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Defence.

Ref. A09931

PRIME MINISTER

Defence Costs in Germany

(OD(79) 16)

BACKGROUND

The current Anglo-German offset agreement expires in March 1980 and this note by officials examines what approach the Government should adopt. The paper sets out the costs we incur annually on the defence budget by stationing forces in Germany (£310 million more than if they were in the United Kingdom) and the burden this places on our balance of payments (a net foreign exchange deficit of about £450 million). The German economy benefits conversely and this argues for our seeking some form of compensation. But the last offset agreement was particularly difficult to obtain and we had to agree with the Germans to have no more bilateral offset agreements. Furthermore they have stated that they are not prepared to consider making any contribution towards our expenditure, even in any multilateral scheme we might propose.

2. The question is whether we should press the Germans to change their view and to agree in principle to contribute somehow to our defence costs burden, despite the risk that such an approach could prejudice German support for our case on the EEC budget. We have however much more at stake in the EEC budget context (to be considered under the next agenda item) and Ministers may conclude that the rather remote chance of gaining perhaps £50 million on account of our defence costs should not be pursued separately, but that our forbearance should be used with our allies as an additional argument in support of our EEC budget case.

HANDLING

3. You might wish to invite the Secretary of State for Defence to speak first on the defence case and the Chancellor of the Exchequer to comment on the balance of payments implications. In subsequent discussion, the following points could be established:-

(a) Chancellor Schmidt's attitude. He is known to be personally committed to the ending of existing offset arrangements. What would be his reaction if you now reopened the question of compensation? Would the Germans be prepared to contemplate a multilateral scheme if it gave sufficient disguise to the inevitable fact that the Germans would be the major net contributor?

(b) What benefit could we hope to get? The current offset agreement is worth about £40 million a year. Could we hope to negotiate significantly more and, if not, is it worth pursuing such a figure at the risk of upsetting our EEC budget hopes?

(c) Is there a negotiable scheme? Neither of the two schemes suggested by officials is particularly attractive in its own right. Either would be regarded as no more than a complex disguise for offset. Even with German acquiescence, could we expect to negotiate either scheme successfully within NATO?

(d) What is the risk to our EEC budget case? The case is set out in the Chancellor's paper for Item 2. Would an approach to the Germans over defence costs in some degree jeopardise our chance of support from them over the EEC budget? Could we use the defence arguments to our advantage in the budget context?

CONCLUSION

4. Subject to the discussion, you may be able to sum up that the general conclusion in paragraph 20a. of the paper is agreed, i.e. that we should make use of our German stationing costs as part of our argument about financial overstrain; but that no further approaches should be made to the Germans over defence compensation at least until the course of the EEC budget negotiations is clearer.

JOHN HUNT

9th July, 1979

THE TIMES TUESDAY NOVEMBER 27 1979

WEST EUROPE

London prepares for battle with Bonn over costs of BAOR

By Henry Stanhope
Defence Correspondent

Britain, already confronting its allies over EEC budget contributions, is preparing for a clash over the costs of stationing troops in West Germany.

The Ministry of Defence, with Cabinet approval, is drawing up a list of proposals to be put to the Bonn Government early in the new year.

Payments by which West Germany helps to offset the foreign exchange costs to Britain of keeping troops overseas, have long been a source of friction between the two allies.

But this time ministers are bracing themselves for a battle of wills which promises to be the most heated so far. The trouble is that Mr Callaghan's government, after long and difficult negotiations over the last offset agreement in 1977, signed away the right for Britain to go back for any more.

Mrs Thatcher's Government is insisting, however, that negotiations will have to be reopened over the mounting burden on Britain's fragile economy. It wants a better deal than the last one, which expires in March.

There are already signs of friction between the Ministry of Defence and the Foreign Office which conducts the negotiations. Diplomats are reluctant to take up the cudgels again over an issue which they thought had been settled.

The Ministry of Defence blames the Foreign Office and the previous Government for concluding the present agreement which was largely felt to be a triumph for the West Germans.

In 1977 when the agreement was signed, the foreign exchange costs of maintaining 55,000 troops in the British Army of the Rhine (BAOR) and 10,000 more in RAF Germany, were running at an annual £569m. To offset this the West Germans finally agreed to pay only £125m over a period of three years—about £41m a year.

But this was not to be paid in cash. The Bonn Government insisted instead carrying out £125m worth of building for British troops, whose barracks have long been in need of modernization.

This not only meant work for the German Construction Agency, but also that the German money would be invested in real estate on home soil. Together with the written agreement that it was to be the last offset payments deal, it was a very satisfactory bargain from the West German point of view.

As Britain has to pay about £100m every year on construction alone for its troops stationed there, the deal has meant, however, that the Germans have met only 40 per cent of that single bill. Moreover, the foreign exchange costs have risen to an estimated £666m in 1979-80.

The proposals being prepared by the Ministry of Defence will be put to the West German Government once the dust has settled after the EEC budget confrontation.

One idea is that the Germans should be asked to sign an agreement similar to, but better than, the existing one. Another is that they should pay the wages of the 25,000 German workers employed by British Forces Germany. A third is that they should buy more British military equipment. At present they do far more business with the United States and France.

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cc Cabinet Office

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MAIN BUILDING WHITEHALL LONDON SW1
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27th November 1979

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Dear Richard,

HENRY STANHOPE'S ARTICLE IN THE TIMES

You asked me for a line to take with the Federal German Chancery on the article in today's Times by Henry Stanhope. Can I suggest the following:

> "The Times carries an article which says that we are preparing to make an approach to you on the costs of stationing British Forces in Germany. There is no truth whatever in this report. The last Administration agreed with you a terminal offset agreement, and agreed with you that this marked the end of bilateral offset agreements, as they had existed since 1955. We have absolutely no intention of reopening this understanding."

A piece on Top Day questions is being forwarded separately. I am sending a copy of this letter to Paul Lever in the Foreign Secretary's Office.

I also explained that there was a danger that this form of words could restrict (although not eliminate) our freedom of manoeuvre if at some later stage we wished to consider the question of burden sharing in the Alliance

Yours ever,
David Omand

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Private Secretary

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No 10 Downing Street

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27 November 1979

Henry Stanhope's Article in The Times

You wrote to Michael Alexander earlier today about Henry Stanhope's article in The Times about Offset.

I spoke this afternoon, on the Prime Minister's instructions, to Jurgen Ruhfus in Chancellor Schmidt's office on the lines suggested in your letter. Ruhfus said that he was very grateful for the message which he would bring to the Chancellor's attention immediately.

I am sending a copy of this letter to Paul Lever (Foreign and Commonwealth Office).

C.A. WHITMORE

D.B. Omand, Esq.,
Ministry of Defence.

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