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*Euro Pol
Nov '76*

Foreign and Commonwealth Office

London SW1A 2AH

3 December 1976

Dear John,

European Council 29/30 November

We have had a word on the telephone about distribution of the records of the European Council such as they are. In fact those to whom this letter is copied will have seen the Prime Minister's statement in the House of Commons on 1 December (Hansard col. 918 onwards). The declarations issued by the Council were reported by telegram from The Hague together with a report on the press conference by the Dutch Presidency (see The Hague telegrams nos 436 - 442).

So far as the record of the discussions is concerned, I made a transcript from the Foreign and Commonwealth Secretary's notes of the discussion on the first afternoon, a copy of which I attach for those to whom this letter is copied. It includes the full English text of President Giscard's contribution to the discussion on the economic and monetary situation and the Prime Minister's two major interventions as recorded by Patrick Wright. I also attach, with your agreement, a copy of Patrick Wright's record of the account given to him by the Prime Minister of the discussion at dinner on Monday 29 November.

Unfortunately, there is no record of the meeting on the morning of 30 November. It was largely devoted to the discussion of drafting changes to the declarations and Mr Crosland did not take any record but I believe that some of the Prime Minister's speaking notes eg on the Tindemans report and on the green pound, may be with you at No. 10.

I am sending a copy of this letter and its enclosures to Nick Monck (HM Treasury), Richard Manning (ODM), Tony Hutton (Trade) and Martin Vile (Cabinet Office), and a copy of this letter without its enclosures to Roy Denman (Cabinet Office).

Yours ever,
E. A. J. Fergusson
(E. A. J. Fergusson)

John Meadway Esq.,
10 Downing Street.

RTD

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Present

BELGIUM
Monsieur Leo Tindemans -
Prime Minister
Monsieur Renaat van Elslande -
Minister for Foreign Affairs and
Development Cooperation

DENMARK
Mr. Anker A. Joergensen -
Prime Minister
Mr. K.B. Andersen -
Minister for Foreign Affairs
Mr. Ivar I. Norgaard
Minister for Foreign Economic Affairs

FEDERAL GERMAN
REPUBLIC
Herr Helmut H. Schmidt -
Federal Chancellor
Herr Hans Dietrich Genscher -
Foreign Minister and Vice-Chancellor

FRANCE
Monsieur Valery Giscard d'Estaing -
President
Monsieur Louis de Guiringaud -
Minister for Foreign Affairs

REPUBLIC OF
IRELAND
Mr. Liam Cosgrave -
Prime Minister
Dr. Garret FitzGerald -
Minister for Foreign Affairs

ITALY
Signor Giulio Andreotti -
Prime Minister
Signor Arnaldo Forlani -
Foreign Minister

LUXEMBOURG
Monsieur Gaston Thorn -
Prime Minister
Monsieur Pierre Wurth -
Secretary-General, Ministry of
Foreign Affairs

NETHERLANDS
Mr. Joop den Uyl -
Prime Minister
Mr. Max van der Stoep -
Minister of Foreign Affairs

UNITED KINGDOM
The Rt. Hon. James Callaghan, MP -
Prime Minister
The Rt. Hon. Anthony Crosland, MP -
Foreign Secretary

EUROPEAN
COMMISSION
Monsieur Francois Xavier Ortoli -
President
Herr Wilhelm Haverkamp -
Vice-President

The following has been transcribed from Mr. Crosland's notes.

The meeting opened with the usual courtesies and it was agreed that for the first session the agenda should be:

- i) Economic and Monetary Situation;
- ii) CIEC;
- iii) The Tindemans Report.

Economic and Monetary Situation

The President of the Commission introduced the Commission's paper and gave an agreeable if conventional analysis of the economic situation in the Community with a certain emphasis on the Duisenburg proposals for exchange rate target zones.

President Giscard said that he was depressed at the slower growth prospects for European economies than had been expected and therefore higher-than-foreseen-level of unemployment. He was also concerned at the marked fluctuations in exchange rates which had had the effect of pushing up monetary compensatory amounts (M.C.A.s) to intolerable levels. The likely rise in the price of oil gave cause for anxiety and, finally, the Western economies faced a serious threat from the Japanese. He therefore wished to propose that the European Council should issue a declaration saying that they must

- i) preserve what had already been achieved in the Community and that, therefore, the member states should commit themselves not to introduce trade restrictions; and that they should also rehabilitate the functioning of the Common Agricultural Policy and bring its operations back to normal;
- ii) re-establish balance in their respective economies and seek common standards in monetary and budgetary policy
- iii) pursue economic and monetary union as soon as the possibility of doing so were judged to exist: they should therefore hold a special meeting of the European Council in the second half of 1977 to review progress. / Mr. Crosland commented that this was completely vague⁷

(See the full text in French of President Giscard's remarks - Annex A)

/Mr. Joergensen

Mr. Joergensen spoke on predictable lines about his concern over the economic situation in general and its effect on the Danish economy in particular. He placed particular weight on the effects on the smaller and more fragile economies of any substantial rise in the oil price following the OPEC meeting in December.

Chancellor Schmidt said that the outlook for 1977 was now more gloomy than had been foreseen. His estimate was that it would be the fourth consecutive year of serious world structural (not cyclical) economic crisis. He poured scorn on the call at the meeting of the Socialist International at Geneva for more planning because he observed that the present crisis hit planned as well as unplanned economies. If the oil price were to rise there would be no hope of more economic aid for the developing countries. Furthermore, a price rise would create more unemployment in the industrialised West which would in turn threaten their democratic societies. The root of all current evils was the failure to get a grip on inflation; in these circumstances traditional Keynesian economics were irrelevant. The current discussions following UNCTAD for action in the raw materials sector were likely to lead to rises in raw material prices. But this would help the richer developing and developed countries and would give very little help to the poorer countries. Saudi Arabia and Iran now had financial resources which now made them among the most powerful countries and they had an importance greater than that of many countries who were members of the Group of 10. Of the international economic organisation UNCTAD; GATT and the CIEC were not functioning effectively. But the IMF was and it was crucial that nothing should be done to impair its functioning. Turning to domestic European policy, he said that economic and monetary union, given the present variations in domestic rates of inflation, was totally illusory. To sum up, he said that the surplus countries could not expand their economies at a faster rate because the level of their current surpluses was too small. In particular Germany would not expand at a faster rate partly because of that reason, but also because/ ^{to} the German people inflation was still the biggest enemy. /- Mr. Crosland commented that Chancellor Schmidt's tone was apocalyptic and a little hectoring and his views miles to the right of Mrs. Thatcher! -/

/Sgr. Andreotti

Sgr. Andreotti commented on the danger that the IMF would press countries in difficulties, like Italy, too hard. The Community ought to act together in working out methods of collective help for its weaker members. He warned that if there were a substantial oil price rise, Italy would be the worst hit country in Europe.

Prime Minister [see Annex B]
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Mr. den Uyl said that he shared the general feelings of gloom and uncertainty about the prospects for the Community's economic situation during 1977, though he did not wholly share the sentiments which had been expressed by Chancellor Schmidt about oil and raw material prices. He expressed grave concern about the action of the Italian Government in introducing measures of import restraint. He went on to advocate the Duisenberg proposals for exchange rate target zones and finally added his endorsement to the remarks which had been made about the crucial importance of controlling the rate of inflation.

President Giscard interjected that it was essential that action should be taken and be seen to have been taken by the European Community. M. Tindemans whole heartedly endorsed President Giscard's view. In face of its current economic difficulties the Community was in a state of crisis. Unless a means could be found by which the Community could show that it was capable of effective action, there would be those who would argue that the discussion in the European Council was a waste of time and that even the continued existence of the Community should be called in question.

Chancellor Schmidt said that, while as had been seen, he was not unduly hopeful, he felt that President Giscard, Mr. den Uyl and M. Tindemans had been too pessimistic in their analysis. The Prime Minister agreed with President Giscard that it was essential to look for a means of combatting their current difficulties within a Community framework. But, the key to Community progress lay in finding a way by which the economies of the member states could be brought from their current divergence within measurable time to convergence.

Points to emerge from the discussion of the Economic and Monetary Situation.

1. There was a deep general feeling against import restrictions.
2. The Germans would not take any early steps to expand their economy.
3. The Italian Government felt that, left to itself, the IMF would press for more drastic economic measures (public expenditure cuts) than was justified by the economic situation or possible in terms of domestic political reality.
4. It was generally agreed that no serious progress would be possible towards convergence during 1977, though there were several approving references to the Duisenberg proposals.
5. The French were determined to give the impression that they were speaking in a communautaire tone and they almost went so far as to attack the United Kingdom for not being sufficiently pro-Tindemans.

EEC AND JAPAN

There was a brief discussion of the proposed declaration, as previously agreed in COREPER, and the Heads of Government approved the text with the following addition put forward by the Presidency as a new last sentence.

"The European Council notes with appreciation that the Japanese Government is willing to cooperate with the European Community on the basis of a mutual understanding in solving the problems arisen".

It was also agreed that after the next meeting of the European Council a representative of the Commission should visit Japan.

NORTH/SOUTH DIALOGUE

M. Ortoli said that the Council ought to try to take an overall view of the current stage of development covering the CIEC, UNCTAD, and other occasions where relations with the developing countries came under discussion. A group of officials had already been given the responsibility for considering overall strategy and he thought that today the Council might concentrate on having

a general discussion of tactics and timing. Mr. den Uyl said that the Council ought to indicate clearly what it thought were the main objectives in the relationship between the Community and the developing world.

President Giscard said that a key question for the Council was whether they favoured a postponement of the December Ministerial meeting of the CIEC. In his view the answer was yes. If there was general agreement it would be for those present to give broad guidance to those of their Ministers who would thereafter carry out the more detailed work in the Conference. So far as raw materials were concerned, the French Government stood firmly behind the proposals which they had put forward at UNCTAD IV, Nairobi, as a first step towards the establishment of a common fund. Mr. Joergensen said that he was in favour of postponement.

The Prime Minister was in favour of postponement and spoke to his brief. (See separate record attached - Annex C)

Sgr. Andreotti said that although it might be possible to postpone the December meeting of the CIEC, it would not be possible to put off discussing the Community's reaction to a significant increase in the oil price at the forthcoming OPEC meeting. Moreover, it was essential that at the last the Community should confirm its support for the common fund.

M. Thorn also argued in favour of postponement. He thought that the correct policy for the Community would be to say that, because of the US Presidential election, they could not do more now than to say that they would be prepared to put forward positive proposals after consultations with the new US administration.

Chancellor Schmidt said that the German Government would be prepared to accept transfers of resources to the poorest countries, but they could not agree that such transfers should be made to the OPEC countries nor to the rich raw material producers. He went on to argue that the Council should state clearly that further transfers of resources should be in inverse proportion to any rise in the oil price. Why should the Community have donned a hair shirt at Nairobi when the Soviet Union in effect gave nothing? Such attitudes only helped the Soviet Union. As far as indexation was concerned he was firmly opposed. He had serious doubts about the value of buffer stocks save in a small number of specific commodities, and he was very sceptical about the value of the common fund proposals. The

principles adopted by the Community in their relationship with the developing countries under the Lome Convention. were the right principles to maintain. So far as debt relief was concerned, offers should be made only in individual cases. He went on to issue a powerful warning to his colleagues that they should not be driven by pressure from the developing countries to offer too much i.e., more than their economies could stand.

President Giscard disagreed with the line which Chancellor Schmidt had taken. He said that if there were not a dialogue, in the framework of the CIEC, under way in Paris now there would already have been a further large oil price increase. The least that the Community could do would be to stick to the conclusions reached at UNCTAD IV in Nairobi. However, he agreed that action on debt should proceed on a case by case basis.

Mr. van der Stoep said that he agreed with President Giscard. Perhaps the right solution would be to convert the Lome Convention into a universal system of aid for the developing countries.

ANNEX A
STATEMENT BY THE PRESIDENT OF THE FRENCH REPUBLIC

K.H cc. H. Wright (2)
LMP M. Jermann
M. Gonthier
H. Fredwell
H.F. Sidi Mathan
M. Jordan
Mass

At our meetings in the European Council we have grown accustomed to examining the economic and financial situation of the Community. Today this examination is of a particularly topical nature. The Community is confronted with difficulties on all sides, both internally and externally. Our Governments are meeting this situation by putting in hand the economic measures which they consider appropriate. However, they could increase the effectiveness of their policies by implementing them in unison and in a European perspective.

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The current economic and monetary state of the Community is a cause for concern.

Personally, I discern three causes for anxiety.

The overall economic situation constitutes a serious problem, as is shown by an examination of two indicators.

The general level of activity in 1976 will be lower than forecast. The mean growth rate of our economies will not

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exceed 4 3/4% instead of 5 1/2% as envisaged in June, in comparison with the 1975 level, which was already low. Prospects for 1977 are mediocre. The figures fall short of the estimates made before the summer and vary between 3% and 5% for the Community as a whole.

Unemployment remains at a high level, although short-time working in the main been eliminated. It has not proved possible to reduce the average unemployment rate, which still stands at 4.5% for the Community, and unemployment is on the increase among young people. The estimates for 1977 hold out no hope of any drop in excess of 1/2%.

The Community's internal monetary relations are in utter disarray.

Since early 1976 the slide of exchange rates has taken on hitherto unknown proportions which bear no relation to the real purchasing power of currencies. The fall in certain currencies has been compounded by an appreciation in others, giving rise to considerable variations in parities: approximately 30% between the German mark and the lira and 25% between the lira and the German mark in 10 1/2 months. The financial and commercial consequences of these variations remain incalculable both as regards undertakings and national economies.

On account of monetary disturbances, the common agricultural policy, which is one of the most solid achievements of our Community, is facing the hardest test of its history. The monetary compensatory amounts were intended, in order to maintain the unity of the markets, to give a certain flexibility to price movements resulting from parity changes. They have now reached a quite unacceptable level - about 50%, for example, for exports from Germany to Great Britain. In 1977 it could require a quarter of the Community's agricultural budget to finance them; their impact is distorting normal trade patterns.

Serious disturbing factors are also coming from outside. I am thinking, first of all of the energy problem. The external financial imbalances resulting from the increase in the price of oil three years ago have not yet been absorbed and it is very probable that we shall shortly be subjected to a further increase, even if we may hope that it will be moderate. Another threat derives from the commercial dynamism of countries which do not have the same economic structures or the same methods of calculating prices as our own. I refer particularly to Japan, whose exports endanger the level of activity and sometimes even the existence of some of our own industries such as shipbuilding, the steel industry, certain branches of electronics and even the motor industry.

Faced with this situation, I propose that we carry out a three-point programme of preserving, re-establishing and developing: preserving the Community's attainments; re-establishing the balance of our economies; affirming our intention of resuming the construction of the Economic and Monetary Union as soon as circumstances permit.

1 - The Community's attainments must be preserved. This applies to the commercial sector: we must refrain from taking protectionist measures affecting the free movement of goods between our countries. It applies to the common agricultural policy: we must search for flexible and inexpensive methods of maintaining the unity of the European agricultural market, in spite of anarchistic movements in monetary parities.

2 - Our second task is to re-establish the internal and external balance of our economies.

Because of the differences in our situations, our priority recovery aims cannot be identical. The fight against inflation, the reduction of unemployment, and a return to an external balance will need to be combined in varying doses. During this stage, the fixing of common standards would not be appropriate to the diversity and fluidity

of the existing situations. As far as budgetary matters are concerned, the question of a common timetable for the reduction of budget deficits could be given consideration.

The necessary measures must also be taken to deal with the external threats which I have outlined. We must define a common energy policy, and begin by adopting a European programme for saving energy. I suggest that the Member States fix a joint ceiling for the value of their oil purchases for the next two years. Our industrialized trading partners must also make a contribution. On the question of trade, we must talk to our American and Japanese partners. We expect the new American administration to put into practice a policy of independence for energy. We hope that Japan will agree to limit its exports in sensitive sectors.

3 - We must affirm our intention of resuming progress towards Economic and Monetary Union, as soon as circumstances permit. I propose that a special meeting of the European Council should be held at the end of 1977 in order to review progress in restoring balance to our economies, and to determine the procedures for resuming the indispensable construction of an Economic and Monetary Union.

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Present circumstances must not weaken our determination

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to build Europe. We must bring our realism and our faith to preserving it, and then to making further progress. This is what our peoples expect from us.

The Prime Minister said that in all policy, the leading element of economic progress, a reduction in domestic activity, and the general level of inflation in different countries. Many of these factors were not of central, and several of them were important, including the dollar situation, which could have a level of unemployment and inflation, serious balance of payments deficits and inadequate investment in production industry. The other two largely, the three states to set their course in order, and we had not yet seen in the process of doing that.

The Prime Minister said that there were also steps which we must take as a Community, and referred to the Budgetary statement made by Mr. Henderson at the House of Commons, and the fact that the Budget had not been successful in its failure to cope with our immediate problems.

Referring to unemployment, the Prime Minister said that there was a need to carry further the valuable investigations which had already taken place with the world partners. He indicated that the Standing Committee on Unemployment would be convened to consider the next steps at the meeting on 11 November.

The Prime Minister said that in the field of economic activity in the Community was limited to the extent of our expectations.

The Prime Minister said that all members of the EEC were concerned at the present monetary instability in the Community. This was in large part due to the recent major upheavals in the world economy - to the rise in oil prices, the resulting balance of payments problems, a reduction in economic activity, and disparate level of inflation in different countries. Many of these factors were out of control, and several Community countries, including the United Kingdom, still faced high levels of unemployment and inflation, serious balance of payments deficits and inadequate investment in productive industry. The onus lay largely with those States to set their houses in order, and we for our part were in the process of doing that.

The Prime Minister said that there were also steps which we must take as a Community, and referred to the helpful statement made by M. Tindemans at The Hague on 30 October. Discussion of our longer term aims was meaningless if we failed to cope with our immediate problems.

Referring to unemployment, the Prime Minister said that there was a need to carry further the valuable consultations which had already taken place with the social partners. He understood that the Standing Committee on Unemployment proposed to consider the next steps at its meeting on 13 December.

The evidence of a slow-down in the growth of economic activity in the Community was causing us to revise our expectations

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about the strength of the recovery in 1977. This was of concern to all of us, and he hoped that those member countries with strong economies would not allow the recovery to peter out, insofar as this was in their power. Referring to the balance of payments, the Prime Minister said that the Community could play a part in encouraging a wider understanding of the responsibility which all the surplus countries as well as the deficit countries must share equally. This had been recognised in the Commission's Annual Report.

Referring to the longer term, the Prime Minister said that he had been much impressed by the new and constructive mood of realism which the Community had shown on economic and monetary matters. He paid tribute to Dr. Duisenberg's proposals on exchange rates and the need for a convergent economic performance within the Community. We needed a better framework for cooperation and coordination in the area of exchange rate policies. The Prime Minister mentioned that the Monetary Committee and the Committee of Central Bank Governors were still working on the Duisenberg proposals, but that meanwhile it should be possible to make progress towards closer cooperation in managing both the currencies in the Snake and those outside it. He welcomed Dr. Duisenberg's emphasis on the need for convergence of economic performance, and suggested that the Community should address themselves to the persistent underlying differences in growth rates, productivity and investment levels. We should acquire more understanding of each others economic structures and problems. An important underlying problem, in those Community countries with below average growth rates and GDP,

/had been

had been persistent under investment in the private sector of industry. This was perhaps an area which could be profitably studied by the Community as a whole.

The Community should look at its interests in the developing world, particularly in the context of the GATT. It had a clear interest in seeing a success of the GATT. A breakdown for which the industrialized countries, and still more the Community, were held responsible would have negative effects for both the political and economic interests in the developing world. On the other hand, conditions such as the balance of payments, the value of commodity investment and many other factors depending on long term effects, and should be revisited.

The Prime Minister said that the GATT meeting planned for 10 December would be important. Several of the representatives had publicly said a long time ago that they would not raise prices and our best policy was to encourage them to do so. He thought that to wait until then might involve us in a public penalty, and might affect the long-term view of the GATT which was being used wherever developing countries thought of it. But gone far enough to meet them over particular issues in the North/South dialogue.

The Prime Minister said that, in the eyes of the world, it was not the GATT which was the crucial issue for the success of the GATT. He would agree in principle that a necessary part of the final package should be immediate action to help the least developed and some of all of the most seriously affected developed. There was no need to agree now on the Community

The Prime Minister welcomed Chancellor Schmidt's suggestion that there should be a general discussion of the North/South Dialogue at this European Council. It was right that the Community should look at its interests in the Dialogue with developing countries in the round. We had a clear interest in making a success of the CIEC. A breakdown for which the industrialised countries, and still more the Community, were held responsible could have dangerous effects for both our political and economic interests in the developing world. On the other hand, concessions over, for instance, generalised debt relief or commodity indexation and have even more damaging long term effects, and should be resisted strongly.

The Prime Minister said that the OPEC meeting planned for 20 December would be important. Several of the oil-producing countries had publicly made a link between their policy on oil prices and our own policy over non-energy issues in the CIEC. He thought that to admit such a link might involve us in a double penalty, and might incur the long-term risk of the oil weapon being used whenever developing countries thought we had not gone far enough to meet them over particular issues in the North/South Dialogue.

The Prime Minister said that, in the eyes of the group of 19, debt was likely to remain the crucial issue for the success of the CIEC. We should agree on the principle that a necessary part of the final package should be immediate action to help the least developed and some or all of the most seriously affected countries. There was no need to agree now on how the Community

/should participate

should participate in such action. But we should instruct the Foreign Ministers to agree at the appropriate time on how something could be done to satisfy those most in need of help in this field.

It was most important that the Community should agree on a common position over the Common Fund for use today in Geneva. There was already the text of a substantive reply to the UNCTAD Secretary General's letter about the Common Fund, and it should not be difficult for us to reach a compromise on this.