

SECRET

6.

see Master Set
 see Euro PD, Budget Pt 7
 see Extracts CAP + Sheepment Euro PD Pt 4
 " EMS Euro PD, June 79, and Fishing Industry Pt 2
RECORD OF A MEETING BETWEEN THE PRIME MINISTER AND CHANCELLOR SCHMIDT
HELD AT CHEQUERS AT 0945 ON FRIDAY 28 MARCH 1980

Present: Prime Minister
 Mr. C.A. Whitmore

Chancellor Helmut Schmidt
 Herr Otto von der Gablentz

* * * * *

Reform of the CAP

The Prime Minister said that the problem of the UK's net contribution to the Community budget had grown worse since Dublin. The more the total of Community expenditure rose, the greater was the disproportionate increase in the British net contribution. For this reason the UK would stand absolutely firmly on the 1% VAT ceiling. It was in our own national self-interest that we should do so, but it was also in the interest of the Community as a whole that we should take this line, since some elements of the CAP were absurd. There was no hope that the Community would develop the will to reform the CAP until it was brought up against the necessity for change; and that would happen when the 1% VAT ceiling was reached. Chancellor Schmidt said that he agreed completely.

The Prime Minister continued that she knew that Chancellor Schmidt would like the UK to take the lead on CAP reform. But she was very concerned that if we were to do so, the UK would be accused of being non-communautaire and other members of the Community might attempt to use such action on our part against us. She was therefore reluctant to see the UK take the lead on this. Rather, she hoped that it would be possible for all members of the Community to agree upon the need to change a policy which was so outdated and out-of-tune with reality.

Chancellor Schmidt said that he hesitated to agree with what the Prime Minister had ^{just} said. Much would depend on the way in which the reform of the CAP was brought up in the Community. He had had it in mind for years that reform would be brought about only on the initiative of the UK. He took this view because the British agricultural system was such that the UK was better placed than any other member of the Community to give a lead. ~~Most~~ continental

/ members

SECRET

SECRET

members have much stronger vested interests which were opposed to the reform of the CAP. Nonetheless, he did not believe that those countries would criticise the UK for raising the issue of reform. He had mentioned this when talking to President Giscard two days previously. He had put it to the President that the question of medium-term reform of the CAP would need to be included in any package designed to solve the problem of the UK's net budgetary contribution. President Giscard had said that he thought that procedural reform of the CAP would have to be included in any package, though he had gone on to point out that it would not be possible to say very much about the substance of reform in a deal that had to be struck this Spring. He had said that to give the issue of reform concrete substance would take much more time. President Giscard had suggested that it might be possible to ask Agriculture Ministers or the Commission to come forward with firm proposals on how to proceed, perhaps in time for the meeting of the European Council in Venice.

Chancellor Schmidt continued that he had mentioned his conversation with President Giscard to show the Prime Minister that there was not a general reluctance within the Community to consider reform of the CAP. He was sure that, as well as Germany and the UK, France, Denmark, Holland and perhaps Italy would all agree at the level of Heads of Government that reform was necessary, in particular in order to be able to reduce expenditure on the CAP. He believed that President Giscard would stick to the 1% VAT ceiling and the President had implied to him that he accepted the need to limit agricultural expenditure.

The Prime Minister said that she was encouraged to hear what Chancellor Schmidt had said. She had been concerned by some French statements which suggested a rather different attitude. Nonetheless, she remained concerned that if the UK took the lead on CAP reform we should be charged with being non-communautaire and we would then have to retreat very quickly. She would prefer to see the UK, France and Germany taking the initiative together.

/ Community Budget

SECRET

Community Budget

The Prime Minister said that reform of the CAP was for the longer term, but the UK's budget problem was immediate and urgent. The increase in our forecast net contribution which had taken place since Dublin showed the speed with which the problem was running away from us.

Chancellor Schmidt said that he agreed that the matter was urgent. But it was important to look at it not only from the British point of view, but also from the standpoint of each of the other eight members of the Community. When he had seen the Prime Minister of Denmark recently, he had told him that he thought that the Community was in a very serious situation over the UK's budget problem. He had asked him to consider what it would mean for Denmark if the UK withheld its contribution to the budget or even left the Community altogether. If either of those things happened, the Commission would immediately stop all financial outlays. The Eight would then have to fill the gap or would have to accept an absolute cut in Community expenditure. He had told Mr. Jorgensen that the effect might well be more than the Danish economy could bear. The same was probably true of Italy and Holland. He recognised that the UK could not make this kind of point to its partners since it would imply a threat to leave the Community, but he was ready to draw the attention of his partners to these worst case possibilities. He had done so recently with President Giscard. The President's reply had been that he did not think that the UK would interrupt its payments to the Community because he believed what the Prime Minister had said about the UK's commitment to Europe. He had, however, told President Giscard that he was less confident in the light of British public opinion at present.

The Prime Minister said that Chancellor Schmidt was right to be concerned about British public opinion. The feeling that the UK was not getting a equitable deal was growing stronger and stronger. One hundred and twenty backbench Members of her own Party had signed a motion calling for the withholding of Britain's VAT contribution if a reasonable settlement of the budgetary problem was

/not

SECRET

- 4 -

not reached. Moreover, Mr. Callaghan had recently challenged her twice in the House of Commons to say that she would ^{be} ready to withhold VAT. In reply to him she had had to agree that in the last resort we would indeed have to consider withholding our VAT contribution. If she had not said this, the implication would have been that she was not fighting hard enough for the UK. She accepted, however, that it would be clearly illegal for the UK to withhold its levies.

Chancellor Schmidt said that to withhold levies would indeed be a flagrant breach of Community law, but he accepted that VAT was different and that the UK might be able to claim that it was unable to transfer its contribution.

The Prime Minister said that now that the meeting of the European Council had been postponed, it was even more important to be in a position to reach an accord by the end of April than it had been by the end of March. We had only three or four weeks in hand and we must make the very best use of this time. She recognised that President Giscard wanted other outstanding problems settled. She believed that these issues and the problem of the budget had to be settled on their respective merits, though she accepted that, with the probable exception of fish on which matters were going ahead rather more slowly though still steadily, they might all be solved within the same time scale.

The Prime Minister continued that any settlement of the budget problem had to be one that would endure. She did not want to have to come back to her partners again in 2 or 3 years time and ask for yet another settlement. They would accuse the British of coming back a third time and would understandably find it that much more difficult to be sympathetic on the issue. We needed a solution that would endure as long as the problem of our contribution itself lasted.

/Chancellor Schmidt

SECRET

SECRET

- 5 -

Chancellor Schmidt said that it was quite clear that all the Community's major outstanding problems would have to be solved at the same time. If they were not, he saw no hope of resolving the budget issue. He accepted that the UK case was just and sound, but the plain political fact was that when it was resolved, the other Eight partners would have to be able to take something home to their own Parliaments and public and show that they too had obtained something. It would be impossible for any of the other Heads of Government, especially himself and President Giscard, to return home empty-handed, saying that they had agreed to pay more to the Community budget in order to help Britain. There had to be a semblance of a quid pro quo. In saying this, he asked the Prime Minister to bear in mind that if the Eight were each to find its contribution to the solution of the UK problem, they would all have to make substantial sacrifices and reduce important programmes. None of them had made provision for such changes, and the political difficulties they would cause were plain. There therefore had to be a package deal which would be such that all nine governments left the battle scene with an equal feeling of dissatisfaction. If that did not happen and one country was able to emerge claiming a victory, the compromise that had been achieved would not be workable.

As regards duration, he did not believe that it would be possible to bring about a solution to the UK's budgetary problem that would stick for a number of years. In the short term it would be possible only to find a compromise made up of gimmicks, gadgets and tricks to improve Britain's receipts, but such an arrangement would not be in true accord with the Community's basic regional, social and agricultural policies as they existed today. The kind of compromise he foresaw might last 2 or 3 years but no longer. If a solution was to stick the basic policies would have to be revised. He agreed with the Prime Minister's views that some of these policies were absurd, but we had to reckon with the inescapable fact that they had been developed by first the Six and then the Nine over 20 years.

/In particular

SECRET

SECRET

- 6 -

In particular, there were some very powerful agricultural lobbies on the continent which were politically much more important than the British farming lobby. Nonetheless, as he had already made clear, he was convinced that the CAP had to be reformed. He thought that an essential element in the package deal he was envisaging would be a declaration that agricultural policies had to be changed so that expenditure in this area ceased to grow disproportionately in relation to the total budget but might, for example, be limited as a proportion of the growth of GNP of the Nine members. He knew that all the Agriculture Ministers of the Nine would oppose some part of the set of principles for reforming agricultural policies which the package deal would have to contain, and for this reason the declaration he had in mind could come only from the Heads of Government. It might similarly be necessary to lay down in the package a set of principles for settling the problem of fish.

The Prime Minister said that although Chancellor Schmidt understood the political pressure which she was under to reach an equitable settlement of the budget problem, she was not so certain that the other members of the Community really grasped her difficulty. She saw the difficulties facing the other members of the Community and she hoped that they equally would put themselves in her shoes. She agreed that there would be no lasting solution to the budget problem unless the underlying policies were changed. For example, every time the Commission proposed changes in the cost of the CAP, the burden fell unduly heavily on British farmers because they were large and efficient, whereas the smaller and less efficient farms of the Eight escaped. At the same time, because of the structural surpluses, our farmers were denied export opportunities despite their greater efficiency.

Chancellor Schmidt said that he agreed that the best possible use needed to be made of the time between now and the postponed meeting of the European Council. He did not propose, however, to offer himself as a mediator. He could not carry his own party if he volunteered himself to settle a problem whose solution was bound to lead to Germany paying more. Moreover, he had been

/criticised

SECRET

SECRET

- 7 -

criticised by the French and Dutch after Dublin for putting forward precise figures too soon. But someone had to come forward with figures because otherwise there would be no solutions. There were three possible sources. The first was the Commission. The Treaty of Rome required the Commission to make proposals in this kind of situation, and he had tried to convince Mr. Jenkins that it was his duty to take the initiative. But he had not done so, perhaps because he was inhibited because he was British. Second, one might normally expect the Presidency to put forward solutions. But the fact was that Signor Cossiga was in a weak position to do so because of his domestic problems: nobody could dance at two wedding parties simultaneously. Third, the country seeking a solution, in this case the UK, could offer a solution. Of these three possibilities, he believed that the Commission should be pressed to propose solutions to the present critical situation.

The Prime Minister said that she believed that Mr. Jenkins would like to solve the problem, but because he was British, he was reluctant to make the attempt. She did not want to put forward figures herself. She had already moved away from asking for broad balance and her position now was that she was ready to be a modest net contributor, even though in terms of average GNP per head there was a perfectly good case for asking that the UK should be a net beneficiary. If the UK now came forward with figures, these would be negotiated down, just as in any industrial pay dispute.

Chancellor Schmidt said that however figures were eventually put forward, the amount that the Community settled upon would be much lower than the UK had been seeking in Dublin. Broad balance was impossible. If that was the principle of the eventual settlement all nine countries would want it: it would, for example, give Germany an enormous sum of money.

/Sheepmeat

SECRET

SECRET

- 8 -

Sheepmeat

In response to a question by Chancellor Schmidt, the Prime Minister said that the issue of sheepmeat was of considerable domestic importance in the UK. Just as it would be unconstitutional to interfere with the transfer of levies to the Community, so the interruption of the free movement of goods within the Community - which was what the action being taken by the French on sheepmeat amounted to - was also illegal. In the UK's view the French were in clear breach of the Treaty. Britain was the biggest producer of mutton in the Community, and if there were to be any benefits available, we should receive them. We did not want an intervention regime for sheepmeat. We could not see why the French could not provide financial assistance nationally for their sheep farmers.

Chancellor Schmidt said that he did not pretend to understand the details of the sheepmeat problem. He agreed with what the Prime Minister had said about the unconstitutional nature of the action taken by the French, though he understood President Giscard to claim that there was a provision in the Treaty which allowed a country to apply to the European Court twice on any particular issue and that the Court's first ruling was therefore not yet final. But he agreed that it was dangerous if any country defied a ruling of the Court, even though the problem of sheepmeat was in itself a small one. He did not believe that the rest of the Community understood what the argument about sheepmeat was all about and he thought that if the UK and France could reach an agreement between them, the other members would accept it (though he added that he did not wish this to be quoted in Community circles). It would be psychologically very good for the Community if France and the UK could pull an agreement out of their pockets and say the problem of sheepmeat was solved.

Chancellor Schmidt continued that one way of dealing with the disposal of the present surpluses might be to make food from them available to Third World countries and to use the Community's Development Aid Budget to meet the cost. This might sound absurd but it made political sense and he thought the possibility should be explored. The Prime Minister agreed.

SECRET

/Fish

Fish

Chancellor Schmidt reverted to his suggestion that any package deal should include a series of principles for solving the fisheries problem. He doubted whether it would be possible to put together a package, if there was no mention in it of fish. Fish was becoming an urgent political problem not only in the UK but also in Germany, Denmark and France.

The Prime Minister said that discussions on fish, particularly with the French, were going ahead satisfactorily, though slowly. We had not, however, yet reached the point of talking about figures, and this would be when the difficulties really started. She doubted whether we were in a position to include fish in any package of the kind the Chancellor had in mind. Fish was the only resource which was designated under the Treaty as a common resource, and the UK contributed 60 per cent of the Community's waters and 72 per cent of its fish. The UK was therefore contributing massively to the Community's resources. Fish was a highly political issue in the UK, and we had to have an acceptable settlement. When she had talked about solving problems on their merits she had meant that she could not enter a bad permanent agreement on fish in order to get a temporary agreement on the budget.

EMS

Chancellor Schmidt repeated that the UK could not declare that it had certain vital national interests and simply ignore the fact that her eight partners also equally had such interests. Whether the Community would be able to solve the problem of the budget and the other outstanding issues was a question of political will and whether that will would develop would be strongly affected by the UK's readiness to solve the other issues such as fish and energy. He accepted that we were not going to join the EMS at the present moment, but it was a pity that we had missed the chance to demonstrate, by joining the EMS, our will to settle other issues.

/The Prime Minister

The Prime Minister said that the UK would like to join the EMS when we had established clearly that we had the money supply under control.

The International Context

Chancellor Schmidt reiterated that France and Germany did not want the UK to make all the sacrifices while everybody else benefited. President Giscard was as aware as he was that in the present world situation we could not allow the Community to break up because of the problems now facing it. He knew that the UK had to do something about its budget problem: he understood the pressures on the Prime Minister. But he did not want the UK to do something which would prevent the Community, and in particular France, Germany and the UK, holding together.

said
The Prime Minister/that she agreed. It was the political significance of the Community which was our main reason for joining it.

The meeting ended at 1145 hours.

AMS.