

SUBJECT

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✓ cc. Robert alt.

RECORD OF A CONVERSATION BETWEEN THE PRIME MINISTER AND
COMMISSIONER DAVIGNON AT 1200 HOURS ON WEDNESDAY 8 DECMEBER 1982
AT 10 DOWNING STREET

PRESENT

The Prime Minister
Mr. Robin Gray
Mr. John Coles

Commissioner Davignon
Private Secretary

The Prime Minister said that she much welcomed the opportunity to discuss with Commissioner Davignon certain pressing trade problems. The United Kingdom was an ardent supporter of free trade. Our market was open and our distribution system was excellent. But Japan, which excelled in production, took full advantage of our efficient distribution system. Meanwhile, the Yen was maintained at an artificially low level. She had made a determined effort at two Economic Summits to secure agreement on action against Japan but had received little support.

It was difficult for the Commission to negotiate with Japan or Spain because of the diverse interests of the various Member States in these issues. Italy was able to prevent the entry of Japanese goods; France used her own methods; some Member States did not have car industries of their own. As regards Spain, France and other Member States had made capital investments in Spain, had taken advantage of lower overheads and labour costs and had benefited from the tariff structure.

The United Kingdom could not wait much longer for action on Japan and Spain. Japan now took 10.6 per cent of our car market. There was now a prospect, as shown at the Smithfield Agricultural Show, of serious penetration by low-cost tractors. There was no doubt that the British Government would have popular support for action against Japan; nor need we fear serious Japanese retaliation against our own exports. There was now a prospect of an early settlement of the Common Fisheries Policy. We should work hard for a reasonable Budget settlement by March. But if the problem of trade with Spain continued, there would be a serious reaction in Britain. So, she had to repeat, that if we could not sort out these matters through the Community, we should have to take independent action.

/Commissioner Davignon

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Commissioner Davignon said that he understood these problems. The question was - could the European Community obtain for Britain what we wanted? He had always taken the view that if the Commission could not deliver, it should not criticise Member States for actions they might take. But he believed that the Commission could deliver a solution in the next two months covering such Japanese exports as cars, electronics, machine tools, video recorders and light commercial vehicles. He hoped that the United Kingdom would give the Commission strong support. The Prime Minister might say to the Commission that if a solution was not achieved in two months, Britain would take action itself to solve its problems. On the other hand, we should be wary about weakening the Community at a time when, in other areas, we should need all the strength it can muster.

The Prime Minister agreed that it was better to have a Community arrangement if possible. But what action would the Commission take about Spain?

Commissioner Davignon said that he was not so familiar with that problem. He was aware in general terms of the difficulties created by Spanish car exports to the United Kingdom but he had not studied the matter in detail.

The Prime Minister said that the problem arose from both tariff and non-tariff barriers. She did not believe that our problems could be solved by Spanish entry into the Community since President Mitterrand was likely to prevent that entry for a considerable period. We could not wait that long.

Commissioner Davignon said that if the Commission obtained strong support from Member States on Japan, it would take soundings in Tokyo. The Prime Minister commented that the problem had been with us for a very considerable time. Surely soundings had been taken already?

Commissioner Davignon said that on every occasion in the past when the Community had been disposed to take positive action, the Japanese had approached one or more Member States, made a concession to them, and persuaded them to block Community action. In other words,
/the Japanese

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the Japanese had bought off certain Member States. He had recently discussed these matters with President Mitterrand. He had asked whether the French decision to insist that certain Japanese products entered France via Poitiers meant that France had abandoned the idea of a Community arrangement with Japan. President Mitterrand had replied that if the Commission could not obtain an arrangement in three months' time, France would act unilaterally. This was significant because it meant that France was now working for a solution on a Community basis.

The Prime Minister said that she would write to the Commission about these matters and would deal with both Japan and Spain. Commissioner Davignon commented that the two cases were different. A special solution was needed for ^{the} problem caused by high Spanish penetration of the UK market, but this could be dealt with through existing EC instruments. But a new approach would be needed for Japan.

Mr. Gray pointed out that the Commission was due to make proposals on Spain in time for the Foreign Affairs Council on Monday or Tuesday of next week. The problem would be to obtain support from Germany. Commissioner Davignon said that he believed that German support could be secured, especially if Chancellor Kohl felt that it was not just relations with Japan but relations within the Community that were at stake.

Mr. Gray said that he had recently discussed the Spanish problem with representatives of Ford and General Motors and the Secretary of State for Trade would be seeing representatives of these companies next week. Both companies were sensitive about ^{the} numbers of cars that they were bringing into the United Kingdom.

The Prime Minister said that she very much wanted the problem of the UK Budget contribution to be sorted out by March of next year. She did not wish any EC problem to become an issue in the next election campaign, whenever that began.

The Prime Minister then raised the problems confronting the European steel industry.

/Commissioner Davignon

Commissioner Davignon said that the Commission had had a major argument with the German Government about the Arbed Steel Company. Three German bankers had now been appointed to present re-structuring proposals. He had had some discussion with them and expected that their report would recommend a 25 per cent reduction of German steel capacity in the next three years.

The Prime Minister said that it was not possible for the United Kingdom to reduce capacity further. There was a strong feeling that we had taken our share of reductions and that it was now up to others in Europe to act. Commissioner Davignon said that he accepted that Britain had done a good deal and Mr. Ian MacGregor had done an excellent job. But because of the collapse in the steel market, BSC would not make sufficient money in 1983 to avoid a loss. So additional measures would probably have to be taken in existing plants, though without these being closed down. The Prime Minister said that the Government had had to be extremely tough with the steel industry since 1979, but it now had to keep the competitive plants in existence. Commissioner Davignon said that many of the difficulties arose because the previous British Government had not taken the necessary decisions.

Commissioner Davignon said that at the end of this week he and other Commissioners would be seeing Mr. George Shultz in Brussels. The Prime Minister said that we must get through to the United States the message that its budget deficit was now becoming a foreign policy issue. The deficit had to be brought down, if necessary by reducing public expenditure. Economic growth in Europe could not be restored without a change of policy in the United States. Commissioner Davignon said that a group of United States businessmen had recently expressed to him the view that the American economy would, at best, take off again in the fourth quarter of next year - this meant that 1983 would be a bad year for Europe. He urged the Prime Minister, in her own talk with Mr. Shultz, to raise the issue of trade with Japan since there was a danger of the United States arriving at a separate settlement with that country, thus making the European task harder.

The discussion ended at 1300 hours.