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NOTE OF A MEETING BETWEEN THE CHANCELLOR OF THE EXCHEQUER AND COUNT LAMBSDORFF  
AT NO.11 DOWNING STREET AT 8.45 A.M. ON FRIDAY 21ST MAY, 1982

Present:-

Chancellor of the Exchequer  
Mr. J.O. Kerr

Dr. Otto Graf Lambsdorff  
Ambassador Jurgen Ruhfus

Community Issues (i) BUDGET/CAP

1. The Chancellor said that he had been shocked and dismayed by the events of 18 May in the Agriculture Council. The tearing-up of the Luxembourg compromise had amounted to a betrayal of trust, and had created an extremely serious situation. Count Lambsdorff said that there had been faults on both sides. The FRG had long warned against trying to link the budget and farm prices issues, and it was absurd to pretend that additional increases of half a percentage point or even a full percentage point on farm prices could infringe any vital British national interest. Moreover Mr. Walker had accepted the substance of the farm price settlement. It would be best to regard the events of 18 May as an accident: the FRG had long accepted that the Luxembourg compromise was crucial to the British and French approaches to the Community: it need not, and should not, be damaged by the 18 May voting.
  
2. The Chancellor rejected this analysis. The essence of the Luxembourg compromise was that it was for each nation itself to decide when an issue affected its vital national interests. Moreover, the link between the CAP and the Community budget problem could not be plainer, given the extent to which agricultural support costs inflated the Community budget. And it had been accepted, at Lancaster House and since, that progress should be made in parallel on the CAP and budget issues. On points of detail, it was not correct either that agreement had been reached



by 17 May on the substance of all the farm price decisions subsequently voted through, or that HMG had been warned in advance that the Luxembourg compromise was to be set aside. Speaking personally, he found it difficult to see how the Luxembourg compromise could, after 18 May, ever be the same again; and profoundly disturbing that there should have been such a breach of good faith between close Community partners.

3. Count Lambsdorff agreed that under the Luxembourg compromise it was for each nation itself to define its vital national interests. Conceivably, though rather implausibly, the UK could have argued that certain particular agricultural price increases would infringe a vital UK national interest. But the UK had in fact agreed virtually the whole package. Herr Ertl had reported to the German Cabinet on 13 May that there would be majority voting in the next Agricultural Council; and that Mr. Walker, while he had objected 62 times to individual price proposals, had raised no points of substance. Moreover, Chancellor Schmidt had warned the Prime Minister at the last European Council about what might happen, and had in the end happened. But what mattered most now was to ensure that the Luxembourg compromise was re-affirmed and re-established.

4. The Chancellor said that he could not accept either that we had been fore-warned, or that the Luxembourg compromise should not have applied. The link between the agricultural price settlement and the budget negotiation was founded in plain logic, and had been accepted by all at Lancaster House.

Community Issues (ii) ECONOMIC SANCTIONS AGAINST THE ARGENTINE

5. Count Lambsdorff said that, contrary to what seemed to be the view of British public opinion, the FRG's support for economic sanctions against the Argentine was strong, although they were more costly for the FRG than for any other third country. The Argentine Finance Minister had suggested to him that the FRG should sympathise with a determination to resolve a long-standing



territorial grievance: he had however replied that this totally misunderstood the FRG's position. The FRG had firmly renounced, and wholly disapproved of, the use of force to resolve territorial issues. And the status of Berlin, as well as the existence of BAOR, together with Community ties, impelled the FRG to unequivocal support for the UK position. That said, he had to warn that he thought it very doubtful that the Foreign Affairs Council would on 24 May agree to another Article 113 determination. The Danes would certainly resist it, and would not be alone. He had warned Mr. Lawson at the Bildeburg Conference that he thought it unlikely that the Council on 17 May would agree to a four-week extension of sanctions: he had then thought that a two-week extension should be feasible, but in fact we had secured only one. The position might be still more difficult on 24 May.

6. The Chancellor said that HMG was very grateful for the firm support which the FRG had given throughout the Falklands crisis. We had sought a negotiated settlement with the Argentine, but their proposals had been totally unacceptable, since they had amounted only to a request for the legitimisation of their conquest. While the dispute remained unresolved, we thought it reasonable to seek full Community support. Count Lambsdorff enquired whether we would be prepared to see sanctions lifted if and when we had re-taken possession of the Islands. The Chancellor said that a new situation would then have arisen, which would certainly merit a review.

Community Issues (iii) INSURANCE

7. The Chancellor said that Count Lambsdorff would no doubt be discussing with Lord Cockfield the position now reached on the draft Insurance Services Directive. He wished only to say that he was disturbed at the slow progress made, and at the reluctance of the FRG to change its position on notification and government control of policy conditions and premium rates. He understood that a review was now in progress in Bonn: he very much hoped that it would be productive." Count Lambsdorff took note.



### Summit Issues

#### (i) Japan

8. The Chancellor said that he thought it important that the Japanese should be pressed at Versailles not only to liberalise their internal market, but also to adopt a less restrictive fiscal policy and a less lax monetary policy. A talk with Mr. Kohmoto at OECD on 10 May had suggested to him that some in Japan, including Mr. Kohmoto, would welcome such pressure. It was important that the UK and the FRG should eye-to-eye on this; and Chancellor Schmidt's Hamburg speech on 5 April suggested that there was no disagreement. On the other hand, Dr. Lahnstein had seemed, at the ECOFIN dinner in Brussels on 17 May, reluctant to envisage any such pressure on the Japanese at Versailles.

9. Count Lambsdorff said that the Japanese, while still enmeshed in internal debate, would undoubtedly announce before Versailles some new moves towards opening their markets to imports. But the key was whether they would agree to open their capital markets. The yen remained a "mousetrap" currency, representing only 4 per cent of total international currency reserves, whereas deutschemark reserves amounted to 14 per cent. They must be brought to accept that the yen would have to appreciate. They must also accept that their "laser beam" technique for the destruction of particular European industries would have to be dropped. But he had low expectations of progress at Versailles: Japanese Ministers, if they followed their previous Summit form, would make short statements, and then keep silent: they would neither defend, nor change, their positions.

10. The Chancellor asked whether we could count on German support in arguing for a change in the balance of Japanese macro-economic policies. We would not of course seek any relaxation of their effort to control inflation. Count Lambsdorff said that he saw no difficulty about German support, provided that we were not seeking to revive the "locomotive" theory.



11. The Chancellor said that, on the trade issues, exhortation would not be enough. The Community had so far failed to use its muscle: we ought at Versailles to demonstrate that we meant business, and would be prepared to act. Count Lambsdorff said that the French would certainly wish to wield a big stick. The German position was rather different, but not necessarily incompatible: the Germans would be happy to see protectionist counter-action by the Community discussed, e.g. at Versailles, provided that the approach was similar to NATO's discussion of the nuclear deterrent - i.e. that we had weapons, and would if necessary be prepared to use them, but would greatly prefer not to have to do so.

Summit Issues (ii) EXPORT CREDIT

12. Count Lambsdorff asked why the UK had difficulty with the Swedish compromise consensus proposal. The Chancellor said that our particular concerns were with the new level of Japanese rates - we thought they should rise rather more than was proposed - and with the need to secure better access to yen financing.

Count Lambsdorff said that the issue was bound to arise at Versailles, and that the French would clearly be seeking rather greater changes in the compromise proposal than those which we had in mind. As far as he was concerned, he would be content to discuss raising Japanese rates by, say, 0.5 per cent rather than 0.3 per cent. The FRG might in fact back this, though they would not go along with the French demands.

Summit Issues (iii) TECHNOLOGY

13. Count Lambsdorff was dismissive of the French ideas on technology for discussion at the Summit. They had a flavour of Comecon, and would attract no German support. He was glad that they seemed to be shunted successfully into the siding of further study.

14. The meeting ended at 9.30 a.m.

*J.O.K.*

J.O. KERR  
21 May 1982



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