY BUDGET
PROVISIONAL TWELFTHS REGIME

Thank you for your letter of 19 December about the consequences of the European Parliament's rejection of the Draft 1985 EC Budget.

The Prime Minister has noted this.

I am copying this letter to Private Secretaries to members of OD(E) and to Richard Hatfield (Cabinet Office).

Yours sincerely

Charles Powell

C.D. POWELL

David Peretz, Esq.,
HM Treasury.