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Ref. A0649

PRIME MINISTER

This personal note attempts to set the scene for the visit of President Giscard and the meeting of the European Council at Dublin. It supplements an "official" Cabinet Office brief, which I attach.

2. The reduction we shall achieve in our contribution to the EEC Budget will depend in the end on Germany and France: in other words, on Schmidt and Giscard. We have to remember that the first Community crisis that hit these two after taking their present offices was the Labour Government's demand for "renegotiation" of the terms of British entry. There was, by all accounts, some fairly plain speaking by both of them in the course of that episode. In the end, however, they made it possible for Mr. Wilson and Mr. Callaghan to "succeed" in renegotiation: Schmidt and Giscard each had his own reason for wanting us to be in rather than out, and they were convinced that both Mr. Wilson and Mr. Callaghan on balance - and perhaps for negative as much as positive reasons - wanted Britain to stay in.

3. What is the position five years later?

4. Schmidt made his position clear at Bonn a fortnight ago. He acknowledges the strength of our case for a reduction of our net contribution, and understands the seriousness of the problem. He would rather we were in the Community than out of it. He needs us, in political and defence terms. He will be helpful, within limits. But he will not go as far as "broad balance". This is partly for domestic reasons - not increasing the German contribution by too much; it is partly that he will not want to be too far in front of the other members of the Community; and above all because he will not be prepared to push the French too hard. His relationship with Giscard has grown much closer in the last five years; he foresees a period of great political uncertainty ahead, as a result primarily of the weakness of American leadership, and in this period his first priority is to maintain the closeness of the French connection; and he has not been impressed by the European performance of Britain under the Labour Government.

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5. Schmidt does not seem to be unduly worried about his own domestic political position. But he has an election at the end of next year, and we know that he and Genscher are apprehensive about the position of the FDP, whose share of the vote is only just above the 5 per cent which they must achieve to be represented at all in the German Parliament. That would, even without the French, set limits on the extent to which he can or will help.

6. Giscard has to face a Presidential election in May 1981 - less than eighteen months from now. He must be thinking about the need to protect his domestic political position: he has to fend off the challenge of Chirac who represents the Gaullist element on the French right (never wholly reconciled to British membership), as well as to ~~best~~ test the left. His worries must have been compounded by the scandal surrounding the suicide of his Minister of Labour. The farming vote is of great importance to him.

7. I would think that Giscard himself would prefer us to continue in membership of the Community. But the political and defence considerations which must affect Schmidt probably affect Giscard less strongly; he would be less concerned than Schmidt at the prospect of our coming out of the Community; and I have no doubt that he calculates that, despite North Sea oil, we need the Community more than the Community needs us (this is a judgment that you may want to test with the Foreign Secretary).

8. Giscard, like Schmidt, remembers "renegotiation", and was disenchanted with Britain as a member of the Community under the Labour Government. He too will be looking for evidence that under your leadership Britain will become a more whole-hearted member of the Community, and looking for evidence of the genuineness and depth of the European commitment which you have publicly stated. That does not mean that he will not expect you to fight for British interests: the French are expert at protecting their own national interests, and do not think the worse of other people for protecting theirs. But he as well as Schmidt will want to be sure that you see British national interests as including continuing British membership of the Community and that you and your colleagues are committed to preserving and strengthening the Community, and to closer European co-operation, as well as to protecting our national interests.

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9. Schmidt is less likely to look for some definite quid pro quo from us for his support on the budget question. Giscard, on the other hand, will do so: not just because the French always do, but because he will need, in domestic political terms, to have something which he can claim as a benefit for France. This does not mean that we have to negotiate in terms of a bargain: we can discuss the budget issue on its merits. But we must not blind ourselves to the fact that he will be looking for, and will need, some signs of movement from us on other points. And he would no doubt prefer it on things which interest his farmers and fishermen: he will think that, if we claim to want to be good partners in the Community, we should be responsive to his political needs just as we expect him to be responsive to ours.

10. Both Giscard and Schmidt will see it as one of the tests of our commitment to the Community that we should look for solutions to our budget problem that are within the framework of Community rules and principles and do not ^{do} violence to them. There is increasing evidence that there will be little or no support for new mechanisms based on net contributions or on GNP figures.

11. A smaller net contribution for us means larger net contributions (or smaller net receipts) for our partners. On a question of timing, you already have it in mind that the Community itself and many of the member countries (including France) work to a financial year which coincides with the calendar year. Those countries will have made up their budgets for 1980, and we are very late in the day in asking for changes that will take effect on their budgets in that year. On the other hand there may be some help in the fact that our financial year runs from April to March: benefits which accrued to us in the Community's fiscal year 1981 would to some extent be reflected in our financial year 1980-81.

12. The case in equity for getting our net contribution to somewhere near broad balance is strong. It is not equitable that we should be seventh by the GNP per head standard, and pay the largest net contribution of all. We have the 1971 undertaking when we came in that if unacceptable situations should arise "the very survival of the Community would demand that the institutions find equitable solutions".

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13. But the argument of equity may not be the one which will carry most weight with our partners, or the most advantageous one for us to rest our case on, for two reasons:

- (a) An argument from equity carries with it the implication that our partners have treated us inequitably. It invites them to contest the basis of the argument, in an almost legalistic fashion, by counter-arguments to the effect that our problem results not from their inequity but from our own failures and weaknesses. That road may lead to sterile debates rather than constructive negotiations.
- (b) An argument from equity also invites other partners to compare their situations with our own, and to look for the respects in which they can claim to be suffering from inequity, or to be in no less difficult a situation than ourselves. Some of our partners will certainly claim that their economic situations and prospects are no less difficult - in their own way - than ours.

14. Thus the argument from equity may stimulate resistance from our partners. Is there another line of argument which would go more with the grain?

15. There is a considerable fund of goodwill in the Community towards you and your Government. They believe that you are committed to Europe in a way your predecessors were not; they admire your policies, and the strength of purpose with which you are pursuing them; and they want those policies to succeed. There is some reason to believe that they all, including Giscard, will be more responsive to a line of argument which says in effect: you gave our predecessors transitional arrangements (the transitional period under Article 131 and the 1975 financial mechanism which has proved to be ineffective) which, because of their other policies, they failed to take advantage of; we have different and better policies, but we need time; give us the same amount of time that they wasted, and just see what we do with it; we are not the only people who need time: the Community needs time for the development of structural changes (notably, reform of CAP) which most of us think are needed; so the Community's need for time and ours coincide.

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16. If in Dublin we are having to negotiate about mechanisms as well as figures, we shall be in considerable danger of coming away with nothing, except loss of goodwill. As I have already indicated, if we are arguing for new mechanisms based on net contributions or on GNP figures, we are likely to encounter resistance. Thus there would be negotiating advantage if, following the line of argument I have just described, we were to go on to say to our partners in effect: we do not want to call in question the structure of the Community or its received principles; we do not even ask you necessarily to consider new mechanisms; we should be content to work on the basis of adapting and developing the existing mechanisms (the 1975 financial mechanism and, if our partners think that this provides a suitable framework, the provisions of Article 131), or of ad hoc arrangements within Community principles, provided these methods can yield the sorts of figures we need and you are prepared to accept, and will last for a reasonable period of years (i. e. four years, to match your predecessors' four "wasted" years).

17. This line might help to narrow the area of negotiation: we should be able to avoid negotiating about mechanisms. We could leave the Commission to sort that out, and report back to the Council of Finance Ministers. Mechanisms are in any case a subject of such complexity as to be difficult to deal with at Heads of Government level. You could then concentrate at Dublin on the figures.

18. What is the range of figures in which we look for a solution? The indications are that both the French and the Germans are thinking in terms of removing the constraints on the 1975 financial mechanism, which would produce a reduction in our net contribution by £380 million to £700 million. We cannot, I believe, have any hope of getting agreement to a smaller net contribution than the French; if that is right, the maximum reduction we could hope to achieve would be by about £750 million to about £300 million. This suggests that a solution will in practice have to lie within the range £300 to £750 million. If we could get a solution near the upper end of that range, it could be presented both in this country and in Europe as a reasonable outcome:

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it would compensate us for the fact that the proportion of the Community budget accounted for by the CAP had not come down to 40 per cent, as predicted at the time of our entry, while enabling us to claim that we were ready to accept and not bill our partners for the consequences of our own economic inadequacy in recent years.

19. The disadvantage about the kind of approach I have outlined in paragraphs 15 to 18 of this note is that it is a temporary solution: it does not go to the receipts side of the balance sheet, and if in four years' time there had not been other economic or structural changes which improved our net contribution, we should have to have another battle. But we shall in any case have to fight our corner in future discussions of structural change, and the advantage of the approach I have outlined is that we ought to get more benefit (i. e. hard cash) out of it in the next two or three years than our partners will concede on any other basis. But we should certainly combine it with a determination to pursue the reform of the CAP (on which we shall have strong German support) and other structural changes which both contain the total and improve (so far as we are concerned) the distribution of Community expenditure. These questions will also come up at the Dublin meeting (which should not be confined exclusively to the budget problem), and we should have to make it a condition of our approach on the budget question, whatever it is, that the Community commits itself to the initiation of a programme of structural change, and above all reform of the CAP.

20. You have a tough negotiation on your hands, if you are to get at Dublin a reduction reasonably near the top of the £300 to £750 million range I have indicated in paragraph 18. It is arguable that, on the sort of approach I have outlined, you would be making the most of the goodwill you enjoy in the Community, and cutting with rather than against the grain; and that, because you were cutting with the grain, you would cut deeper.

21. There will be a great desire on the part of our partners and of the Commission not to have an unsuccessful outcome to the Dublin meeting. We should make the most of that in order to try to get what we want at Dublin. It may be, however, that, in order to achieve as much as we need to achieve, we

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shall have to precipitate a "crisis of the Community" at Dublin. I do not think that we need shrink from that, if it is necessary, provided that we can keep the situation under control, and in particular that:

- (a) we do not put our membership of the Community at stake;
- (b) we make it clear that we want a quick settlement, and have no desire for a long drawn out crisis.

It is not in our own national interest that the Community should be in prolonged crisis through 1980, with all that that would mean in terms of its ineffectiveness in a very uncertain international economic and political scene. Moreover, we know that this prospect looms large in Schmidt's thinking: we shall risk losing such support as we hope to have from him if we do not seek to resolve the budget problem quickly as well as satisfactorily, so that the Community can be solidly together in the coming year. Lastly, because Schmidt faces elections at the end of 1980 and Giscard in the spring of 1981, we cannot calculate that a better solution will be available later in 1980 than at the beginning of it. If therefore we cannot agree a solution at Dublin, we should press for an early resumption of the meeting. I guess that, in practice, it could hardly be before the second or third week of January 1980, but we might want to propose an earlier date, as a demonstration of our desire to solve the problem quickly.

REA

(Robert Armstrong)

13th November, 1979