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RECORD OF A DISCUSSION IN PLENARY SESSION BETWEEN THE PRIME MINISTER AND SIGNOR COSSIGA, THE PRESIDENT OF THE ITALIAN COUNCIL OF MINISTERS, AT THE PALAZZO CHIGI AT 1120 ON FRIDAY 5 OCTOBER 1979

Present

Prime Minister	Signor Cossiga
Foreign and Commonwealth Secretary	Signor Malfatti
HE Sir Ronald Arculus	Minister of Foreign Affairs
Mr. J.L. Bullard	Signor Pandolfi
Mr. M. Butler	Minister of the Treasury
Mr. M. Franklin	Ambassador Malfatti
Mr. C.A. Whitmore	Secretary-General, Ministry of Foreign Affairs
Mr. H. James	Ambassador Ducci
Mr. J. Adams	Italian Ambassador in London
Mr. M.O'D.B. Alexander	Minister Ruggiero
Mr. G.G.H. Walden	Head of Private Office, Minister of Foreign Affairs
	Minister Alessi
	Assistant Under Secretary supervising EEC matters
	Counsellor Squillante
	Signor Cossiga's Private Office
	Minister Berlinguer
	Diplomatic Adviser
	Signor Zanda
	Press Attache
	Signor Santini
	Economic Adviser

Bilateral Talks

Having outlined the agenda and referred to his tête-à-tête with the Prime Minister the previous evening, Signor Cossiga said that he hoped it would be possible to institutionalise talks between the Italian and British Governments at Head of Government level. The Italian Government already had talks on a regular basis with other members of the Community. It would be appropriate for the talks to take place twice a year. The Prime Minister said that bilateral talks were often more productive than summit meetings. She agreed that the bilateral talks at Head of Government level should be institutionalised on the basis proposed by Signor Cossiga.

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/(The Prime Minister

(The Prime Minister said initially that the talks should be held on an annual basis. But in the subsequent discussion she agreed that the talks should be held bi-annually.) She looked forward to seeing Signor Cossiga in London next year.

EEC

Signor Cossiga said that while there might be some differences in the short-term objectives of the two Governments, their long term interests in the EEC were identical. It should be possible to develop a line of common action. The basis of this would be that the Community could not count on a full contribution from Italy and the United Kingdom if they were not getting satisfaction from the partnership. The Prime Minister said that she was absolutely committed to making Europe function as effectively as possible. However, the grievances of individual members would have to be resolved if it were to work as well as it could.

The Community Budget

Signor Malfatti said that the Italian Government were very critical of the reference document produced by the Commission in response to the directive from the European Council at Strasbourg. The document failed to stress the deterioration in the balance of trade between Italy and the rest of the Community. As compared with 1978, the balance of trade had moved against Italy to the tune of 1,000 MUA. The erosion of the external tariff was also causing major difficulties for the Italian Government. It had a particularly damaging impact on the poorer section of the population. As regards the figures on the budget, the Italian Government did not accept the Commission's forecast. They expected that their net balance would be no more than 150-200 MUA, i.e. much less than the Commission had anticipated.

In explanation of this point, Signor Ruggiero said that the Commission had shown the MCAs as benefitting Italy. The Italians did not accept this. Moreover, the Commission's calculation was based on a payments forecast that was quite unrealistic. In addition, the Commission had failed to produce solutions to the problems created for Italy by the inadequacies of the present

regional policy; by the CAP; and by the erosion of the external tariff against the import of Mediterranean produce from non-members of the Community. Signor Malfatti said that the Italian Government would await the production of a further document by the Commission before they would be prepared to refine their demands any further. They were looking for a general shift in the balance of CAP expenditure. They wanted action on a number of headings:

- (a) the operation of the guarantee section of the FEOGA fund should be changed so that the impact on the Italian balance of payments of the import of agricultural products, e.g. beef, from other members of the Community, was reduced;
- (b) the present discrimination against Mediterranean products within the CAP removed;
- (c) the present wasteful surpluses in the CAP, particularly dairy products, reduced, perhaps through the use of co-responsibility levies;
- (d) aid given to improve the marketing of Mediterranean products within the Community; and
- (e) an assurance that if trade concessions had to be made to non-Community producers of Mediterranean products, the European producers, notably Italy, should be compensated.

More generally, Signor Malfatti said that they wanted to see the relationship within FEOGA between the guidance and guarantee sections changed; and to see the relationship between the CAP and other elements in the budget changed. At present 72% of the budget was taken up by the guarantee fund; 12% by structural, regional and social policies; and only 2% by energy, industry and transport. The Italians would like agreement to be reached in Dublin on a three-year programme by the end of which, e.g., 25% of the budget would be being spent on structural policies. There should be specific structural mechanisms to meet the particular situations of member countries.

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The Prime Minister said that as she understood it there were three principal Italian complaints. These were that:

- (a) too much of the total Community budget was spent on agriculture as opposed to regional, structural and other policies. The British Government agreed on this but considered that the total size of the budget should not go over the 1% VAT ceiling. Any changes in budgetary allocations would have to take place beneath that ceiling;
- (b) within the CAP, the balance of expenditure should be changed. Less should be spent on surpluses and more on dealing with other agricultural problems; and
- (c) Italy was having to bear too much of the cost of concessions made in the negotiation of trade agreements from which the EEC as a whole was the beneficiary.

Signor Cossiga said that the Prime Minister's summary was accurate. The Prime Minister repeated that the British Government had much sympathy with the Italian Government's complaints. They agreed that less should be spent on surpluses and more on aid to the regions. They accepted that this meant the re-structuring of the CAP. But it was essential that these changes should take place within the 1% VAT ceiling. They would like to see a start made with the reform of the CAP but considered that this would take time to bring to fruition. Signor Malfatti said that while the Italian Government wanted a re-allocation of expenditure, they were less concerned about the total size of the budget. The Prime Minister said that if Governments showed flexibility on the ceiling, the CAP would never be re-structured. The ceiling gave those who favoured reform a lever which had to be used.

Signor Pandolfi said that the broad objective of the Italian and British Governments seemed to him to be similar. Basically both Governments were asking that the requirements of convergence should be given a higher priority in EEC policies. However, in the short term there was a possible conflict in the positions of the Italian and British Governments. The British Government

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had a specific short-term problem, viz that their contributions and receipts were grossly out of balance. The Italian Government understood the necessity for the British Government to secure change in this situation. The Italian Government were less concerned about the budget. Even if the Commission figures were wrong, the Italian position had improved substantially. Their concerns were more general, viz the disproportion between the CAP and the rest of the budget and the imbalance between the guidance and guarantee sections of FEOGA. Given this difference of interest, the Italian and British Governments needed to work out guidelines for common action in ECOFIN and elsewhere. The Italian Government were ready to support the UK but in doing so they would rely on the UK to support them.

Signor Pandolfi said that he had talked to the Germans in Belgrade about these problems. He sensed a disposition on the part of the Germans to be helpful on both the British and Italian requests. But there would be limits on German helpfulness. They were not prepared to go through the 1% VAT ceiling. Signor Pandolfi said that he personally agreed that in present circumstances that ceiling should be maintained. There was in any case a 13% margin in hand. (Signor Pandolfi noted the potential complications of enlargement in this context.) The Germans, secondly, would not be prepared to accept either the British or the Italian position in full. They would propose gradual implementation of any solution in either area.

The Prime Minister said that the British Government were suffering from the operation of the budget in two ways. Britain was contributing more than their GNP share and receiving less. The third poorest member of the Community was the largest contributor. The Prime Minister said that much as she would like to play Lady Bountiful to the Community she could not afford it at a time when the British Government was having to cut back its expenditure on health, education, local government and numerous other areas of great electoral sensitivity. The present situation was grossly unjust. Failing a move on the budget, there would be a serious and hostile reaction in the United Kingdom. The British Government were not asking that

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they should be net beneficiaries from the budget. They did not want money from their partners. They sought instead a broad and reasonable balance. The Community should not underestimate the determination of the British Government.

As regards the longer term, the Prime Minister said that it was of course ridiculous to create and support agricultural surpluses. The CAP would have to be changed. The Italian Government would encounter no difficulties with HMG in its efforts to secure such a change. But perhaps some of the other members would see more difficulties. Perhaps it would suffice for the European Council to declare its intention to seek reform in the CAP. Signor Cossiga questioned the use of the word "intention". The Italian Government would need a commitment, not a statement of intention. The Prime Minister said that the problems identified by the Italian Government were even more complicated than that faced by the British Government. Perhaps the Dublin Council should aim to define the Italian difficulties more clearly; to declare its intention to deal with them; and to commission papers for the following Council. The British Government would support such a programme very strongly. It seemed doubtful whether the Italian Government could get all they were seeking at the Dublin meeting. Signor Pandolfi said that the Prime Minister's remarks suggested there was some difference of position between the two governments. The Foreign and Commonwealth Secretary said that the British Government sympathised with and would support the general approach put forward by the Italians. They had no wish to ignore the difficulties faced by the Italian Government. However, we needed more details of what the Italians had in mind. It might be that the difficulties of securing movement would not be as great as appeared. The Prime Minister agreed with the Foreign and Commonwealth Secretary's remarks and asked whether the Italians had worked out their ideas in detail and whether a paper could be made available so that it could be discussed in further bilaterals at official level and with other Governments.

Signor Pandolfi said that the Italian Government would be putting specific proposals to the Commission in the following week.

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The proposal would seek action under three headings:

- (a) that a decision should be taken to reduce gradually but in a definite period (3-5 years) on a year-by-year basis the percentage of the total expenditure of the budget devoted to the CAP. The reduction might be of the order of one or two percentage points per year;
- (b) that the same process should take place within FEOGA, re-directing expenditure from the guarantee to the guidance fund; and
- (c) that action be taken to diminish the cost to Italy of the import of agricultural products from other members of the Community and to encourage the increased production of some agricultural products, particularly meat, in Italy.

The Prime Minister asked whether Italy would be seeking fixed percentages and timescales in Dublin. Signor Pandolfi said that if precise decisions were not taken in Dublin there would be further delay. It was essential that the Italian and British Governments should not be divided. Both the Prime Minister and the Foreign and Commonwealth Secretary said that it would be easier to get a decision in principle than a decision with figures. Signor Pandolfi said that figures were essential, although he was not dogmatic about what those figures should be. The Prime Minister said that it was essential to have the details of the Italian proposals as soon as possible. The British Government would look at them carefully and sympathetically with the intention of being constructive. The interests of the two Governments were the same. British representatives in forthcoming bilaterals would say that they were studying the Italian proposals sympathetically. The Prime Minister hoped that Italian representatives would say the same about their approach to the British problem.

Signor Cossiga said that Italy's experience had been that the decisions at Strasbourg had not been translated into a paper satisfactory to his Government. The Italians did not want to find themselves after Dublin in the same position as they were now after Strasbourg. It was essential that the problem should

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be quantified. General political indications would not suffice. Signor Pandolfi said that Monsieur Ortoli would be in Rome the following week and would be given precise details of the Italian proposal. (Officials in subsequent discussions cast some doubt on whether the Italians would in fact hand a paper to the Commissioner.) It was agreed that the discussion would be continued at the forthcoming meeting between Signor Malfatti and the Foreign and Commonwealth Secretary and that in the interim talks at official level would continue.

/European Monetary System

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European Monetary System

Signor Cossiga said that Signor Pandolfi had just returned from the meeting of the IMF in Belgrade where he had been elected Chairman of the Interim Committee. It might be useful if he were to say something about the EMS and then about the international monetary situation in general. The Prime Minister congratulated Signor Pandolfi on his appointment.

Signor Pandolfi said that the Italian Government had been unhappy about the fact that when the EMS had recently decided to adjust its central rates, Britain had not been represented. He had spoken very frankly to the Germans about the need to observe Article III(2) of the 1978 Brussels declaration. It was wrong that meetings on such sensitive subjects should be held at such short notice and in the absence of a major member Government. The Italian Government would insist on improvements in the consultative procedure.

As regards the central rate adjustment, Signor Pandolfi said that they had opted for a modest change but the interest rate situation was still under stress. It was essential for the members of the EMS to achieve a common policy. The weakness of the Dollar meant that there would have to be day to day consultation on the rate. Otherwise the EMS would be unable to maintain a common position on rates vis-à-vis the Dollar. The modest re-alignment agreed in Brussels would suffice for a short period only and constant surveillance of the evolution of the market would be required.

Signor Pandolfi said that the United Kingdom should in due time join the system. Without the UK, the system was incomplete. The Prime Minister said that the British Government would like to join the EMS but that the present fluctuation in the value of sterling was a problem. The value of sterling was being determined by our oil reserves rather than by our economic performance. It was the British Government's objective to join the EMS when conditions were sufficiently stable. The adjustment of the central rates had gone well but the Prime Minister did not expect it to last

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very long. It was not easy to maintain an island of stability in an unstable world. So long as the general economic situation was unstable, that instability was likely to be reflected in currency fluctuations.

In reply to a question by the Prime Minister, Signor Pandolfi said that the discussions in Belgrade had concentrated on one medium and long term problem - the need to find a new reserve regime - and one short term problem - the Dollar. On the first issue, the consensus had been that neither a one currency system nor a multi currency system was desirable. They had decided therefore to study what seemed likely to be a better mechanism viz the substitution account. But it would not be easy to design a system that was attractive from the point of view of value maintainance and burden sharing. As regards the shorter term problem, no solutions had been found. The Germans were unwilling to produce additional liquidity or to accept Carter Bonds. Closer co-operation between the central banks would be required and the agreement of 1 November 1978 would have to be renewed on a firm basis.

Theatre Nuclear Forces

Signor Cossiga said that his Government was extremely anxious to avoid a prolonged hiatus between the forthcoming meeting of the Nuclear Planning Group, at which the question of Theatre Nuclear Forces modernisation would be discussed, and the subsequent Ministerial meetings of the Defence Planning Committee and the North Atlantic Council. He was anxious about the possibility that there would be Parliamentary and extra-Parliamentary pressure against the formal approval by Ministers of the recommendations of the Nuclear Planning Group. The Italian Government was not changing its policy but he knew that his concern about the gap between the two meetings was shared by other Governments, notably by the Germans and the Dutch. Signor Cossiga asked whether it would be possible either for the formal decision to be taken by the Permanent Representatives of all member Governments immediately after the NPG meeting or for the NPG meeting to be moved closer to the Ministerial meetings in December. It was important that the first decision should be definitive. The

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sooner that decision could be taken the better.

The Foreign and Commonwealth Secretary, having noted the importance of the forthcoming decision, said that there might be difficulties in either course. At the last meeting of the NAC it had been clear that a number of countries would insist on the TNF decision being a political one taken by all the Ministers at their December meeting. It would be difficult to get it through any earlier. Postponing the NPG to nearer the meeting would certainly reduce the gap but might be difficult to arrange. Perhaps the Italians should discuss the problem with the German and Dutch Governments at the meetings due to take place in the following week. The Prime Minister said that the British Government would be prepared to go along with any procedure that was acceptable to the other members of the Alliance and that enabled the decision to be taken with despatch. Signor Cossiga, agreeing, noted that Mr. Brezhnev had already begun to make propaganda on the subject and to claim that by seeking to modernise their Theatre Nuclear Forces, the members of the Alliance were playing with fire. The Prime Minister said that members of NATO must be prepared to counter-attack vigorously where propaganda was concerned. The Soviet Government already had Theatre Nuclear Forces. The Alliance needed them to counter-balance the Soviet capability. She saw no difficulty in conducting this argument.

Commercial Credit

In discussion over lunch, Signor Cossiga and the Prime Minister agreed that there would be advantage in trying to agree a common line on the question of the interest rates offered to the Soviet and Chinese Governments in credit agreements. This was relevant both in that the subject would certainly come up during Premier Hua's forthcoming visit and in that both Governments, like the French Government, had credit agreements with the Soviet Government coming up for renewal near the end of the year. It was agreed that the matter should be pursued by officials.

The plenary session ended at 1320 hours.

6 October 1979

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