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 Community Budget etc.



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10 DOWNING STREET

From the Principal Private Secretary

12 June 1980

Dear Paul,

BF 23.6.80

Meeting with Chancellor Schmidt

The Prime Minister met Chancellor Schmidt at 1445 today in her room in the Hotel Cipriani.

Presidency of the Commission

The Prime Minister said that she wondered what Chancellor Schmidt's ideas were about possible successors to Mr. Jenkins. The principal task of whoever succeeded Mr. Jenkins would be to take charge of the restructuring of the Community Budget, and this was going to be a very big job indeed. This meant that we should go for someone who was a considerable person in his own right, regardless of nationality. The UK had begun to take the view that Signor Pandolfi might best fill the bill, but Signor Cossiga had now given her to understand that Signor Pandolfi's name would not be going forward. She thought that this was something which Heads of Government should discuss when they were alone after dinner that evening.

Chancellor Schmidt said that the ideal candidate should be somebody who had been a strong and effective Finance Minister in his national government: this was the kind of person needed to undertake the reform of the Community Budget. Against this criterion, both Signor Pandolfi and Signor Colombo would have been good candidates. On the other hand, he did not believe Mr. Gundelach would be suitable. But even if Signor Pandolfi and Signor Colombo had been prepared to be considered, there was the difficulty that it was the turn of one of the small countries to have the Presidency of the Commission. These various factors meant that the choice boiled down, in practice to Viscount Davignon and M. Thorn. Neither of them was the ideal person to undertake the restructuring of the Budget. Viscount Davignon was a little too pro-French and a little too protectionist. But he was one of Europe's better diplomats. M. Thorn was too cautious and too diplomatic, but he had a great deal of experience. He thought that President Giscard would prefer Viscount Davignon; whereas Herr Genscher would favour M. Thorn who was a personal friend of his. He had no strong preference himself between Viscount Davignon and M. Thorn and could live with either. He agreed that Heads of Government should discuss the matter after dinner that night.

Community Procedures

Chancellor Schmidt said that it was ridiculous to invite the European Council to discuss the formal agenda which the Italians had proposed. The original purpose of the European Council was not to solve specific problems but to allow just the nine Heads of Government to discuss in an informal and

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personal way the major issues facing the world. The nature of the meetings had changed greatly within recent years, and the Heads of Government were now behaving like Agriculture Ministers. The European Council had now become a piece of machinery like NATO or the United Nations. The Heads of Government ought to be able to speak their minds alone without a Secretariat. Moreover, the bureaucracy in Brussels was getting out of hand. It was growing all the time and now numbered more than 5,000 people. After enlargement there would, on present plans, be seventeen Commissioners, and this was ridiculous.

The Prime Minister said that she agreed entirely with what Chancellor Schmidt had said. She thought meetings of the European Council should consist of an informal exchange of views between the Heads of Government. She did not like the habit of issuing a formal communique. Moreover, she thought that the Council met too frequently: two meetings a year would be enough. She would be very happy to settle for only one Commissioner for the UK after enlargement. The Commission issued far too many directives which were very detailed: they were seeking standardisation and not harmonisation.

Encouraged by the Prime Minister, Chancellor Schmidt said that he would raise the possibility of reducing the number of European Council meetings to two a year with the other Heads of Government after dinner that evening.

Restructuring of the Community Budget

The Prime Minister said that she was fearful that rather than face up to the difficult task of restructuring the Budget, the Commission would take the easy way out and propose that the 1% VAT ceiling should be breached. If they did that, she would be in a difficult position because she did not want to be isolated again in the Community in saying no.

Chancellor Schmidt said that he thought it important that the UK should not find itself isolated again in the next two years or so. He agreed about the importance of not going above the 1% VAT ceiling, but he had been alarmed to be told in the last week or so that the ceiling was not the clear and firm limitation which he had previously supposed it was. He was advised that if the Community reached a ceiling on its revenues and was thus unable to make payments to those who, under existing Community law, were entitled to receive them, these people could apply to their national governments for payments in substitution, and the latter were obliged, again in accordance with existing Community law, to make such payments. When the Prime Minister suggested that the way of dealing with this situation would be to change the treaties, Chancellor Schmidt said that he did not believe either the Bundestag or the House of Commons would ratify the necessary amendments. He was in any case facing considerable difficulties over the Community Budget in the Bundestag. The German Government had always been willing to make large contributions to Community finances in order to encourage convergence. But he could not persuade either his own party or the FDP that Germany should pay in order to enhance the standard of living in countries like Denmark and Holland which were richer than Germany. He did not know where he was going to find the additional contribution required of Germany as a result of the recent Brussels package. His Government would now have to find DM2½ billion but they had provided for only DM600 million in their forward plans. The Federal Budget was already in deep deficit, and the servicing of it was getting out of hand. His Government could not borrow any more on the capital market because to do so would push up interest rates and this would have a disastrous effect on the German economy. This left him with no alternative but to increase taxes, and he had had to announce the previous week that taxation would be raised to meet the Brussels package on the 1st January 1981. The political

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implications of having to do this four months before the Federal elections did not need spelling out. Against this background, he had it in mind to tell the other Heads of Government after dinner that evening that it was likely that he would demand in about a year's time that ceilings should be imposed on net receipts from the Community Budget as well as on net contributions. He recognised that this approach was a little crude but it might be necessary and it would also help in the restructuring of the Budget.

The Prime Minister said that she entirely understood Chancellor Schmidt's difficulties, and she had pointed out at Luxembourg that it would not be fair to ask Germany to pay substantially more to the Community Budget than they already did. What he had said underlined the importance of getting ahead quickly with the restructuring of the Budget and she wondered whether some steps at least could be taken in time to be incorporated in the 1980 Budget.

Chancellor Schmidt said that that might be trying to move too quickly. The Commission would not come forward with any worthwhile proposals in the next twelve months, and he believed that the impetus would have to come from national governments. But the brake here was the French Government: although President Giscard wanted to see the CAP reformed, he would not be able to do anything, because of the strength of his agriculture lobby, until after the Presidential elections in April and May of next year. This meant that restructuring would have to go ahead very quickly after that and should be completed by the summer of 1982, if it was not to get caught up in the run-up to the French Assembly elections in 1983. He was not saying that the Commission should not make a start on preparatory work straightaway, though he doubted whether they would get very far. In any case he thought that member Governments should set up small bilateral task forces to work up ideas for restructuring. There might, for example, be an Anglo-German task force composed of, perhaps, two aside, and there might be similar Anglo-French and Franco-German groups. It was essential for these groups to work secretly, with no leak of their activities, for otherwise the French would have difficulties.

The Prime Minister said that she agreed that the restructuring of the Budget needed a lot of preparation. She thought that Chancellor Schmidt's idea of bilateral groups was a good one and she would consider it further.

I should be grateful if you could let me have a note for the Prime Minister on Chancellor Schmidt's assertion that those who were unable to get from the Commission payments that were due to them could have recourse, under existing Community law, to their national Governments for payments in substitution.

I am sending copies of this letter to Martin Hall (HM Treasury) and David Wright (Cabinet Office).

Yours sincerely,

Muri Whitmore.

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Foreign and Commonwealth Office.

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