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OD(81) 17th Meeting

COPY NO 47

CABINET

DEFENCE AND OVERSEA POLICY COMMITTEE

—
MINUTES of a Meeting held at
10 Downing Street on
THURSDAY 12 NOVEMBER 1981 at 4.30 pm
—

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon William Whitelaw MP
Secretary of State for the
Home Department

The Rt Hon Lord Carrington
Secretary of State for Foreign
and Commonwealth Affairs

The Rt Hon John Nott MP
Secretary of State for Defence

The Rt Hon Humphrey Atkins MP
Lord Privy Seal

The Rt Hon John Biffen MP
Secretary of State for Trade

THE FOLLOWING WERE ALSO PRESENT

The Rt Hon Peter Walker MP
Minister of Agriculture, Fisheries
and Food (Items 1 and 2)

The Rt Hon Patrick Jenkin MP
Secretary of State for Industry

The Rt Hon Leon Brittan QC MP
Chief Secretary, Treasury

The Rt Hon Nigel Lawson MP
Secretary of State for Energy (Item 1)

The Rt Hon Neil Marten MP
Minister of State, Foreign and
Commonwealth Office, and Minister for
Overseas Development (Item 3)

The Hon Nicholas Ridley MP
Financial Secretary, Treasury (Item 1)

Sir Kenneth Couzens
Treasury (Item 1)

SECRETARIAT

Sir Robert Armstrong
Mr M D M Franklin
Mr R L Wade-Gery
Mr D M Elliott
Mr R L L Facer

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1. EUROPEAN COMMUNITY BUDGET RESTRUCTURING: THE NOVEMBER EUROPEAN COUNCIL
Previous Reference: OD(81) 15th Meeting

The Committee considered a memorandum by the Secretary of State for Foreign and Commonwealth Affairs (OD(81) 54) covering a Note by Officials reviewing the main tactical options for the United Kingdom in the approach to the November European Council, together with a memorandum by the Minister of Agriculture, Fisheries and Food (OD(81) 53) outlining in more detail proposed tactics for the Common Agricultural Policy (CAP) aspects of the mandate negotiations. It also had before it a minute to the Prime Minister, dated 11 November, setting out the views of the Chancellor of the Exchequer on these matters.

THE FOREIGN AND COMMONWEALTH SECRETARY said that the prospects for the discussion of the mandate at the meeting of the European Council on 26 and 27 November were not encouraging. It was therefore necessary to use the series of forthcoming meetings - the visit of M Thorn on 13 November, the Council of Ministers (Foreign Affairs) on 16, 17 and probably 19 November, and the Anglo-German summit on 18 November - to bring about some movement, and to decide more clearly what the Government's objectives for the European Council should be. We should in any event not allow others to gain the impression that we did not expect decisive progress towards a solution. We should keep the pressure up with the aim of getting as far as possible at the November European Council on all three chapters of the mandate. The chapter dealing with non-agricultural policies was the least contentious; this was the means by which those member states who would lose most from a settlement on the budget chapter could justify such a decision to their own public opinion. Agreement on the agriculture chapter would probably not be achievable unless we could make some concessions of principle towards the French in November, whilst leaving any substantive trade-offs between the budget and agriculture chapters to be dealt with later when we could exert leverage over the next price fixing. On the budget, the approach put forward by the Chancellor of the Exchequer in his Hague speech had not found favour with other member states, although we could continue to argue for it. If the modified limits scheme which we had put to the Germans as an alternative did not attract their

support, it would be unwise for the United Kingdom to put it forward at the Council. In those circumstances we should have to consider how to achieve our budgetary aims within the framework of the Commission's ideas, amended to suit our needs. There would be no value in provoking another 9 : 1 row at this Council, at which our freedom of manoeuvre would be constrained by our Presidency responsibilities. The best hope for some advance would be to work for guidelines to be agreed at the Council covering all three chapters and providing a basis for further negotiation in the period up to the 1982 agricultural price fixing.

THE MINISTER OF AGRICULTURE, FISHERIES AND FOOD said that so far as the CAP guidelines were concerned the French were making all the running. They had staked out a series of demands for changes in the CAP including degressive guarantees in favour of smaller producers, the reinforcement of Community preference, increased protection on cereal substitutes and vegetable oils and the dismantling of the system of Monetary Compensatory Amounts. Some of these measures might produce a reduction in the cost to the Community budget but at the expense of British farmers, since their proposals on co-responsibility levies, for example, would discriminate against larger production units. Others, like the Commission proposal for long-term export contracts, were supported by the French as a means of subsidising their agricultural exports through the Community budget. The only limited concessions he could contemplate would be a readiness to examine proposals for the negotiation of multi-annual export agreements, and a willingness to consider exploratory discussions by the Commission with third country suppliers of cereal substitutes. It would be wrong to rely on sustained German support for our desire to cut the cost of the CAP: signs of a Franco-German deal, with Commission connivance, were already evident. This could only weaken the United Kingdom's negotiating position.

In discussion it was argued on the one hand that it would be wrong to make any concessions now, even of principle. Holding the Presidency would limit our ability to defend British interest. Nor should we give any hint that we might be willing to accept the Commission's scheme for giving relief to the United Kingdom through compensation under the agricultural guarantee mechanism. As the Chancellor of the Exchequer's minute pointed out, the

only version of this scheme which might succeed in eliminating or substantially reducing our net contribution would be one in which all the critical parameters were settled in a manner exceptionally favourable to the United Kingdom. Similarly, even a gesture on long-term export contracts could lead later to substantial extra costs; such contracts would tend to institutionalise surpluses and thus consolidate one of the most acceptable features of the CAP; and would damage the Community's relations with third countries. The Community had already been accused at Cancun of being a protectionist club. The United Kingdom should therefore ensure that discussion at the European Council took place on a footing consistent with her own objectives, rather than those of the Commission. This might be achieved by tabling the modified limits scheme, provided that it was not rejected outright by the Germans in the bilateral summit meeting on 18 November; extolling the virtues of a Community approach to the budget problem; and aiming to get agreement on a set of guidelines for reform of the budget which would be compatible with either the Commission's approach or our own.

On the other hand, it was argued that if the United Kingdom did not give an inch, no-one else would. There would be no effective negotiation; the United Kingdom as the biggest demander would get the blame, and the Community would be seen at its worst, to the detriment of public support for the Government's commitment to continued membership of the Community. If the United Kingdom wanted progress on the budget, we should have to make some balancing concessions on the CAP; without movement on these two chapters there would be no agreement on guidelines on which we could build for the next round of negotiations. It was not necessary to yield on specific issues at this stage, since the main bargaining would inevitably now take place in the context of next year's price fixing. It would then be necessary to weigh the cost of any concessions on the CAP against the gains to the United Kingdom on the budget. A row would doubtless occur then, but there would be no merit in provoking one now. It would be incomprehensible to our partners if the United Kingdom, in both its Presidency and national capacities, did not make an effort to secure progress at the November European Council. To put forward a modified limits scheme with a zero net contribution would risk arousing renewed suspicion that we were seeking a juste retour.

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THE PRIME MINISTER, summing up the discussion, said that the Committee agreed that the United Kingdom should seek to avoid a row at the forthcoming European Council. It was nevertheless clear that little progress towards a solution could be expected then, and it would be difficult to present the mere absence of open conflict as a success. If the main bargaining took place next spring, it would do so under the uncertain handling of the Belgian Presidency. In these circumstances our general aim for the November Council should be to get the United Kingdom in as favourable a position as possible for the next round of negotiations, when we would be free of our Presidency inhibitions and might need to go right to the brink to secure our mandate objectives. The approach recommended by the Chancellor of the Exchequer appeared to be the best one to adopt, subject to the outcome of the discussions at the Anglo-German summit. She would however wish to review tactics in more detail with the Foreign Secretary and the Chancellor of the Exchequer after the Foreign Affairs Council and the Anglo-German summit meeting.

The Committee -

Took note, with approval, of the Prime Minister's summing up of their discussion.

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2. ECONOMIC AID FOR POLAND

Previous Reference: OD(81) 16th Meeting

The Committee had before them a memorandum by the Secretary of State for Foreign and Commonwealth Affairs (OD(81) 52 and a Note by the chairman of the Official Group on Economic Assistance to Poland (OD(81) 51), concerning possible United Kingdom participation in a Western rescheduling operation for Polish official debt in 1982 and the possible provision of new credit for Poland in 1982.

THE FOREIGN AND COMMONWEALTH SECRETARY said that the Polish Renewal represented the most serious challenge the Russians had yet to face in their east European empire. But there was a grave risk that the Polish economy would collapse. Poland's external debt would continue to rise for several years; and in 1982, even with a repetition of the rescheduling agreement of 1981, the financing gap was expected by the Poles to be \$4.3 billion. The British Ambassadors in Moscow and Warsaw believed that a collapse of the Polish economy would not be to the advantage of the Russians, who were therefore likely in the last resort to provide further assistance. But the West also needed to help, because a collapse would be very damaging to Western political interests and would have a serious effect on the Western banking system. An adequate British contribution was essential, although it could not by itself be decisive. He proposed that official debts in 1982 should be rescheduled on easier terms and that the United Kingdom should provide new official credits in 1982 amounting to £90 million. These credits should comprise the £30 million due for the URSUS tractor project; £20 million to finance the export of British food from European Community stock piles; and £40 million to finance British industrial exports. If so directed by Ministers, the Export Credits Guarantee Department (ECGD) could underwrite provision of the URSUS money from an existing line of credit, as heretofore. But ECGD could no longer help with the other credit proposed, which we therefore represent extra public expenditure since it could not be found from existing Foreign and Commonwealth Office programmes.

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THE CHIEF SECRETARY, TREASURY said that he accepted the need to reschedule official debt in 1982 on the softer terms proposed. The Government should, through the Bank of England, continue to maintain close contact with British banks involved in the Polish problem but should not support American ideas of putting pressure on the banks to soften the terms of their 1982 rescheduling of non-official debt. Any such pressure would have serious implications for the Government's relations with the banking system. Since the URSUS project was well advanced he was prepared to agree to its continuation, although he would have preferred to avoid adding in this way to ECGD's existing commitments. But new British Credits for other purposes should not be contemplated. They would make only a marginal difference to Poland's situation. Food aid was in any case not Poland's most pressing requirement; according to the Polish Foreign Minister there was no actual shortage of food but only a problem of distribution.

In discussion there was general support for rescheduling Polish official debt in 1982 on softer terms than in 1981 and for continuing the URSUS project. Other industrial credit would of course be welcome to British industry, and food aid might help to reduce European Community stockpiles. But such loans would in effect be grants. Much British credit had already been provided for Poland on generous terms, not least in the context of shipbuilding orders. It would be wrong to add to these liabilities, and thereby to reduce the incentive for the Poles to put their economic house in order. On the other hand the United States would soon need to decide whether to undertake a major economic rescue operation for Poland. Many Americans disliked the idea of giving massive help to a Communist state in alliance with the Soviet Union. But if the United States Government did mount such an operation they would certainly expect their European partners to make a significant contribution. In that case the Committee would need to consider the British position further.

THE PRIME MINISTER, summing up the discussion, said that the rescheduling of official debt on the softer terms proposed and the continuation of the URSUS project should be an adequate British contribution to assisting Poland in 1982. Britain should keep in step with her Western partners over rescheduling, and should make clear to them the size and importance of the URSUS project.

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If strong pressure for a larger British contribution developed, eg in the context of a major American rescue operation, the matter should be brought back to the Committee for further consideration.

The Committee -

1. Agreed that, without taking the lead, the United Kingdom should participate with other Western countries in the rescheduling of Polish official debt for 1982, on the softer terms proposed in OD(81) 51.

2. Invited the Secretary of State for Trade to direct the Export Credits Guarantee Department to underwrite loans required for the URSUS project in 1982 up to a total of £30 million.

3. Agreed that as things stood no other medium or long term industrial credit and no food aid should be provided for Poland from British official sources in 1982.

4. Invited the Foreign and Commonwealth Secretary to report further if changed circumstances made it necessary to reconsider the possibility of food aid or increased industrial credit in 1982.

3. GIBRALTAR DOCKYARD

The Committee had before them a Note by the Secretaries (OD(81) 50) covering a paper prepared by an inter-departmental group of officials on the future of the Gibraltar Dockyard.

THE SECRETARY OF STATE FOR DEFENCE said that as a result of his review of the defence programme announced in June 1981 it was necessary to reduce the number of naval dockyards from 5 to 2. The closure of Chatham and Portsmouth had already been announced. There was no defence requirement for the Gibraltar dockyard after 1982 and the defence budget contained no provision for it beyond that date. At present expenditure on the dockyard constituted about 15 per cent of Gibraltar's gross domestic product. But other defence expenditure amounted to as much as 35 per cent, making 50 per cent in all; and Gibraltar enjoyed a higher growth rate and a far lower unemployment rate than the United Kingdom. He therefore supported the course of action set out in paragraph 30a. of the paper by officials; the Gibraltar Government should be told that the naval dockyard could not be sustained after the end of 1982. In practice the process of closing it down might well not be complete by that time. But if consultations did not begin on the basis of a firm cut-off date the Gibraltar Government would have little incentive to press ahead with the process of identifying alternative economic activities which might be introduced. The Minister of Defence could not contribute to the capital cost of converting the dockyard for commercial use. But despite the extra cost to the defence budget which would be involved, he would be willing to offer, if necessary, some further naval work to ease the transition and perhaps some concessions on dockyard assets, although neither of these possibilities should be revealed to the Gibraltar Government at the present stage.

In discussion the following points were made -

- a. Closing the naval dockyard would have a very serious effect on the Gibraltarian economy. The resulting unemployment would be partially mitigated to the extent that some of the workers involved were immigrant Moroccans who might be expected to return home; and in the longer term, if Spain finally re-opened the Gibraltar frontier,

tourism and other offsetting activities could be developed. But it would be impossible in present circumstances for Britain not to provide extra assistance to sustain Gibraltar after the naval run-down was complete. Commercialisation of the dockyard was one possibility, but it would be expensive.

b. Complete naval closure as early as the end of 1982 would leave the Gibraltarians little time to make alternative arrangements. It might be better to present the decision as being to start the closure process at the beginning of 1983, or possibly somewhat earlier.

c. If closure were too rapid or compensations assistance inadequate the Chief Minister of Gibraltar might well resign. That would provoke a political crisis, and the Government would come under strong pressure from some of their supporters in Parliament.

d. Gibraltar's partisans in Parliament had been encouraged by their success in forcing through an amendment to the Government's new Nationality Act, under which Gibraltarians would now be able to register as British citizens with full rights of establishment in the United Kingdom. Rising unemployment in Gibraltar would be likely to mean more people exercising those rights.

e. Although the main union involved in dockyard closures in Britain also represented dockyard workers in Gibraltar, British public opinion was likely to resent any suggestion that the naval dockyard should be kept open in Gibraltar while Chatham and Portsmouth closed. Chatham's unemployment rate in particular was already 15 per cent and would rise to over 20 per cent after closure. Gibraltar's was at present only 3 per cent.

f. Gibraltarian dockyard workers were paid the same as their counterparts in Britain. The viability of commercial ship-repairing in Gibraltar was therefore uncertain. But in so far as a commercial yard did succeed in the Colony it would tend to do so by taking business from British yards, some of which were already threatened with closure through lack of work.

g. A long-standing source of friction with the Gibraltarians was the lands agreement under which they were required to pay for surplus Ministry of Defence buildings or reclaimed land for which they had a continuing use. The forthcoming consultations would be eased if free transfer could be offered in such cases, as well as in the case of dockyard land and assets.

THE PRIME MINISTER, summing up the discussion, said that the Committee endorsed the approach to the consultations with the Gibraltarians on the future of the dockyard set out in paragraph 30a. of the note by officials attached to OD(81) 50. Longer notice of closure should, however, be given. It was unreasonable to expect the Gibraltarians to accept that one of their principal sources of employment should close in just over 12 months' time; and to try to enforce so rapid a closure could attract criticism in Parliament. The Gibraltarians should be told that the process of closure would start by the beginning of 1983, although this did not rule out preparatory action to run down the dockyard during 1982. Appropriate concessions could be made if in the course of the consultations it appeared that difficulties with the Gibraltarians could be mitigated by offering free transfer of dockyard land and assets and of surplus Ministry of Defence buildings and reclaimed land outside the dockyard. But it would be premature to agree to this at the outset.

The Committee -

Invited the Foreign and Commonwealth Secretary, in consultation with the Secretary of State for Defence, to arrange for consultations to be opened on the basis indicated in the Prime Minister's summing up.

Cabinet Office

13 November 1981