

PREM19

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ELECTIONS

(briefing for
incoming PM)

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Ref. A09456

PRIME MINISTER

Summary and Timetable of Urgent Economic Issues

This brief summarises the most urgent economic issues which the Government will need to tackle in the next few months. They are:-

- (a) The Budget. The last week of May and the first week of June are not available because of the Bank Holiday and the recess for the European elections. Present Treasury thinking is that the best date is 12th June. A Budget before the European elections would be too soon for the new Chancellor to prepare and for colleagues to take any related decisions. But to leave matters much after 12th June would leave too little time for the passage of the Finance Bill. I am giving you a separate brief on the broad issues which will arise on the Budget.
- (b) The CAP Price-Fixing. Negotiations will reopen in May. The outcome is important, among many other reasons because it affects the net payments we will make to the Community Budget over the next 12 months.
- (c) The Public Expenditure Review. Decisions on the current year will presumably be taken in the Budget context. You have more time in which to re-examine the inherited expenditure plans for later years. The annual PESC review of expenditure from 1980-81 onwards has already begun at official level. But this is a policy-neutral exercise, confined to three questions: what can be afforded within the already published totals: what adjustments are inevitable for demographic reasons; and what options are available for increases or reductions. You will clearly want to set new guidelines for this operation, and I know that Treasury officials will have draft proposals ready for the Chancellor to put to Cabinet very quickly.

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If the spending agencies are to adjust their policies in good time for 1980-81, you will need final Cabinet decisions in the autumn - and perhaps before then. The PESC exercise is carried out in 'constant price' terms and there will be a separate and difficult job of setting cash limits for 1980-81. This will be particularly important in the local authority field - see below.

- (d) Rate Support Grant. The annual fixing of Rate Support Grant for local authorities takes place in the autumn. The grant (over £9 billion in 1978-79 always has to be based on assumptions about local authority pay and has important implications for both central and local authority expenditure. Because you will be relying on cash limits as an important element in controlling public sector pay, you may want to give an earlier indication than usual this year of the sort of pay increases to be ^{assumed.} ~~announced.~~ This points to a decision on the level of RSG for 1980-81 before the summer recess.
- (e) Pay. The "current pay round" ends on 31st July. The original White Paper governing the round ("Winning the Battle against Inflation - Cmnd 7293) is presumably no longer operative but 31st July nevertheless represents a watershed. A number of key problems will arise before that date. In particular:-
- (i) you will want to consider how the Manifesto idea of "more open and informed discussion of the Government's economic objectives" is to be pursued. The previous Government had made a start on similar lines through bilateral talks with the TUC and CBI but had not got very far when the Election intervened. If any new exercise is to have an influence on pay bargaining after 1st August a very early start will be necessary;
 - (ii) your Manifesto had a clear line on pay bargaining in the public corporations but still leaves detailed application to be worked out, e.g. some public corporations, such as British Gas, are highly profitable and can "afford" substantial pay increases and

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- others, e. g. British Rail, are permanent public pensioners and cannot, in a strict sense, "afford" to pay wages at all. Moreover pay settlements in some nationalised industries inevitably read across to others, e. g. for manual workers in the gas, electricity and water industries where there are close historical links stemming from their common 'municipal' past. Luckily most of the public corporations' pay bargaining this year has been completed. (The main outstanding case is the Post Office where the offer made has just been rejected by a ballot of the employees.) The reflection of these issues in the Government's financial arrangements with the nationalised industries will require quick examination if a coherent and disciplined framework is to be embodied in the Government's public expenditure plans;
- (iii) Similarly your own approach to pay bargaining in the public services will have to be worked out in detail before cash limits for next year are set.

A fuller brief on public sector pay and cash limits is being submitted separately.

- (f) Immediate public service pay issues. You will be faced almost immediately with the need for decisions on five public sector pay issues: the pay of MPs and Ministers (on which the Boyle Report should be available very shortly); the pay of doctors and dentists (where the Report of their Review Body is to hand); the pay of other "top salary groups" (covering e. g. judges, nationalised industry chairmen, generals and senior Civil Servants) where the TSRB Report is just available; teachers, where negotiations were postponed because of the intervention of the Election (and where the Government has a direct interest through RSG); and the broad mass of local authority white-collar employees whose settlement date is 1st July.

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- (g) Energy. I have sent you a separate brief covering the energy sector where a number of difficult issues are outstanding. Among the most urgent of these are:-
- (i) Measures to cut oil consumption next winter in order to meet our IEA and EEC obligations. Decisions are needed before the summer recess.
 - (ii) Linked with this is the question of coal. The NCB is heading for a major loss this year and carries a fringe of heavy loss-making pits in politically sensitive areas like Wales and Scotland. Early decisions on these could help reduce losses - next year if not this. You will also need to consider how far you are prepared to pay for extra British coal next winter to replace oil or whether we should import more coal.
 - (iii) The reorganisation of the nuclear supply industry. By common consent the present system will no longer serve and reorganisation is long overdue. Delay will mean setting back completion of the next batch of stations.
- (h) Industrial Issues. There are a number of difficult industrial issues which are bound to come up in the next few weeks. You may care to note the following check-list of the more sensitive of them:-
- (i) The future of the shipbuilding industry (badly hit by the world shipbuilding slump and very expensive to maintain).
 - (ii) The equally expensive problem of the steel industry.
 - (iii) The almost certain early financial collapse of the Port of London Authority.
 - (iv) Possibly the financial problems of Dunlop.
 - (v) Constraints on industrial development caused by planning procedures (the CPRS are conducting a study) - with Moss Morran as the current leading case.

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- (vi) Regional development with heavy expenditure, doubts about the cost effectiveness of some of the techniques, but continuing pressure for more money. This links with the future of Government support for industry in general and in particular the operation of the Industry Act 1972.
- (i) The European Council. The next regular meeting of the EEC Heads of State and Government is at Strasbourg on 21st-22nd June. The quality of these meetings and the importance of the decisions to be taken varies. But this will be your first appearance and the proceedings are likely significantly to influence at least the atmosphere, and possibly the direction, of EEC policy over the years ahead. We are now the Community's largest paymaster but its third poorest member. There is a lot to play for in terms of redressing this imbalance. I am sending you a separate brief about European matters.
- (j) The Economic Summit. This is scheduled to take place in Tokyo on 28th-29th June. The attenders will be President Carter, President Giscard, Chancellor Schmidt, the Prime Ministers of Japan Italy and Canada, Mr. Jenkins as President of the EEC and yourself. The Summit will be particularly important this year because the international financial situation is still shaky (and has not been helped by the larger than expected rise in oil prices). The Summit provides a good opportunity to urge our partners to react in a sensible manner.
- (k) UNCTAD V. This triennial meeting starts in Manilla on 7th May and may go on until early June. With the MTNs more or less under control and the framework of the Common Fund already agreed, UNCTAD V could create less of a trauma for North/South relations than did UNCTAD IV in Nairobi in 1976. But representation in the final stages is normally at Ministerial level and there will be a good deal of interest in the attitude of the United Kingdom Administration to North/South issues in general and to aid in particular.

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CONCLUSION

2. There is a great deal to be done in a short time on these issues (and inevitably others will arise in the normal course of business). The most immediately pressing is the shape of the Budget and associated matters like the money supply target. On these you will no doubt wish to await the Chancellor's specific proposals. But close behind in terms of time, and ahead in terms both of intrinsic importance and inherent difficulty, is the development over the months ahead of a strategy for public expenditure. And such a strategy will take you and your colleagues deep into a complex of related issues such as relations with the nationalised industries, the finance of local government and the difficult realities which lie behind the adoption of cash limits for central Government. One essential concern of the Cabinet Office is of course to ensure that the work which clearly needs to be done, and which Ministers wish to be done, is tackled in an orderly fashion and in good time so that the Ministers have a sound basis for decision-taking. This in turn relates to the structure of Ministerial Committees on which I will let you have recommendations when you have made your main Ministerial appointments.

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John Hunt

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Ref. A09464

PRIME MINISTER

The Budget

The 3rd April Budget was of course a holding operation. A new Budget needs to be introduced as soon as possible. The longer it is delayed, the greater the revenue loss in the current year from any increases in indirect taxes. (Cuts in direct taxes can of course be backdated to the beginning of the financial year). Delay would leave little time for completion of the Finance Bill without cutting into the Summer Recess. The Treasury think 12th June is the earliest feasible date.

2. The Chancellor will no doubt let you have an early appreciation of short-term prospects. This will inevitably be based on a "neutral" forecast (i.e. reflecting continuation of existing policies) and will thus only provide a starting point for the new Government: a full and more detailed forecast will be ready in about 2-3 weeks after the election. The main features of the present forecast are:

- (i) Earnings and Prices: the outturn in the present round is likely to be about 13-14 per cent, in both public and private sectors. Prices will be rising by around 11-12 per cent during 1979. In 1980, without changes in policy, both pay and prices would be increasing at about the same level.
- (ii) Growth. About $1\frac{1}{2}$ per cent in 1979 and 1980, involving some rise in unemployment, but the current account remaining in balance in 1979 and moving into deficit in 1980.
- (iii) PSBR. Rising from about £8½ billion in 1978-79 to about £10 billion or a little more in 1979-80, and a further increase the following year. Company profits remaining low, but no widespread liquidity problem because of low stock building and downturn in investment.
- (iv) Domestic and External Monetary Policy. Assuming that the 8-12 per cent monetary target range continues - see below - some increase in interest rates would be needed. The present upward movement in the exchange rate will probably be reversed later in the year.

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3. Thus the overall picture in the short term on present policies is a rising rate of inflation and slow growth, leading to continued uncertainty and instability.

4. The main problems to be faced in framing the Budget are:

(a) The overall stance - demand management. With the economy still depressed, the conventional response in past years would have involved a mild budgetary stimulus. This year, until recently, the confidence factor seemed to rule this out. But sterling continues strong. In addition a Conservative Government with clear long-term policies on public expenditure can probably rely on confidence remaining high even if it decides to go for gentle expansion. So one of the first decisions the Chancellor will want to discuss with you is whether to aim at some stimulus to demand, or whether to offset the cuts in direct taxation completely with reductions on public expenditure and increases in indirect tax. Obviously you will not want to allow very much net stimulus until there have been real improvements on the 'supply' side of the economy; otherwise increased demand merely fuels inflation and sucks in additional imports. On the other hand you are relying on the direct tax cuts to produce the necessary dynamic improvements. So there is a chicken-and-egg problem here.

(b) Money supply. Your policy - especially for pay and inflation in the private sector - depends on keeping tight control over the growth of money supply. You will want to balance this against the need for expansion. The previous Government was committed to keeping control over money supply (expressed as a 12-month target growth range of £M3, rolled forward every six months). The present published target runs to October 1979. The City expects the Chancellor to announce in the Budget a new target up to April 1980. In setting a new target the main elements are the PSBR, external policy (including intervention on the exchanges), interest rates and direct controls on the banking system. Here too a Conservative Government may have the advantage of greater market confidence: because it will be able to sell more gilts as a result,

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it will probably be able to afford a slightly higher PSBR at least in the short term, for any given rate of money supply expansion. This may help a bit in finding room for net cuts in taxation.

- (c) On the latest information, allowing for the Rooker-Wise indexation and published public expenditure plans, PSBR is likely in the current year to be around £10-£10.5 billion ($5\frac{1}{2}$ per cent of GDP). Its composition will be as important in many respects as its size, both for its direct monetary effects and its effect on market confidence. Despite the favourable factors mentioned in (b) above some reduction will be necessary to keep the money supply within the existing 8-12 per cent target range during 1979-80. You will need to judge what reduction is feasible in the current year, given the late date of the Budget, and how to balance tax changes and public expenditure to achieve this.
- (d) Direct taxation. Once the central budget judgment on the permissible size of the PSBR has been made, and a view taken on growth in the coming year, the problem is to balance cuts in personal taxation (beyond the Rooker-Wise indexation in the recent Finance Act, which is allowed for in the forecast) with increases in indirect taxes and cuts in public expenditure. The more you aim for cuts in personal tax the more of offsetting action you will need on indirect taxes and expenditure. Illustrative figures on possible cuts in direct tax are: reducing the top rate to 75 per cent, and revalorising the bands to April 1973 levels, would cost about £800 million in a full year, and £450 million in the current year; each penny off the basic rate of income tax has a revenue effect of about $\frac{1}{2}$ billion; and to increase the main single and married personal allowances by, say, £50 and £100 respectively, on top of revalorisation, could cost about £600 million in a full year.
- (e) Indirect taxation.
- (i) VAT is the prime runner for raising new revenue. The options include harmonisation of the two rates at 10 per cent or $12\frac{1}{2}$ per cent; or moving both rates up. Harmonisation at 10 per cent would bring in about £900 million in a full year and

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£400 million in the current year and add 0.9 per cent to the RPI. Harmonisation at $12\frac{1}{2}$ per cent would bring in about £2250 million in a full year (£1200 million in the current year) and add 2.1 per cent to the RPI.

- (ii) Specific duties. The options here are to increase (revalorise) the rates of the specific excise duties (alcohol, tobacco, petrol). Straight revalorisation to last year's level would yield about £400 million, and add 0.5 to the RPI. To return to 1977 levels would roughly double these figures. There is a good case on energy conservation grounds for increasing petrol tax anyway, particularly if you maintain the previous Government's decision to phase out VED in the next few years. There are good health arguments for putting more on alcohol and tobacco.
- (iii) National Insurance surcharge. Sir Geoffrey Howe virtually ruled this one out in the Budget debate. The earliest date a change announced in a June Budget could take effect is the beginning of October.
- (iv) Nationalised Industry prices. These have much the same effect as indirect taxes. Some increases will be needed anyway to achieve even the published targets for nationalised industry borrowing. (See below under 'public expenditure'). If you want to go further, the main candidates are probably gas prices (dealt with in the separate brief on energy) and postal/telecommunications charges.
- (f) Public Expenditure. There are two main problems: some inevitable (mainly statutory) increases in expenditure on social security side (allowed for in the forecast) and the long-term search for structural changes leading to real reductions. Notes on each one:-
 - (i) The normal uprating of social security benefits next November had been built into the forecast, and administrative action is already in hand. To delay it would have made it impossible to pay out on time. The previous Government were also committed to a

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50p increase in child benefit in November which would cost about £100 million this year and £300 million in a full year. It is not allowed for in the forecast. There is no immediate pressure for any other changes, though there may be small concessions (e.g. the pre-1945 widows) which you will want to make. There is no statutory obligation to increase child benefit, but the uprating of the main national insurance benefits is required annually under existing legislation.

- (ii) On the generality of public expenditure, you are committed to large and early cuts. The Treasury will be suggesting a possible 1979-80 package to the Chancellor, and he will probably want to put it to Cabinet very soon. It is likely to involve a mixture of policy changes, sales of assets, and trimming of the Contingency Reserve for the rest of the year. You will obviously need an early Cabinet discussion on this. The immediate question is how much saving you can secure in time for the Budget.
- (g) Cash limits for the rest of the year. You have made it clear that cash limits will be one of the main weapons used by the Government to control expenditure, and by implication to maintain restraint in the public sector. Since their introduction cash limits have worked well as a control: but those for this year have already been increased, and corresponding RSG support promised, to allow for those public sector settlements which had been reached for various local authorities groups during February and March. Otherwise, the cash limits have been maintained at the level assumed in January. They will therefore come under increasing pressure during the year both from pay and price increases over and above the assumed levels. In the Health Service and in central Government, to maintain the level of cash limits in the face of approved pay increases implies a volume squeeze on expenditure. You are committed to implementing in full the recommendations of the Armed Forces Pay Review Body, and this will impose a similar squeeze on MOD

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expenditure unless you are prepared to increase their cash limits. There is a similar problem in the nationalised industries, where the PSBR forecast assumes that their borrowing is held constant, and that the extra cost of recent pay settlements, over and above the original forecast assumptions will be met by increased prices or reduced investment. You will need an early paper from the Treasury on all this so that the Ministers concerned (most of the Cabinet) can agree together on the line to be taken.

5. To sum up, you will need:

- (i) An early discussion with the Chancellor about the main shape of the Budget.
- (ii) Probably - though this is for you to decide - a general discussion in a Ministerial Economic Strategy Committee and/or Cabinet on the same theme.
- (iii) At least a first round of specific decisions by Cabinet about public expenditure cuts (though a fully worked out strategy for public expenditure in the longer term is unlikely to be feasible before 12th June).
- (iv) Specific decisions by Cabinet about nationalised industry borrowing (and thus prices and investment) for the remainder of the year.

John Hunt
(John Hunt)

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Ref. A09457

PRIME MINISTER

PAY AND CASH LIMITS

This note seeks briefly to summarise the main features of the pay scene and prospects at the outset of your Administration. In the light of your Manifesto it is largely concerned with pay in the public sector.

Pay determination machinery

2. You have inherited five formal pieces of pay determination machinery.

They are:-

- (a) The Civil Service Pay Research Unit and Pay Research Board.
- (b) The new Standing Commission on Pay Comparability.
- (c) The Armed Forces Review Body.
- (d) The Doctors and Dentists Review Body.
- (e) The Top Salaries Review Body.

3. The first three of these base their recommendations on "comparability" (i. e. the systematic assessment of the going 'rate for the job'). The last two are influenced by comparability but their recommendations, e. g. on doctors or Members of Parliament, also have a judgmental content. The PRU and the three Review Bodies have a long history and well-established procedures and techniques. The Standing Commission is new and reflected a decision by the previous Government to allow a substantial extension of the comparability principle into pay determination in the public service in its widest sense, i. e. in all of the public sector excluding only trading bodies like the nationalised industries. Although new, the Standing Commission already has a number of remits to fulfil extending from local authority manual workers to nurses. You will wish to consider at an early stage whether to accept the continuation of these various pieces of machinery and in particular whether to seek to cut back on the Standing Commission or to continue to leave it available to any public service group in the non-trading public sector where both sides agree to call on its services.

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4. The previous Government had already begun the process of seeking to establish an annual economic assessment with the TUC and the CBI to inform future wage bargaining. You are committed to a rather similar idea in your Manifesto. If progress is to be made an early start is needed. The idea has long been advocated by the CBI and you should find a ready acceptance by them. The TUC, on the other hand, may seek to claim that the understandings they had reached with the previous Government were specific to that Government and that all bets are off. Such an attitude is however more likely in relation to their commitment to achieve a reduction in the rate of inflation to below 5 per cent by 1981 (where the TUC would in practice have found it very difficult to agree on the specific implications of honouring that commitment) than to taking part in a joint assessment of the economic outlook. The trouble of course is that no economic assessment can be divorced from policy on taxation and public expenditure, where views are influenced more by political judgment than by cold analysis, so that a tripartite agreed analysis is probably not attainable. Nevertheless the process of education is valuable in itself as is the impact of discussion on expectations. German experience is particularly relevant here. You will need to arrange for early thought to be given on the best way of proceeding.

Early public sector cases which will require Government decision

5. Large parts of the public services and the nationalised industries have already concluded their pay negotiations for this year but there are a number of outstanding issues and negotiations still to be settled. The most important of these are likely to be:-

- (a) Armed Forces. You are committed to increase the pay of the Armed Forces. The Review Body's recent report giving their recommended full rates of pay for 1st April 1979 is available and its implementation need cause no difficulty in itself. There would however be some problems of overlap given that the pay of senior serving officers is handled by the TSRB rather than the AFRB. Without special action for them inverse pay differentials would result from the full and immediate implementation of AFRB report, e.g. Brigadiers would be paid more than Major Generals.

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- (b) Doctors and Dentists. Like the Armed Forces the Doctors and Dentists Review Body (DDRB) produced a report last year which showed that very substantial pay increases were needed to bring the Doctors' and Dentists' pay up to date following the period of pay restraint. The then Government agreed that these increases should be paid in stages - 10 per cent last year, half the balance on 1st April this year and the remainder on 1st April next year - with both this year's and next year's stages being updated to current levels. The DDRB report on what those current levels should be on 1st April 1979 is now to hand. The presentation is complicated because the report also deals with the new contract for senior medical staff. Early decisions will also be needed on:-
- (i) Whether this year's updating is acceptable to the Government.
 - (ii) Whether the cost of introducing the new contracts is acceptable to the Government.
 - (iii) Whether, like the Armed Forces, the outstanding payment due next year should be brought forward to this so that the acknowledged anomaly is fully corrected at the outset of this Parliament. So far as I am aware, the doctors have not yet argued for this but it would be surprising if they did not press for parity of treatment.
- (c) The "top salaries" groups. The Top Salaries Review Body covers a wide range of senior public appointments ranging from Members of Parliament and Ministers to senior civil servants, senior officers in the Armed Forces, judges and the Chairmen and Board members of nationalised industries. These groups, too (with the exception of MPs and Ministers), had a report last year recommending substantial increases in pay as a catching up operation. The then Government accepted the proposals in principle subject to staging over this year and next but with an important difference as compared with doctors and soldiers. This was that the Government expressly deferred a decision on whether the recommended

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pay rates should be updated in 1979 and 1980 to take account of developments since the main report was produced in early 1978. The TSRB has however now reported on what it believes the updating should be for 1979. The Government therefore needs to decide whether it will accept the proposals for updating included in the latest TSRB report. You may also care to note that, as with the Armed Forces, there can be problems in Civil Service pay structures arising from the fact that grades up to Assistant Secretary are handled through PRU and more senior officials through the TSRB. The particular problem here is that the TSRB's latest report recommends salaries for Under Secretaries below those which PRU evidence suggests for Assistant Secretaries. This has happened before and has been met by cutting back on Assistant Secretaries' pay. But a conscious decision will be needed.

(d) Members of Parliament and Ministers. The TSRB report on the pay of MPs and Ministers is in a different category because it is the first report on their pay for many years. The Government will therefore need to decide ab initio:-

- (i) Whether it accepts the recommendations of the report.
- (ii) Whether it is prepared to implement them at once or to provide some form of staging for implementation over a future period.

In handling all of these cases, other than the Armed Forces, you and your colleagues will need to balance the case for getting rid of old anomalies quickly (including the political case that any increase for the higher paid arouses opposition and that staging therefore prolongs the presentational agony) against the immediate cost of full implementation and the repercussions on other groups, e.g. the police, the nurses, the non-industrial Civil Service, who have accepted varying degrees of staging for their outstanding claims.

(e) Local Authority non-manual employees. The local authorities' white-collar (APTCS) grades, largely represented by NALGO, are due for a pay settlement on 1st July. Although they have traditionally sought to strike their own bargains without reference to "comparability" (and may have done rather better from this than they would on a strict "fair

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comparisons" basis) they may well this time press for "comparability" and a reference to the Standing Commission. The problem with local authority pay settlements is of course that they involve an underlying battle between Government and local authorities about who should pay the cost. On recent form the local authorities will only make an offer when they have a Government assurance that Rate Support Grant will be forthcoming because otherwise the cost of any settlement above what is already allowed in RSG falls on the rates. This question is part of the wider issue of the control of public expenditure by local authorities and the drain on central Government resources represented by the RSG to which your Government may want to give a good deal of attention in the public expenditure review.

- (f) Teachers. Negotiations on teachers' pay continued up to a late stage in the election campaign and were then deferred at the Government's request until the election was out of the way. The basic issue dividing the two sides was that of the terms of reference for any comparability study. The teachers saw the purpose of a new study as up-dating the Houghton report (which was particularly generous to teachers) and wanted terms of reference framed accordingly. The management side (including the Government) wanted an honest comparability study done with full weight given to the non-pay terms and conditions of teachers' service. If the negotiations do not lead to agreement the teachers enjoy a statutory fall-back right to arbitration which they have so far been reluctant to exercise. Negotiations will have to be resumed very quickly now that the election is over.
- (g) Post Office. At a very late stage in the election campaign Post Office employees rejected by ballot the terms of a pay offer made to them in negotiation. The negotiations must therefore be resumed at an early date. The Government will need to decide what guidance if any should be given to the Post Office.

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Cash limits

6. Cash limits are central to your approach to the control of public expenditure, and indirectly of pay levels in the public sector. There are however two points to be made:-

- (a) The degree of control exercisable through cash limits varies depending on the particular part of the public sector in question. The key distinction is whether the Government itself is the sole paymaster or one among several. In central Government and the NHS the Government is the sole source of finance. If you set cash limits here, and stick to them, excessive pay increases (over and above those for which you have allowed in setting the cash limits in the first place) will inevitably and necessarily result in a reduction in the number of staff employed or the volume of goods and services bought. In the case of the local authorities, 61 per cent of expenditure in England and Wales is met by the RSG and 68½ per cent in Scotland. A decision to set a cash limit on the amount of RSG provided, therefore, puts the burden of adjustment, whether through rates, charges, alterations in balances or the volume and quality of service provided, on the local authority concerned. In the case of the nationalised industries, the proportion of Government finance provided to them varies from industry to industry. The balancing factors are prices, employment, investment and the quality of service. Moreover, with the nationalised industries, the nature of the "cash limit" varies. In some it will be a limit on their borrowing from the National Loan Fund. (Though the British Gas Corporation, for example, is a net repayer of Government borrowing.) In others it will relate to specific subsidies (e.g. those to British Rail and some of the payments to the National Coal Board). In yet others it will relate to deficit financing, whether described as borrowing or not (e.g. British Steel). This does not mean to say that the concept of cash limits is inappropriate to these industries. But it does mean that the financial arrangements with each will need to be tailored to its particular circumstances.

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- (b) Cash limits are not a painless instrument of financial control. In central Government, for example, the application of a cash limit to a Department can have three quite separate and distinct effects:-
- (i) It intensifies the search to cut out waste in administration. And it must be true that in any organisation as large as the Civil Service there will be waste in some areas. The real problem is to carry through the detailed and searching enquiries needed to bring waste to light. There is of course already a substantial apparatus of staff inspectors etc. who carry out detailed surveys but the real problem is to motivate the line managers. Many are cost-conscious and do their not inconsiderable best to economise. But top management is generally too involved with policy and the needs of Ministers to get deeply involved and it is, unfortunately, very rare indeed to find a Minister who takes a personal interest or is willing to devote time to the detailed, and in personal political terms unrewarding, work required. You have I know your own ideas about how the 'war on waste' should be conducted.
 - (ii) It intensifies the search to find ways in which the objectives of policy could be achieved by less expensive means (the Treasury have expenditure on housing in their sights as an example here). Success here depends on a lively and imaginative input by Ministers (the Programmes, Analysis and Review arrangements - PAR - have tended to wither precisely because Ministers react against the disturbance and interference with their own parishes which can result). The possibilities are nonetheless worth systematic identification.
 - (iii) Finally, it causes Departmental Ministers to rethink their priorities so as to identify the functions they are prepared to drop in the interests of economy. Politically this is the hardest of all. (Every expenditure and every policy has its own lobby.) And of course it is here that Departmental Ministers most hesitate

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to act because they are at the receiving end of the pressure groups' attentions. But no serious programme of cuts in public expenditure and no serious intent to hold to cash limits can succeed without a realistic assessment of priorities. Again you will need to decide whether some external 'input' would help Departmental Ministers.

7. Of course central Government expenditure is most subject to your control. But many substantial sums of public money are spent through the local authorities and the NHS in both of which, by common consent, there is a good deal of 'waste'. Local authority expenditure is particularly difficult to control - and attempts to do so will lead into very difficult areas of relationships with independent-minded and elected authorities. The prize however could be substantial. The NHS is in an intermediate position. It is wholly funded by Government but enjoys a good deal of autonomy and is riddled with difficult characters (especially the professionals) besides being a political minefield. You will want the responsible Ministers to turn in quick and thoughtful reports on the possibilities.

Looking ahead

8. Given your Manifesto commitments, your administration will escape the treadmill of private sector cases which took up so much of the time of your predecessors. You will however still have an inescapable responsibility for pay in the public services. The main issues to which you may wish to direct attention are:-

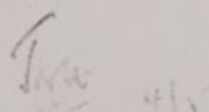
- (a) Do you confirm that 'comparability' (properly carried out) is the key to establishing public service pay?
- (b) If so can improvements be made in the machinery and techniques for carrying it out? In particular do you want to work towards the merging of the present five Boards, Commissions, etc? And what can be done to improve the methods used to determine true comparisons? This is an area in which you might like to commission an early report by officials to serve as the basis for Ministerial discussions.

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Conclusion

9. There are a number of specific decisions which you will have to take quickly, mainly relating to specific pay cases; you will need to launch quickly a national debate on the economic outlook and this involves deciding how, where and with whom the debate is to be conducted; you will need to begin the process of settling cash limits for 1980-81 and to settle the level of RSG, before the summer Recess; and you will need to begin quickly a searching examination of public expenditure, including in that examination a search for areas where, and the techniques whereby, waste can be eliminated, new and cheaper ways found of achieving agreed objectives, and priorities established so that functions can be jettisoned to lighten the ship. In all of this you will inevitably get drawn into questions of pricing, investment and employment policies for the nationalised industries, the whole difficult area of local authority expenditure, efficiency and finance, and the question of charges for services at present free or higher charges for services at present provided too cheaply. At the same time you will be concerned with redressing the balance in pay bargaining by the various means outlined in your Manifesto and you may find that you have to go on to consider more fundamental questions like the structure and organisation of the British trade union movement. And you will want to think through the machinery for public service pay determination.

10. The handling of these issues within Government will depend partly on the decisions you have yet to take about the Committee structure and possibly wider machinery of Government issues. Nevertheless it is clear that at an early stage you will want to give a series of remits to Ministers or Ministerial Committees to produce papers and proposals on the sorts of issues touched on in this note. You may also want to precede the issuing of specific remits by a general discussion in Cabinet. If you wish we could readily produce an annotated agenda for you to circulate to your colleagues.


(John Hunt)

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Ref. A09465

PRIME MINISTER

Energy Issues

The free world uses about 7,000 million tonnes of coal equivalent of energy a year. About 50 per cent of this is oil, about 20 per cent coal, about 20 per cent natural gas, about 7 per cent hydroelectric power and about 3 per cent nuclear. Most of the non-oil energy is consumed near the point of production. Oil is the balancing fuel. About 45 per cent of the free world's oil is produced in the Middle East and 90 per cent of this enters international trade.

2. With the exception of the United Kingdom, Norway and Canada, the industrialised Western countries are all heavily dependent on imported oil to maintain their economies. The USA imports 40 per cent of its supplies and takes nearly 20 per cent of the oil moving in international trade - mostly from the Middle East. The EEC countries import something over half of their combined energy requirements, again mostly oil and mostly from the Middle East. Japan imports 90 per cent of her energy - once again mostly as oil and mostly from the Middle East.

3. The United Kingdom has an especially favoured position among Western nations in terms of energy supply. By next year we should be producing as much energy as we consume - though because our oil is mostly valuable high-quality crude, and two-thirds of our requirements can be met adequately by cheaper low-quality crude, we will remain substantial international traders in energy.

4. The heavy dependence of the Western industrialised countries on Middle East has become a point of danger. The price-fixing activities of the OPEC cartel have imposed very heavy burdens on the Western economies and have threatened the stability of the world financial system. The vulnerability of the West to interruptions in oil supply has been underlined by recent events in Iran. But Iran provided only about 10 per cent of the world's oil consumption. Saudi Arabia produces nearly twice as much.

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5. Against this background energy issues loom large on any Government's agenda. Internationally we are joined, through our membership of the International Energy Agency, in a joint effort with the industrialised West to cut oil consumption. Nationally we are seeking to save energy and need to devote a substantial effort to the production of our own energy supplies.

6. As three (coal, gas and electricity) of our energy industries are in national ownership and the fourth (oil) has a considerable public stake (BNOG plus the Government's share in BP and the necessary Government involvement in the regulation, licensing, taxation and control of the North Sea) a good many energy issues inevitably come to the Government for decision. The Department of Energy is of course in the lead in these matters but other Departments, notably, but not exclusively, the Treasury, the Foreign and Commonwealth Office and the Scottish Office have a locus, and a high proportion of the necessary decisions require to be taken by Ministers collectively. The following paragraphs describe briefly the main issues which you and your colleagues may face on energy matters over the coming months.

Issues

7. Oil consumption: In order to achieve the target 5 per cent reduction in oil consumption to which we have committed ourselves in the IEA and to accommodate to a rather similar EEC decision, we have now embarked upon the policy of increasing the burning of coal in power stations through the summer months. But our ability to continue the effort next winter is in doubt, partly because the hard winter has run down our coal stocks and partly because of uncertainties about coal production - and transport capacity - next winter. You will want to satisfy yourself that continued increased coal burn can be accommodated at a reasonable cost and without reducing coal stocks to a dangerous level (and thus affecting the Government's bargaining position with the miners). Among other matters this raises the difficult question of coal imports. An early situation report is needed from the Department of Energy.

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8. Coal: Linked with this is the dreadful financial position of the National Coal Board (NCB), with a prospective loss of around £300 million in 1979-80. To keep within the cash limits will probably require either cutting back heavily on investment or closing uneconomic pits, together with a substantial further increase in coal prices in the autumn (perhaps to levels which affect the NCB's ability to keep its market share). In simple economic terms the choice is clear, but pit closures will not be easy. Imported coal is substantially cheaper than that of our marginal pits and you will wish to consider what place imports should have in our economy. A particularly important case is fuel for the steel industry as further imports of coking coal have recently been the subject of licensing controls. These fundamental questions will arise naturally over the next few months when the Government come to consider the long-term coal policy review on which officials are now working.

9. Nuclear energy: We are at present committed to building two new advanced gas-cooled reactors (AGRs) and to proceeding with design and development work on a pressurised water reactor (PWR). The organisation of the nuclear construction industry is in disarray. There is a general wish to change the structure of the National Nuclear Corporation, ownership of which is currently vested partly in the public and partly in the private sectors and in which GEC have the management contract. GEC were strong protagonists for the PWR and since the decision was taken to go ahead with additional AGRs, they have indicated their wish to pull out of the business. The uncertain future of the industry has led to the loss of key staff and continuing low morale. You will need therefore to consider quite quickly what needs to be done to prevent the industry drifting further and to remove uncertainties about its future. Decisions are also needed fairly soon on our policy towards Fast Breeder Reactors (FBRs). In particular a decision is needed on whether we should go ahead with a first commercial FBR and, if so, whether it should be built on the basis of international collaboration. This is likely to be a difficult decision not least because of the great

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uncertainties of what will necessarily be a very expensive project. There are those who would advocate not proceeding with an FBR at all, relying on thermal reactors (AGRs or PWRs) until such time in the 21st century when fusion may provide virtually unlimited low-cost energy. But either route involves a highly risky gamble. Department of Energy are in the lead and you will want early proposals from them over the whole nuclear field.

10. Interest relief grants: Interest relief grants under the Industry Act have been used for some years as a means of stimulating the United Kingdom offshore supplies industry. They are currently under attack from the EEC as a distortion of competition and there are growing doubts in Whitehall whether they still represent value for money. There is a strong possibility that the EEC Commission will initiate legal proceedings against us over these grants and a very early review of their effectiveness will be needed.

11. Taxation of North Sea Oil: Your Party is now committed to making the changes in Petroleum Revenue tax proposed by the previous Government. As world oil prices rise the possibility of extracting yet further Government revenue from the North Sea will present itself. This is a matter for the Chancellor of the Exchequer in the first instance, but you will want to keep the possibility in the back of your mind.

12. British Gas Corporation profits: The British Gas Corporation is highly profitable, partly because it enjoys some very favourable supply contracts from the earlier North Sea fields and partly because its prices to the industrial consumer are related to the price of oil and rise with it. As a result the Corporation is actively and massively repaying its debts to the Government. You will want to consider whether there is a case for clawing back some of this profit in a more direct way. This, too, is primarily a matter for the Chancellor but again you will want to bear the possibility in mind.

13. North Sea Oil and Gas Depletion policy: So far the exploitation of oil and gas from the North Sea has been on the basis of maximum exploitation for maximum short-term benefit to the economy. The time may however be approaching when we need to assess anew the balance between short-term gains and the possible longer-term advantages of spinning out our reserves. No

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immediate decisions are needed because the sixth licensing round has just been completed and there is a legacy of past promises to those holding earlier licences. Nevertheless future decisions on licensing and to an extent production from existing finds require to be based on a view of the most nationally advantageous profile of future production. The Department of Energy keep these matters under regular review and you might care to ask for a paper to come forward later in the year.

14. Electricity: Decisions in the nergy sector are characterised by long lead times, none more so in electricity generation where power stations have to be ordered 7-10 years ahead of forecast need. Past decisions mean that we have a good deal of apparently spare capacity in hand or on order. Current demand on the power plant industry is therefore low and it is desperately short of work. It is difficult to believe that the two turbine manufacturers - GEC and NEI(Parsons) - can both stay in the business and early rationalisation may be inevitable. There are substantial regional employment implications and you may wish to commission an early review from the Departments of Industry and Energy as a basis for later decisions.

15. The Role of the BNOC: BNOC is at present a producer and trader in oil, adviser to the Government on oil matters and an important instrument in carrying out the previous Government's participation policies. You will want an early review here so that the future course of the BNOC can be charted in ways acceptable to you. Linked with this is the future of the existing "participation" agreements with the private oil companies. Views about their real importance vary and there is some doubt about their legal validity. The Department of Energy should be asked for advice.

16. BP: The Government is the major shareholder in BP and its relations with that company are of prime importance. You will want to consider whether the Government prefers to reduce its shareholding (remembering that 17 per cent of the Company's shares are held by the Bank of England as a result of the Burmah rescue operation and their ownership is currently a matter of legal dispute).

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17. Disposal of North Sea Oil: The previous Government erected three non-statutory guidelines for the disposal of oil from the North Sea. These guidelines covered the proportion of North Sea oil which it was felt desirable to refine in the United Kingdom; the maximum length of contracts for the sale of North Sea oil; and the restriction of North Sea oil imports to member countries of the EEC and the IEA. The issues are complex and link with foreign policy, not only through the IEA and the EEC but also through the recurring questions of the possible supply of oil to Israel and South Africa. You will want an opportunity to confirm, alter or abandon the guidelines.

18. Energy Conservation: The Iranian situation showed clearly how vulnerable was the world in general and the West in particular to even a marginal and temporary interruption in oil supplies and it jolted the IEA countries to make further immediate efforts towards energy savings. By international standards our present policies are reasonably good, but there is no doubt that more can be done. A number of proposals are in preparation by officials. As some involve extra Government spending you will want to take decisions in time for them to be reflected in the public expenditure review.

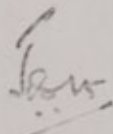
19. Energy Prices: Soundly-based energy prices are the key to energy conservation, to the financial health of the energy industries and to the Government's tax take or expenditures on energy supply. Oil prices are set externally by the world market and you presumably would not wish to seek to hold down our domestic oil prices artificially. The price of coal and natural gas follow oil prices (not always very closely) and there is no national economic advantage to be gained by seeking to interfere in this process. Electricity prices follow from the costs of the primary fuels used and the very heavy capital costs incurred in providing new generating capacity. Given the strength of the OPEC cartel it is likely that energy prices will in any case tend to rise in the long run faster than prices in general. More immediately a substantial increase in coal prices seems inevitable in the autumn which will have a consequential effect on electricity prices. In the normal course of business both of these decisions would come to Ministers for endorsement.

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There are however two underlying energy price issues which you may also care to have examined. The first relates to gas prices where those for domestic supplies, unlike industrial sales, are currently below the oil-related price. Should they be increased in the interests of conservation? Both the coal and electricity industries will argue that they currently suffer unfair competition in their domestic sales from gas. The other issue relates to current cost accounting. The BGC's accounting practices already come close to full CCA depreciation. But the depreciation practices of both the NCB and the Electricity Supply authorities fall well short of this. The effects of full CCA depreciation could be particularly dramatic for electricity. You may think that Ministers should be presented with the arithmetic so that they can take a conscious decision on the issue.

Conclusions

20. The energy sector will present your Administration with a series of challenging and complex problems of great national significance. It would be well worth while asking the new Secretary of State for Energy, in consultation with interested colleagues, to let you have quickly a full list of the main issues that need to be tackled together with a considered timetable for bringing them forward for collective consideration.


John Hunt

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Ref. A09460

PRIME MINISTER

European Issues

The new Government faces both a challenge and an opportunity in Europe - a challenge because it has a number of difficult negotiating objectives (not all that dissimilar from those of its predecessors) in respect of our contribution to the EEC Budget, a freeze on farm prices, etc.: and an opportunity because a greater commitment to Europe expressed publicly and in direct contact with our partners will ensure a more sympathetic hearing.

2. The attached paper sets out the main issues which will need early discussion and on which fuller Departmental briefing is of course being submitted. On agricultural prices for 1979-80 there will be meetings of the Agriculture Council probably coming to a crunch at the end of June; and "Convergence", which from our point of view means our net contribution to the Community Budget, will be a key subject for the European Council on 21st-22nd June. The Government will therefore need to take an early decision on how it is going to play its hand.

3. Tactics will be very important. There are a number of areas where we could show a more forthcoming attitude without any detriment to our substantive negotiating objectives. For example -

- (a) EMS: even if the new Government does not want to take an early decision on joining the exchange rate mechanism, we can deposit 20 per cent of our reserves against the issue of ECUs. This would cost nothing in practical terms but would be an important gesture of support for the EMS and would be confirmation of an open-minded approach to the concept of a zone of monetary stability in Europe consistent with the mainstream of Community development.
- (b) There are a number of issues which are not intrinsically of great importance but where the United Kingdom is blocking otherwise unanimous Community decisions simply because they imply an extension of the Community's role. These include a number of maritime and environment matters, such as signature by the Community of Protocols to the Bonn and Barcelona Conventions.

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- (c) We are in dispute within the Community on certain state aid questions which the new Government's attitude to subsidies would make it easier to resolve.
- (d) Energy in particular is an area where our favourable situation leaves room for us to play a more co-operative role within the Community without any sacrifice of our vital interests in relation to North Sea oil.
4. The fact that, in the last two or three years, the mood of the Community has changed and there is less emphasis on supranationalism, and a greater readiness to accommodate different national requirements, makes it easier for us to move on all these fronts.
5. But it would be wrong to do so without regard to the value of such moves in relation to our major objectives on the CAP and the Budget. The last thing we should do is to give the impression that the United Kingdom is now a soft touch, or to arouse exaggerated expectations. On the fisheries issue, for example, we have important interests to defend, although there are strong arguments for seeking an early settlement to safeguard fish stocks and before Spanish entry to the Community. The timing of moves on those matters where we could be forthcoming will need very careful consideration in relation to the sort of response we are getting from other member Governments on issues of crucial importance to us.
6. Ministers may feel however that there is a strong case for an early statement in Parliament and possibly in the Council, which would set a new tone from the outset and establish a momentum towards solving problems rather than digging into opposing trenches. This could be based on Chapter 6 of the Manifesto showing a genuine wish to co-operate with our partners combined with firmness on matters which are of real importance to us.
7. Copies of the attached paper, but not of this covering minute, are being given to the Foreign Secretary and other Ministers concerned with European questions.

JH
(John Hunt) 415

EEC : SURVEY OF MAIN CURRENT COMMUNITY ISSUES : MAY TO JULY

INTRODUCTION

1. This paper sets out the major issues which will be discussed in the Community during the summer and on which Ministers will need to take positions. The issues will be dealt with in more detail in departmental papers. Ministers may however find a tour d'horizon useful since effective negotiation in the Community requires a coherent policy across the whole range of Community questions. The policy priorities need to be set clearly and pursued consistently; and negotiating capital saved for issues which are of real importance to British interests.
2. Our main concerns are the related problems of the UK contribution to the Community Budget and the excessive cost of the Common Agricultural Policy. Both will be live issues in the next two months. The Commission have proposed a price freeze for 1979/80 as the beginning of an attempt to eliminate agricultural surpluses and this awaits decision in the Agricultural Council (paragraphs 12 to 15 below). The European Council on 21/22 June will as usual be a focal point for discussion of the main Community and world issues. There will be continued discussion of the impact of the Community Budget on the economic performance of individual Member States (paragraphs 6 and 7 below). As this will be the first European Council after the general elections in the UK and Italy and probably with a new Government in Belgium as well, it could be an important opportunity for a new look at this problem, though a single meeting is unlikely to prove a decisive turning point.
3. The EMS (paragraphs 9 to 11 below) and the Common Fisheries Policy (paragraphs 16 to 18) will also require decisions in the period. In other areas of less importance (eg certain environmental and maritime proposals - see paragraph 22 below) there are outstanding UK reservations which are preventing agreement.
4. The Community as a whole has other preoccupations: the general economic situation (likely to be discussed at the European Council in the context of preparations for the Tokyo Summit on 28/29 June), enlargement (paragraphs 26-30)

below), and the Direct Elections to the European Assembly on 7-10 June: the Community will be running a short campaign to give these elections publicity and other Member States will watch with close interest the line taken by the Government and its supporters in the campaign.

5. Against this background, and the forthcoming programme of Community meetings requiring Ministerial attendance (at Annex), the paragraphs which follow outline the state of play on the main problems.

THE COMMUNITY BUDGET AND CONVERGENCE

6. The latest Commission figures show that, on the interpretation of the figures which we favour, our net contribution in 1978 was £747 million - the largest net contribution to the Budget. (The figures depend on the treatment of monetary compensatory amounts (MCAs) on which there is an unresolved dispute; but even on the basis of the least favourable interpretation the UK emerges as the second largest net contributor. The problem can only get worse as long as 75 per cent of the Budget goes on the CAP. In our view the less prosperous Members of the Community should not be significant net contributors to the Budget. The immediate UK interest is to secure acceptance of the principle that net resource transfers resulting from Community policies, taken as a whole, should contribute to convergence by being properly related to the relative economic strengths of Member States. Once this principle is secured, and its application to the UK is accepted, there are a variety of ways in which the alleviation of the UK budgetary burden can be sought.

7. Though some progress has been made in getting the rest of the Community to accept that a problem exists, there is still great resistance to doing anything about it from all except the Italians, who have been useful allies. The task for the UK at the June European Council will be to get agreement that a problem exists, that a specific solution is required in terms as close as possible to those in paragraph 6 above and that a mandate be given to the Commission to make proposals for remedial action in time for decisions at the December European Council. Before then, meetings of the Finance and Foreign Affairs Councils will provide opportunities for discussion of this question and for a statement of UK policy.

EUROPEAN MONETARY SYSTEM

8. This is a major issue in its own right which Ministers will wish to consider carefully. The EMS started on 13 March 1979. The UK does not participate in the exchange rate and intervention mechanism but does participate in other aspects, notably the introduction and development of the ECU (the European Currency Unit, a basket unit comprising weighted proportions of all Community currencies), the expansion of the Community's medium term credit facility and the long term goal (scheduled for two years after the start of the system) of the creation of a European Monetary Fund.

9. An early question the UK faces is whether to deposit 20 per cent of our gold and dollar reserves with the European Monetary Co-operation Fund in return for which we shall receive ECUs. We can do this at any time, but if an affirmative decision is taken there would be political advantage in making these deposits at the earliest moment since this action would help to confirm that the UK does have a commitment to the EMS even though we are not participating in the exchange rate mechanism.

10. The EMS will be discussed at the Finance Councils on 14 May, 18 June and 16 July. In September 1979 there will be a review of the functioning of the divergence indicator, an aspect of the EMS which has been considered to be of particular importance to the UK in that it is a way of putting pressure on strong currencies corresponding to the pressure weaker currencies experience in using reserves to maintain their levels within the margins. The review provides a natural occasion for re-examination of the question of UK participation in all aspects of the EMS.

COMMON AGRICULTURAL POLICY (CAP)

11. The immediate issue for Ministers will be the Government's attitude towards the Commission's proposal for a price freeze for 1979/80. Negotiations have been suspended during the United Kingdom Election. In the meantime various changes have been made in "green currency" rates, including a 5 per cent devaluation of the Green Pound.

12. Currency fluctuations and the measures taken to operate the CAP in spite of them - green rates and monetary compensatory amounts - mean that prices in national currencies have diverged markedly from the agreed 'common' price. German prices, the highest, are now some 30 per cent higher than UK prices, the lowest. High common prices, exacerbated by even higher German prices, inevitably produce surpluses and increase the United Kingdom contribution to the budget and the resource costs of importing food. The United Kingdom's interest, as far as the CAP itself is concerned, is to reduce the cost of the CAP and to eliminate structural surpluses.

13. The United Kingdom can secure a price freeze if the Commission stands firm on its proposals and the United Kingdom refuses to accept any increase, since the Council may change the Commission's proposals only by unanimity. If the Commission were to yield to pressure from other member states for price increases, and change its proposals, the Council may then accept them by a qualified majority and the United Kingdom might have to invoke the Luxembourg Compromise to assert a right of veto in order to enforce a freeze. The freeze is not generally popular. Italy still supports it in a rather half hearted manner but may well allow itself to be bought off. The countries with positive MCAs, Benelux and Germany, are determined not to agree to a fall in their agricultural prices in their own currencies. They therefore insist that only a price increase will enable them to begin to dismantle their MCAs. Denmark and Ireland who effectively have no MCA might accept a freeze on products in surplus (milk and sugar - perhaps cereals). France is anxious for some price increase, not least as a method of securing some reduction in positive MCAs.

14. The next Agriculture Council is scheduled for 8 May (but not to deal with prices). There is to be an informal Council meeting from 14-15 May at Perpignan, and the next Council is fixed for 18 June. It is possible that additional Council meetings will be added in order to speed up the price fixing. Meanwhile, prices remain fixed at last year's level.

COMMON FISHERIES POLICY (CFP)

15. The immediate problem is on conservation measures. HMG must decide whether to implement certain conservation measures which have already been announced in Parliament as coming into effect on 1 June but which may well

be challenged in the Community. Conservation is also likely to be a prominent aspect of the next Fisheries Council which will probably be during June. Three UK national conservation measures taken in 1978 were challenged by the Commission and are now before the European Court and generally the UK's freedom of manoeuvre on conservation is narrowing.

16. On the general internal regime for a modified Common Fisheries Policy there have been long and inconclusive discussions. The UK's principal requirements in the areas in dispute have been: virtually exclusive access for UK fishermen within 12 miles of the entire UK coastline; preferential access for UK fishermen in wide areas beyond 12 miles; an adequate conservation regime including the residual right to take national measures; a greater percentage allocation of catch quotas than is envisaged under the present Commission proposal; and a preferential share of any growth in fish stocks. The question of preferential access is the most difficult. The Eight and the Commission argue that the UK demands, particularly beyond 12 miles, are in conflict with the principle of equal access accepted by the UK (with temporary derogations) in the Treaty of Accession. The Community has been waiting for a general election in the UK and may now hope for a new approach from HMG.

17. The Community's external fisheries regime is unlikely to present critical problems in the period. Annual arrangements on reciprocal fishing access have been concluded for 1979 with the other countries concerned, notably the Faroes, Norway, Sweden and Spain. However, the UK has withheld its agreement to the signature of longer term framework agreements with third countries pending progress on the internal regime. The Government will need to decide whether to maintain these reserves and more generally the extent to which parts of the CFP package should be linked.

INDUSTRIAL, REGIONAL AND INTERNAL MARKET QUESTIONS

18. Attempts to set up a general Community industrial policy have been unsuccessful but the similarity of problems throughout the Community has led in particular sectors to a readiness to find some common policies. On steel, there is in operation a regime for trade between the Community and third countries. A draft Decision determining the conditions under which aids to the steel industry may be granted is opposed only by the UK and

Italy and there will be pressure to agree to a steel aids decision before the summer. The Commission are pressing for the adoption of guidelines for a Community policy on textiles. For shipbuilding the Fourth Directive agreed in 1978 sets out the conditions under which aids can be granted. The Commission has raised difficulties over certain proposed aids to British Shipbuilders and Harland and Wolff, and has not approved a renewal of the Intervention Fund. It is also still considering whether the last Government's proposal for an Employment Development Aid is compatible with competition policy.

19. The Community's funds for non-agricultural purposes are still small but there is an awareness of the imbalance in the pattern of Community spending. The Regional Development Fund has recently been increased to approximately £600 million for 1979 and may be further expanded in the context of enlargement. The Social Fund, which aims to alleviate unemployment by supporting training schemes, will dispose of some £500 million in 1979. On both these Funds, we receive a higher share (27 per cent of the Regional Fund and 20-35 per cent of the Social Fund) than our share of contributions. Proposals for concerted action to combat unemployment (such as an agreement on shorter working hours) have been discussed but there is little sign of early Community agreement. Other schemes are under discussion including a fund for industrial restructuring, a fund for transport infrastructure and a subsidised loan scheme for projects of Community interest. If these or other schemes are pursued we need to ensure that the criteria will benefit the United Kingdom eg by focussing on the United Kingdom's regional problems and the economic disadvantages of our peripheral location, ageing infrastructure and high concentration of declining industries.

20. Progress towards the completion of the common market through the elimination of non-tariff barriers has been slow but could be accelerated if there were a common political will to achieve results. The United Kingdom has stimulated proposals for progress towards a genuine common market in fields where United Kingdom industry is likely to prove competitive eg insurance and motor vehicle components; but has in general shown an aversion to "harmonisation" proposals (under Article 100 of the EEC Treaty) which have not always been justified in terms of their beneficial trade effects.

21. There are a number of proposals in the environmental and maritime fields on which the United Kingdom has reserves, because of their possible implications for the "competence" of the Community although they do not raise matters of significant practical importance for the United Kingdom. These include proposals on aircraft noise control, ship inspection, and Community Accession to the Bonn and Barcelona Marine Pollution Conventions.

EURATOM

22. A discrepancy exists between the extensive powers accorded to the Commission in certain areas of the Euratom Treaty and the limited role it actually plays in nuclear trade. European Court judgements have confirmed that the provisions of Chapter VI of the Treaty remain in force even though unused. The United Kingdom has argued that Chapter VI of the Treaty should be amended as provided for in the Treaty itself. We have also argued that responsibility for non-proliferation controls and conditions applied to nuclear trade within or outside the Community should remain in the hands of Member States. French views on these points are similar and they have been taking the lead. Opposition can be expected, particularly from some of the smaller Members. Discussions on non-proliferation is expected to begin in political co-operation in May. Commission proposals relating to Chapter VI of the Treaty itself are also expected soon. Discussion will also continue of a mandate for the Commission to negotiate a safeguards agreement which will enable deliveries of Australian uranium to be made to the Community; our own bilateral agreement with the Australians will also need to be authorised by the Commission.

ENERGY

23. The Community has had great difficulty in moving towards its consistently stated objective of a common energy policy despite the pressures of a turbulent world energy situation. The significantly different energy endowments and different economic strengths and weaknesses have made agreement very difficult. Our relatively strong energy situation gives us something potentially to contribute; others would welcome a lead, but up to now we have shown greater concern to avoid encroachments on our national competence. At the last meeting of the Council of Ministers (Energy) on 27 March, the main emphasis was put on the national energy programmes of Members States. The Community's role was seen as agreeing common objectives, for example on reduced dependence on imported oil; comparing national energy programmes and their adequacy to meet these objectives; and considering whether there are any gaps

which might usefully be filled by Community action . In line with this approach the Council commissioned a study of national policies; work on a long term outlook for world oil supply; and work on the development of Community coal policy (which could benefit the United Kingdom provided the terms are right). There is likely to be a short meeting of Energy Ministers on 17 May to consider the difficult oil supply situation resulting from the Iranian crisis, but the Council will return to the main questions of Community energy policy on 25 June and Ministers will wish to reassess the United Kingdom line .

24. An issue on which an early decision is likely to be required by Ministers is the handling of our Interest Relief Grant (IRG) Scheme for offshore supplies . We know that the Commission have already approved in principle a Decision requiring us to abolish the scheme although they have not yet formally communicated this to us (because of the General Election). If we do not comply with the Decision we would risk being taken to the European Court (where we would be likely to lose). The Commission have also queried other important aspects of our North Sea policies -- the requirement under which all North Sea oil must be landed in the United Kingdom unless a specific exemption is granted, the policy of ensuring that British industry has "full and fair opportunity" to compete for North Sea business; and the requirement for United Kingdom Continental Shelf licences to have their central management and control in the United Kingdom. A further approach can be expected from the Commission after the Election.

ENLARGEMENT OF THE EUROPEAN COMMUNITY

25. Although there are still some questions to be resolved which are sensitive for the United Kingdom, the negotiations for the enlargement of the Community are generally proceeding satisfactorily.

26. The Greek negotiations have been virtually completed and signature of the accession Treaty is due to take place in Athens on 28 May. The Prime Minister and the Foreign and Commonwealth Secretary have been invited to attend). Greece is likely to enter the Community on 1 January 1981. There will be a transitional period of five years (seven in certain sectors, eg the free movement of labour).

27 . Negotiations with Portugal began formally in October 1978, but the main substance will not be tackled before the summer break and is unlikely to be settled before the end of 1980. This suggests signature of a Treaty in 1981 with accession perhaps on 1 January 1983. Since the Portuguese economy is weak a transitional period of ten years in some sectors may be necessary.

28 . Spain with a population of 36 million presents larger problems than Greece (population 9.1 million) and Portugal (9.7 million). The Spanish market has so far been relatively protected from EEC industrial exports which can therefore expect to benefit from Spain's accession. On the other hand there will be problems for Community producers of Mediterranean agricultural products , and on textiles and fisheries . The negotiations with Spain opened formally in February with the substantive phase due to start after the summer break . Spain might enter the Community together with Portugal in 1983 with a transitional period of perhaps eight years.

29. Fears have been expressed on the effect which enlargement will have on the workings of the Community's Institutions. It will be more difficult to reach a consensus on certain matters with 12 members than nine; and the Community will have three new official languages . The risk of stratification of the Community into more and less prosperous members may be increased. The Committee of three Wise Men, including Mr Edmund Dell, is looking into some of these problems and is due to report in the Autumn.

EXTERNAL RELATIONS

30. The Community's external relations cover a wide field of economic activity , but give rise to few major immediate problems for the United Kingdom. Now that the GATT Multilateral Trade Negotiations (MTNs) have been initialled by the main participants (though not yet by the development countries), the main item on the Community's external agenda in the coming months concern the re-negotiation of the Lome Convention and the Community's policy at the May meeting of UNCTAD V. Also under active discussion are the Community's relations with Japan, Yugoslavia, Turkey, CMEA and China. Later in the year decisions will be needed on the post 1980 Generalised Scheme of Preferences (GSP) and on the lending commitments of the European Investment Bank (EIB) after 1981.

31. Under the present Lome Convention 57 African, Caribbean and Pacific ACP) states (which include 27 Commonwealth countries) enjoy an advantageous aid and trade relationship with the Community. This expires in March 1980 and a successor agreement is currently under negotiation. The final Ministerial conference to settle its terms is due to be held in Brussels on 24/25 May. The

last Foreign Affairs Council at which the Community's position can be discussed is that of 8 May, though it is possible that a further special Council will be needed for this purpose, perhaps just before the 24/25 May meeting. One important decision required will be the amount of EEC aid to be offered under the new Convention.

32. UNCTAD V opens at Manila on 5 May. The co-operation of Community positions was discussed at the March and April Foreign Affairs Councils and the 8 May Council is likely to approve detailed positions now under intensive discussion in Brussels.

33. Trade relations between the EEC and Japan are under some strain. Negotiations are in progress for a new preferential trade agreement with Yugoslavia. Turkey presents important and urgent economic problems for the Community. Negotiations with the Soviet-dominated CMEA to which the Eastern Europeans and the Soviet Union belong have arisen because the CMEA has insisted that there should be an EEC/CMEA trade agreement before CMEA members would be entitled to negotiate bilaterally with the Community. The Community agreement with China was signed in 1978 and has given rise to practical problems, including access for Chinese textile exports. There are also unresolved problems with Malta, Cyprus and Turkey over access for textiles.

FORTHCOMING COMMUNITY MEETINGS REQUIRING THE ATTENDANCE OF MINISTERS
(To be revised)

May

8	Foreign Affairs Council (Brussels)
8	Agriculture Council (Brussels)
12-13	Foreign Ministers' informal meeting (Cahos)
14-15	Agricultural Ministers' informal meeting in Perpignan
14	Finance Ministers (Brussels)
15	Social Affairs Council (Brussels)
15 or 22 (subject to cancellation)	Research Council (Brussels)
17	Energy Council (Brussels)
22	Standing Committee on Employment (Brussels)
24-25	ACP/EEC Ministerial Negotiating Conference
28	Possible signature of Greek Accession Treaty in Athens
29 (provisional)	Foreign Affairs Council (Brussels)

June

12	Foreign Affairs Council (Luxembourg)
11-12	Agriculture Council (Luxembourg)
13	Transport Council (Luxembourg)
18	Agriculture Council (Luxembourg)
18	Finance Ministers (Luxembourg)
18	POCO Ministerial (Paris)
19	Environment Council (Luxembourg)
21-22	European Council (Strasbourg)
25	Energy Council (Luxembourg)

July

16	Finance Ministers (Brussels)
16-17 or 23-24	Agriculture Council (Brussels)
23-24	Foreign Affairs Council (Brussels)

PRIME MINISTERHouse of Commons Procedure: Open Government:
Official Secrets

The Government are likely to be asked early in the new Parliament whether they support the immediate reorganisation of the Select Committees to monitor the work of Departments, as proposed in the Report of the Procedure Committee. Or alternatively whether, at least for the time being, they favour the appointment of select committees on the existing basis.

2. In the Manifesto you undertook to give the House the early chance of coming to a decision on the Report. You may like to seek the Lord President's advice on the handling of its various recommendations and on the extent to which the Government should commend them to the House. The Cabinet Office are preparing a fuller note for him.

3. The Procedure Committee's proposals have some links with Open Government and Official Secrets; in particular there is the recommendation that select committees should have wider powers to order the attendance of Ministers and the production of papers and records. The Government will wish to consider this carefully. With its reference to the release of documents, it ties in with Open Government and raises some of the questions discussed in the previous Administration's Green Paper. The counterpart of open government are official secrets and the acknowledged need to amend Section 2 of the Official Secrets Act. The two subjects were, of course, taken together in Mr. Freud's Freedom of Information Bill.

4. You may think that it would be worth having the three issues examined together by a group of Ministers under the chairmanship of the Lord President: if so, I could let you have advice on composition. Alternatively, you could invite the Lord President to advise urgently on the

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Procedure of the House, the Lord Privy Seal to work up proposals on open government and the Home Secretary to bring forward a Bill to amend the Official Secrets Act.

5. Assuming that there will in due course be much more systematic openness in Government, there is a case for correspondingly tighter control over the unauthorised disclosure of material which continues to be restricted. The last Government had an increasingly bad record for leaks, and you may want to set a different tone from the outset.

John
4/13
John Hunt

CONFIDENTIAL

Ref. A09458

PRIME MINISTER

Devolution

Although no immediate action or decisions are required on devolution, this note is submitted because:-

- (a) Responsibility for devolution at official level has been located in the Cabinet Office itself with a small Constitution Unit working directly to the Lord President of the Council on this issue since 1974.
- (b) You may want to consider whether Ministerial responsibility might now revert to the Secretary of State for Scotland on a view of the kind of changes in the government of Scotland which remain to be considered; devolution to Wales is clearly no longer a distinct policy issue.

2. The draft Orders in Council for the repeal of the Scotland and Wales Acts were laid on 22nd March and survive for consideration in the new Parliament. They require approval by a Resolution of each House. Before the draft Orders are debated, however, you might first want to have reviewed what the Government might propose about possible changes for the government of Scotland and Wales.

3. For Wales, there is a Manifesto commitment to propose a Select Committee for Welsh Affairs. This proposal can be put to the House together with the recommendations of the Select Committee on Procedure for which you have undertaken to provide an early opportunity for the House to come to decisions. There is also a commitment to propose a reformed Welsh Council consisting of representatives of all the county and district councils. No doubt you will look to the Secretary of State for Wales to undertake the necessary consultations with the interests concerned.

4. For Scotland, your Scottish Manifesto also proposed the early establishment of a Select Committee for Scottish Affairs. This too could be pursued in the context of the Select Committee on Procedure's recommendations, without prejudice to whatever might be the outcome of the discussions with other Parties on the future government of Scotland to which you are committed.

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5. As for a possible forum for these discussions, you might want to proceed relatively slowly. Informal soundings of the views of other Parties on what arrangements might attract the widest support would seem necessary. The possibilities could include an all-Party conference of Ministers and Party Leaders, a Joint Select Committee and a Commons Select Committee. But the choice of a forum might in the main depend on what options for change the Government themselves might want to put forward.

6. The outcome of the referendum can be accounted a rejection of an elected Assembly with legislative and executive powers for Scotland alone and it has not so far been possible to conceive alternative proposals for such an Assembly which would be likely to prove more acceptable or provide for greater constitutional stability, particularly in respect of the role of Scottish Members of Parliament. Although a federal system for the United Kingdom as a whole, with a parity of relationships for each of its parts, could accommodate a Scottish legislative Assembly, there is clearly little interest in and less demand for so fundamental a change in the country as a whole.

7. Although it might not be possible to avoid discussion of these options given the policies of other Parties, and both were included in the draft of a submission for an all-Party conference published by the Conservative Party last December, the remaining options proposed for discussion in the draft were:-

- (a) Further changes to House of Commons procedures for Scotland, including a greater role for the Scottish Grand Committee which might meet when practicable in Scotland.
- (b) An inquisitorial Assembly constituted from representatives of local government or other interests, although this could result in a conflict of role with a Scottish Select Committee and might not be welcomed by Scottish Members. If elected, an Assembly of this kind would more acutely provide for uncertainties about representation and could foster political instability.

8. You will want a considered political judgment on this issue in the light of the experience of the election campaign in Scotland but, on a preliminary view, the course of action might be:-

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- (a) Repeal of the Scotland and Wales Acts.
 - (b) As a first step, propose a Select Committee for Scottish Affairs and that all-Party consideration might be given (for example, by the Select Committee on Procedure and the Scottish Grand Committee) to other possible changes in House of Commons procedures for Scotland.
 - (c) Consider in the longer term whether some different all-Party forum should be constituted to consider other possible changes for the government of Scotland on a view of what the Government itself might wish to propose.
9. You might want to invite the Secretary of State for Scotland to take the lead in developing proposals.

JH
4/5
(John Hunt)

PERSONAL AND CONFIDENTIAL

Ref. A09455

PRIME MINISTER

Northern Ireland

Northern Ireland is likely to become a more urgent political problem following the Election than it has been for many months past. Though the previous Administration tried to make progress with the Northern Ireland Parties with its so-called "framework" proposals, in practice everybody was marking time in the months before the Election. Both the Unionists and the SDLP believed that they stood to gain more after the Election than before, and so neither was prepared to move off its entrenched positions. The Unionists want to return to full devolved government of the pre-1972 Stormont kind. They are firmly opposed to any kind of power-sharing in government with the minority. The SDLP seek to participate in the government of Northern Ireland and they will resist any moves which, in their view, will make it more difficult for them to achieve their long-term aim of a united Ireland. The impression has built up in Northern Ireland that the period of political inactivity before the Election was a prelude to some new initiative by an incoming Government with the authority of a fresh mandate.

2. Expectations are also high in Dublin and the United States. The Irish Republic Government have in general been reasonably helpful to us over Northern Ireland in the recent past, but they are under constant pressure to take a tougher, more nationalist line. One source of that pressure is from the Irish lobby in the United States. The United States Government come under similar pressure from the same direction. The approach of election year in the United States will add to this pressure; recent speeches by Speaker O'Neill and Governor Carey are a foretaste. So far they too have been helpful in their approach to Northern Ireland. But if we are not seen to be taking some early and positive steps to bring about some progress, it will be increasingly difficult for both the Irish and American Governments not to become more critical in private and in public. This would encourage the SDLP to make more extreme demands; and the Unionists would take fright and in turn become even less disposed to compromise.

PERSONAL AND CONFIDENTIAL

3. There is therefore a clear need for the Government to move into a higher gear. But however high the expectations of a new approach by the Government may be, the reality is that the room for manoeuvre is very tightly constrained. The Northern Ireland Office do not have a new blueprint ready to put to the Parties which is likely to solve everything. They have a number of ideas. Some of these are similar to initiatives that have been tried before and failed: others are more imaginative but more risky, and we may well have to consider these. In this situation the role of the person you choose as Secretary of State for Northern Ireland will be crucial. There will be a short period after he takes office when he will have a stock of political credit. If we are to make any progress, he must use this to the best advantage before the sheer pressure of events compromises him in the eyes of one side or the other.

4. I think this means that the Secretary of State should make rapid contact with the Parties and with the Irish Government. He will need to be firm on law and order but to gain the confidence of both communities: this means that he must be seen to be open-minded and without bias in one direction or the other, while at the same time capable of having ideas of his own. He will need to be highly active in private but ready, at least initially, to take a restrained line in public. If he succeeds in getting things off the ground, he will have to handle complex and possibly protracted negotiations.

5. When he has completed his initial round of contacts with the parties, the Secretary of State will need to seek your approval for the way he proposes to try to make progress since it will be essential for him to have a clear objective and to be seen to have the full backing of the Cabinet. Because of the nature of the problem he will necessarily have to operate rather more on his own than most Ministers do; and experience shows that Secretaries of State for Northern Ireland can easily get out of touch with their colleagues.

John Hunt
John Hunt

CONFIDENTIAL

Ref. A09468

PRIME MINISTER

East-West Relations

Both the North Atlantic Alliance and the Warsaw Pact are committed to the pursuit of detente. But detente means different things to different people. This brief takes it to mean the evolution of East-West relations away from confrontation and towards a sober modus vivendi based on a common interest in the avoidance of a nuclear war and leading to a measure of co-operation both between the two super-powers and between their respective allies, but without the security of either side being weakened.

2. The Soviet Union sees detente both as meeting its own security interests and as facilitating the pursuit of its long-term objective of the triumph of the Soviet brand of communism. The Russians seek to avoid a renewed spiral in the arms race, to institutionalise strategic parity with the United States, to secure access to Western technology and credits, to retain freedom to conduct "the political and ideological struggle", to expand their influence in the Third World, to isolate China and to preserve and if possible extend their authority on the European continent (which includes the containment of Germany). The United States seeks to manage the emergence of the Soviet Union as a super-power by involving it in a range of arms control negotiations, where possible in a degree of international crisis management, and in a network of bilateral links designed to create a vested interest in co-operation. The Eastern European States seek access to Western markets and technology and opportunities for some assertion of their national personalities. The Western European countries in general share American objectives but tend to attach somewhat greater importance to East-West trade. The Federal Republic of Germany has special concerns arising from the division of Germany, from its geographical location and from the large number of ethnic Germans seeking to emigrate from the Soviet Union and Eastern Europe. France has long sought to maintain something of a special relationship with the Soviet Union as an aspect of her independent role in international affairs. The United Kingdom has been particularly conscious of

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the paradox that, as detente progresses, public recognition of its limitations as an instrument for change in Soviet policies has increased; but we have stressed within the Alliance the need to pursue detente in the absence of an acceptable alternative and to formulate a co-ordinated Western policy.

3. For the two super-powers, SALT is very important in the detente context and a SALT II agreement has now almost been reached (I have submitted a separate brief on SALT). A further major element in the development of detente is the negotiation of a Comprehensive Test Ban Treaty which is now going on between the United States, Soviet Union and the Kingdom Kingdom (see also separate brief). Another important negotiation between East and West is the talks on Mutual and Balanced Force Reductions (MBFR) in Central Europe (I have not prepared a separate brief on this subject at this stage). These negotiations, which involve several members of NATO, including the United Kingdom, and of the Warsaw Pact, have been going on for over five years. The West are seeking reductions in the forces of both sides to a common level and are arguing that because of existing disparities the Warsaw Pact should reduce by more than NATO. The Soviet Union and its allies accept the goal of approximate parity at a lower level of forces but claim that assymetrical reductions are not needed because the forces on both sides are roughly in balance now. The prospects of an early agreement are not good. A further aspect of the East-West relationship is the Conference on Security and Co-operation in Europe (CSCE). Both East and West attach importance, though in different ways, to the implementation of the provisions of the CSCE's Final Act. Preparations are now beginning in the Nine and in NATO for the next follow-up meeting in Madrid in 1980.

4. The credibility of detente has been damaged in recent years by Soviet readiness to exploit instability in the Third World, in some cases with the active support of Cuban military intervention. But while exploiting opportunities offered by existing tensions, the Russians have not been able to create new opportunities or to capitalise on all the existing ones, and in some countries they have lost ground. Their wish to avoid a major confrontation with the United States acts as a constraint. Their dismal aid performance and their irrelevance to the North-South economic dialogue are liabilities in the more stable areas. The

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Soviet threat in the Third World therefore needs to be seen in perspective. Nonetheless, it remains a serious challenge to which the West must constantly seek an adequate response. The most effective response in many cases will be found in a concerted and enlightened Western approach to the needs and aspirations of Third World countries.

5. The Russians have an atavistic fear of China and regard its burgeoning relations with the West with great suspicion. China poses no military threat to the Soviet Union at present but the Russians fear that with Western arms and technology it could come to do so, thus contributing to the "encirclement" of the USSR.

6. Soviet foreign policy seems unlikely to change greatly when Brezhnev goes. As for other countries, there are a number of basic constants. The Soviet Union will remain fundamentally antagonistic to the West and China and expansionist in the Third World, but its aims will continue to be pursued pragmatically and with a healthy awareness of the Soviet Union's own needs, problems and uncertainties. These include China, currently the most important; potential instability in Eastern Europe; economic problems at home; and fissiparous tendencies in the world communist movement.

JHC
(John Hunt) 4/5

SECRET

Ref. A09463

PRIME MINISTER

Comprehensive Test Ban

You will of course know that since July 1977 the United Kingdom has participated in negotiations with the United States and the Soviet Union for a multilateral comprehensive test ban treaty. Much of the treaty has already been agreed tripartitely, but there are a few outstanding and important issues still to be settled, including especially problems relating to verification.

2. I attach a note describing the current state of play in the negotiations and indicating the problems which remain to be resolved. It has been prepared by a small group of officials under Cabinet Office chairmanship and is for information only. Further submissions will be made as and when decisions are required by Ministers.

3. It is convenient to mention one related point at this stage. Difficult scientific and technical questions arise over e.g. stockpile reliability and safety in the absence of testing (see paragraph 7 of the attached note): and we have felt the need for some independent source of advice in addition to that provided by the experts in the Ministry of Defence. Accordingly a small panel of eminent outside scientists was established a few months ago under the chairmanship of Lord Penney to advise on such nuclear weapons matters as might be referred to it.

4. Copies of the attached note are being given to the incoming Foreign and Commonwealth Secretary and the Secretary of State for Defence: but it will not have any wider circulation until you decide whether you wish sensitive matters of this kind to be handled in the Defence Committee or in a smaller group. I will let you have a separate submission on this when your main appointments have been made.

J. Hunt
4/15
JOHN HUNT

COMPREHENSIVE TEST BAN NEGOTIATIONS

The United States, the Soviet Union and the United Kingdom have been engaged since July 1977 in negotiations in Geneva on a multilateral Comprehensive Test Ban (CTB) Treaty, to be supplemented by a Separate Verification Agreement (SVA) between the three of them. The greater part of the multilateral treaty has been agreed, but much of the SVA has still to be negotiated.

United Kingdom Objectives

2. Since the Partial Test Ban Treaty was concluded in 1963, the United Kingdom has supported the aim of making the ban comprehensive, by extending it to cover underground tests. This objective is widely shared in the international community. The non-nuclear powers see a CTB as a necessary demonstration of the nuclear weapon states' commitment to nuclear arms control, as a counterpart to their own renunciation of nuclear weapons.

3. The United Kingdom's main objectives in seeking a CTB, which are shared by the United States Administration, are to curb the qualitative development of nuclear weapons without adversely affecting Western security; and to help prevent their proliferation to more countries. The first of these objectives should be met, provided the CTB is properly verified and provided no safety or reliability problems arise in the existing weapons stockpile which are beyond our capability to solve without nuclear testing. The second objective requires the kind of treaty which will attract the adherence of key non-nuclear weapon states, such as India and Pakistan, that have kept open the nuclear weapons option by not adhering to the Non-Proliferation Treaty. This is an aspect to which we have attached special importance since there is disquieting intelligence about the extent to which Pakistan in particular is pressing ahead with a nuclear weapons programme.

Soviet Motives

4. The Russians have long claimed to want a CTB. When President Carter proposed negotiations on assuming office they readily agreed. They share our interest in non-proliferation, and they probably see a CTB as contributing to the process of detente. We have to recognise that no CTB is totally verifiable and we must therefore seek to reduce to a minimum the possibility for the Russians to gain military advantages by cheating (see paragraphs 9-11 below).

The Scope of the Treaty

5. It has been agreed in the negotiations that the multilateral treaty should ban all nuclear tests in all environments. A protocol, which would form an integral part of the treaty, is to provide for the cessation of peaceful nuclear explosions (PNE). The Russians earlier in the negotiations wanted to exempt PNE, which they argued were necessary in the development of the Soviet economy. But the United States and United Kingdom insisted that PNE should cease, since in their development the same basic technology as nuclear warheads is used and they would inevitably confer military benefits.

6. The Americans intend during a CTB to continue very small nuclear experiments (of yields below 100 lb in TNT equivalent) in order to maintain their technical capability. Such experiments are not nuclear tests in the accepted sense of the term and therefore in our view would not detract from the comprehensiveness of the treaty. The United Kingdom will have similar requirements but no decisions have been taken on any British programme of experiments. Experiments of these very small yields cannot be used to test weapons in the stockpile or to develop new weapons. The Americans will probably want the Russians to accept some understanding that such experiments will not fall within the treaty prohibitions. But the Russians are likely to resist because they can conduct them without detection and see no need for any understanding. This difficult point has yet to be settled.

The Duration of the Treaty

7. The United States and United Kingdom originally proposed unlimited duration. This position was changed in order to take account of possible problems in maintaining the safety and reliability of their stockpiles of nuclear weapons indefinitely without testing. On United States initiative all parties are now negotiating on the basis that the treaty will have an initial duration of three years as advocated by the Russians from the start. But the United Kingdom has made clear that it would have preferred an initial duration of five years, as a greater inducement to non-nuclear weapon states.

8. It is envisaged that during the final year there will be a review conference of the parties to the treaty to consider what should happen on expiry of the initial period. The Americans want the conference to be able to consider all options, including not only the lapsing or extension of the

Treaty, but also its modification, eg by the introduction of a threshold of, say, 3 kt below which testing could be resumed. The Russians insist that the conference should consider only the question of extending the treaty and that this should depend on whether non-parties - ie France and especially China, neither of whom can be expected to adhere to a CTB for the foreseeable future - are conducting tests. The United Kingdom has supported the United States position which would enable us to decide in the light of all the relevant considerations (including the state of our nuclear stockpiles) what should happen after the initial period. In particular we attach importance to keeping the possibility of extension open, so as not to prejudice the chances of adherence to the treaty by key non-nuclear weapon states. This has so far proved an intractable issue.

Verification

9. The multilateral treaty will provide for parties to use their national technical means for verifying the compliance of others with the Treaty; and for an international exchange of data from seismic monitoring stations in many countries. It will also give each party the right to request an on-site inspection of another party's territory, if it has reason to suspect that a violation of the treaty may have occurred. The United States and United Kingdom at the start of the negotiations were still insisting that such inspection should be mandatory. But other means of verification, notably satellite monitoring, have been developed, so that inspection, while still important as a means of checking suspect events, is not as central to verification as in the past. We have accordingly accepted that inspection will be subject to the agreement of the inspected state.

10. In the case of the three negotiating states, these multilateral measures of verification will be supplemented by additional ones in the tripartite Separate Verification Agreement (SVA). This will make clear that refusal of a properly substantiated request for inspection under the SVA would be a serious political matter. It will also spell out the detailed arrangements for inspections between the three parties. We have proposed that the United Kingdom should have a special status in this connection: rather than exercising an independent inspection capability, we should be free to participate in United States inspections in the Soviet Union.

11. The most important provision of the SVA will be for high quality seismic monitoring installations, known as National Seismic Stations (NSS), to be located on Soviet, United States and British territory. The United States, with British support, is seeking 10 NSS in the Soviet Union, to be installed during the first two years of the treaty. These tamper-proof stations will augment the existing means of detecting, identifying and locating seismic events in the Soviet Union. It is estimated that United States national technical means of verification supplemented by 10 NSS in the Soviet Union would reliably detect seismic events (whether earthquakes or nuclear explosions) in the Soviet Union down to a yield between about 300 tons and about 3 kilotons (TNT equivalent) depending upon whether the event occurred in hard or soft rock. The network would positively identify a seismic event as an explosion (and not an earthquake) at yields three times those levels. This United States verification capability would deter attempts at evasion and have a high chance of detecting Soviet testing at large enough yields to advance nuclear warhead technology. The Russians might hope to get away with very small clandestine tests to check the safety and reliability of warheads in their stockpiles. But under a three year treaty this would be unlikely to bring them militarily significant advantages over the Americans.

12. The Russians have agreed to accept 10 NSS on condition that the United States and United Kingdom each does likewise. They have proposed that 9 of the United Kingdom stations should be in British dependent territories. They have refused to discuss the technical characteristics of NSS (which will govern their performance) and the timetable for installation until agreement is reached on numbers. The United States has accepted 10 NSS. The United Kingdom has agreed to one NSS in the United Kingdom itself (at Eskdalemuir in Scotland) but has maintained that there is no technical justification for NSS in United Kingdom dependent territories. We have argued that NSS are relevant only for monitoring large land masses and would add nothing to the capability of Soviet national technical means, such as satellite observation, to monitor our dependent territories. Moreover they would represent an addition to public expenditure and there may be difficulties over finding enough suitable sites in dependent territories. The Russians have countered that there is no technical case for NSS anywhere under a three year treaty; that they only accepted 10 NSS because they considered that this was a political requirement of the United States Administration (to make the CTB acceptable to Congress); and that it is

a Soviet political requirement that the United States and United Kingdom should accept "equal obligations". The Americans, at official level, have suggested to us that the present United Kingdom position could endanger the chances of securing the important breakthrough of 10 NSS in the Soviet Union and that we shall have to change it when the negotiations resume (scheduled for 21 May) if progress is to be made. This is another very difficult issue, which will be the subject of a separate submission.

Negotiating Timetable

13. The timetable for completion of the tripartite negotiations is likely to be determined largely by the time it takes to negotiate the details of NSS. That might involve several months of intensive discussion. Meanwhile the Russians recognise that, because arms control proposals are controversial in the United States, the Administration will not wish to reduce the chances of SALT II ratification by submitting a CTB treaty to the Senate before the latter has voted on SALT II.

14. There is no agreement yet on how the treaty should be handled once tripartite agreement has been reached. The Russians favour immediate signature by themselves, the Americans and ourselves. The United States and United Kingdom consider that there will be more chance of persuading key non-nuclear powers to adhere if they are given some part in the preparation of the treaty. We therefore envisage that the tripartite negotiations might be followed by a series of consultations about the resulting treaty with key non-nuclear powers. In the light of these, we would decide whether to sign the treaty or first to submit it for discussion - but not substantive amendment - to the 40-nation Committee on Disarmament in Geneva.

May 1979

SECRET

Ref. A09462

PRIME MINISTER

Strategic Arms Limitation Talks

It is probable that the SALT II Agreement will be signed shortly at a Summit meeting between President Carter and President Brezhnev. This will be followed by a lengthy and controversial ratification debate in the United States Congress. The Government will need to take up a public position, both nationally and through the Alliance, soon after signature of the agreement. Separate advice will be submitted on the line we should take. Meanwhile I attach a background note which has been prepared by a small group of officials under Cabinet Office chairmanship on the content of the SALT II Agreement, and on the main issues which have arisen during the negotiations and are likely to affect our interests in SALT III.

2. Copies of this note are being given to the incoming Foreign and Commonwealth Secretary and the Secretary of State for Defence.

John
(John Hunt)

STRATEGIC ARMS LIMITATION TALKS

The SALT II Agreement is virtually complete and is likely to be signed soon at a summit between Presidents Carter and Brezhnev, although no date has yet been fixed. Thereafter there will be pressure for early governmental reactions. European statements on SALT II will be scrutinised very closely in the United States and will have an important bearing on relations with the Carter Administration and on the ratification process. Advice will be submitted separately about the line which might be taken publicly by Her Majesty's Government.

Content of the Agreement

2. The main provisions of SALT II are summarised at Annex. SALT II is an advance on the 1972 Interim Agreement in several important ways. It covers all types of strategic nuclear delivery systems. It imposes equal ceilings within each category. It limits certain new systems both in number and in kind. It also makes more detailed provision for verification.

General Criteria

3. For the Alliance as a whole SALT II is likely to be assessed under four general criteria.

i. The East/West balance SALT II codifies the "essential equivalence" in strategic arms between the super powers. It does not assume exact equivalence: the Soviet Union will retain its advantages in heavy missiles, throw-weight and "deliverable megatonnage", while the United States will still have more warheads (except possibly for a short time in the middle of the treaty period), greater accuracy and a more balanced spread between land, sea and air systems. The agreement provides a framework of limitations within which each side can develop its own strategic posture and which does not in itself confer an overall strategic advantage on either side.

ii. NATO strategy The Alliance's deterrence strategy places four main requirements on SALT II: that strategic sufficiency should be maintained; that the Alliance's ability to maintain an adequate theatre nuclear capability should not be impaired; that there should

continue to be credible linkage between strategic and theatre nuclear systems; and the continued effectiveness of the strategic and theatre nuclear elements of the deterrent triad, where survivability is one of the major considerations. In our judgement, these requirements are satisfied by the provisions of SALT II. But the United States Administration accept that they will need to improve their forces during the life of the treaty (see iii. below), and there are some special British and European interests which we shall wish to keep under review (see paragraph 4 below).

iii. Future options The United States Administration consider that American strategic needs can be met fully within the SALT II framework. The agreement would allow the United States to develop and (after the Protocol expires at the end of 1981) to deploy a mobile ICBM to offset the problem of the vulnerability of its existing land-based missiles. It also permits the deployment of cruise missiles on aircraft with the proviso that those with a range greater than 600 km should be carried only on designated heavy bombers and should count against the agreed ceilings. The deployment, but not the testing and development, of ground and sea-launched cruise missiles with a range greater than 600 km is prohibited for the duration of the Protocol (this is especially relevant to the European Allies - see paragraph 4 below).

iv. Arms control The SALT II cuts are modest: about 250 Soviet systems in all. But, in addition to tighter verification provisions, SALT II also bans certain new systems, limits the total number of MIRVs and restricts each side to one new ICBM. All of these constraints mean that the Soviet Union is able to undertake fewer strategic military programmes than would probably be the case in the absence of an agreement.

Special British and European interests

4. In addition to these general criteria (which are of overriding importance to the United States as well as Europe) there are three issues of special concern to the Europeans. These have dominated our consultations with the United States on SALT II.

i. Transfers of systems and technology SALT II does not forbid the transfer to a third party of equipment or technology. But each side undertakes "not to circumvent the provisions of this agreement through any other State or States or any other manner". The United States will set out their interpretation of this clause in a unilateral statement after signature. This will state that the non-circumvention provision simply makes explicit the inherent obligation any State assumes when party to an international agreement and that it will not in practice interfere with continued United States nuclear co-operation with the Allies. In this connection we have sought and obtained confidential bilateral assurances from the Americans. In July 1977, they assured us that SALT II would not prevent the United States from meeting its obligations under the 1958 Defence Agreement and the 1963 Polaris Agreement; and that, under SALT II, new forms of United States assistance could be agreed in the future. In December 1978, the Americans clarified that the transfer of long range air-launched cruise missiles to the United Kingdom was not precluded in principle under SALT II. They have, understandably, emphasised throughout that any United Kingdom request for transfers would have to be dealt with in the light of circumstances at the time. These private assurances, although in theory not completely watertight, are substantial and should ensure that in practice the United States will be able to transfer systems and technology to meet our foreseeable needs. They have been reflected in a number of official public statements made in the United States (including one by President Carter on 20th February) that the agreement will permit the United States and the Allies to pursue all the defence programmes that may eventually be needed, including cruise missiles. There is one outstanding point on the proposed United States' public statement which has caused us difficulty and which we were trying to resolve in discussion with the Americans. A separate submission will be made on this.

ii. The Protocol Concern has been expressed that the United States will come under pressure to extend the Protocol limits on ground and sea-launched missiles and mobile ICBMs after 1981. The United States have, however, frequently assured us that the restrictions contained in the Protocol would lapse on its expiry.

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Furthermore all the indications are that the United States takes seriously the freedom of choice which it will regain when the Protocol expires. It is spending over \$200 million on ground and sea-launched cruise missiles this year and has budgeted \$670 million for the development of a mobile ICBM next year. According to the State Department, any future limitation on these systems would require United States agreement and Congressional approval. Moreover, Alliance policy on long range theatre systems is being made (under active United States leadership) on the assumption that all types of cruise missile will be deployable from 1982 onwards.

iii. "Grey area" The Soviet Union has a growing advantage in the grey area between strategic systems covered by SALT II and battlefield nuclear systems. It is a source of concern for Western Europe, particularly the Federal Republic of Germany, that SALT II puts no limits on Soviet long range theatre systems, notably the SS20 missile and Backfire, which are targetted on Europe and are therefore strategic in European terms. They were excluded partly because they do not have a genuinely inter-continental range, but, more importantly, as a consequence of United States insistence which, with the support of the Alliance, has been maintained since SALT I, on excluding American theatre nuclear systems from the negotiations. It is expected that the Russians will press for such systems, together with British and French nuclear forces, to be included in SALT III. The Americans intend to state publicly that any future limitations on United States systems principally designed for theatre missions should be accompanied by appropriate limitations on Soviet theatre systems. Meanwhile a NATO Group of senior officials is studying what improvements are needed in NATO's long range theatre nuclear forces (TNF). The indications are that in its final report to Ministers in the autumn, the Group will recommend a mixture of cruise missiles (probably ground-launched) and a longer range

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version of the Pershing ballistic missile launcher. In parallel with this a Special Group is considering possible arms control options for limiting Soviet long range theatre systems. This Group will also report in the autumn. It is hoped that Ministers will thus have a wide framework within which to take timely decisions about TNF modernisation.

5. Although we judge that British and European concerns have so far been adequately safeguarded in the SALT process, our interests will increasingly be at issue as future negotiations focus on deeper cuts and possibly on grey area systems. There will be a need for close consultation in the Alliance and for a clearer view of where our interests lie. We hope that the two NATO Groups referred to above will provide the basis for a stronger and more coherent European input.

The United States Ratification Debate

6. It is at present far from certain that President Carter will secure the two-thirds Senate majority needed to ratify SALT II. The position of the United States Administration would become even more difficult if, as seems increasingly likely, the issue becomes entangled with the 1980 Presidential elections. Much of the debate addresses technical questions such as verifiability, ICBM silo vulnerability and whether the United States can afford to allow the Soviet Union to retain the advantages that it has (eg in heavy missiles, throw weight and deliverable megatonnage). But it also coincides with a painful realisation that the United States has lost strategic superiority and must work hard to maintain parity with the Soviet Union during the 1980s. As a result, SALT II is being blamed for problems which have other causes and the issue is broadening into a critique of United States defence policy and of detente in general. But the signs are that the ratification debate, far from inducing complacency, is serving to alert the United States to the need for fresh efforts to preserve strategic stability.

Assessment

7. SALT II is a compromise which covers only a facet, albeit an important one, of East-West competition. It is ideal for neither side. For the West, its main limitations are that, while confirming a rough

equivalence in strategic systems, it will not change the existing and growing imbalance in long range theatre nuclear systems; that it sets a precedent for restraining one of the West's most promising answers to this problem - the cruise missile; and that it has only limited effect on the advances which the Soviet Union has made since SALT I in strategic programmes.

8. These problems would however not disappear if SALT II was rejected; some could be made worse. Rejection would, moreover, set back the process of arms control and would undermine the possibility of restraining Soviet theatre nuclear forces in the foreseeable future. It would rupture the consensus on strategic matters which has served the United States and the Alliance well over the last three decades, and would damage the credibility of United States' leadership. Moreover it would adversely affect the whole conduct of relations between the United States and the Soviet Union. It will therefore be very important that the Alliance is seen to give solid support to the Americans over SALT II. In any case there are positive advantages for the West in the new agreement. It will be seen to be compatible with Alliance strategy. It will largely preserve our own and the Alliance's nuclear options. It will help to reduce the vulnerability of United States ICBM silos. It should provide a useful, if by no means infallible, constraint on Soviet behaviour, especially in the post-Brezhnev era. Finally, it will avoid an all-out competition between the super powers in strategic systems.

May 1979

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SALT II: THE BROAD OUTLINES

The Shape of the Agreement

1. The SALT II Agreement consists of three parts:
 - (a) A Treaty lasting until 31 December 1985.
 - (b) A Protocol expiring on 31 December 1981, which will cover a number of issues not included in the Treaty.
 - (c) A Joint Statement of Principles on subsequent SAL negotiations.

2. There are also a number of associated documents or statements including:
 - (a) An agreed exchange of statements on the Backfire bomber.
 - (b) A unilateral American interpretative statement on non-circumvention.
 - (c) A unilateral American statement on Theatre systems.

The Treaty

3. The SALT II Treaty is based on the 1974 Vladivostock Accord. The central feature is the ceiling agreed for the total number of strategic nuclear delivery systems both sides may possess, and sub-ceilings for different elements within that aggregate, as follows:

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MIRVed ICBM launchers	820
MIRVed ICBM launchers <u>plus</u> SLBM launchers	1,200
MIRVed ICBM and SLBM launchers <u>plus</u> aircraft carrying long- range cruise missiles	1,320
All strategic systems	2,250

4. The Treaty contains a large number of detailed provisions associated with these ceilings. In particular:

- (a) an agreed timetable of reductions to reach the overall aggregate by 31 December 1981. About 250 Soviet systems will be dismantled. The Americans are already below the ceilings.
- (b) provisions limiting fractionation (ie the number of separate Re-entry Vehicles (RVs) which may be fitted to any one missile). The maximum number of RVs on existing missiles is frozen at existing levels. For new ICBMs, up to 10 RVs are permitted. For new SLBMs the figure is 14.
- (c) provisions permitting the testing and deployment of ALCMs capable of ranges in excess of 600 km only on aircraft counted under the sub-ceiling for MIRVed systems. This restraint applies both to conventional and nuclear-armed ALCMs.
- (d) provisions to aid verification, which, as with SALT I, will be carried out by "national technical means". These include exchange of data, advance notification of missile tests, and the prohibition of the encoding of radio signals transmitted from missiles under test ("telemetry encryption"). This scope of this prohibition remains one of the important unresolved issues.

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5. The Treaty also prohibits the flight testing and deployment of new types of ICBMs, with the exception of one light ICBM for each side (MIRVed or non-MIRVed). There are no limitations on new types of SLBMs.
6. There are restrictions on the modification of existing types of ICBM and SLBM although the details remain a key unresolved issue.
7. The Treaty also prohibits additional fixed launchers of heavy ICBMs as well as the development, testing and deployment of mobile launchers of heavy ICBMs, of heavy SLBMs and their launchers, and of heavy ASBMs.
8. The non-circumvention provision states:-
"In order to ensure the viability and effectiveness of this Agreement each party undertakes not to circumvent the provisions of this Agreement through any other State or States or in any other manner."
There is also a requirement not to assume international obligations in conflict with the Treaty.

The Protocol

9. The central feature is the limitation on Ground and Sea launched Cruise Missiles and mobile ICBMs.
 - (a) The deployment of conventional and nuclear-armed Cruise Missiles with a range over 600 km on sea-based (SLCMs) or land-based (GLCMs) launchers is prohibited. Testing and development are permitted.
 - (b) Testing and deployment of light ICBMs from mobile launchers banned. The testing of mobile light ICBM launchers themselves is permitted.

The Joint Statement of Principles

10. This statement contains four agreed principles governing the approach to be adopted towards future negotiations.

(a) a commitment to continue to negotiate to limit strategic arms further in number and in kind.

(b) a reference to the need to strengthen verification and the Standing Consultative Commission in the interests of strengthening compliance with the Treaty.

(c) three specific objectives for future negotiations:

(i) substantial reductions in the number of strategic arms;

(ii) qualitative limitations on strategic arms, including restrictions on the development, testing and deployment of new types of strategic arms, as well as the modernisation of existing strategic arms;

(iii) the resolution of issues included in the protocol.

(d) agreement to consider further measures to enhance strategic stability, including a provision that "each party will be free to raise any issue relative to the further limitation of strategic arms".

/Exchange of Statements on Backfire

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Exchange of Statements on Backfire

11. The Americans have accepted that the Soviet Backfire bomber will not count in the overall limitations on strategic systems but they are looking for assurances on this aircraft outside the formal Treaty. The Russians have indicated that they will provide a unilateral statement giving assurances that they would freeze their current Backfire production rate at "approximately 30" per year and not upgrade the aircraft so as to give it a capability against the United States. The Americans want the production rate to be stipulated precisely at 30 per year and assurances that there will be no significant upgrading of the aircraft's capability.

Unilateral American Interpretative Statement on Non-Circumvention

12. The Americans intend to issue an interpretative statement on non-circumvention for the North Atlantic Council and for Congress. We are still discussing the US draft bilaterally. No draft has yet been considered by the Alliance.

Unilateral American Statement on Theatre Systems

13. The American unilateral statement is designed to reinforce their position on future negotiations. It states that:-

"Any future limitations on US systems principally designed for theatre missions should be accompanied by appropriate limitations on Soviet theatre systems."

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PRIME MINISTER

Rhodesia

The Rhodesian elections which ended on 21st April pose the urgent question of how we should react to them and to the new Rhodesian Government which will be formed at the end of May under Bishop Muzorewa. Indeed much international attention will focus on the first indication which the new British Government gives of its intentions and this will need to be carefully considered. You will of course wish to obtain the early advice of the Foreign and Commonwealth Secretary and to discuss the matter with him and other senior colleagues: but here are my preliminary views.

2. There is now a new situation in Rhodesia. The main question is how best to take advantage of it in order to bring Rhodesia as rapidly as possible to independence without leaving behind a situation which would only be exploited by anti-Western elements.

3. The elections. You will wish to consider reports from Lord Boyd and from other non-official observers. Most comment so far indicates that the elections were well conducted. A number of criticisms have been made (under pressure to vote, plural voting, under-age voting, under-estimates of the total number of voters and so on). But the fact remains that a very large number of Africans did turn out happily to vote and the Patriotic Front, despite their previous threats, were unable to stop them doing so.

4. The problem, however, is that the election, and the establishment of a black government, are not of themselves going to bring the war to an end, nor to bring international recognition of the new government. On the contrary, the initial reaction of the African governments most immediately concerned is violently negative and the rest of Africa and the Third World are likely to follow this lead. Whatever we may say, our own friends and allies will not be easily persuaded to take a strong line against this tide. And of course the Security Council resolution of 30th April (on which we, the Americans and French abstained but did not veto) condemned the elections as null and void and called for continued non-recognition and sanctions.

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5. A lot of this reaction is of course emotional and the result of fixed attitudes, but it will not go quickly away and we cannot afford to disregard it without having regard to our other interests. There is moreover some substance in the contention that the election was held under conditions of martial law and with ZANU and ZAPU banned. It is also fair comment that the constitution, which was approved by a referendum of Whites only, contains a number of clauses which leave room for serious doubt as to whether real power will be exercised by representatives of the black majority.

6. I think you will need therefore to handle the matter in a way which will be acceptable to those parts of the Conservative Party who would like to see early recognition and a lifting of sanctions, but which will at the same time avoid:-

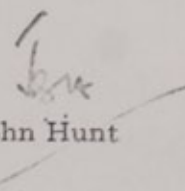
- (i) very severe reactions in Black Africa (where we have increasingly large economic interests) - and from other Commonwealth governments; condemnation at the United Nations and a call for mandatory sanctions;
- (ii) the blame being laid at our door for disruption of plans for The Queen's State Visit to Lusaka and for the Commonwealth Heads of Government Meeting immediately thereafter (1st-8th August);
- (iii) danger of increased Soviet exploitation of black African nationalist frustration and of Zambia's acceptance of Cuban and Soviet aid and influence (despite Kaunda's reluctance and Zambia's recent heavy dependence on the southern route through Rhodesia and South Africa for its copper exports);
- (iv) the end of hopes for a negotiated independence for Namibia on the lines supported by the Five Powers (United States, United Kingdom, Germany, France and Canada) and by the United Nations (because SWAPO and the Front Line States would not co-operate and South Africa might feel free to proceed with an alternative internal settlement).

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Precipitate action could risk all these without achieving the main objective. But that is an argument for playing the hand carefully rather than inaction.

7. A further important point is the close involvement of the Americans in a joint United Kingdom-United States Rhodesian policy hitherto. Once a new Rhodesian government is installed President Carter is required by the 'Case/Javits' amendment to decide whether it was chosen by free elections. The United States Administration will be anxious for early consultations on the line the British Government intends to pursue. Present indications are that they will acknowledge the progress made and the possibility of building on it but will not at this stage wish to recognise the new government. They will, however, face strong Congressional pressures to lift sanctions.

8. My own view is that we should seek to build on the undoubted advance which the Rhodesian elections represent. But the line between missing this opportunity on the one hand and causing great damage to our wider interests on the other (without necessarily gaining our aim of a stable democratic future for Rhodesia) is very narrow. It will need great care to find and tread it successfully. The first steps, after you have discussed the matter with the Foreign and Commonwealth Secretary and other senior colleagues, may be to make early contact with the new Rhodesian Government (and with the South Africans): to consult with the Americans and other allies: and to consider how best to play the cards we have in order to achieve adequate international support for the new regime and real progress towards ending the war. At home this would mean a cautious welcome to recent developments an impression of being willing to seize the opportunity now present: but an avoidance of commitments until these consultations (particularly with the Americans) have taken place.


John Hunt

4th May 1979

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cc/Master set

RECORD OF THE PRIME MINISTER'S CONVERSATION WITH PRESIDENT
GISCARD D'ESTAING AT THE ELYSEE IN PARIS ON 5 JUNE 1979 AT 1110

<u>Present</u>	Prime Minister	President Giscard d'Estaing
	Mr. B.G. Cartledge	M. Jacques Wahl
		M. Christopher Thierry

European Policy

After welcoming the Prime Minister, President Giscard asked her how she would like to arrange their discussions and invited her to begin them. The Prime Minister said that she would like first to explain to the President that there would be two fundamental changes in the policy of the British Government. The first would be designed to strengthen the British economy and the Government would be moving towards the same kind of policies which had been pursued in France in recent years. It was essential that there should be changes in the law concerning the trade unions and these would be made. The Government had the advantage of a good working majority and there should be no doubt of their determination to put into effect the policies for which they had been elected. Secondly, the Prime Minister went on, there would be a change in British policy towards Europe. The Prime Minister said that she was the leader of a Party devoted in its philosophy to Europe, dedicated to the idea of the European Community and determined to pursue a policy of genuine co-operation. In such co-operation lay the best interests both of Europe and of the UK. There were, of course, particular problems over which the UK would have to fight for her interests but this would be done against a background of committed Europeanism. The Prime Minister suggested, and President Giscard agreed, that during their tete-a-tete discussion they might concentrate on European issues, with the forthcoming European Council meeting in mind, turning to wider international issues, including that of energy, when Monsieur Raymond Barre and Lord Carrington had joined them in an hour's time.

/Following

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Following up her reference to energy, the Prime Minister said that this was an issue on which there had been a great deal of analysis but too little work on possible solutions; a great deal of thought had been devoted to objectives so far as relations between the consumer and the producer countries were concerned but very little to the methods by which these could be achieved. The Prime Minister said that it had been her particular wish to visit a French nuclear plant during her brief visit because France had been the first European country to take fundamental decisions on energy policy, decisions which would stand her in very good stead in the future.

President Giscard said that France and the United Kingdom had a long history of partnership. He would like to speak very frankly about recent developments in their relations. With Jim Callaghan, President Giscard said, he had enjoyed a good and easy personal relationship. He had tried to build on to this a good working relationship but this had not really been possible since the last British Government had shown no interest in joint action in Europe nor any faith in the European Community. They had been interested only in unilateral advantage. This had been the experience not only of France but of the other governments in the Community, even those who might have sympathised, because of their Socialist beliefs, with a Labour Government. The result had been the formation of a kind of front from which the UK had been excluded. Despite their history as adversaries, France and the FRG had formed the habit of working very closely together. President Giscard said that the Germans were easy people to work with: they were constructive, showed good faith and kept their promises. There had been no intention on the part of France or Germany to exclude Great Britain from their deliberations; indeed, the FRG had tried very hard to bring Britain in. But, following a series of disappointments, it had proved impossible to do this.

President Giscard went on to say that the larger membership of the Community, soon to grow larger still, introduced difficulties and complications into its work. The smaller Community members were inclined to resent the fact that some decisions were, inevitably, imposed upon them. The larger members did their best to take account of the legitimate pride and interests of

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the smaller countries: but the fact was that important goals could only be achieved by those countries which had the means to do so. President Giscard said that he hoped that the United Kingdom would now be a more active partner in the Community. Her contribution was badly needed; she had, for example, a much wider international experience than the FRG.

The Prime Minister said that there was a very real determination on the part of the new British Government to play their full part in Europe. So far as the Anglo-French bilateral relationship was concerned, there were things in common between France and Britain which did not exist as between Britain and the FRG. This was particularly true in some defence matters, where the division of Germany created a different dimension in the German approach. The Prime Minister said that it was her special wish that bilateral relations between France and the UK should go well, not just at the time of major meetings but for twelve months of the year. President Giscard said that his reading of history and historical biography had impressed him with the very special nature of the Anglo-French relationship: there had been competition between them for hundreds of years, interspersed by close links and bitter fights. During the nineteenth century, the relationship had been characterised by suspicion and irritation. It was his personal belief that this period was now over: neither country was any longer competing with the other for international supremacy, since the period of empire had come to an end. Both countries now faced similar problems. Against this background, it should not be difficult to create an atmosphere of partnership between France and Britain.

Commenting further on the British approach to the EEC, President Giscard recalled that the UK had joined the Community late and had then engaged in a so-called renegotiation; the result had seemed to be that the UK had never been at ease within the Community. Having entered under special terms, there had always been a feeling that the UK was pleading a special case.

/EEC Budget

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EEC Budget

The Prime Minister told President Giscard that the present structure of the Community budget presented the UK with a very major problem: at the end of the transitional period, the UK would be making a net contribution of £1500 million. The Government would like to have some of this money to pay for domestic tax reductions. The Prime Minister said that she hoped very much that this question could be given a place on the agenda for the next meeting of the European Council at Strasbourg. She had already asked the President of the Commission to establish the facts. The present situation was a grave embarrassment to the Government's efforts to push the case for Europe in the UK; it was unjust and unreasonable. The UK certainly did not expect to get out of the Community exactly what she put into it; the Government also expected to improve the UK's economic performance. The budgetary situation in 1980, however, would nevertheless be acutely difficult. A constructive discussion at Strasbourg, leading to solutions, would be a great help to the Government in putting the case for Europe to the British people. The Prime Minister expressed the view that the problems of the CAP and those of the Community budget could and should be kept separate; there was also a clear distinction between the CAP as such and the way in which it was financed. The Prime Minister said that, as a committed European, she did not wish this one major problem to dominate the UK's future discussions with her partners any longer.

President Giscard said that he understood the Prime Minister's view. He recalled that, in the past, the UK had always supported higher expenditure by the Community, while asking that she should pay a smaller share of it. It was necessary to adjust in both directions. The Community's budget was now far too lavish; it was absurd that money should be thrown away on a building of 110,000 sq.m. in Brussels. The French Government favoured a tight budgetary policy for the Community. They also strongly favoured the "own resources" system of calculating the contributions: import duties paid in Rotterdam should not belong to the Dutch but to European trade as a whole. France had agreed to allocate 1% of VAT revenue to the Community budget but this should be sufficient.

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/Turning

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Turning to the problem of the MCAs, President Giscard said that France was opposed to them and believed that they could be quickly eliminated if it were not for the UK and Italian positions. ^{On the Community budget,} 1979 was the last year in which some of the UK contribution would be refunded: the question was, should this period be extended further? The Prime Minister said that this would be one possibility. She showed President Giscard the table of figures, from her briefs, setting out the UK net contribution in 1980. President Giscard admitted that there was a problem. The Prime Minister pointed out that a 50% reduction in the UK's net contribution would be the equivalent of a 2% reduction in income tax. She went on to say that the MCAs had never been intended to operate as they now did: the UK could produce more food, particularly butter and bacon, very competitively. President Giscard commented that the agreement reached in Dublin on the corrective mechanism lasted only until 1979 and the Prime Minister pointed out that, since it required three years of balance of payments deficit, it would not operate in any case for the UK, because of North Sea oil. The Prime Minister said that, although the Government hoped that the UK's GNP would grow, it was nevertheless wrong in the meantime that, with only 15½% of the Community's GNP, the UK should account for 18% of the Community's budget.

President Giscard told the Prime Minister that if the UK wished to ask the European Council to include the problem of the budget in the agenda for Strasbourg, France would have no reason to object although, for formal reasons, she would have to consult the other members. He for his part would be prepared to circulate appropriate proposals for the agenda and would suggest to the Prime Minister an appropriate formulation on the budget. He suggested that there should be, at Strasbourg, a general discussion of the budget lasting for, say, half an hour, and that the Council could then instruct the President of the Commission to establish the facts and analyse the situation; then, at their next meeting in Dublin, the Council could draw the necessary conclusions. The Prime Minister commented that the facts had already been established: they could be laid before the Strasbourg Council and the Commission could then be asked,

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/not for

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not for facts, but for ideas on how the position could be corrected. President Giscard said that he could agree to this. The Council could conclude that a problem existed and ask the Commission to suggest ways of correcting distortions in the situation. It would be necessary to work closely with the Germans and to have discussions with them behind the scenes.

CAP

President Giscard said that France had earned a bad reputation so far as the CAP was concerned and he wished to change it. France was the largest producer of agricultural products in the Community, although in some areas such as meat and dairy products she was not the most competitive. France wished to compete on fair terms. The French Government would, he repeated, be glad to see the MCAs eliminated but any such move was blocked by the UK's attitude on the question of a price freeze. It was difficult for any Government to reduce the prices payable to their farmers: Chancellor Schmidt had agreed to reduce the MCAs provided that there was a nominal increase in prices at the same time. An increase of 2%, for example, would reduce positive MCAs to zero. It would be possible for the UK to share this position while opposing any increase in the prices of products which were in surplus. President Giscard said he hoped the British Government could reconsider their attitude on this matter. France, for her part, had no desire to increase the surpluses still further and was, indeed, prepared to contribute to their reduction. France was nevertheless profoundly attached to the principle of a single market in agriculture and to the maintenance of a barrier around the Community against the rest of the world. Although the proposal was still confidential and he did not wish the press to learn of it, the French Government was thinking of suggesting that a system should be devised in which those countries which were responsible for creating the agricultural surpluses should also be responsible for financing them.

/The Prime Minister

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The Prime Minister pointed out that the UK was quite capable of engaging in fair competition but could not be expected to compete against subsidised produce. She expected heavy competition from France and Germany in manufactures, an area in which the UK was herself less efficient, but the UK's efficiency in agriculture did not bring a fair reward. President Giscard commented that the UK would encounter problems in endeavouring to change the situation - not from France, but from countries such as the Netherlands, Denmark and Ireland. If the UK were to concentrate her efforts at reform on the problem of agricultural surpluses, she would encounter no adverse reaction from France; there would, however, be a French reaction if the concept of the single market for agriculture were to come under attack. The organisation of the CAP and the method of financing it were different questions.

EMS

Turning to the EMS, the Prime Minister noted that the review of the exchange rate system would be taking place in three months' time. The UK had, at present, a high exchange rate for sterling, not because of the UK's economic performance but because of North Sea oil. The Government needed to keep the rate high for the time being and this would make it difficult to enter the EMS straight away. It might, however, prove possible at the time of the exchange rate review to swap some of the UK's reserves for ECUs. In the longer term, the UK was keen to join the European Monetary System if this was feasible. President Giscard commented that it was not necessary for the UK to reach a final decision on joining the EMS quickly. It would, however, be significant if the UK were to create the conditions for joining; he recommended a progressive approach to entry, which would be better than to attempt to move too fast.

* * * * *

/At 1215

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At 1215 the Prime Minister and President Giscard were joined by:

M. Raymond Barre
The Foreign and Commonwealth Secretary
Mr. G. G. Walden
M. Robin

* * * * *

Energy and the Tokyo Summit

President Giscard summarised the subjects which he and the Prime Minister had already covered during their tete-a-tete discussion and said that the Prime Minister had suggested that, with Lord Carrington and M. Barre, they should discuss the forthcoming Economic Summit in Tokyo and the problem of energy, before moving on to wider international issues.

The Prime Minister said that energy was expected to be the main item on the agenda of the Tokyo Summit. The problem was how the leading energy users could persuade the leading energy producers not to raise their prices still further and thereby cause a world recession. Western objectives were thus quite clear but the methods by which they might be achieved were very unclear. Specific ideas were needed. The problem was common to many Western countries, although France had moved further along the road to a solution than any other country in Europe, through her nuclear programme. The UK, for her part, had found only a temporary solution in her North Sea oil. President Giscard asked how temporary a solution this was. The Prime Minister said that it would last for 15 to 20 years. President Giscard commented that this was a help. The Prime Minister went on to say that the alternatives facing some countries were either to go all out for nuclear power, or, if they were unwilling to do this, to accept a significant reduction in their standard of living.

The Prime Minister said that she had never attended an Economic Summit but she had studied their communique closely: they were always the same. Meanwhile, the world's economic problems continued;

/ and so

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and so did the communiques. President Giscard agreed and said that, although discussions at Economic Summits had become academic, the first such meeting, at Rambouillet, had produced useful results in the form of a stabilisation of exchange rates. Unfortunately, however, participation in the Summits had then been enlarged: their communiques were now just words. President Giscard agreed with the Prime Minister that the next Economic Summit should concentrate on energy. He thought that it should, despite everything, be possible to achieve some useful results. He would like to suggest what these might be.

Firstly, President Giscard said, the Summit could demonstrate a real determination on the part of the major energy users to reduce their consumption. France, for her part, would lower temperatures in public buildings and impose a ceiling on the amount of oil consumed by power stations. These measures could be discussed at the European Council meeting in Strasbourg.

Secondly, it was a fact that the operation of the spot market in oil produced unacceptable results. The international oil companies should be asked to keep out of the spot market during, in the first instance, the month of June. Chancellor Schmidt, in a recent discussion with M. Barre, had agreed that this measure should be taken in order to produce a moderating effect on prices. It was a fact that every Gulf ruler had the latest spot market price on his desk first thing every morning.

Thirdly, agreement should be reached on an annual approach by the major users to the major producers in order to assess whether the savings planned by the users during the coming year, as well as the production levels planned by the producers, would be sufficient and in phase with each other.

Fourthly, the Summit participants should discuss a programme for exploiting alternative sources of energy. This was mainly a problem for the Europeans, since the Americans and Canadians were already making progress in this field. President Giscard added,

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in parentheses, that he had just received a report from M. Francois-Poncet, who was in Washington, to the effect that press reports about the U.S. Administration's decision to subsidise oil imports were too pessimistic: President Carter was in fact working on the introduction of quite drastic conservation measures, on a possible approach to the oil producers and on steps to stabilise the spot market in oil - precisely those measures which he was himself advocating. President Giscard said that he thought that the American approach seemed quite constructive.

Lord Carrington commented that it was essential to formulate, during the European Council meeting in Strasbourg, a European approach to the Tokyo Summit. The Prime Minister said that, ever since the Yom Kippur war, the West had managed to absorb substantial increases in the price of oil, to the extent that it would soon be economic to extract oil from the tar sands and shale - this would require a price of \$40 per barrel. A situation had been created a year ago in which the West had once again found itself with a surplus of oil but this situation would not be repeated because of events in Iran.

Describing the French nuclear power programme, President Giscard commented that an anti-nuclear demonstration in Lorraine on the previous day had attracted only 500 participants. France was currently building ten new nuclear plants: he thought that if the Government continued to give a strong, clear line, there would not be a great deal of public opposition. It would be helpful if both France and the UK were to take a strong and positive line on nuclear power in Strasbourg. The Federal German Government found itself in difficulties on nuclear power, largely because of the constitutional powers of the länder. Germany still had no reprocessing plant.

President Giscard went on to say that he fully shared the Prime Minister's view that the objective should be to arrive at practical conclusions, first in Strasbourg and subsequently in Tokyo. The Prime Minister said that the British Government was at present pursuing a policy of requiring power stations in the UK to substitute coal for oil: if continued, however, this policy could affect the UK's capacity to build up coal stocks, which

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would be needed against the possibility of further trouble from the miners during the coming winter. The Government might, therefore, have to reconsider.

President Giscard asked who in the British Government would be responsible for preparing the UK position on energy at the European Council in Strasbourg. The Prime Minister said that she thought she would. Lord Carrington asked whether President Giscard was suggesting that it would be useful to have bilateral consultations on energy in advance of the European Council and President Giscard confirmed that he was. It was agreed that bilateral consultations would be arranged, at the highest practicable level, as a matter of urgency.

South Africa

Lord Carrington explained that the proposals put forward by the Five on Namibia were still blocked by South Africa. The British Government, which might have^a little leverage with the South Africans who felt that the new Government had a better understanding of South Africa's internal problems than the Labour Government, had decided to send an Envoy, Mr. Luce, to assess the prospects for reviving the U.N. Secretary General's proposals. Mr. Luce's assessment was that there might just be a chance of succeeding in this; if so, it was important to take it since the consequences of abandoning the plan would be very serious. The Five had therefore agreed to have another try. Lord Carrington expressed the view that the prospect of a move to impose economic sanctions against South Africa had such grave implications for the Western world that every step towards that situation demanded very careful consideration. The Prime Minister said that the British Government, for their part, could not possibly contemplate sanctions against South Africa.

Turning to Rhodesia, Lord Carrington said that the British Government's position was that five conditions had been laid down for Rhodesia's return to legality and that, by the end of 1978, the only one of those remaining unsatisfied was that requiring any settlement to be put to the test of its acceptability to the Rhodesian

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people as a whole. The Conservative Party had therefore sent observers to assess the validity of the elections held in Rhodesia last April: their report had shown that, in all the circumstances, the elections had been both free and fair. The last remaining pre-condition for Rhodesia's return to legality had, therefore, been broadly satisfied. The new Rhodesian constitution was not perfect but this was a matter for the people of the country. Looked at from the standpoint of Rhodesia/Zimbabwe, however, recognition by the UK alone would not amount to very much: what the country needed was wide international recognition. The new British Government had therefore decided to build on the recent elections and to send an Envoy to meet the Front Line Presidents, and others, to see if there was any flexibility in their attitude to the recognition issue. Progress would clearly not be easy but there were some encouraging signs, including the fact that President Nyerere seemed, at present, to be less denunciatory of the internal settlement than, for example, President Kaunda. When the British Government emissary, Lord Harlech, returned from his mission it would be possible to make a better assessment of the possibility of bringing Nkomo and Mugabe on the one hand, and Bishop Muzorewa on the other, closer together. The timetable, however, was very tight given the forthcoming Commonwealth Heads of Government meeting in Lusaka at the beginning of August.

The Prime Minister commented that most of the countries to be represented in Lusaka could not claim to hold elections on the basis of one man, one vote, with a choice between four different political parties. A more crucial deadline was, so far as the United Kingdom was concerned, the fact that sanctions against Rhodesia would lapse in November unless renewed by Parliament. There was no prospect whatsoever of such a renewal. The Prime Minister said that she, for her part, was convinced that the test of acceptability had been satisfactorily completed; this was, after all, a matter for the people inside Rhodesia to decide. It was now the British Government's duty to restore Rhodesia to full independence. She had found both the United States and the FRG co-operative in their attitude to this objective.

/President Giscard

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President Giscard said that he would be happy to see a more active British policy in Africa. So far as South Africa was concerned, he agreed that sanctions must be avoided. The South African regime was not, however, acceptable in terms of its internal policies. Everything possible should be done to create a more democratic approach in South Africa. On Namibia, President Giscard agreed with Lord Carrington that the plan of the Five should not be abandoned: it was a fact that South Africa had been deceived by the United Nations. Turning to Rhodesia, President Giscard said that he had never understood the policy pursued by the United Kingdom in recent years. He had always believed that a moderate African Government offered the right solution and this would not be achieved without a new commitment to Rhodesia by the UK. What was required was a solution on the Kenyan pattern. Continuing pressure from the Front Line Presidents could only result in the installation of a radical regime in Salisbury and a bloody exodus by the Whites. The attitude of the other African countries would, however, pose serious difficulties; they had formed a collective position and most of them had links with the guerrillas. President Giscard commented that the Prime Minister could face really serious problems at the Lusaka meeting with, for example, Nigeria. The Prime Minister agreed and said that Nigeria had already taken steps to deprive British firms of contracts.

President Giscard went on to say that at the Francophone African Summit meeting at Kigali which he had recently attended he had found the position of many Heads of State and Government to be moderate towards Rhodesia; they seemed to recognise the importance of the elections which had taken place. There was, however, a problem over timing: the time was not yet right for international recognition of the new Government of Zimbabwe/Rhodesia. The prospects would be better if Bishop Muzorewa's regime was seen to adopt progressive internal measures. France, for her part, would try to use her influence helpfully: but the UK might be well advised to move forward step by step.

/ The Prime Minister

The Prime Minister said that the British Government would certainly not recognise Bishop Muzorewa's regime before the Commonwealth Conference in Lusaka. The critical time would be between that Conference and the Parliamentary debate on sanctions in November. Lord Carrington said that more would be known of the American attitude when President Carter made his determination on the Case/Javits amendment: this would probably be to the effect that the settlement was not acceptable as it stood but could be made so. There was no real distinction between the lifting of sanctions, which were imposed by a mandatory UN resolution, and recognition of the new regime.

President Giscard repeated that the French Government would do everything it could to be helpful on this issue. He pointed out that the next meeting of the Organisation of African Unity would take place before the Commonwealth meeting in Lusaka and that the one could very well have an effect on the other. The President of Liberia would be Chairman of the OAU Conference and it would obviously be useful if the UK were to make contact with him. The best outcome from the OAU meeting would be the appointment of a Committee to review the situation in Rhodesia, thus postponing any immediate judgement as to the new regime's legality. In that situation, the UK's hands would still be free at the time of Lusaka. If the OAU Conference adopted a public position, this could only be a negative one. The Prime Minister agreed and said that the prize for the West in a peaceful settlement in Rhodesia would be enormous: a prosperous Rhodesia would bring great benefit to the whole region.

Defence

The Prime Minister said that the British Government was being pressed by President Carter to support Salt II. The Government had some worries about it but had concluded that the consequences of failure by the United States Congress to ratify the Treaty would be more serious than any shortcomings in the Treaty itself. The UK was concerned about the Soviet SS20 missile, to which the Russians could easily add a third stage. The British Government also faced major decisions on the replacement of its Polaris deterrent and would have to choose between a new missile of that type or cruise missiles. She understood that France would soon have its own

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satellite guidance system for cruise missiles. President Giscard said that this was so. The Prime Minister asked President Giscard whether he thought that Europe should be directly involved in the SALT III negotiations. Lord Carrington pointed out that Europe did not as yet know even the terms of reference for SALT III: the UK could not be involved in these negotiations if they directly concerned the UK's own deterrent.

President Giscard said that he had not taken a firm position on SALT II, since no text of the Treaty had yet been made available to the French Government. Lacking a text, he could only support the agreement in principle. He expected, however, to take up a positive public position on the Treaty when the text became available in the middle of June. The President said that he took the view that failure to ratify the Treaty would do grave damage to international stability: ultimately, he saw no alternative to a decision by the U.S. Senate to ratify.

President Giscard went on to say that SALT III raised more difficult issues. It was important to France that their strategic forces should not be included, since if they were the Western ceiling would be increased, and French forces would come under de facto U.S. leadership. There was also the problem of the "grey areas". The FRG, having raised the issue, now appeared to have retracted their concerns about it, since they did not wish to be the first Western country to create a situation in which the West would have to move towards a production of a counter-poise to the SS20. He found the German position more vague now than it had been a year ago. The fact remained that any discussion of the grey areas in the absence of a Western bargaining counter would be a nonsense. Why should the Russians dismantle their SS20s? The question was, did the willingness exist on the Western side to develop such a counter weapon? If it did, the level of weapons in the grey areas could be discussed in SALT III. But Europe had a further interest which distinguished its position from that of the United States. President Giscard said that he was concerned less too many levels of parity in strategic weapons might diminish the clarity of the United States' nuclear commitment to Europe. For this reason, France was rather ambivalent about the grey area negotiations. President Giscard said that he thought that France

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would probably develop the cruise missile but without entering prior commitments on parity or equilibrium. When the Prime Minister commented that the Soviet Union had developed a very significant lead in medium-range missiles, President Giscard said that France was ahead so far as submarine launched missiles were concerned.

Lord Carrington said that the need to proceed with the modernisation of Theatre Nuclear Forces in parallel with SALT III created an added complication, along with domestic political difficulties in the Low Countries. It was likely that Belgium, the Netherlands, and the FRG would insist on a new strategic arms limitation conference as a pre-condition of TNF modernisation, perhaps even in advance of SALT III. So far, the NATO Council had decided only that there must be a decision on TNF modernisation by the end of 1979. President Giscard said that it would be useful to exchange views on this further. The French Government was at present studying France's interest in SALT III and in the development of the French deterrent after 1990. The main options under consideration were cruise missiles and mobile launching systems. The necessary scientific data would be ready during 1980. President Giscard went on to say that the French had never had a real discussion of these matters with the FRG, since they did not wish to imply a commitment to German security which would involve France's own deterrent. It was impossible not to discuss these problems with the Germans but equally impossible to have a real discussion. The Prime Minister said that she had discussed these matters with Chancellor Schmidt.

Lord Carrington said that he had some understanding of the West German view that they could not accept the deployment of medium-range systems on German soil unless a third country, in addition to the UK, did so too. President Giscard said that he thought that Belgium would probably accept medium-range systems in the end, perhaps for a limited period of time.

Defence Sales to China

President Giscard asked the Prime Minister whether the British Government had reached a final decision on the sale of Harrier aircraft to China. The Prime Minister said that the Government, for their part, were ready to sell Harriers to the Chinese

but some problems had arisen during the commercial negotiations. In response to the President's question, Lord Carrington said that the United Kingdom had it in mind to sell something under one hundred aircraft along with a licence to manufacture them in China. President Giscard said that the French Government had taken a different decision since it regarded the sale of arms to China as a major bilateral test of the relations of any country with the Soviet Union. The French Government was also a little apprehensive of the future attitudes of the Chinese military establishment. No mood of expansionism was detectable yet, but would the situation last? In view of these factors France had decided to sell the Chinese nothing more than anti-tank weapons.

Vietnamese Refugees

The Prime Minister told President Giscard that UK merchant ships in the Far East were continuing to pick up large numbers of Vietnamese refugees. There were now over 40,000 refugees in Hong Kong and the UK had agreed to take another 1,000 from the "Sibonga". The Government was now faced with the problem of 300 Chinese children on a British ship off Taiwan whom the Taiwan Government were refusing to take in. President Giscard said that France had already accepted 60,000 Vietnamese and they were coming in at the rate of 500 a month. The whole problem was in essence one for the United Nations but the UN was handling it very inefficiently. President Giscard said that he had noted the Prime Minister's message to Dr. Waldheim.

The discussion ended at 1310.

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Extracts Copied to :

- Vietnam: Refugees: May 79
- China: Defence Sales: "
- Defence: SALT etc: "
- Rhodesia: Situation: "
- Econ Pol: Tokyo Summit: "
- Euro Pol: EMS: June 79
- Euro Pol: CAP: May 79
- Euro Pol: Policy towards: "





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