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PRIME MINISTER

You will have seen the telegrams reporting the outcome of the Finance Council on Monday. You may care to have, in addition, my own reflections about the next stage in our pursuit of a sensible solution of our budget problem.

2. The meeting was successful - from our point of view, more successful than at one time seemed possible. Despite a last-minute threat by the Italians to block the whole debate until their own case had been more fully presented (which I managed to head off in prior talks with Pandolfi and the Presidency) and despite delaying tactics by others, we have managed to maintain the momentum of the Strasbourg remit, and we have both the Presidency and the Commission firmly committed to the preparation of solutions in good time for decisions at Dublin. With the help of the Commission's reference paper, I have been able to state the UK case for equitable treatment - its nature, scale and urgency - in terms which cannot reasonably be refuted or brushed aside. And I have fulfilled our part of the European Council remit by indicating both those solutions which would be inadequate, and those which could give us what equity demands.

3. This, I consider, is good progress and better than par for the course. But the most difficult work is still ahead. Indeed, we can expect the going to get tougher from now on precisely because our problem and our position, and its implications for the others, are now so clear.





4. We must now follow up vigorously on what we have gained. By the end of this week, we shall be sending supplementary factual material to the Commission (following Ortoli's general invitation) to refute the argument that the budgetary picture fails to take account of non-budgetary factors: we can show that the non-budgetary factors make our own position even worse than the budgetary picture alone indicates. We are also inviting Italian officials to London to help them with the presentation of their non-budgetary problem.

5. Next, the remit from OD to prepare more detailed work on possible solutions is being discharged. This will provide us with the necessary basis for further discussion with the Commission in the course of the preparation of their paper on solutions. In the procedural conclusions of Monday's Finance Council, this work by the Commission is supposed to await the further discussion of the reference paper at the October Finance Council, but the Commission are under no illusions that, in practice, they will have to start work straight away if they are to meet the Strasbourg deadline. And (as with the reference paper) we shall be in close informal contact with their work to make sure that their thinking is on the right lines and that their ideas for solutions are commensurate with the problem.

6. Above all, we must maintain the initiative through bilateral talks at Ministerial and official level. Your own meetings with Schmidt, Giscard and Cossiga will have a vital part to play. I have in mind a programme of visits which I might make to key Finance Minister colleagues as soon as I can arrange them after Malta, Belgrade and the Party Conference. Influencing the French will be vital and I shall try to see Monory and perhaps Barre: indeed, our strategy should be to lose no opportunity to convince French Ministers and officials of the seriousness of our concern over the Budgetary issue. The Germans seem likely to be





considerably more helpful than the French. Also important will be the smaller countries - the Dutch, the Belgians and the Danes: they may not be ready or able to help much, but their potential for obstruction is considerable. As for the Italians, we must continue to be as sympathetic as possible for as long as possible, if only to reduce the risk of their holding up our own progress; but in the long run we must beware of too close involvement in solutions for Italy which could be expensive for us.

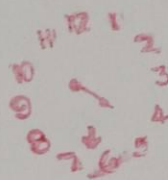
7. A final note on the decision of the Council to conclude the EMS review. This was at German instance, said to be to calm speculation that major changes, either in the mechanisms or in the pivot rates themselves, were in prospect. I expressed some doubts about the justification for or wisdom of such an unexpected statement, but the participants were unanimous in supporting the German proposal. It could be said that the conclusion of the review removes one answer to those who may wish to press us for a decision whether or not to enter. But the fact that the participants, after a review of some elements of the system, have decided that, in the light of experience so far, there seems to be no need to alter the machinery at present has very little to do with the fundamental considerations which will underlie our own choice, and Monday's statement should not subject us to any serious new pressure.

(G.H)

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21 September 1979

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