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From the Principal Private Secretary

SIR JOHN HUNT

I enclose, for your personal information, a copy of my record of the Prime Minister's meeting with Chancellor Schmidt which covered:-

- a) relationships with the Soviet Union and the United States; and
- b) civil aircraft developments.

You should know in connection with a) that the Prime Minister urged Chancellor Schmidt personally and in the strongest possible terms to make an effort to get to understand President Carter whom he described as a man more decisive and sensitive than the Chancellor evidently recognised.

You will see from the civil aircraft discussion that the Prime Minister clearly intends to remain firmly in charge of this exercise, and this reinforces my view that he should continue to be supported by an interdepartmental group in the Cabinet Office under Mr le Cheminant.

I am not copying this record elsewhere.

K. R. STOWE

24 April 1978

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Handwritten initials

Extracts copied to:
Defence: Pt 3: SAH
Nationalisation: Pt 13: Aerospace

NOTE FOR THE RECORD

Prime Minister's Meeting with Chancellor Schmidt at
Chequers on Monday 24 April 1978

Present:

Prime Minister
Mr. K.R. Stowe

Herr Helmut Schmidt
Dr. Joergen Ruhfus

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The Prime Minister asked the Chancellor for his assessment of President Brezhnev's and Soviet intentions.

Chancellor Schmidt said that he thought that President Brezhnev was perhaps benevolent in intention, but surrounded by people who while not benevolent themselves were prepared to let him be so if he did no damage. Brezhnev knows that his political life is coming to an end and sees his task as wanting to stabilise peace; and to avoid the Third World War. Herr Schmidt thought that in this he was genuine and that he had the agreement of some of the other Politburo; but others were not too keen. What Brezhnev had done of course was to purchase his political freedom to pursue this policy by letting the Forces have their way over armaments and expansion. But he was not sure Brezhnev knew what the scale of their activity was.

The Prime Minister asked what then should be our attitude towards Brezhnev. Herr Schmidt said that we should exploit the situation while he is there - fix and stabilise it. It was possible that when Brezhnev went we should enter an interim period of outward calm and inward nervousness. None of us knew the possible successors so we should go as far as possible while Brezhnev was there. The Prime Minister commented that he thought Mr. Gromyko was growing in importance. Herr Schmidt said yes: the MFA was taking more responsibility as they were being allowed to refer less and less to Brezhnev - but at the same time the Politburo too had enlarged its influence.

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The Prime Minister asked what of the Soviet role in Africa? He gave his own view as being that the Soviet presence was accidental in the sense that they had got into Angola by accident and had then found that they encountered no resistance from the West. So they had gone on from there. Once they had got in however it was difficult to get out.

Herr Schmidt said that the trouble was that President Carter could not be firm with the Russians - he could not stop them and this had been shown by his handling of SALT II. The Prime Minister said that technology and trade might be levers, for Brezhnev undoubtedly wanted trade. Herr Schmidt said no, this was not so. He thought it was important that the Russians should be put into the position of losing their fear of Germany. The Russians would not reduce their armaments but the goal should be to engage them in a joint perspective of trade, industry and technology over the next 20 years within which would emerge a greater Soviet dependence upon European supplies. This would result in more European influence on their policies. Their planning system was very rigid and their plans for the next 5-10 years equally so. They could not accommodate short-term change. If however they could rely upon a long-term perspective of the kind he had described they would take account of it. The Russians themselves seemed to have embarked upon a policy of diminishing from indebtedness to the West. The Prime Minister asked had they decided that they wanted to have more influence in Europe - was this their perception of their future, to keep Europe away from the United States? Herr Schmidt commented that this was not logical, for Russia itself had helped to establish the United States as a European partner eg at Helsinki and Vienna. Even so, the fact was that the United States influence in Europe was considerably weaker now than six years ago and weaker still since Kissinger left. It was a pity that the Year of Europe had come to nothing.

The Prime Minister remarked that the Chancellor seemed sceptical of the United States' policy. Herr Schmidt replied that he was not - only sceptical about the present office holders. The Prime Minister urged him not to underestimate President Carter: he ought to engage with him on defence issues. Herr Schmidt said

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/he regretted

he regretted that they had differences and he spoke feelingly about the handling of the neutron bomb issue. But he said he would leave the Prime Minister in no doubt that Germany would hold fast to the United States.

The Prime Minister said he hoped they would be able to agree a line about the response to the NATO long-term programme and, without being uncritical, give a fair wind to the programme, making it clear to the United States that we see their commitment as a serious one. Herr Schmidt agreed and said that he wished they would maintain the philosophy of LBJ - like it or not you, the US, must lead but without showing it. His despair was that the United States was not now leading. Their leadership was neither continuing nor predictable and this created instability. The FRG depended on the United States much more than the UK did. Without the United States Berlin would go and if it did then the results and consequences were unforeseeable.

The Prime Minister said he was sure that Herr Apel was reviewing the FRG's defence programme and he was sure that this was quite right to do. But he thought it was politically essential not to let Apel give the impression that his review or the NATO long-term programme/^{itself} amounted to a tacit admission that German and NATO policies had been wrong or defective. Herr Schmidt said that the FRG's response would be positive but they could not agree with all the United States Government's decisions. They thought they had handled AWACS badly. The Prime Minister said that Herr Schmidt did not suffer fools gladly! Herr Schmidt replied that the face of public opinion could not be shoved around. President Carter had said at the NATO meeting in London that NATO procurement would be a two-way street. In fact nothing had happened and US purchases amounted to 10% or less. He did not care very much that that was the figure. He did care that the President of the United States could not keep promises. The people to blame were the people below Carter and he did not accept the excuses about the problems on Capitol Hill: we all have our political parties to deal with.

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Civil Aircraft

The Prime Minister said that he would like to give the Chancellor an account of the present position of the British Government over the civil aircraft programme, which was giving rise to some very difficult issues. British Aerospace had agreed in December not to talk to US contractors while pursuing the possibility of European collaboration. This had proved to be very difficult because information had not been provided to them until the FRG intervened and he was grateful to Herr Schmidt for the German Government's action in doing this. The Prime Minister explained that conclusions on major civil aircraft issues in the UK had to be reached in the next 2-3 months. They would be very difficult, because we were torn between Europe where we had a political commitment but with whom we might sell few aircraft and Boeing with whom we had only a commercial relationship but whose aircraft would sell by their domination of the world market. They were all sources of conflicting considerations with British Aerospace wanting to go to Europe and Rolls Royce to the US. This was the UK's problem not the FRG's. But he would not decide it without consulting France and Germany. He wanted the Chancellor to know that he had authorised British Aerospace to talk to the US companies.

Herr Schmidt said that Rolls Royce were canvassing against the airbus in Europe and it was not understood why the British Government was allowing this to happen, for British industry was building wings. If the UK Government opted out of the airbus and went for Boeing, they would be giving them (ie Boeing not the UK) a bridgehead into Europe. It would be folly for the British Government to commit itself wholly to US aircraft manufacturers. What was needed was a strong development by the FRG, France and the UK industry to build the airbus development and to sell it world-wide. If we concluded that such a co-operative venture was impossible, and that major aircraft construction in Europe was not feasible, then we were saying that Europe was incapable of the high technology collaboration that we required if we were to find new industries: we had already lost rocketry; we were still left with a chance for aircraft consideration; and more than a chance for aero-engine construction and we should exploit those chances.

/The Prime Minister

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The Prime Minister said that Rolls Royce were being pulled both ways: they are already in the US big aircraft but they have no agreement yet to get into the European medium size aircraft. British Aerospace (BAE) are involved in the European consortium for the airbus. Rolls Royce wants to stay US oriented because otherwise we would be exchanging Rolls Royce's position as certain world leaders with a speculative venture.

Herr Schmidt said that the UK should decide whether it wanted to be the 52nd State. Boeing were too powerful. The AWACS system and its consequences had resulted from great pressure and salesmanship by Boeing. They had misled the FRG and possibly the US Government into thinking that 27 aircraft were necessary when the reality was only 16. Herr Apel was still considering all this but was very inclined to say no. Herr Schmidt commented that if a Government was told that it had to buy certain amounts of aircraft and ships and then only told of a different purpose for them afterwards, it led to loss of confidence.

The Prime Minister explained why AWACS was not a viable option for the UK, for whom the Soviet threat was essentially an Atlantic sea-borne threat for which we had to introduce a new aircraft much more quickly.

The Prime Minister, reverting to the civil aircraft issues, said that he had begun to get a view of all this but no decision had yet been taken. His present view was that we had got a successful aero-engine firm and a large aircraft industry. We had an offer from the United States which could establish both for a long-term. On the other hand, British Aerospace was not as strong as Rolls Royce and was pulling in two different directions.

Herr Schmidt said that it was a very important subject and he would regret it if decisions were taken on a purely national basis. Aircraft construction was one category of industries which was safe from the low-cost competitors: and there was a prospect of 5% per annum growth in the years ahead with no possibility that the LDCs or the super-competitives would enter into that market. We could be profitable. We have developed

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Herr Schmidt/the Tornedo

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the Tornado together. This was the industry, given investment and training, with the greatest prospects for future growth. He would deeply regret it if the UK were isolated from it for the US industry would then "sink" the European affiliates. The Prime Minister commented that he was not unaware of his responsibilities for Europe.

Herr Schmidt said we needed to decide urgently who was to speak to whom and at what level about these issues. We could not leave it to executives of Airbus industries and airlines. We should do it at Ministerial level, and it was certainly not for Junior Ministers involved only in aircraft issues. There were political, economic and military issues at stake here. If the UK went for the United States option, they would lose the base for military development in Europe.

The Prime Minister said he wanted to get a co-ordinated programme of work undertaken in the United Kingdom on this. It was not something he could leave to Junior Ministers or to separate departments: and they could not decide any of this in isolation. Herr Schmidt said that having told him about the seriousness of the situation and how the United Kingdom intended to proceed, the Prime Minister should tell President Giscard and then get together. He should send something soon to France to ensure that the President was fully informed. The Prime Minister said that he had taken charge of this only last week but he certainly took the point about President Giscard.

Herr Schmidt returned to the point that if there was no European aircraft industry, then by the year 2000 the market would be dominated 75% by the United States, with the balance of 25% supplied by the Soviet Union. We must beware that Europe did not become only a service industry area.

The Prime Minister said that we had also to take account of the fact, however, that if British Airways (whose posture he had explained) were not allowed to go into Boeing 737s, then there was a real possibility that Congress would stop Rolls Royce development inside the United States.

/Herr Schmidt asked

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Herr Schmidt asked what the view was of the Tornado development. The Prime Minister said that he thought our people were very satisfied with it. Herr Schmidt said that his were too. We should use this to influence public opinion and make something of the fact that this Anglo/German approach was successful and satisfactory. The Prime Minister said he agreed with this and we should set up an opportunity.

Herr Schmidt said he would look into the situation from his end.

KRS

The figures for the per cent increase in trade between 1973-1976 show that the value of G.F.R. visible exports to the U.K. has been growing less than the value of U.K. visible exports to G.F.R.. No doubt this principally reflects the results of exchange rate movements combined with the effects of U.K. accession to the E.E.C. Among the categories shown, Food, Drink and Tobacco provides an exception because of the effects of the Communities' Agricultural Policy.

These figures for per cent change need to be treated with care in that they refer only to movements between two point years but general inspection of the tables suggests they are a useful indication as to recent changes in the value of flows of trade. Note, however, from the figures showing the value of trade flows with the U.K. of nearly \$1.7 billions in visible trade reflecting exports of \$3.3 billions and imports of \$5.0 billions from the U.K. point of view.

The overall picture is dominated by trade in manufactures. Even in 1977 U.K. exports of oil to G.F.R. amounted to only \$425 millions, although G.F.R. imports of oil originating in the U.K. may well be greater than any of these figures suggest because of the role of Rotterdam as entrepot. In contrast U.K. imports of manufactures from G.F.R. still amounted to \$5.6 billions and the G.F.R. surplus in manufactures in 1977 was \$2.3 billions.

Although volume figures are not available general trade deflators are such that the real value of the G.F.R. surplus widened between 1973 and 1974 before narrowing with the general contraction in world trade in 1975. The real value of the surplus narrowed in 1976 and was probably more or less unchanged in 1977.

Over the period