



MR ALEXANDER

PS/PM.

(4)

Prime Minister
 Successful discussion.

Nant

RECORD OF A CONVERSATION BETWEEN THE CHANCELLOR OF THE EXCHEQUER
AND M. JACQUES DELORS, FRENCH MINISTER FOR THE ECONOMY AND FINANCE,
AT 11, DOWNING STREET AT 4.00 P.M. ON 10 SEPTEMBER, 1981

Present:

Chancellor of the Exchequer	M. Jacques Delors
Sir Kenneth Couzens	M. Jean-Yves Haberer
Mr. D.J.S. Hancock	M. Michel Freyche
Mr. J.O. Kerr	M. Dominique Sauvel
	M. Benoit Jolivet

Welcoming M. Delors to London, the Chancellor suggested that it might be appropriate at the outset of their conversation to review developments in the two national economies against the back-drop of the wider world economic scene. In the United Kingdom, the fight against inflation had so far been notably successful, with the year-on-year increase in retail prices down to some 11 per cent, which was approximately half the rate applying a year ago. Further progress might be more difficult, because of sterling's fall. Most of the relevant indicators suggested that the deepening of the recession had ceased, but the prospects for renewed growth in output were heavily dependent on the Government's success in keeping public expenditure in check, and keeping pay bargaining realistic and responsible. While productivity had improved, the level of unemployment was of course very worrying: the Government was anxious to encourage the growth of new small businesses. The United Kingdom had gone into recession rather earlier than had our main European partners: our hope now was that we might emerge from it rather sooner than for example the Germans.

2. M. Delors said that the new French Government had taken office at a time of particular difficulty in the world economy. While international experts had long been predicting early recovery from recession, the rise of oil prices, the dollar, and interest rates had



ensured its prolongation. The new Government was particularly concerned about unemployment: while its level in France was lower than in some other countries, the upward trend was worryingly clear and constant. No less disturbing was the high rate of unemployment among skilled workers. The French economy had in fact been already running into trouble, with output and investment dropping and inflation high, when the electoral period began - and it had of course been a lengthy period, lasting from February to June, and had caused considerable disruption, particularly to the proper working of the capital markets. The new Government had thought it right to take new measures to encourage industry and fight unemployment: this would entail a substantial budget deficit, but it was important to remember that the Government had inherited a budget deficit. M. Delors was nevertheless determined to operate a tight monetary policy. The Chancellor asked about the risk that the new measures to combat employment might fuel inflation. M. Delors acknowledged that the risk was real, but he hoped that it would be possible to hold down wages in the public sector: private sector wages might be more difficult to control. And the Government was also determined to keep prices down.

3. Turning to interest rates, M. Delors explained why it had been necessary - given that the franc had been under pressure from 15 February - to raise money market rates. They had now come down, to some 17½ per cent, but it was hard to see how they could be further reduced while US rates remained so high. The Chancellor, agreeing that the current level of US rates posed a major problem, recalled that we had managed to bring our former MLR down to some 12 per cent for a time, but that the more recent upward tendency had been strong, and was continuing. The United Kingdom Government perhaps attached more importance than did the French to the need to avoid public criticism of the Americans which might be construed as undermining the President's efforts to reduce US domestic inflation rates: but we were at one with the French in wishing to maintain discreet pressure on the Administration, reminding them of the consequences for the European and other economies of their current



interest rate policy. M. Delors entirely agreed that the pressures must be discreet: German public complaints had probably been counter-productive.

4. The Chancellor noted that the existence of the EMS had not prevented considerable volatility among Community currencies under the current dollar pressure. The UK position on EMS had not changed: we remained genuinely doubtful as to whether it could make sense for sterling, as a petro-currency, to be included in the system, given that oil-prices contained to fluctuate sharply. M. Delors thought that the Europeans would have been in greater difficulties vis a vis the dollar but for the existence of the EMS. He did not accept that even the Germans would have been better off without it. He recognised that the question of full participation in EMS was a difficult one for the UK; and that the present time was hardly propitious for a great leap forward. M. Haberer however pointed out that if the EMS were to move to a second, and more institutionalised, stage, the United Kingdom might be obliged to reach some definite conclusion before the revised arrangements took effect. Given the volatility of sterling over the last two years, it had been as well for France that the UK had not been a full EMS participant; but conceivably a period of greater stability in sterling was now in prospect. M. Delors said that if the United Kingdom had any propositions on EMS which should be explored, he would be more than willing to facilitate, or himself take part in, such explorations. The Chancellor took note.

5. M. Delors then turned to the question of bank nationalisation in France. He had expected the Chancellor to berate him about possible effects on UK banks, and was grateful for the Chancellor's courtesy in not doing so. He would like to make it plain beyond doubt that he had no wish to prejudice the fruitful links between British and French banks, and their joint operations in third countries. The bank nationalisation proposals which he had put to his colleagues in Paris would not, he thought, create any new difficulties for UK banks with French links. If the UK Government became aware of any



such problems, he would be grateful if they could be drawn to his attention. The Chancellor said that this might well be useful. But it would be important, particularly for merchant banking operations in third countries, that potential difficulties should be identified and defused in advance of the implementation of nationalisation plans. M. Delors agreed, and thought that this should be feasible, since there would be no changes in advance of individual negotiations with individual banks. Sir Kenneth Couzens drew attention to the risk to merchant banks, such as Warburgs, arising from the prejudice in certain areas - e.g. the US and the Gulf - against doing banking business with nationalised concerns. The Banque de Paris et des Pays Bas had a substantial shareholding in Warburgs. M. Delors said that he was well aware of the Warburgs problem: he had in fact talked to Sir S. Warburg. He was clear that nationalisation must not exclude the continued existence of private sector merchant banking operations in third countries. He was confident that a formula to solve the Warburgs problem could, and would, be found. More generally, he thought it right that the scale of the bank nationalisation operation in France should not be exaggerated. Much of the banking sector was already nationalised: in the remainder, Co-operative banks would of course not be affected. M. Haberer interjected that only an additional 12 per cent of the banking sector would be taken into public ownership.

6. The Chancellor then turned to the question of the reform of the Community budget. The present budget arrangements were inequitable, and the issue must be speedily resolved. He hoped that M. Delors shared his view that the point could be ducked no longer. M. Delors said that he could give only a personal view, since the Government in Paris had yet to reach any firm conclusions on the matter: they aimed to do so before the forthcoming Community Summit. He recognised that the current budgetary arrangements were harsh on the United Kingdom, and on the FRG, but the right solution would probably be to inject a new dynamism into the Community, stimulating it to make progress in ways which would have the effect of eliminating the problem for the UK and the FRG. Increased regional programmes,



increased action against unemployment, more aid to industry, more common action to open up external markets: progress on these lines would create fewer difficulties with domestic opinion in countries such as France than a solution along the lines envisaged in the 30 May mandate, and would have the same effect. The Chancellor, referring to his speech at the Hague, argued that the Community must certainly escape from the treadmill of perennial squabbles over the budget, but could not hope to do so without fundamental budget reform. In national capitals spending decisions affecting national budgets were taken in the round, attention being paid to regional considerations etc; yet when Finance Ministers met to consider the Community budget they were faced with the sum of individual spending decisions, taken separately and to no coherent pattern. The Community had no procedure for taking an overall view, yet an overall view must be taken. The United Kingdom would warmly welcome the injection of a new dynamic into the Community, along the lines M. Delors had in mind, but it would be rash to count on new spending decisions, again taken individually and separately, to have the appropriate regional consequences, and to solve the problem of budgetary inequities. Obviously it would be easier for those who would have to pay more, if the budgetary burden were equitably distributed, if the re-distribution were to place at a time when the Community was demonstrably making progress in other fields. But it was no less obvious that a solution to the budgetary problem could not be further deferred, without further weakening the Community. It was a cancer requiring urgent surgery.

7. M. Delors said that he personally was inclined to agree. But he asked that the UK recognise the domestic political problem in France. The agricultural community, cosseted by the Giscard administration, and disposed to be critical of the new government, would need delicate handling. The Chancellor said that reform of the CAP, though difficult - there was an agricultural lobby in the UK too - was certainly necessary, not least to deal with the problem of surpluses: but that it would be misleading to assume that such reform could solve the overall problem of the budget. Reform of



the budget via the CAP route would take years, if not decades: the problem would not wait that long.

8. M. Delors said that he did not dispute the Chancellor's logic. No doubt the Chancellor would remember, as French public opinion certainly did, that the original establishment of the Community a six had been on the basis of a bargain from which French agriculture had benefitted and expected to benefit permanently. It was also a political fact that agricultural reform in France must be kept consistent with the maintenance of the small-holder population in the rural economy. He accepted that costs must be kept in check, and that current CAP arrangements were far from perfect: but he also feared that the Chancellor was right not to expect dramatic progress.

9. The Chancellor said that this reinforced his point that the budget must itself be re-examined, and proper budgetary procedures established. Mr. Hancock asked how the French approach to budget reform fitted with the timetable which the Community had laid down. The new French Government had not of course been party to the 30 May mandate, but were aware of its terms, and that it was intended as a purely temporary solution. Agreement, at least in principle, on a permanent solution by the end of 1981 had been envisaged. M. Delors' impressive presentation on the need, which we warmly endorsed, to re-launch the Community with a new dynamic suggested that he attached paramount importance to this rather than a solution of the budgetary problem. The United Kingdom Government, for its part, could not however ignore the damage to support for the Community in this country which would result if it became clear at the end of the year that no solution to the budgetary problem was in fact in sight. Increased disillusionment about the value of Community membership in this country would be damaging to the Community as a whole.

10. M. Delors said that the point was well taken. He was not, however, in a position to give a definitive view on how the French Government would wish to handle discussions on budgetary reform.



French ideas would have crystallised by November. Further bilateral contacts, at official level, might be useful before then. The Chancellor agreed. He, and Sir Kenneth Couzens stressed that time was of the essence: we must seek to avoid an adversarial negotiation in the last weeks of the year. We welcomed the new French Government's plans to give a new impetus to the development of the Community; we would not wish to see progress bogged down in further budgetary squabbles; but we were clear that a permanent solution to the budgetary problem was essential to the satisfactory future development of the Community.

11. The talks were adjourned at 6 p.m.

J.K.

J.O. KERR

11 September 1981

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