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RECORD OF A CONVERSATION BETWEEN THE PRIME MINISTER AND THE CHANCELLOR
OF THE FEDERAL REPUBLIC OF GERMANY, HERR HELMUT SCHMIDT, AT CHEQUERS
ON FRIDAY, 19 MARCH 1982 AT 1530 HOURS

Present:

Prime Minister	Herr Helmut Schmidt
Foreign and Commonwealth Secretary	Herr Matthöfer
Chancellor of the Exchequer	Dr. Schlecht
Secretary of State for Industry	Herr Rohr
Secretary of State for Defence	Herr Becker
Minister of Agriculture, Fisheries and Food	Dr. Ruhfus
Secretary of State for Trade	Herr von der Gablentz
Sir Robert Armstrong	Dr. Feiter
Sir Michael Palliser	Dr. Fischer Dieskau
Sir Jock Taylor	Herr Frickinger
Mr. Julian Bullard	Herr Walter
Lord Bridges	Dr. Pfeffer
Sir Kenneth Couzens	Dr. Fischer
Sir Brian Hayes	Herr Paschke
Mr. Michael Franklin	Herr Wendler
Sir Frank Cooper	Herr Heck
Mr. D. Hancock	Herr Hansland
Mr. Clive Whitmore	Herr Stütze
Mr. David Gillmore	Herr Mueller Thuns
Mr. John Coles	Herr Witt
Mr. David Gladstone	Herr von Alten
	Dr. Kudlich
	Dr. von Ploetz

/ FOREIGN AFFAIRS

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FOREIGN AFFAIRS

Welcoming the German Ministers, the Prime Minister said that the Anglo-German consultations were taking place at a very important time in advance of the three Summits, the economic and NATO summits and the European Council at the end of the month. The Versailles summit would be particularly important in that the recent reduction in oil prices could herald the end of the world recession provided the West could coordinate action. The Chancellor and she had discussed the broader strategic problems in particular with regard to the handling of East/West relations. Afghanistan was still occupied, Poland was in a very difficult situation and decisions needed to be taken on credit for the Soviet Union. She asked Lord Carrington to report on the Foreign Ministers' discussions.

Lord Carrington said that discussions had focussed on the 30 May Mandate. They had been uncertain what Messrs. Thorn and Tindemans would put in their report: the German side had thought that there should be further elaboration of guidelines. There had been general discussion of some ideas put forward by Herr Fischer for follow-up action. Their joint concern had been to find a way of avoiding a repetition of the old arguments leading to the familiar result, namely that a decision was left to the European Council. Both sides sought an early solution to the problems based either on the guidelines or on figures: the trouble was that it might be too soon to broach discussion of the one and too late to carry on the other.

The Foreign Ministers had also discussed the problem of tin. As to the Genscher/Colombo plan, Herr Genscher had thought that the Danes would not wish this question to come to fruition during their Presidency, because of the embarrassment it generated within the Governing party itself. Progress might therefore be faster than expected.

Lord Carrington said that there were no specifically Anglo-German problems. The two sides were in close touch about the

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problem of transatlantic communications in NATO. Herr Genscher had suggested 'Gymnich'-type meetings: there were also some new ideas from Sr. Colombo. Of the two, Lord Carrington favoured Herr Genscher's idea, but he admitted that the prospect of two 'Gymnich' meetings on top of the two NATO Ministerial meetings every year was somewhat daunting.

FINANCIAL/ECONOMIC AFFAIRS

Sir Geoffrey Howe said that he had had a relatively short discussion with Herr Matthofer of the two sides' domestic economic measures. The German side had explained the steps they had taken to combat unemployment and both sides had agreed that unemployment represented the most pressing political problem of the day. In a longer discussion of the world economy, three issues had predominated:-

- (a) It was agreed that the slackening in the oil price would be helpful to the prospects of growth provided there were no relaxation in the drive for energy conservation. Sir Geoffrey Howe had explained that the fall in the oil price meant a fall in government revenue but was still helpful to the economy overall.
- (b) Both sides had expressed anxiety about the lack of control in the US economy and the level of interest rates. They had agreed that advice to the Americans should be offered off- rather than on-stage if it was to be effective.
- (c) In relation to the impact of the Japanese economy on that of other countries, it had been agreed that the main ingredients were:-
 - (i) Japanese resistance to imports;
 - (ii) their devastating export drive;
 - (iii) the Japanese combined tight fiscal policy with a relaxed foreign exchange policy with the result that the yen had fallen by 8% the previous year.

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However, the two sides had agreed that it would not pay to take an aggressive line with the Japanese nor to reopen arguments about 'economic locomotives' (Chancellor Schmidt confirmed German dislike of this concept). Sir Geoffrey Howe noted the striking contrast between the Japanese approach he had just outlined and that of the United States who were combining a tight monetary with a lax fiscal policy. Asked by Chancellor Schmidt whether this Japanese policy helped to explain their success, Sir Geoffrey Howe said that it might be an additional factor but that the main problem it presented to the outside world was that it led to a strong dollar and a weak yen. This in turn increased worldwide pressures for protectionism. He and Herr Matthofer had discussed a European approach to this problem and the British side had handed over a paper.

Sir Geoffrey Howe said that they had also discussed their anxieties in relation to the US economy and the prospects for the EMS. On the latter, they had found limited scope for institutional changes and had agreed on the importance of convergence if the EMS were to become a stabilising influence. A discussion of the 30 May Mandate had brought no fresh insights: they had focussed on the importance of agricultural expenditure in the context of the Mandate and had agreed on the principle that agricultural expenditure should grow more slowly than overall Community expenditure.

In further discussion together with their trade colleagues, Sir Geoffrey Howe said that anxiety had been expressed about Hungarian liquidity problems. They had agreed that the Hungarian economy was basically sound and it would be important to avoid a default. It was not however certain whether Hungary was in a position to make an IMF drawing. It might be necessary for a multi-lateral approach to be made to the USA to persuade the latter to regard Hungary differently from the other East Europeans.

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TIN

On tin, Sir Geoffrey Howe noted that there was no concensus of view within governments. Finance Ministers were keen to avoid early signature of the International Tin Agreement (ITA) because of past manipulation of the market. The United States would not be signing the Agreement. Herr Matthofer thought it would be desirable to talk to the Japanese and to take account of the US reaction. There would be many opportunities to talk privately to the Japanese, who were well aware of the problem and willing to help. He had learned much about the Tin Agreement from his discussions with Sir Geoffrey Howe and felt most reluctant to subscribe DM 50 million to the tin producers as the German contribution to the buffer stock. This would not benefit the people in the producing countries but only the companies actually using the buffer stock. He was therefore glad to hear that the British side was adamantly opposed to the Agreement.

The Prime Minister said that no one in their senses would wish to sign such an agreement at the present time. However, politically, unless we did sign the ITA, countries like Indonesia could discriminate against those opposing the ITA. In the light of these considerations, the Federal Chancellor and she had agreed that it was probably necessary to sign, but that an agreement should be sought that those signing the Agreement must also agree to observe the normal rules of the market and eschew manipulation, since the rise and fall in prices caused many problems.

Lord Carrington said that there were in fact powerful reasons for signing the Agreement. The money paid by governments into the buffer stock would be buying tin: it would not be wasted. If we did not sign, the tin producers would set up a 'TINPEC' which would not work to Western advantage in the short or medium term. It should be noted that the Malaysian raid on the market had ended unsuccessfully; the Malaysians had lost money, had quarrelled with their Swiss advisers and would be most unlikely to try the same tactic again. Finally, the biggest producers, who happened also to be members of ASEAN, had made it very clear

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to him that they did not wish to establish a 'TINPEC' but would be forced to do so if we did not sign (this recalled the problems with textiles the year before). He himself attached importance to our relations with ASEAN. But in any case, he did not believe that we would lose much if we did sign.

"Herr Matthofer said that he had already decided that the German Finance Ministry would follow the lead of the Economics Ministry which would take its cue from the British Treasury who would follow the lead of the British Foreign Office (Chancellor Schmidt wondered whether Agriculture Ministers had no contribution to make).

Asked if Industry Ministers had a view, Mr. Jenkin said that it was questionable objectively whether there was much point in an ITA if the Americans did not sign: they were the major consumers. If the US were not involved, the producers would dominate the Agreement. And it was not the case that the poorest producers would benefit. Mr. Biffen wondered whether it might be possible for the UK and FRG to frustrate the ITA in concert with the USA. He thought that ASEAN held no very powerful counter-weapon. If it was our judgement that we could together frustrate the ITA, it would be to our common advantage to do so. He doubted if the threat of retaliation was credible should the ITA be stillborn. Herr Schlecht said he fully agreed with Mr. Jenkin. Particularly without US participation, the ITA would not stabilise the world market. Nevertheless, the political factors were very important and he doubted whether the Agreement would in practice harm or help anyone very much. Herr Matthofer said that it represented a further step towards the New World Economic Order and thus a further step away from free market principles.

Chancellor Schmidt wondered whether we should sign the Agreement and hope that the United States would wreck it. Lord Carrington said that if we signed it would be important for

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EC countries to make a statement expressing their expectation that the market would not be manipulated. Herr Matthofer said that this would be the first time that the consumer countries would have paid 50% of the costs of a buffer stock. In the past, the producers had always paid.

Summing up, the Prime Minister said that bad economic decisions were too often taken for good political reasons. Nevertheless, she thought the consensus was that we should be guided by the political considerations and sign the Agreement, doing our best to secure an accompanying undertaking on non-manipulation of the market.

WORLD ECONOMY

Reverting to Sir Geoffrey Howe's report, Chancellor Schmidt asked about the nature of the opportunity presented by the decrease in oil prices. He himself feared that the suddenness of the downward move in prices would create 'discontinuities' in the balance of payments of OPEC countries and interrupt their import and development programmes. He could see that a sudden deterioration in the position of the OPEC nations would be mirrored by an improvement in the balance of payments of consumer countries but wondered what this would mean in practice.

Sir Geoffrey Howe said that the decrease in oil prices was not in fact sudden. Spot prices and North Sea oil had come down, but OPEC was still holding out. The industrial economies had suffered greatly from the rise in oil prices in the past and in general a drop now would be beneficial: it would allow real growth which would offset the impact on the OPEC economies. There had been no dramatic withdrawal of buyers from the world market and he thought the net effect would be beneficial to world growth.

Chancellor Schmidt remained doubtful. In the best case, somebody else would replace Saudi investments in the New York Stock Market, and take up the orders lost in the Middle East. But he

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doubted whether this would in practice occur. All sudden change was bad and he did not believe that the West should welcome the fall in prices unreservedly at the Versailles Summit. Herr Matthöfer pointed out that the rise in the price of oil had been much more sudden than the current drop. But it was true that the FRG stood to lose disproportionately from a reduction in OPEC purchasing power since they had obtained a disproportionate share of OPEC orders. The Prime Minister pointed out that OPEC surpluses had not all been channelled towards Western industry: much had gone into unproductive property deals. Sir Geoffrey Howe said that instability in world currency markets had been brought about mainly by OPEC surpluses.

INDUSTRIAL AFFAIRS

Mr. Jenkin said that he had discussed steel, textiles, Airbus and industrial policy with Herr Schlecht. On steel, they had agreed that the industrial code must be respected: there were problems with the Italians. The next EC meeting on 4 May must settle quotas. On textiles, there was common concern about the escalation of subsidies, especially in Belgium and Italy. The Germans had challenged Commission support for Belgium in the European Court. How that the French had failed to notify their textile aids we would press the Commission to report. Pressures on our own textile industries were growing. On Airbus, the French were pressing both the UK and the FRG for a decision on the A320. Neither of us wanted a political aircraft and neither was satisfied that the market existed. They had agreed that Community industrial policy was like cotton wool. They would try to pin the Commission down to some firm proposals. Count Lambsdorff would come to London shortly for discussions.

TRADE

Mr. Biffen said that he had discussed Japan and the GATT Ministerial meeting with Herr Schlecht. The success of the Japanese economy was creating problems in both the GATT and the IMF. This made discussions with the Japanese necessary in their own

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interest. We agreed with the Germans on the need to avoid protectionism. Mr. Biffen explained that the aim of using Article XXIII of the GATT would be to hold the Japanese accountable for failing to take account of the effect of their actions on their partners. Discussions would be pursued in the OECD and at Versailles.

Mr. Biffen said that at the GATT Ministerial meeting in November the emphasis would be on the need to resolve trade problems in a GATT framework. It was necessary to resist an approach based on bilateral reciprocity. They would also wish to liberalise trade in services.

The two sides had agreed on the need to strengthen the Community's internal market by reducing border formalities, which were now less in evidence between Sweden and Norway than between EC member states. Finally, they had touched on air fares and the Insurance Directive.

The Prime Minister commented that competitive subsidies were not being effectively dealt with by the Commission.

AGRICULTURE

Mr. Walker said that the situation had been transformed since the Commission had originally tabled its proposals. Subsequent substantial currency realignments meant that the French, Belgians, Luxembourgers, Danes and Italians had all been granted uncovenanted increase in agricultural subsidies. This meant that most countries in the Community were already likely in advance of the next price fixing to gain more than they were claiming. Against this background, it was even more unfair that the FRG was being asked by the Commission to reduce MCA's and the UK to revalue the Green Pound. In addition, the Mediterranean countries were seeking improvements in respect of fruit, vegetables, wine and olive oil which, if achieved, would lead to further financial burdens falling on the FRG and UK. As to the price fixing exercise, in the FRG view delay would be bad

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for Europe. The two sides disagreed over the coresponsibility levy. The British considered it a bad principle to exempt small and low income producers, while the Germans maintain that the exemption was not as significant as the British side claimed. There was also a difference of view over the cost of the current price fixing. The Commission proposals were based on trends in future prices. But these were uncertain. This uncertainty, combined with the ambitions of Mediterranean producers, was leading to instability in the Community. Both sides aimed to ensure that these problems were settled in the context of the 30 May Mandate.

The Prime Minister recalled that the principle agreed at Lancaster House had been that agricultural costs should increase more slowly than the Community's own resources. But the Commission's proposals would lead to their absorbing a larger proportion. Herr Rohr said that the outcome would depend on the basic increase in agricultural costs. Estimated Commission figures for 1983 showed agricultural support absorbing 14 billion ECU. In 1982 the increase had in fact been less than the increase in own resources. The Prime Minister said that the Commission had changed its method of calculation: it was now based on assumptions about movements in world prices.

DEFENCE

Mr. Nott said that defence programmes in both countries faced similar problems. Large-scale capital programmes conceived long ago had led to pressure on budgets which would last for the next three years. The two sides had discussed joint equipment budgets and agreed that they must resist the Berry amendments aimed at cutting exports to the USA. He and Herr Apel had agreed on the need to press the US Government to get the START negotiations under way. At the NPG the following week he would be explaining to his colleagues that the Trident programme would only absorb 3% of the British defence budget over 15 years.

/ Mr. Nott

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Mr. Nott said that he and Herr Apel both felt it would be difficult for them to explain to their electorates why defence ministers were to be excluded from the forthcoming NATO Summit. They had agreed on the need to improve European cooperation in the defence field and to involve the French more. However, NATO remained the principal forum, given the need to retain the US commitment to Europe. The two Ministers had noted the rise of anti-Americanism, especially on the Continent, as expressed in the various peace movements.

The Prime Minister queried the decision to exclude defence ministers from the NATO Summit. Mr. Nott thought they should not participate but should be in attendance. Chancellor Schmidt said that he did not want the Bonn Summit to produce another instant military strategy. He recalled previous Summits at which the Heads of Government had been presented at the last moment with ready-made texts drafted in the DPC and NATO Council. He himself had, for example, only heard about the commitment to a 3% increase in real defence expenditure the night before he was supposed to agree it. He wanted a natural, relaxed, restatement of the grand strategy of the Alliance, without attempting to predict the future.

WORLD ECONOMY

The Prime Minister asked Herr Matthöfer["] for his view on prospects for the world economy next year. Herr Matthöfer["] said his prime concern was to disengage as far as possible from developments in US interest rates. The day before the Bundesbank had decreased German rates at the same time as US rates had increased still further. US rates were now some 5% above the inflation rate. Herr Matthöfer["] said he could not understand US economic policy. The Administration had planned for a \$23 billion deficit in Financial Year 1983: Mr. Stockman was now talking about a deficit between \$120 to \$169 billion. Since the US had a much lower savings rate than the Germans (approx. 4.5% compared with 15%) the US government would thus be mopping up virtually all spare capital

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accumulation. This process was depressing the world economy. The Europeans must stick together, solve their current account problems and disengage themselves from pernicious US interest rates. Mr. Regan and his colleagues were in a trap from which they did not know how to escape. They were hoping that something would turn up, but the Europeans could not afford to wait. The German government were now more optimistic, believing that they were the second country after the Japanese to adapt their economy to the new world requirements. The oil price decrease, the increase in their own exchange rate and capital inflows were positive developments allowing a decrease in interest rates. But unforeseen developments could upset matters. In particular, Japanese actions could produce a US reaction which would harm everybody.

The Prime Minister said that the British and German governments were pursuing similar economic strategies. Herr Matthofer agreed that many passages in Sir Geoffrey Howe's recent budget speech had sounded very familiar to them. He stressed the importance of trade union cooperation in the running of the economy and the importance of the mass purchasing power of their members. Manufacturers needed a reasonable expectation of being able to offload their additional production. Chancellor Schmidt said that a decrease in retail turnover discouraged investment. Consumers must not be made to suffer for too long. The German government had reduced private purchasing power for two years in a row but did not believe it possible to do so for a third without creating social disturbance. German consumers had had to accept a loss of real purchasing power of 1½ to 2% in the current financial year.

The Prime Minister said that nevertheless the real worry was the increasing level of unemployment. In the UK an increase in output would be perfectly possible without increasing employment. Increased savings did not imply a reduction in the standard of living.

Herr Matthofer referred to the problem of Turkish workers. The position was now grave: 180,000 wives and 300,000 young Turks

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now had the right to enter the FRG to join the breadwinners already there. Commission rules foresaw the gradual introduction of free movement of workers from Turkey until 1986. This could lead to 12 million Turks living in the FRG. Chancellor Schmidt recalled that former Prime Minister Demirel had once told him that the Turkish Government was planning on the assumption that at least 10 million Turks would go to Germany in the next decade. He said that the German government would fight a bitter war over the Community's Treaty of Association with Turkey. The Prime Minister said that he could rely on British understanding.

The meeting ended at 1715.

A.J.C.

23 March, 1982.

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10 DOWNING STREET

From the Private Secretary

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23 March 1982

Anglo/German Summit

I sent you earlier (my letter of 21 March to Brian Fall) the records of the restricted meetings which took place during this Summit. I now enclose the record of discussion at the plenary meeting on the afternoon of Friday 19 March.

I am copying this letter and enclosure to the Private Secretaries to the Chancellor of the Exchequer, the Secretary of State for Industry, Secretary of State for Defence, Minister of Agriculture, Fisheries and Food, Secretary of State for Trade and David Wright (Cabinet Office).

A. J. COLES

Francis Richards, Esq.,
Foreign and Commonwealth Office.

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CONVERSATION

RECORD OF A DISCUSSION BETWEEN THE PRIME MINISTER AND THE CHANCELLOR OF THE FEDERAL REPUBLIC OF GERMANY, HERR HELMUT SCHMIDT, AT CHEQUERS ON FRIDAY 19 MARCH 1982, AT 1530 HOURS Present

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|---|-----------------------|
| The Prime Minister | Herr Helmut Schmidt |
| Foreign and Commonwealth Secretary | Herr Matthöfer |
| Chancellor of the Exchequer | Dr Schlecht |
| Secretary of State for Industry | Herr Rohr |
| Secretary of State for Defence | Herr Becker |
| Minister of Agriculture, Fisheries and Food | Dr Ruhfus |
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| Sir Robert Armstrong | Dr Feiter |
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| Mr David Gillmore | Herr Paschke |
| Mr John Coles | Herr Wendler |
| Sir Kenneth Couzens | Herr Heck |
| Sir Brian Hayes | Herr Hansland |
| Mr Michael Franklin | Herr Stützle |
| Sir Frank Cooper | Herr Mueller Thuns |
| Mr D Hancock | Herr Witt |
| Mr David Gladstone | Herr von Alten |
| | Dr Kudlich |
| | Dr von Ploetz |

Mr. Coles,
No. 60

cc PS/PUS
Lord Bridges
Mr. Bullard
Mr. Gillmore

Dr Gladstone
22/3

Type Name
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3. The Foreign Ministers had also discussed the problem of tin. As to the Genscher/Colombo plan, Herr Genscher had thought that the Danes would not wish this question to come to fruition during their Presidency, because of the embarrassment it generated within the governing party itself, ~~and~~ Progress might therefore be faster than expected.

4. Lord Carrington said that there were no specifically Anglo-German problems. The two sides were in close touch about the problem of transatlantic communications in NATO. Herr Genscher had suggested 'Gymnich'-type meetings: there were also some new ideas from S^A Colombo. Of the two, Lord Carrington favoured Herr Genscher's idea, but he admitted that the prospect of two 'Gymnich' meetings on top of the two NATO Ministerial meetings every year ^{was} somewhat daunting.

FINANCIAL/ECONOMIC AFFAIRS

5. Sir G Howe said that he had had a relatively short discussion with Herr Matthöfer of the two sides' domestic economic measures. The German side had explained the steps ^{they had} taken to combat unemployment and both sides had agreed that unemployment represented the most pressing political problem of the day. In a longer discussion of the world economy, three issues had predominated:

- a) It was agreed that the slackening in the oil price would be helpful to the prospects of growth provided there were no relaxation in the drive for energy conservation. Sir G Howe had explained that the fall in the oil price meant

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a fall in government revenue but was still helpful to the economy overall.

- b) Both sides had expressed anxiety about the lack of control in the US economy and the level of interest rates. They had agreed that advice to the Americans should be offered off- rather than on-stage if it was to be effective.
- c) In relations~~s~~ to the impact of the Japanese economy on that of other countries, it had been agreed that the main ingredients were:

i) Japanese resistance to imports;

ii) their devastating export drive;

iii) the Japanese combined tight fiscal policy with a relaxed foreign exchange policy with the result that the yen had fallen by 8% the previous year.

However, the two sides had agreed that it would not pay to take an aggressive line with the Japanese nor to reopen arguments about 'economic locomotives' (Chancellor Schmidt confirmed German dislike ~~of~~ this concept). Sir G Howe noted the striking contrast between the Japanese approach he had just outlined and that of the United States who were combining a tight monetary with a lax fiscal policy. Asked by Chancellor Schmidt whether this Japanese policy helped to explain their success, Sir G Howe said that it might be an additional factor but that the ^{main} problem it presented to the outside world was that it led to a

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strong dollar and a weak yen. This in turn increased worldwide pressures for protectionism. He and Herr Matthöfer had discussed a European approach to this problem and the British side had handed over a paper.

6. Sir G Howe said that they had also discussed their anxieties in relation to the US economy and the prospects for the EMS. On the latter, they had found limited scope for institutional changes and had agreed on the importance of convergence if the EMS were to become a stabilising influence. A discussion of the 30 May Mandate had brought no fresh insights: they had focused on the importance of agricultural expenditure in the context of the Mandate and agreed on the principle that agricultural expenditure should grow more slowly than overall Community expenditure.

7. In further discussion together with their trade colleagues, Sir G Howe said that anxiety had been expressed about Hungarian liquidity problems. They had agreed that the Hungarian economy was basically sound and it would be important to avoid a default. It was not however certain whether Hungary was in a position to make an IMF drawing. It might be necessary for a multi-lateral approach to be made to the USA to ~~bring~~ ^{persuade} the latter to regard Hungary differently from the other East Europeans.

TIN

8. On tin, Sir G Howe noted that there was no consensus of view within governments. Finance Ministers were keen to avoid early signature of the International Tin Agreement (ITA)

because of past manipulation of the market. The United States would not be signing the Agreement. Herr Matthöfer thought it would be desirable to talk to the Japanese and to take account of the US reaction. There would be many opportunities to talk privately to the Japanese, who were well aware of the problem and willing to help. He had learned much about the Tin Agreement from his discussions with Sir G Howe and felt most reluctant to subscribe DM 50 million to the tin producers as the German contribution to the buffer stock. This would not benefit the people in the producing countries but only the companies actually using the buffer stock. He was therefore glad to hear that the British side was adamantly opposed to the Agreement.

9. The Prime Minister said that no one in their senses would wish to sign such an agreement at the present time. However, politically, unless we did sign the ITA, countries like Indonesia could discriminate against those opposing the ITA. In the light of these ^{considerations,} ~~conditions,~~ the Federal Chancellor and she had agreed that it was probably necessary to sign but that an agreement should be sought that those signing the Agreement must also agree to observe the normal rules of the market and eschew manipulation, since the rise and fall in prices caused many problems.

10. Lord Carrington said that there were in fact powerful reasons for signing the Agreement. The money paid by governments into the buffer stock would be buying tin: it would not be wasted. If we did not sign, the tin producers would set up a 'TINPEC' which would not work to Western advantage in ^{the} short or medium term. It should be noted that

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the Malaysian raid on the market had ended unsuccessfully; the Malaysians had ^{had} lost money, ^{had} quarrelled with their Swiss advisers and would be most unlikely to try the same tactic again. Finally, the biggest producers, who happened also to be members of ASEAN, had made it very clear to him that they did not wish to establish a 'TINPEC' but would be forced to do so if we did not sign (this recalled the problems with textiles the year before). He himself attached importance to our relations with ASEAN. But in any case, he did not believe that we would lose much if we did sign.

11. Herr Matthofer said that he had already decided that the German Finance Ministry would follow the lead of the Economics Ministry which would take its cue from the British Treasury who would follow the lead of the British Foreign Office (Chancellor Schmidt wondered whether Agriculture ^{and} Ministers had no contribution to make).

12. Asked if Industry Ministers had a view, Mr Jenkin said that it was questionable objectively whether there was much point in an ITA if the Americans ^{did not sign: then} were the major consumers. If the US were not involved, the producers would dominate the Agreement. And it was not the case that the poorest producers would benefit. Mr Biffen wondered whether it might be possible for the UK and FRG to frustrate the ITA in concert with the USA. He thought that ASEAN held no very powerful counter-weapon. If it was our judgment that we could together frustrate the ITA, it would be to our common advantage to do so. He doubted if the threat of ~~Italian~~ retaliation was credible should the ITA be stillborn. Herr Schlecht said he fully agreed with Mr Jenkin. Particularly

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without US participation, the ITA would not stabilise the world market. Nevertheless, the political factors were very important and he doubted whether the Agreement would in practice harm or help anyone very much. Herr Matthöfer said that it represented a further step towards the ~~New~~ World Economic Order and thus a further step away from free market principles.

13. Chancellor Schmidt wondered whether we should sign the Agreement ^{and} ~~hoping~~ that the United States would wreck it. Lord Carrington said that if we signed it would be important for EC countries to make a statement expressing their expectation that the market would not be manipulated. Herr Matthöfer said that this would be the first time that the consumer countries would have paid 50% of the costs of a buffer stock. In the past, the producers had always paid.

14. Summing up, the Prime Minister said that bad economic decisions were too often taken for good political reasons. Nevertheless, she thought the consensus was that we should be guided by the political considerations and sign the Agreement, doing our best to secure an ^{accompanying} ~~undertaking~~ on non-manipulation of the market.

WORLD ECONOMY

15. Reverting to Sir G Howe's report, Chancellor Schmidt asked about the nature of the opportunity presented by the decrease in oil prices. He himself feared that the suddenness of the downward move in prices would create 'discontinuities' in the balance of payments of OPEC countries and interrupt

their import and development programmes. He could see that a sudden deterioration in the position of the OPEC nations would be mirrored by an improvement in the balance of payments of consumer countries but wondered what this would mean in practice.

16. Sir G Howe said that the decrease in oil prices was not in fact sudden. Spot prices and North Sea oil had come down, but OPEC was still holding out. The industrial economies had suffered greatly from the rise in oil prices in the past and in general a drop now would be beneficial: it would allow real growth which would offset the impact on the OPEC economies. There had been no dramatic withdrawal of ^{buyers} ~~power~~ from the world market and he thought the net effect would be beneficial to world growth.

17. Chancellor Schmidt remained doubtful. In the best case, somebody else would replace Saudi investments in the New York Stock Market, and take up the orders lost in the Middle East. But he doubted whether this would in practice occur. All sudden change was bad and he did not believe that the West should welcome the fall in prices unreservedly at the Versailles Summit. Herr Matthöfer pointed out that the rise in the price of oil had been much more sudden than the current drop. But it was true that the FRG stood to lose disproportionately from a reduction in OPEC purchasing power since they had obtained a disproportionate share of OPEC orders. The Prime Minister pointed out that OPEC surpluses had not all been channelled towards Western industry: much had gone into unproductive property deals. Sir G Howe said that instability in world currency markets had been brought about mainly by OPEC surpluses.

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INDUSTRIAL AFFAIRS

18. Mr Jenkin said that he had discussed steel, textiles, Airbus and industrial policy with Herr Schlecht. On steel, they had agreed that the industrial code must be respected: there were problems with the Italians. The next EC meeting on 4 May must settle quotas. On textiles, there was common concern about the escalation of subsidies, especially in Belgium and Italy. The Germans had ~~had~~ challenged Commission support for Belgium in the European Court. Now ^{that} the French had failed to notify their textile aids ~~and they~~ ^{we} would press the Commission to report. Pressures on our own textile industries were growing. On Airbus, the French were pressing both the UK and the FRG for a decision on the A320. Neither of us wanted a political aircraft and neither was satisfied that the market existed. They had agreed that Community industrial policy was like cotton wool. They would try to pin the Commission down to some firm proposals. Count Lambsdorff would come to London shortly for discussions.

TRADE

19. Mr Biffen said that he had discussed Japan and the GATT Ministerial meeting with Herr Schlecht. The success of the Japanese economy was creating problems in both the GATT and the IMF. This made discussions with the Japanese necessary in their own interest. We agreed with the Germans ~~for a~~ ^{on the} need to avoid protectionism. ^{Mr. Biffen} He explained that ~~use of~~ ^{the aim of using} Article XXIII of the GATT would ^{be to} hold the Japanese accountable for failing to take account of the effect of ~~that~~ ^{their} actions on

/their

their partners. Discussions would be pursued in the OECD and at Versailles.

20. Mr Biffen said that at the GATT Ministerial meeting in November the emphasis would be on the need to resolve trade problems in a GATT framework. It was necessary to resist an approach based on bilateral reciprocity. They would also wish to liberalise trade in services.

21. The two sides had agreed on the need to strengthen the Community's internal market by reducing border formalities, which were now less in evidence between Sweden and Norway than between EC member states. Finally, they had touched on air fares and the Insurance Directive.

22. The Prime Minister commented that competitive subsidies were not being effectively dealt with by the Commission.

AGRICULTURE

23. Mr Walker said that the situation had been transformed since the Commission had originally tabled its proposals. ^{Subsequent} (Substantial currency realignments ~~since then~~ meant that the French, Belgians, Luxembourgers, Danes and Italians had all been granted uncovenanted increases in agricultural subsidies. This meant that most countries in the Community were already likely in advance of the next price fixing to gain more than they were claiming. Against this background, it was even more unfair that the FRG was being asked by the Commission to reduce MCA's and the UK to revalue the Green Pound. In addition, the Mediterranean countries were seeking ~~for~~

/improvements

improvements in respect of fruit, vegetables, wine and olive oil which, if achieved, would lead to further financial burdens falling on the FRG and UK. As to the price fixing exercise, in the FRG view delay would be bad for Europe. The two sides disagreed over the coresponsibility levy. The British considered it a bad principle to exempt small and low income producers, while the Germans maintain that the exemption was not as significant as the British side claimed. There was also a difference of view over the cost of the current price fixing. The Commission proposals were based on trends in future prices. But these were uncertain. This uncertainty, combined with the ambitions of Mediterranean producers, was leading to instability in the Community. Both sides aimed to ensure that these problems were settled in the context of ~~CAP and budget reform.~~ *the 30 May Mandate.*

24. The Prime Minister recalled that the principle agreed at Lancaster House had been that agricultural costs should increase more slowly than the Community's own resources. But the Commission's proposals would lead to their absorbing a larger proportion. Herr Rohr said that the outcome would depend on the basic increase in agricultural costs. Estimated Commission figures for 1983 showed agricultural support absorbing 14 billion ECU. In 1982 the increase had in fact been less than the increase in own resources. The Prime Minister said that the Commission had changed its method of calculation: it was ^{now} based on assumptions *about* movements in world prices.

/DEFENCE

DEFENCE

25. Mr Nott said that defence ^{programmes} ~~progress~~ in both countries faced similar problems. Large-scale capital programmes conceived long ago had led to pressure on budgets which would last for the next three years. The two sides had discussed joint equipment budgets and agreed that they must resist the Berry amendments aimed at cutting exports to the USA. He and Herr Apel had agreed on the need to press the US Government to get the START negotiations under way. At the ~~MPG~~ the following week he would be explaining to his colleagues that the Trident programme would only absorb 3% of the British defence budget over 15 years.

26. Mr Nott said that he and Herr Apel both felt it would be difficult for them to explain to their electorates why defence ministers were to be excluded from the forthcoming NATO Summit. They had agreed on the need to improve European cooperation in the defence field and to involve the French more. However, NATO remained the principal forum, given the need to retain the US commitment to Europe. The two Ministers had noted the rise of anti-Americanism, especially on the Continent, as expressed in the various peace movements.

27. The Prime Minister queried the decision to exclude defence ministers from the NATO Summit. Mr Nott thought they should not participate but should be in attendance. Chancellor Schmidt said that he did not want the Bonn Summit to produce another instant military strategy. He recalled previous Summits at which the Heads of Government had been

presented at the last moment with ready-made texts drafted in the DPC and NATO Council. He himself had, for example, only heard about the commitment to a 3% increase in real defence expenditure the night before he was supposed to agree it. He wanted a natural, relaxed, restatement of the grand strategy of the Alliance, without attempting to predict the future.

WORLD ECONOMY

28. The Prime Minister asked Herr Matthöfer for his view on prospects for the world economy next year. Herr Matthöfer said his prime concern was to disengage as far as possible from developments in US interest rates. The day before the Bundesbank had decreased German rates at the same time as US rates had increased still further. US rates were now some 5% above the inflation rate. Herr Matthöfer said he could not understand US economic policy. The Administration had planned for a \$23 billion deficit in Financial Year 1983: Mr Stockman was now talking about a deficit between \$120 to \$169 billion. Since the US had a much lower savings rate than the Germans (approx 4.5 % compared with 15%) the US government would thus be mopping up ^{virtually all} ~~the~~ spare capital accumulation. This process was depressing the world economy. The Europeans must stick together, solve their current account problems and disengage themselves from pernicious US interest rates. Mr Regan and his colleagues were in a trap from which they did not know how to escape. They were hoping that something would turn up, but the Europeans could not afford to wait. The German government were now more optimistic, believing that they were the second country

after the Japanese to adapt their economy to the new world requirements. The oil price decrease, the increase in their^{own} exchange rate and capital inflows were positive developments allowing a decrease in interest rates. But unforeseen developments could upset matters. In particular, Japanese actions could produce a US reaction which would harm everybody.

29. The Prime Minister said that the British and German governments were pursuing similar economic strategies. Herr Matthöfer agreed that many passages in Sir G Howe's recent budget speech had sounded very familiar to them. He stressed the importance of trade union cooperation in the running of the economy and the importance of the mass purchasing power of their members. Manufacturers needed^a reasonable expectation of being able to offload their additional production. Chancellor Schmidt said that a decrease in retail turnover discouraged investment. Consumers must not be made to suffer for too long. The German government had reduced private purchasing power for two years in a row but did not believe it possible to do so for a third without creating social disturbance. German consumers had had to accept a loss of real purchasing power of 1 1/2 to 2 % in the current financial year.

30. The Prime Minister said that nevertheless the real worry was the increasing level of unemployment. In the UK an increase in output would be perfectly possible without increasing employment. Increased savings did not imply a reduction in the standard of living.

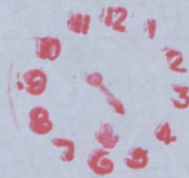
31. Herr Matthöfer referred to the problem of Turkish

workers. The position was now grave: 180,000 wives and 300,000 young Turks now had the right to enter the FRG to join the breadwinners already there. Commission rules foresaw the gradual introduction of free movement of workers from Turkey until 1986. This could lead to 12 million Turks living in the FRG. Chancellor Schmidt recalled that former Prime Minister Demirel had once told him that the Turkish Government was planning on the assumption that at least 10 million Turks would go to Germany in the next decade. He said that the German government would fight a bitter war over the Community's Treaty of Association with Turkey. The Prime Minister said that he could rely on British understanding.

32. The meeting ended at 1715.

A. J. C. $\frac{22}{3}$.

22 MAR 1982



W.C.H.

MR. COLES

Plenary Meeting
Chequers: Friday, 19 March

1. I attach list of those expected to attend the Plenary.

Also a seating plan for those sitting round the table. Miss Thomas has place cards for all these. Should the plan change I have given her spare cards.

2. I also attach the programme as the Prime Minister will need to agree where you will hold the various meetings, etc.

Sue
→

18 March 1982

10 Downing Street

Prime Minister

Mr. Clive Whitmore

Mr. Bernard Ingham

Mr. John Coles
Cabinet Office

Sir Robert Armstrong

Mr. David Hancock

Foreign and Commonwealth Office

Rt. Hon. Lord Carrington

Sir Michael Palliser

Sir Jock Taylor

Mr. J.L. Bullard

Mr. David Gladstone (note-taker)

HM Treasury

Rt. Hon. Sir Geoffrey Howe, MP

Sir Kenneth Couzens

Ministry of Agriculture, Fisheries and Food

Rt. Hon. Peter Walker, MP

Sir Brian Hayes

Department of Industry

Rt. Hon. Patrick Jenkin, MP

Sir Peter Carey

Department of Trade

Rt. Hon. John Biffen, MP

Mr. Michael Franklin

Ministry of Defence

Rt. Hon. John Nott, MP

Sir Frank Cooper

Interpreter

Mrs. Bloom

PLENARY TALKS

- 2 -

German Delegation

Herr Schmidt

Herr Becker

Herr von der Gablentz

Herr Fischer-Dieskau

? Dr. Feiter

Foreign Minister's Delegation

Herr Genscher

Herr Pfeffer

Dr. Fischer

Dr. Wandler

Herr Weber (Interpreter)

Finance Minister's Delegation'

Herr Matthofer

Herr Heck

Defence Minister's Delegation

Dr. Apel

Dr. Leister

Economic Ministry Delegation

Dr. Schlecht

Herr Mueller-Thuns

Frau Scheben (Interpreter)

Agriculture Ministry Delegation

Herr Rohr

Herr Witt

FRG Embassy

Dr. Ruhfus

Herr von Alten

Dr. Kudlich

PLENARY TALKS: GREAT PARLOUR

Herr Fischer-Dieskau (note-taker)

Sir Michael Palliser

Herr von der Gablentz

Sir Robert Armstrong

HE German Ambassador

Rt. Hon. Patrick Jenkin

HE Herr Dr. Schlecht

Rt. Hon. John Nott

HE Herr Matthöfer

Rt. Hon. Lord Carrington

HE Herr Schmidt

Prime Minister

HE Herr Genscher

Rt. Hon. Sir Geoffrey Howe

HE Dr. Apel

Rt. Hon. Peter Walker

HE Herr Rohr

Rt. Hon. John Biffen

Herr Kurt Becker

Sir Jock Taylor

Herr Wendler (note-taker)

Mr. David Gladstone
(notetaker)

ENTRANCE

Remainder to sit behind