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RECORD OF A DISCUSSION BETWEEN THE PRIME MINISTER AND
CHANCELLOR HELMUT SCHMIDT IN BONN ON 17 NOVEMBER AT
0900 HOURS.

PRESENT

Prime Minister	Chancellor Helmut Schmidt
Foreign and Commonwealth Secretary	Herr Hans-Dietrich Genscher
Sir Oliver Wright	Dr. Jurgen Ruhfus
Mr. M. O'D. B. Alexander	Herr Otto von der Gablentz

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World Economic Situation

The Prime Minister said that the world recession was impeding the efforts of her Cabinet to achieve economic recovery at home. Did Chancellor Schmidt have any views on when the recession was likely to end? Chancellor Schmidt said that the world was suffering from something more than a recession. A further stage in the structural upheaval which had begun with the first oil price rise was in progress. Britain, like Norway, would eventually overcome present problems and would then be in a different category from the rest of the major industrialised countries. Britain had oil while the rest of her partners would be congenitally in deficit. This would, inter alia, mean that it would become impossible for the industrialised world to help the developing world with development aid.

The oil exporting countries seemed not to understand what they were doing. The situation of the oil importing developing countries seemed likely to deteriorate very rapidly. Aid from the industrialised world would, at least in real terms, decrease as a proportion of the world's gross product. The developing countries would be increasingly unable to keep pace with the interest payments on their debts, and still less to repay those debts. The new

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international order was "rubbish". The new order was already with us. No-one understood its implications. No-one had foreseen it. Neither J.M. Keynes nor Mr. Friedman had anticipated a situation where the industrialised world would be so dependent for a vital resource on "outsiders". They had thought in terms of a closed system of national economies. The consequence of the present uncertainties included loss of faith in the future, a declining willingness to invest and, as a result, inflation and unemployment.

The Prime Minister said that Britain was no more insulated from the effects of structural upheaval than the other industrialised countries. We exported more of our national product than any other country. The unjustifiably high exchange rate of sterling resulting from its petro-currency status ~~was~~ had created great difficulties for our exporters. On the broader issue, the Prime Minister said that we had witnessed in recent years a massive redistribution of world resources in favour of governments which did not understand the world economic system. The oil rich states were still talking the language of the past. They were still hoping to extract money from the West. This was apparent in the Global Negotiations. The prejudices of the developing countries made it essential that the World Bank and the International Monetary Fund should be masters in their own house. Chancellor Schmidt said that he was in entire agreement. The independence of the IMF must not be impaired. Even if they could not take on new responsibilities they had to retain those which they had. It was impossible to tell how the future would work out but there was an obvious risk that "national egoism" would become more marked. The Prime Minister, agreeing, said that she saw a risk of a resurgence of isolationism in the United States.

Chancellor Schmidt said that the same risk existed in the European Community. There would be increasing pressure from trade unions and entrepreneurs for the exclusion

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of outside suppliers from the European market in order to protect their position. Imports of cars from Japan and of butter from New Zealand were obvious targets. The Prime Minister said that this was a problem which should be discussed at the European Council in Luxembourg. People in Britain were looking for protection against the Japanese. They felt that they were being denied access to the Japanese market. (Chancellor Schmidt agreed.) Of course it was politically important that the Japanese should not become isolated. They were an integral part of the West and must be allowed to trade with the West. (Chancellor Schmidt agreed.) Nonetheless, unless the surge of Japanese car imports was controlled, the situation could become very difficult.

Chancellor Schmidt said that he had recently talked to leading German entrepreneurs about the question of access to Japanese markets. His feeling was that, despite their complaints, there would be great difficulty in defining which Japanese practices were unfair. Pay in Japan, and social costs generally, were lower than those in Europe. How could they be blamed for this. Herr Genscher referred to the need for more active marketing. The Prime Minister said that some British component manufacturers e.g. Lucas were clearly producing a better product than their Japanese competitors but still could not get into the Japanese market. It might be difficult to define the barriers but the barriers were there. Herr Genscher referred to the dominance of certain import monopolies. The Prime Minister said that greater use should perhaps be made of partnerships. Chancellor Schmidt said that Japan had of course been very seriously affected by the oil price rises. It would be difficult to push them too hard. But this had not prevented France from exerting a great deal of pressure on Japan. He suspected that they had threatened retaliation if the Japanese did not control their exports. He did not know how they had managed to do this while remaining within the Community rules but they had clearly impressed the Japanese. The Prime Minister said that the effect was that Britain and Germany had to take the over-spill of the Japanese goods. Chancellor Schmidt said that this might be so.

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EEC Trade and Industrial Policy

Chancellor Schmidt said that his Government were not satisfied with the recent agreement to limit EEC steel production. He was grateful for the Prime Minister's help, which had made the agreement possible, but the agreement was a senseless one. It served to reduce competition and therefore progress in productivity. It conserved old capabilities instead of developing new ones. There was an increasing tendency for the European Community to become dirigiste. Viscount Davignon was a super dirigiste. His policies were tending to encourage the transfer of the sort of structures developed in the CAP to other areas of economic activity. There were enough entrepreneurs in Europe to beat the world recession but there was a danger that they would be stifled by protectionism and the dirigistes. Lord Carrington agreed that Viscount Davignon's influence had been restrictive. Chancellor Schmidt said that Germany's ship-building and aircraft construction industries would be handicapped and their progress in improving productivity cut back.

The Prime Minister commented that this progress and the introduction of new plant had resulted in enormous surpluses. The United Kingdom had, for instance, been forced to make major cutbacks in its steel production. Chancellor Schmidt said that it was ridiculous to cut back production from new and old plant simultaneously in order to keep alive the old. The Prime Minister said that she was trying to phase out the old. Chancellor Schmidt said that this was easier for her since the British steel industry was nationalised. The Prime Minister said that she wished that it was not. There was a danger that the nationalised industry would survive at the expense of the private sector. She agreed with Chancellor Schmidt about the broad dangers of protectionism spreading to industry and thought that this should be discussed at the European Council meeting in Luxembourg. Chancellor Schmidt said that he thought this would be a good idea.

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The Prime Minister said that the problems they had been discussing had been particularly acute in the textile industry which employed more people in the United Kingdom than the coal and steel industries together. The Multi-Fibre Arrangement was due for renegotiation in 1981. Chancellor Schmidt said that this was another area where dirigisme was on the increase. The Prime Minister said that it would be necessary to review the MFA quotas. Nonetheless, it was clearly right that protectionism meant less trade. Chancellor Schmidt said that of course the developing countries tended to be particularly penalised. They would be "bitten by the dogs". The French were given to Colbertism and would be inclined to encourage the trend to Government intervention. Their economy was run by the Inspecteurs des Finances but of course the trade unions and industrialists encouraged them. The Prime Minister said that they wanted a quiet life. It was the duty of Government to maintain free and fair competition.

European Council Agenda

Chancellor Schmidt said that it would be important not to have too much on the Agenda for the Luxembourg meeting. The smaller countries are always inclined to press for the inclusion of detailed items. The European Council should only be a decision-making body in exceptional circumstances. It should be used for open and wide-ranging discussion between Heads of Government. The secretaries and notetakers should all be turned out. The Council of Ministers had a Secretariat of 2,000 which was ridiculous. Things were getting out of hand. The Prime Minister agreed.

The Prime Minister said that she hoped that there could be a general economic discussion dealing with the recession and other major problems. It should not have ten different sub-heads. There should also be a political discussion and a report from the out-going President of the Commission. Chancellor Schmidt did not dissent.

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Chancellor Schmidt said that he did not think it would be wise at a time of considerable monetary volatility to try to carry the EMS on to a new stage. M. Werner was keen to increase the degree of institutionalisation, but the German Government would be reluctant to follow him. They did not want to disturb the market or to attempt to pre-empt developments. They preferred to wait for things to calm down of their own accord. The EMS was doing well despite the problems experienced by the \$ and by sterling (which was much too high). The French were flattered by the thought that they were giving help to the DM. It was good that this sort of thing happened from time to time.

Re-structuring of the Community Budget

The German Government intended to make it clear that they would be arguing e.g. in June for:

- (a) a rigid adherence to the 1 per cent VAT ceiling;
- (b) a ceiling on all net contributions; and
- (c) ceilings for net recipients.

They knew that an approach on these lines would frighten the smaller members. Nonetheless it had to be brought out into the open. The Prime Minister said that the British Government would stand absolutely on 1 per cent. This was more important in the light of the accession of Greece. Chancellor Schmidt said that one day one might envisage some additional room within the ceiling being created for Greece. But this should be no more than an additional 3 or 4 per cent and should in any case not be considered in the near future. The Prime Minister said that a rigid adherence to the 1 per cent ceiling would require early decisions about the size of the CAP. The German Government had been very firm in their statement in June. Chancellor Schmidt said that the Community's expenditure on the CAP should increase at a rate 'considerably less' than that of the overall increase in the Community's revenues. The Prime Minister asked what would happen if there was then insufficient money to finance the CAP. Chancellor Schmidt said that agricultural prices /should be held

should be held to the point where there was sufficient money to cover their cost. Consumers should be allowed to benefit from the prices which would result.

Chancellor Schmidt said that a number of principles governing the future development of the CAP had been worked out in the course of recent talks between the SPD and FDP. These principles, which had not been made public, were as follows:

- (a) The Federal Government would stress the necessity for agricultural policies to reflect more clearly the principles of the market economy;
- (b) The Federal Government would seek to ^{restored the} have the ^{of} equilibrium of the market/by/production/lower surpluses. To this end they proposed to pursue three objectives:
 - (i) A more cautious price policy aimed primarily at restoring a balance between supply and demand;
 - (ii) Less rigid intervention mechanisms;
 - (iii) The bearing by producers of a greater responsibility, e.g. through super levies, for the financing of surpluses.
- (c) The Federal Government would stress the need to prevent the CAP placing additional strain on the European Community's trade and political links with the rest of the world, notably with the United States;
- (d) The Federal Government would insist on the 1 per cent ceiling and would assume that the ceiling would be reached in 1981. Thereafter, resources would only be placed at the disposal of the CAP at half the rate of the growth in the overall revenues of the European Community.

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Chancellor Schmidt said that, although this had not been put on paper, he and his colleagues did not believe that the price increases sought by France for next year, which were from 8 to 10 per cent, could be financed within the 1 per cent ceiling. The Prime Minister said that if the Federal Republic wanted lower price increases, it would be essential for the Commission's initial proposals to be lower. The British Government thought that 8 to 10 per cent was too high. They wanted significantly more severe price restraint. Chancellor Schmidt said that he was very glad to hear this. He had feared that, under pressure from the farmers, the British Government would opt for higher prices. He asked whether the Prime Minister was conscious of the impact of positive MCAs on British prices. The Prime Minister confirmed that she was. She repeated that she hoped the Commission proposal would be for significantly lower price rises than those which had been mentioned. She agreed with the Foreign and Commonwealth Secretary that co-responsibility levies were unsatisfactory from a British point of view and added that in any case they made it possible to escape the disciplines of the 1 per cent ceiling. Super levies, on the other hand, were acceptable.

The Prime Minister asked whether President Giscard would want the agricultural price fixing to take place before the French elections. Chancellor Schmidt said that he did not know. Herr Genscher said that he thought the French Government would insist on it. The Foreign and Commonwealth Secretary agreed. The Prime Minister noted that if the Community seemed likely to agree on a very low figure, the French Government might prefer to postpone the decision until after an election.

Aid

The Prime Minister said that although there seemed to be a good deal of agreement that too much aid was now being channelled to the developing world through multilateral organisations and too little through bilateral arrangements, nothing seemed to be done to reverse the trend. She asked about the current state of play in the Global Negotiations. The Foreign and Commonwealth Secretary described the situation. Chancellor Schmidt said that the Federal Republic would leave the International Monetary Fund if the General Assembly acquired authority over it. The Prime Minister made it clear that she felt

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equally strongly. Chancellor Schmidt said that Western Governments must be careful not to channel too much aid through the World Bank, the Lomé Convention and other multilateral instruments. The Prime Minister repeated that there seemed to be agreement on this as a principle but no clear view on how to implement it. Governments were concerned at the risk of appearing to reduce their aid effort and of appearing unsympathetic. Chancellor Schmidt said that he was becoming increasingly impatient of criticism from those who were being helped by the industrialised countries. He believed that donors should be rather more self-regarding. He wanted to see some political return for the efforts made by the Federal Republic. He intended to be very frank about this at the North/South Meeting in Mexico. He did not intend to use the meeting to exchange niceties. He "really meant it". Too many bishops had interested themselves in aid policy. He saw no need to pay too much attention to their preaching. Aid was not charity.

The Foreign and Commonwealth Secretary commented that the sums given in development aid were insignificant when compared with the consequences of the recent rise in oil prices. He hoped that some of the discussion in Mexico could be devoted to recycling and related problems. The Prime Minister said that the difficulty was that recycling was meaningless in relation to countries which had no credit. They would be no more able to repay in a few years time than now. Chancellor Schmidt agreed that recycling was ridiculous in these circumstances. He hoped that the kinds of comparison that the Foreign and Commonwealth Secretary had mentioned could be brought out clearly in Mexico. Nonetheless there would be some like President Nyerere who would never understand. Malcolm Fraser and Lee Kuan Yew were among the few Heads of Government who did understand. The difficulty with Mr. Lee Kuan Yew was that he was totally disliked in the Third World. The Prime Minister commented that Mexico ought probably to be a donor country. Chancellor Schmidt agreed and said that this consideration made it important not only that Mexico should be there but that Saudi Arabia, Nigeria and Algeria should also attend. The Prime Minister said that she expected the oil rich countries would nonetheless remain part of the Group of 77. Chancellor Schmidt said that the G77 had to be split up. The oil exporters did not belong in it.

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It was ridiculous that the G77 convoy should be led by the oil rich. He intended to make this clear in Mexico. The Prime Minister asked whether Chancellor Schmidt thought the Mexico meeting should take place before the Ottawa Summit. Chancellor Schmidt said that it should. The Prime Minister asked whether he agreed that it should not be a decision-making meeting. Chancellor Schmidt agreed emphatically. The Foreign and Commonwealth Secretary asked whether the United States was likely to come. Chancellor Schmidt said that they would have no choice.

Patriation of the Canadian Constitution

Chancellor Schmidt asked the Prime Minister for her assessment of the likely outcome of the present discussions on the patriation of the Canadian constitution. The Prime Minister said that it would be easy if the only question at issue was patriation. Unfortunately the Canadian Government also wanted a Bill of Rights. They were seeking this at Westminster because they would not be able to secure agreement for it in Canada. The British Government would have to respond positively to the Canadian request. Chancellor Schmidt said that Mr. Trudeau would be visiting Bonn in a few days. Mr. Trudeau was a personal friend of his. Chancellor Schmidt said that he followed Canadian problems closely but had begun to wonder whether Mr. Trudeau could steer Canada out of her present difficulties. In the western provinces Ottawa was talked of in the same terms as Europeans talked of the New Hebrides. In British Columbia the Atlantic provinces were "out of sight". Ontario was at odds with the rest of Canada. So was Quebec. They had the problems of OPEC versus non OPEC states in one country. Canada was a country with great troubles and great potential. The Foreign and Commonwealth Secretary commented that the difficulty with Canada was that it was three thousand miles long and one hundred miles wide. Too many parts of Canada felt a greater affinity with the neighbouring states in the United States than with the other provinces of Canada.

Nonetheless, Mr. Trudeau had done well so far and he had to be supported. It was a pity that he was making things difficult for the British Government by asking them to do something which he could not do himself. The Prime Minister repeated that we would have to stick to the strict constitutional position. Chancellor Schmidt

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asked whether Mr. Trudeau was aware of the Prime Minister's position. The Prime Minister said that he was. Chancellor Schmidt commented that Canada needed a more prominent role in international affairs than she enjoyed at present. Her self-esteem should be flattered. The Foreign and Commonwealth Secretary said that Canada had tended to lose out in recent years. Her prestige was far lower than it had been in the days of Mr. Lester Pearson.

Namibia

The Prime Minister described the Government's efforts on the one hand to persuade African states of the need not to press the South African Government too hard and, on the other hand, to persuade South Africa of the need to move faster. Unfortunately Mr. Pik Botha, on his recent visit to London, had taken a harder line on Namibia than had been expected. It was not yet clear whether she and the Foreign and Commonwealth Secretary had succeeded in persuading him to moderate his position. The Foreign and Commonwealth Secretary said that unfortunately the South African Government seemed to be relying on Governor Reagan to "take the heat off them". He thought that the Prime Minister and he had had some success in disabusing Mr. Botha of this illusion. But the result of the recent election among white voters in Namibia had not helped. The Nationalist Party had won at the expense of the DTA. This would make it more difficult for the South African Government to bring the internal parties along. The Foreign and Commonwealth Secretary described the negotiations to set up a pre-implementation meeting. It had been hoped that this would take place early in December, but the South Africans now seemed to be backing off, both as regards the timing, and as regards their own participation. He had spoken both to M. Francois Poncet and Dr. Kissinger, who had seen Mr. Botha recently, in the hope that they could persuade him to change his mind. If Mr. Botha stuck to his present line, there was a grave risk that sanctions would be imposed on South Africa before the end of the year.

Chancellor Schmidt asked whether the Five would stand united against sanctions. The Foreign and Commonwealth Secretary said that he did not know.

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/ Herr Genscher

Herr Genscher said that the DTA were losing ground in Namibia. His contacts among the German settlers suggested there was growing interest in opening contact between them and Nujoma. There was a possibility of a meeting between representatives of the German community and SWAPO within the next two or three months. The German /were increasingly assuming that SWAPO would dominate Namibia eventually. They wanted therefore to forge links with SWAPO. The Foreign and Commonwealth Secretary commented that the success of the Nationalists in the recent election hardly supported this theory.

Chancellor Schmidt said that he had thought there were differences between the Five on the question of sanctions. The Foreign and Commonwealth Secretary said that it would be important to have an early discussion on this. A sanctions resolution would put the United Kingdom in a very difficult position indeed. The choice would be extremely awkward. Chancellor Schmidt said that clearly it was important to persuade the South Africans to move and that there was not much time (at this point he asked Herr von der Gablentz to take a careful note of the discussion on Namibia in order that he could raise the matter with Mr. Reagan's advisers later this week). He asked whether Mr. Botha had shown any signs of nervousness lest the West should fail to veto a sanctions resolution. The Foreign and Commonwealth Secretary said that Mr. Botha claimed not to care. He would rather have sanctions imposed on South Africa than have the Russians as neighbours. Chancellor Schmidt said that South Africa's fear of having Russians on their doorstep had hardly been borne out by events in Zimbabwe. The Foreign and Commonwealth Secretary agreed and commented that other Front Line States, particularly Mozambique, were adopting a sensible line. Only South Africa was failing to do so. The Prime Minister said that South Africa's neighbours knew that a sanctions resolution would hit them hard. She hoped that in the event of a sanctions resolution a number of countries would use the veto.

Chancellor Schmidt asked whether Mr. Mugabe was being successful. The Prime Minister said that he was doing as well as could be expected. It had always been apparent that there would be problems

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e.g. with the integration of the rival armies. Nonetheless Mr. Mugabe was showing more statesmanship than the South African Government. One example was his clear statement that Zimbabwean territory would not be used as a base for action against South Africa. Chancellor Schmidt asked about the situation in Angola. Was there any prospect of reopening the Benguela railway? The Foreign and Commonwealth Secretary said that there was no immediate prospect of this. However the Angolans were anxious to help in Namibia because they realised that peace in Namibia would enable them to get rid of UNITA and of Mr. Savimbi who were being supplied by the South African Government. The Prime Minister commented that while this might be true in the short term, a settlement in Namibia would only delay the day when African Governments would turn on South Africa. The difficulties for the West would always be very great because of South Africa's enormous strategic importance and because of the importance of her raw materials. Chancellor Schmidt agreed about South Africa's strategic importance but said that he expected alternative sources of raw materials would be found as time went by.

Middle East

The Prime Minister said that the Foreign and Commonwealth Secretary considered the reconnaissance initiated in the Venice declaration should be continued. At the same time it was important not to make things difficult for the United States. Herr Genscher said that Britain and the Federal Republic had a common view on this issue. Although the French Government would like to go further, the Venice position should not be changed. Chancellor Schmidt said that he thought that it was the Quai d'Orsay rather than President Giscard who were making the running in Paris. He had spoken to President Giscard and had urged him to be cautious. It was important to give Mr. Reagan time to work out his policy. The Foreign and Commonwealth Secretary said that the French Government had reacted very strongly to the recent headline in the New York Herald Tribune. They did not like the implication that the Community would do nothing. But this was the wrong time for a new plan. The Prime Minister said that the subject was bound to come up in Luxembourg. She was glad that the British and German Governments had a joint view.

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Inner German Relations

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Inner German Relations

In response to a question from the Foreign and Commonwealth Secretary, Chancellor Schmidt described the background to the present difficulties in relations between West and East Germany. He had cancelled his planned trip to East Germany in the summer because he was under the impression that there might have been a crisis in Poland during his visit which would have forced him to return home. Herr Honecker, for his part, had probably been equally afraid of a spill-over of events in Poland into East Germany. Following the cancellation of the trip, the East German Government had tried to show both their own population and the Russians how tough they could be. This had led to sharp verbal "position taking" in a number of fields. The Russians had denied responsibility for what had been said by the East German Government but it was obvious that there were many in Moscow who welcomed the present situation. There might of course be others in Moscow to whom it was unwelcome - conflicting views were known to exist there at present.

The West German Government had decided not to respond in kind to the East German statements. To do so would only make life more difficult for families who were divided. The new currency regulations had resulted in a 60% drop in visits by West Germans to East Germany. Although there might be some recovery in due course, Chancellor Schmidt said that he expected that the level of visits would stabilise at about half the previous figure. This development was deeply resented in West Germany. Nonetheless the Government intended to resist pressure from the Opposition for counter measures. They had done the same in 1974. They might however go slow on various negotiations making it plain that they would be willing to resume negotiations when the overall situation improved.

The Foreign and Commonwealth Secretary asked Chancellor Schmidt why the East Germans had attacked him personally. Chancellor Schmidt said that he thought there were two reasons. Firstly Herr Honecker had expected the Chancellor's visit to enhance his own position. No doubt some of his entourage had said "I told you so" after the cancellation. Secondly Chancellor Schmidt had remarked in the course of his own election campaign that West Germans had to

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"think and act" on behalf of their East German compatriots. He believed that this remark had been greatly disliked by Herr Honecker. Herr Honecker was a gifted political tactician but lacked self-assurance.

Herr Genscher said that East Germany was the "most unstable state in Eastern Europe". Chancellor Schmidt said that one should not underrate the stability of the police and army. Herr Genscher said the same had been said of the Shah's security forces. The fact was that East Germans had no identity other than as Germans. 85% of the population of East Germany received West German television. They were on the whole better informed than the population of West Germany. The Prime Minister commented that West German influence was, no doubt, growing all the time. Chancellor Schmidt said that the East Germans looked to the West. But they were, nonetheless, in a resigned frame of mind. Chancellor Schmidt said that supposing there was a break in East/West relations and in trading relations following a crisis in Poland, it would still be very difficult for West Germany to break with East Germany. The Foreign and Commonwealth Secretary asked whether the West Germans would try to differentiate between East Germany and the Warsaw Pact in these circumstances. Chancellor Schmidt said it remained to be seen whether this would be possible. In such a situation the leaders in East Germany might be forced to be more "Soviet" than the Soviet Union itself.

Security Council

The Foreign and Commonwealth Secretary said that he was very anxious about the possible enlargement of the Security Council. In a Security Council with 21 members, it would be virtually impossible to avoid the perpetual use of the veto. Western Governments would never be able to muster a simple majority. This would be a very bad situation. Herr Genscher said that he was not sure. The reaction of the membership of the United Nations to the invasion of Afghanistan had shown that attitudes in the Third World were changing. The Federal Republic would not play an active role in favour of enlargement. But, given their interest in membership of the Security Council, they could hardly be expected to oppose it. Chancellor Schmidt said that this was the first time he had heard any mention of the problem. He could see that the more

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members there were in it, the more difficult it would be to manage. But since the Federal Republic was not a member, it was difficult for them to comment. The Foreign and Commonwealth Secretary said that the Russians were opposed to enlargement and would no doubt use their veto. Herr Genscher said that if the United Kingdom used its veto, the Federal Republic would not make any criticism.

Defence

Chancellor Schmidt referred to his interview on Panorama due to be broadcast this evening. He said that in the interview he had deliberately given the impression that he expected to approach the 3% NATO target next year.

The discussion ended at 1100, it having been agreed that the next bilateral meeting would take place at Chequers in May next year.

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