

Mr Alexander 2 pps

Mr Whitely

4/4

18/3

CONFIDENTIAL

Note for the Record

Copied to:

- Private Secretary
- PS/Lord Privy Seal
- PS/PUS
- Lord Bridges
- Mr Bullard
- Mr Fergusson
- ECD(I)
- ESSD
- Mr Franklin - Cabinet Office
- Mr Alexander - No 10 ✓
- Mr D Hancock - Treasury
- Mr D Andrews - MAFF
- Sir O Wright - Bonn
- Sir M Butler - UKREP Brussels

PREPARATION OF EUROPEAN COUNCIL: 31 MARCH - 1 APRIL

1. British and German officials met in Bonn on 15 March to discuss the next European Council. The Germans were represented by Herr Fischer, Director-General for Economic Affairs at the Auswärtiges Amt, by Herr Möhler one of his heads of department and by Herr Schulmann, Financial Adviser to the Chancellery; the UK by Mr Franklin, Lord Bridges and Mr Hannay. The meeting was in two parts, from 11.30 - 1.15 and over lunch.

2. Herr Fischer said the German Government's concern at the unsolved problem of the British budget contribution had increased in recent weeks. Both Chancellor Schmidt and Herr Genscher had made this clear in public. The Chancellor had said that a Community crisis would affect the whole international situation and would have global repercussions. The Community would be hamstrung just at the moment when, in an American election year, it was most needed to play a rôle. Herr Fischer said there were now two weeks to go to the next European Council and no basis for a genuine compromise had yet been found. In the German view there was no hope of agreeing a solution which would fix the British solution in advance to that of the Member State with the next highest GNP per capita nor one which would be based on achieving a fixed proportion of the Community's average expenditure per head. Either of these solutions would be the wrong direction to go. Gross contributions to the Community budget were determined by the own resources system and

/expenditure

CONFIDENTIAL

CONFIDENTIAL

2.

expenditure by agreed Community policies; there could not be a mechanistic variant imposed on this. It would be much better if these ideas could be avoided at the European Council. If they were not, there would be a bitter discussion. The best way to deal with the British problem was to start from zero and build up a series of decisions within the Community framework which would together constitute a genuine compromise. The Germans would like to leave the question of the Italian and Irish contributions to this solution and their claims for compensation on one side for the moment and concentrate on solving the British problem.

3. The Germans saw such a solution containing two elements:

- (i) There should be no going back on the Dublin decision to remove the constraints on the financial mechanism and steps should be taken to ensure that they did in fact yield a rebate of 520 mua or at least to ensure that the rebate did not vary beyond a floor and ceiling close to that figure.
- (ii) The Commission's suggestion for supplementary expenditure was acceptable. There was no need for a formal proposal at this stage. The sectoral breakdown in the Commission proposal of February was too wide. Expenditure should be based on an overall programme entitled "Special measures for adapting declining industrial regions to the Common Market" (there was a confused discussion amongst the Germans as to the precise title). It would not be acceptable to mention coal explicitly but coal investment could figure under the general rubric. This general approach should be agreed at the European Council and a figure fixed. The Commission would thereafter make a formal proposal. Once adopted the UK would propose expenditure plans and the Commission would examine them.

/The programme
would help
convergence.

4. Herr Fischer explained that there was as yet no government decision on the overall figure to be offered. This would be discussed by Ministers next week. The Germans would certainly be

/ready to go

CONFIDENTIAL

CONFIDENTIAL

3.

ready to go as far as their partners and would not put the brakes on. He personally was convinced that two-thirds of our original request was beyond the financial possibilities of our partners and we would have to settle for less. The German Government wanted a solution in March. It would be dangerous not to agree then. He wanted to hear our ideas on how to manage a crisis if there were no solution in March.

5. Herr Schulmann said the German budgetary situation was pretty grim. There would need to be a supplementary budget to provide aid for Turkey and Pakistan and to finance increased defence spending. The yield from income tax was lower than expected. The Opposition was insisting that all this must be financed without increased borrowing, so public expenditure for 1980 would have to be cut. Beyond 1980 things looked even more difficult. The Finance Minister was under great pressure and there could be threats of resignation. This could not be afforded in an election year.

6. Lord Bridges said we saw the international scene much as the Germans did. We wanted a settlement of the budget issue so that the Community could face its problems united. We appreciated that the German domestic economic problems were real. We had our own. Inflation was rising. The balance of payments was unsatisfactory and oil had masked a serious loss of industrial competitiveness. We heard what the Germans said about disliking a mechanistic solution to the budget issue. We had not made our proposals lightly. Any other approach seemed quite arbitrary and liable to give inadequate results. We wanted a solution that would provide no more and no less adjustment than was needed and which would last no longer but also no shorter than was required. Without prejudice to that view we would be prepared to discuss the question on the basis of the German approach. Mr Franklin pointed out that even if you fixed the 1980 net contribution by the German approach, how did you deal with subsequent years? How did you ensure the problem did not come back in a year or two's time? It was to deal with that problem that we had evolved an approach based on objective criteria.

/Herr Fischer

CONFIDENTIAL

CONFIDENTIAL

4.

Herr Fischer said there was no firm German view on duration. Ministers would discuss that aspect next week. The Auswärtiges Amt wanted three years; some others only wanted two, arguing that oil revenues would then change the UK problem. Mr Franklin said this was the worst possible time scale with the problem thus sure to arise again towards the end of the present Government's period in Office.

7. Mr Franklin said another question was how Community policies in general would develop over the years ahead. We had suggested a numerical target for restructuring the budget in the hope of reducing the underlying problem. Herr Fischer said the Germans agreed with the tendency to reduce the share of the budget spent on the CAP. The rate of increase of agricultural expenditure must be ~~slow~~ low. But they did not think a 55% objective could be fixed for 1986. It was better to concentrate on precise decisions to reduce agricultural surpluses and increase structural spending and not to fix percentages artificially. Mr Franklin pointed out that the weaker the commitment on restructuring, the more it would be necessary to build durability into the solution for the UK. At the very least there should be a clear, general commitment. Herr Schulmann agreed that a general steer would be desirable.

8. Mr Franklin said we would reflect on what had been said in Paris and Bonn about the Financial Mechanism. But we believed the Dublin communique was the basis to build on and that the European Council should not re-open this issue. On supplementary expenditure we agreed that the aim at the European Council should be to agree the broad framework and the amount. The Commission could then table a draft regulation. We would not want the scope for expenditure to be too narrow. Other Member States were looking for some advantage from expenditure on eg coal or transport infrastructure. Expenditure could be linked to declared Community objectives such as developing alternative energy sources and increasing intra-Community trade. In reply to questions we said that we did not greatly favour the French idea of mentioning fisheries as a specific object of expenditure although some resources allocated regionally might go to that. As to the French idea of Community loans with interest rate subsidies, we said we would study

CONFIDENTIAL

/it but were

CONFIDENTIAL

5.

it but were not much attracted by it. Loans were not an acceptable offset to irreversible transfers through the budget. The subsidy element was very small (it transpired that the French had mentioned 200 mua to the Germans for this, not the 100 - 150 mua they mentioned to us).

9. On energy the Germans asked what we thought of the French idea for developing a Community oil well for use in a crisis. Lord Bridges pointed out this did not make much economic sense. The cost would be very large and the oil available only a tiny fraction of the Community's needs. It was a less economic way of proceeding than stockpiling. Herr Fischer said in that case it might make better sense to consider a Community stockpile. The European Council would need to make some general reference to energy. The Germans hoped we would be able to re-affirm what we had often said privately that we would do our best to help our Community and IEA partners in the event of a crisis or a difficult situation.

10. On EMS we were asked what was happening. Lord Bridges said we were re-appraising the situation following Chancellor Schmidt's recent talks with the Prime Minister and Lord Carrington. It was not possible to say how this would come out. There were certainly political attractions in joining and we were aware of them. But there were economic problems and uncertainties connected with the volatility of sterling and the Government's over-riding objective of strict monetary control. Herr Schulmann said he thought we exaggerated the volatility problem. If we had been in the system he did not believe that sterling would have been as volatile as it had been outside. Foreign exchange dealers had changed their attitudes following the setting up of the EMS. The franc and the lira had been highly volatile before they had joined the EMS but now they were the two firmest currencies in the system. Even ~~w~~ide differences in inflation rates and the strains set up by the oil price rises were not exercising strong pressure for parity changes. He was glad we were clear about the political advantages of joining. The Chancellor remained convinced that it would be a very helpful move.

/11. Over lunch

CONFIDENTIAL

CONFIDENTIAL

6.

11. Over lunch the discussion ranged widely and covered the following main topics:

- (i) Sheepmeat. The Germans said they had told the French the day before that they remained opposed to an intervention system and preferred one based on premia. They attached importance to the Community's present openness to imports being maintained. The French had replied that they needed some intervention but did not want a full régime such as existed for beef. It could perhaps be limited to the summer months and there could be "alarm signals" based on maintaining the current level of imports and not exceeding a particular proportion of production which would be further limiting factors. We said our position was the same as that of the Germans. We too attached great importance to the import point. The link the French had made with our budget issue meant it was only at the European Council that a definitive régime would be settled. Herr Fischer opined that, so long as the French demands for intervention could be contained within strict limits their ideas might form the basis for a settlement. He also said that the Germans were much exercised by the refusal of France to comply with the judgments of the Court.
- (ii) Fisheries. The Germans envisaged nothing more at the European Council than firm encouragement to the Fisheries Ministers to settle a revised CFP, perhaps with some broad references to the principles which should guide them.
- (iii) CAP Prices. The Germans repeated their concern that the discussions so far in the Agriculture Council were not going well. They attached the greatest importance to acceptance of the Commission's economy proposals. On price rises, this was an election year in Germany and the pressure for rises higher than those proposed by the Commission was strong. Most Ministries in Bonn would favour an overall figure just above 3%; but

/Herr Ertl

CONFIDENTIAL

CONFIDENTIAL

7.

Herr Ertl had now publicly said that he expected a settlement to be at 4%. Herr Fischer disliked the idea of the European Council getting into the detail of agricultural prices. Perhaps something could be made by building on the February ECO/FIN Council resolution. We said we remained opposed to price rises for products in surplus. Farmers in Britain were pressing for higher prices but there were much stronger pressures on the Government in the opposite direction. Price rises would of course make our budgetary situation worse and our partners who proposed or lent themselves to linkage between agricultural prices and the budget should bear that in mind.

(iv) Crisis Management. The Germans expressed extreme anxiety at what might happen if the March European Council failed to find a solution. They speculated that British press reports of plans for withholding or obstruction reflected Government briefing. It was in no-one's interest to have an open crisis. Whatever happened the German government would continue to work for a solution, even if this would become more difficult to achieve should a process of retaliation and counter-retaliation begin. They pressed us for information about what we would do if no agreement was reached at the Brussels Council? We said we could not in any way predict what would happen if the March meeting failed. We were working all out for a settlement then. An important factor would no doubt be how much progress could be made. A meeting which made substantial progress would be different to an acrimonious deadlock.

(v) An interim solution. The Germans wondered aloud whether there might not have to be a one year solution. Clearly such a solution would be smaller in volume than a definitive one since no-one would be prepared to prejudice their position on the latter. Would not this be better than a crisis? We said we thought it

/sounded like

CONFIDENTIAL

CONFIDENTIAL

8.

sounded like a perfect recipe for a crisis. We could not envisage British Ministers settling for an interim one year solution.

- (vi) New Commission Figures. Herr Schulmann expressed great alarm about the production of new figures for 1980 by the Commission. He clearly anticipated a lot of trouble from Chancellor Schmidt over this. Even these figures were no more than estimates and, if there were substantial changes in the sterling exchange rate in 1980, the figures would change yet again. It would be disastrous if the European Council were to start their meeting with a wrangle over which figures they were using. We said we thought he was exaggerating the problem. The Commission figures would be available next week and they would be available for all at the European Council. The British Government could not simply ignore the fact that the Commission's earlier figures were now out of date and would be seen to be. The real situation was now worse and that could not be disguised; any solution had to take account of it.
- (vii) Future procedure. The Germans were also concerned at the lack of any effective multilateral discussion in Brussels. It might be desirable to activate COREPER ~~or~~ to arrange some ad hoc preparation à neuf. We said we doubted whether a further COREPER discussion would advance matters very far. We hoped the Italian Presidency would now pull the threads together and that Signor Ruggiero's travels next week would help the process of preparation. But if the Germans had proposals for some multilateral procedure of preparation we would respond positively. They welcomed this, but were still worried.

17 March 1980

CONFIDENTIAL

17 MAR 1980

