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Original filed on
Germany June 79
PM's meetings with
Chancellor Schmidt in
Germany.

EXTRACT FROM RECORD OF DISCUSSION BETWEEN PM & CHANCELLOR
SCHMIDT BONN 31 OCT 79



The Community Budget

The Prime Minister stressed the importance of this problem for Britain. Popular resentment on the question was very great. She was constantly being faced in the House of Commons with statements that if no solution was found in Dublin, Britain should withhold its contribution. She had constantly replied that the Government intended to remain within the law. Nonetheless, it was essential that Britain should get satisfaction. There could be no half measures. There had to be a broad balance. Although entitled to it as one of the poorer members of the Community, Britain was not asking for net benefit from the Community budget. But it would be impossible for Britain to make an annual contribution of £1,000 million or more. Chancellor Schmidt said that the English newspapers were over-stating Britain's case. The take-it-or-leave-it attitudes which were being expressed were not prudent. The Prime Minister said that the media were merely reflecting general resentment at Britain's position as the main contributor to the budget.

The Chancellor said that he agreed that Britain had a case. But the psychology of the situation was of great importance. The Prime Minister should be under no illusions about what would happen if the future of the Community came into doubt. It would not fragment: the other eight members of the Community would remain together. However, a split between Britain and the rest of the

CONFIDENTIAL

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Community would represent a terrible weakening of the West's position in the 1980s. There was now no US leadership and no prospect of it. The Foreign and Commonwealth Secretary said that the Community must not break up. Chancellor Schmidt said that it was necessary to look at the worst option. The tone of the British press was detrimental to the prospects of success in Dublin. The French were saying it reflected official briefing. President Giscard was telling him not to be flexible. Chancellor Schmidt was replying to President Giscard that it was essential to be flexible and that no member must be left feeling so dissatisfied as Britain at present did. Nonetheless, President Giscard was building up a tough position.

The Prime Minister said that President Giscard's position was not a strong one. France had after all been a net beneficiary from the budget for many years. Britain's position was neither fair nor equitable. At the same time as she was reducing planned expenditure on education, housing, health and other things of importance to her electorate, she was having to increase Britain's contribution to the budget. Moreover, the budget was going to countries with lower rates of tax. Chancellor Schmidt said that the difficulty with Britain's membership had of course been that she had had to make the necessary structural changes so rapidly. The original members had had many years in which to do it. Nonetheless, Britain would only get the undertakings she required in Dublin if there was an atmosphere there of give-and-take. All the participants would have to be able to defend the outcome of the European Council meeting when they returned to their own countries. The Prime Minister repeated that Britain was paying more than she could afford. The Foreign and Commonwealth Secretary said that it seemed to him legitimate for the other members to say it was Britain's own fault that she was in such a mess. He was ashamed at having to point out that Britain was the third poorest member of the Community. The Prime Minister was determined to rectify the situation but this would take time and would involve the British Government in taking some extremely unpalatable decisions. As and when these decisions were taken and cuts were made, there would be major repercussions. People were going to have to do without things to which they had become accustomed. If the economy was prospering, there might be fewer objections to a major British contribution to the Budget. But how could the present contribution be justified when people were in any case having to make sacrifices?

Chancellor Schmidt said that he fully understood the British problem. But to solve it, the Prime Minister would have to put herself in the shoes of the other members. The German Government had no intention of making difficulties. Equally they could not and would not fight with the French on the question. The Prime Minister said that she had not asked the German Government to do so. Nonetheless, it was difficult to accept the attitude of the French Government. Chancellor Schmidt said that the French would argue that there had already been three negotiations about British membership and that the Dublin mechanism, even if functioning imperfectly, was in place. Their position would be that everyone must obey the agreements which already existed and that a solution should be found by adapting the corrective mechanism. The Prime Minister said that the British people were not prepared to go on financing the other members. Chancellor Schmidt said that the only payment from the British budget was the one per cent VAT contribution. The contribution from levies and tariffs did not go through the budget. The Foreign and Commonwealth Secretary said that nonetheless they represented a transfer of resources. Chancellor Schmidt agreed but went on to argue that if the CAP were abolished, Britain's budget would not benefit in any way. The Prime Minister said that if sugar and beef were de-budgetised, Britain would derive a major benefit. Chancellor Schmidt said that the Prime Minister was right to focus on the question of the financing of the agricultural surpluses. A reduction in the overall outlay on agriculture would reduce the deficit of those who were net contributors. An attack on the financing of the surpluses would have the support of Community Finance Ministers. In approaching the problem in this way, the Prime Minister might find the allies that she needed. No one would lightly agree to shoulder their share of the 1.5 billion units of account needed to bring Britain into a position of broad balance. The Prime Minister said that if the other members were not prepared to pay their share, how could Britain be expected to bear the entire burden. Chancellor Schmidt said that the Federal Republic was certainly prepared to pay more. It was equally clear that Italy, Ireland and France were not at present prepared to pay more. Luxembourg did not count. Belgium, the Netherlands and Denmark were all in surplus. But even if they were prepared to pay, that would not be enough. A way had to be found to bring intelligent people together to find ways of tackling the problem. It could not be left to the last moment

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because Heads of Government did not understand all the intricacies. The Prime Minister said that the problem was a political one and recalled the language approved by Community Ministers in 1970, during Britain's accession negotiations, about the need to take action to avoid unacceptable situations arising. Chancellor Schmidt said that he recognised that Britain had a legitimate case. Unfortunately to state this was not sufficient. A way of solving the problem also had to be found. The problem should be tackled in slices. Agreement should be sought on the need to decrease the outlay on agricultural products. It would be difficult for President Giscard to reject this since it would not hit France specifically. Other problems could be dealt with later. The regional and structural funds should not be touched but changes in the operation of FEOGA were badly needed. Eight of the Agriculture Ministers would no doubt threaten to resign but the Finance Ministers would be sympathetic and President Giscard would understand. (Chancellor Schmidt suggested that the Prime Minister should remind President Giscard that Communist firms in France sold butter out of intervention to the Soviet Union and used the profits to finance the French Communist Party.)

Chancellor Schmidt said that it was essential that the meeting in Dublin should be carefully prepared. If the various locomotives now in motion ran on down the rails without action being taken, there could only be a collision with unforeseeable consequences. The meetings of Finance Ministers and Foreign Ministers in mid-November would be important. Perhaps there could be a private meeting of Foreign Ministers in the evening. The Foreign and Commonwealth Secretary said there would have to be a technical in-put because the Foreign Ministers would not be familiar with the detail. Chancellor Schmidt agreed that the technical problems were formidable. He instanced the problem of how the net transfers would be divided up assuming the scale of relief if Britain had been agreed. Germany could not accept payment on a GNP basis because she would then end up paying more than would be indicated by the one per cent VAT contribution. This would be totally unacceptable. If the budget had to be decreased, there would be a quarrel as to where and how the reduction should take place. Unless the Commission produced a paper with sensible

CONFIDENTIAL

- 8 -

options and unless the Foreign Ministers (not the Ministers of Agriculture) had discussed the paper, the Community would find itself in considerable trouble. Mr. Lynch was unlikely to prove a sufficiently strong President to be able to pull things together in Dublin.

The Prime Minister pointed out that she had been willing to take a decision to accept an extra flight of GLCMs without hesitation and without bargaining. She had been prepared to contribute to the achievement of the targets laid down at the Tokyo Summit (with the establishment of which she had disagreed) without haggling. But when it came to meeting Britain's grievances no one was willing to help. She felt deeply resentful that Britain's grievances were not being dealt with. Chancellor Schmidt pointed out that the decision on the GLCMs and on oil were unilateral decisions. A decision to solve Britain's budgetary problem would have to be a multilateral decision. The Prime Minister said that her unilateral decision in this area appeared to be to contribute £1,000 million per year to the Community budget. The Foreign and Commonwealth Secretary said that the problem was to persuade our friends in the Community that there was a problem and that action had to be taken. Chancellor Schmidt said that if Britain failed to persuade her friends she would have to leave the Community. In order to persuade them, it would be necessary to offer them a means of maintaining face vis-a-vis their own electorates. The other Heads of Government could not simply pay over several hundred MUAs and then return with equanimity to face their respective Parliaments. The Federal Republic might be the only member of the Community who could get away with an offer of as much as two or three hundred MUA per year. Compared with President Giscard, who had to deal with M. Chirac as Leader both of the Guallist Opposition and of the agriculture lobby, the situation of the German Government was relatively easy. Their opponents tended to say

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CONFIDENTIAL

that the Government was not doing enough for the Community. But even within his own Cabinet there would be trouble with Herr Ertl if the agriculture budget was cut, and with the rest of the Cabinet if cuts were made elsewhere. The position in some of the smaller member countries would be even less favourable. In Denmark, where Mr. Jørgensen had just been returned with a reduced majority, it would be very difficult indeed for him to agree to transfer 100 MUA to Britain.

The Foreign and Commonwealth Secretary asked what steps Britain should take to help the other members to reach the right kind of decision. Chancellor Schmidt said that a solution of the fisheries problem might be helpful with the French and the Danes. Energy was the greatest unsolved problem facing the Community. The UK, the Netherlands and Germany had some resources. The other members had nothing, and were getting no help from the Community. France, it was true, had a very large nuclear programme, and by the late 1980s would have substituted nuclear power for something like 70 per cent of its present oil requirements. But they would be awkwardly placed in the interim. Germany would rely on coal and on oil derived from coal. The cost of such oil would be three times the cost of oil today in real terms. The Germans' position would probably be manageable eventually. But as with France, there would be a difficult interim period. Italy, Denmark and Ireland had no energy resources and no alternative programme in prospect.

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The Prime Minister that Britain had already made a concession on energy. As regards fish, the present difficulties had arisen because Britain had conserved her resources, and the French had not. France's waters had been fished out. Britain had done the right thing where others had failed to do so. Chancellor Schmidt said that the British Government should not think they were doing the right thing and others were not. This was not true. Britain had joined a club

CONFIDENTIAL

- 10 -

with fixed rules. She had discovered that the rules were unbearably unjust. But in order to change them, the consent of the other members would be necessary. It would be necessary to campaign with them to convince them of the need for change. They knew that Britain had a case and that they ought to give something up. But Britain would have to give up something as well. If they were given a pretext for saying no or for delaying and confusing the issue, they might well decide that it suited them to take this way out. They would have to be persuaded to subscribe to an undertaking in Dublin. If Britain's attitude were to be one of "take-it-or-leave-it", the other members might well say leave it. This was a real and serious danger. The Prime Minister said that the attitude of the other members, as described by Chancellor Schmidt, mirrored the attitude of her electorate. She herself had always been strongly pro-European, and did not wish to be faced with the prospect of having to tell the anti-Europeans that they had been right.

The Chancellor said that part of the problem was that the judges were party to the dispute. Even a good case needed a good lawyer. For the other eight members to help Britain out, they would have to accept that they would suffer financially. The Foreign and Commonwealth Secretary said that it would be a terrible thing for the Community to break up. But if Chancellor Schmidt was correct in suggesting that President Giscard did not accept that Britain had a case, the Eight would have some very difficult decisions to take. Was it possible that they wanted Britain to wreck the Community? Chancellor Schmidt said that the other members of the Community had long since ceased to believe the previous British Government. They had got fed up with hearing from No. 10 that the situation was intolerable. So far, most of them had only got as far as accepting that Britain wanted yet another renegotiation, they were disinclined to agree. The Foreign and Commonwealth Secretary said that the present British Government had spent

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CONFIDENTIAL

its first five months in office trying to remove misunderstandings inherited from their predecessors. However, the lack of a fair deal on the budget was a serious obstacle. The Prime Minister said that Mr. Callaghan had set out Britain's budgetary problem plainly in his speech at the Lord Mayor's Banquet twelve months previously. The situation was worse now than it had been then. Chancellor Schmidt repeated that he agreed that Britain had a legitimate grievance. He agreed that a solution had to be found. But the presentation of that solution in the other member countries would be a matter of the greatest importance. It would be difficult for all the members, notably for the Italians and the Danes. Foreign Ministers would have to meet informally to try to find relevant procedures and principles. If the principles could be agreed in Dublin, the difficulties would be on the way to a solution. If the principles were not agreed, the break-down of the Community could follow within a year.

The Prime Minister said that her Government would probably face considerable criticism following the publication of the Public Expenditure Paper the following day. There was an increasing likelihood that the Government would be faced on the issue of the Community budget with increasingly strong anti-Community feeling. Chancellor Schmidt said that nonetheless it was necessary for Britain to do more than simply ask for a solution to be found. If everyone was to ask for their money back, the Community would be bankrupt within a very short time. In the search for a solution, much would depend on the way the President of the Commission presented the problem. One difficulty was that Mr. Jenkins was English. Nonetheless his standing and reputation were good. He would have to produce the options. The British Government would have to be clear before Dublin which options it preferred. It would be essential for Britain's representatives to be concrete. The German Government would consider before going to Dublin what concessions it could make. They would adopt a middle of the road position, but would not be willing to act as mediators.

/The Prime Minister

The Prime Minister stressed that she was not prepared to seek a solution which involved a larger budget. Expenditure on the CAP would have to be reduced. Chancellor Schmidt urged the Prime Minister to have this worked out in concrete terms. Without cutting into the CAP, the problem would not be soluble. The Prime Minister said that one way of reducing the expenditure on surpluses would be to de-budgetise a substantial part of the CAP and to fund it nationally.

Chancellor Schmidt said "the man on the moon", looking at the problem, would say it was difficult but not impossible to solve. If it were to be solved, there would have to be contacts before Dublin. The number of options on the table would have to be limited and clear. It was no use expecting Mr. Lynch to do much more than call the speakers in order. There was a risk that the performance of the Presidency would be as weak as that of the Japanese in Tokyo. The Prime Minister said that in the end the problem came down to finding the money. She was afraid that those who were getting it at present would want to go on getting it. She would be looking closely at the legal position in regard to withholding contributions. Chancellor Schmidt said that he hoped the Prime Minister would also look closely at all the various mechanisms which might be used to assist in resolving the issue. Commissioner Gundelach might turn out to be an essential participant in any discussion, Even if there were no problem with net transfers, the CAP might explode under the pressure of existing problems.

The discussion ended at 1700 hours.

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EEC Budget

The Prime Minister said that the problem of the Community Budget was politically extremely difficult for the British Government. It might seem small to the Germans but it loomed very large for the United Kingdom. The facts were simple. Britain was unique within the Community in having below average gnp per head and being a nett contributor to the Budget. We were in fact the seventh poorest member of the Community and in 1980 we would be the biggest nett contributor. The domestic background to next year's nett contribution of £1,000m was that, as part of its efforts to turn round the British economy, the British Government was having to cut expenditure on a number of socially important programmes: for example, spending on housing would be reduced by £700m in 1980 and the education programme by over £300m. There was a good deal of public opposition to these cuts, and this was made much stronger when people saw an outflow of £1,000m, most of which was going to other members of the Community who were far wealthier than Britain. She was now being urged from a number of quarters to withhold the British contribution to the Budget. But she was taking a firm line in reply and making it clear that the British Government would not flout the law. Once Community law was ignored, it would be the end of the Community. Hitherto the United Kingdom had always obeyed Community decisions carrying the force of law. She had told the House of Commons that to withhold our contribution would be contrary to European law and she was not prepared to do this. But this made it all the more necessary that the Community should accept the fairness of our case and agree to an equitable solution to the problem of the Budget. The United Kingdom was not asking

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CONFIDENTIAL

for a penny piece out of the Budget. We were seeking a broad balance between our gross expenditure and our receipts. This meant that Britain should not be a substantial net contributor. During a recent visit to London Mr. Roy Jenkins had told her that there were those who thought that Britain would accept a 50 per cent reduction in our net contribution. She had told him that this would not do: she would not be able to hold British public opinion if our net contribution was reduced by no more than half. It had also been suggested that it would be enough if Britain became the second biggest net contributor after the Federal Republic, but this was not acceptable either: if we were to be compared with anybody it should be with France who was only just becoming a small net contributor now. Because of the growing pressure on the British Government it was imperative that she came away from the Dublin European Council at the end of November with a full answer to the problem. It would not be sufficient for her to be offered a little now with the promise of more negotiations later. She had to return from Dublin with an arrangement which would bring the British contribution into broad balance in 1980. Moreover, Britain wanted to arrive at this solution without the total size of the Budget being increased.

The Prime Minister continued that she believed passionately that Britain should be in Europe. The reasons for her conviction were primarily international political reasons. But she could not stress enough the seriousness of the crisis which would arise if a solution to our Budget problem could not be found. We simply wished to be treated as equitably as our partners in the Community.

Chancellor Schmidt said that it was his personal conviction that the problem had to be solved. When he had spoken to President Giscard about it recently, the President had told him that he was being too forthcoming, but he had replied that a solution had to be found. But he did not believe that this could be done if those concerned staked out maximum positions now. It

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was essential to create an atmosphere in which it would be possible for people to move. It was not so much a question of what was fair and unfair but of adopting the right psychological approach. It would be, nonetheless, extremely difficult to find a solution acceptable to everybody for several reasons. First, because of their complexity, the mechanics of the Community Budget were not understood by the Heads of Government. Second, other countries would have to contribute more or receive less in order to relieve the United Kingdom, and none of them would want to do that. They would argue that the Community's finances were functioning precisely according to the arrangements which had been negotiated and there was no need to change them. The French, in particular, were likely to take this line. Third, a figure of £1,000m was an enormous sum, even if Heads of Government could be brought to comprehend the mechanics of the Budget and they were ready to compromise. An added difficulty was there was as yet no proposal from the Commission on the table, and time was now very short before the Dublin meeting in which to work out a solution to such a highly complex problem. For these reasons he believed that the most the British Government could hope for from Dublin was a clear-cut declaration of intent. It was no use expecting Heads of Government to grapple with the details of a technical solution. The European Council should give Finance Ministers a clear directive to work out a detailed solution, and this would allow the Prime Minister to report to Parliament that Britain had been given satisfactory undertakings. Even this would be difficult to achieve. He believed that the European Council would have to recognise at Dublin that an answer could be found only if expenditure on agriculture was substantially reduced next year: much of the present difficulty was caused because of the explosion in agricultural outlays. He had not made an assessment of which countries would suffer by such an approach, and he had not discussed the matter with his Agriculture Minister, Herr Ertl. But he wanted to find a way forward.

/The Prime Minister

The Prime Minister said that when the United Kingdom's gnp rose to an appropriate level, the British would expect to be net contributors. The Government was making every effort to improve the country's economic performance. One of their recent economic measures designed to make the economy freer was to lift exchange controls. Stirling had had to be supported hard the previous day. It was no part of the Government's policy to let sterling go down but if it did so at a reasonable pace, the Government would have to let it do so. We could not stop the market but only smooth movements in the value of sterling. Britain would not restore exchange controls. Generally, the Government would hold firm to its economic policies, although things would get worse before they got better. The Government was telling the trade unions that they had freedom to negotiate pay deals but that they should use it responsibly. The Government was not going to increase the money supply to finance excessive wage settlements. Chancellor Schmidt said that this was a line he had pursued over the years. He thought that sterling would hold up over the next few months. The British Government could look forward to another 4½ years in office, and he was sure that there would be light at the end of the tunnel by the end of that period.

The Prime Minister said that Britain was prepared to take the lead on many things in Europe such as the much needed reform of the CAP but only when a solution to the Budget problem had been found. Following the last meeting of the European Council, it was for the Commission to come forward with proposals for dealing with the problem, and we had already offered them a number of ideas of their own. She recognised that the other members of the Community would be reluctant to give up some of their present benefits in order to help solve Britain's problems, but if it was difficult for them each to give up something, how much more difficult was it for the United Kingdom to bear the whole burden of its net contribution as it was doing at present.

/Chancellor Schmidt said

Chancellor Schmidt said that Britain should recognise that if a solution to the Budget problem was to be found, the other Governments would need to be able to show that they had got something out of whatever changes were agreed: they had their publics and Parliaments to think about as well. France, for example, wanted to remain in broad balance as she was now. Italy wanted a bigger slice of the cake than she had received hitherto. Sr. Cossiga thought that British and Italian interests were parallel. But the fact was that if the United Kingdom was relieved of its net contribution and the Italians received a bigger transfer of resources, other members of the Community were going to have to give up even more. Moreover, it was inevitable that the other members would not want to meet the Budget in isolation but would want to draw in other problems such as fisheries and energy. It was, in particular, important to give the French the feeling that we were ready to seek a fair deal on fish as well as on finance.

The Prime Minister said that the United Kingdom had tried to be fair in every field: we had not only played our part properly on agriculture by opening up our markets to the other members of the Community on fish and on energy but also on matters like defence which, though not strictly Community business, were of vital concern to members of the Community. But we could not go on being fair if others were not ready to treat us in the same way. At the time of the British accession negotiations in 1970 the Community had recognised that if unacceptable situations arose on our Budget contributions, the very survival of the Community would demand that the institutions find equitable solutions. Britain now expected that to be done. A solution to the fisheries problem should be found separately on its own merits. We wanted a solution and we would abide by any decisions of the European Court on fish as on other things. It was our view that we should reach agreement first on conservation: there would be no point in having a Common Fisheries Policy if there were no fish left. Similarly, we had dealt with energy on its merits and we did not wish to re-open recent decisions.

/Chancellor Schmidt said

Chancellor Schmidt said that he wanted to be frank. It was essential that the Prime Minister should distinguish herself in the eyes of her European colleagues from her two predecessors and must not appear as a third edition of the last two Labour administrations. At present events within the Community were moving towards a clash between the United Kingdom and France. This must be avoided in view of the present world situation. If ever the Community broke up, the Soviet Union would pick its members off piece-meal. When the Commission's proposals on the Budget were on the table, Britain, France and Germany should concert together to establish what each others vital interests were in an attempt to arrive at a solution. It was essential to do this before the meeting in Dublin. It was no good looking to Mr. Lynch as the Chairman of the meeting of the European Council for he knew nothing of the complexities of the problem and would not be able to bring about an agreement.

The Prime Minister said that her approach and that of her Government to the Community was entirely different from that of her Labour predecessors. She did not believe that they would have taken the decision to accept the 16 additional GLCMs or to go beyond self sufficiency in the recent exercise on oil import targets. Nonetheless she did not like the present atmosphere which she recognised would be associated by other members of the Community with previous Labour Governments but she had to emphasise once again the need to find an equitable solution to a problem which imposed such a heavy burden on Britain.