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10 DOWNING STREET

From the Private Secretary

13 February 1984

Dear Roger,

As you know M. Davignon called on the Prime Minister this morning. Their discussion lasted approximately three-quarters of an hour, and Mr. David Williamson (Cabinet Office) was also present.

The Prime Minister began by thanking M. Davignon for his help in finding a solution to the problem of Sheerness Steel's breaches of the Article 58 quotas. M. Davignon said that this had not been easy, and it had been necessary to cut a few corners. But he was pleased with the outcome, and wished the company well. The Prime Minister said that the workforce deserved success - they had continued working despite massive intimidatory picketing because of their determination to keep their jobs.

Turning to the subject of the EC budget, the Prime Minister said that the Community faced substantial problems. She hoped that they could be solved, since failure to do so was preventing the Community from living up to its members' hopes and ideals. She was determined to achieve lasting reform of the underlying difficulties; and she would not countenance a "solution" involving additional taxes and additional surpluses, as had apparently attracted some member states at Athens. M. Davignon said that the Prime Minister was absolutely right in this. In his view a lasting solution to the budgetary problem was within the Community's grasp. The Athens Council had failed partly because of inadequate preparatory work. The appointment of M. Dumas boded well for the next Council.

M. Davignon argued that in addition to finding a solution to the fundamental problems of the budget, the Community needed to find the most effective way of tackling the legacy of past excess production. It may require a temporary increase in own resources to dispose of stored goods (particularly butter and skimmed milk powder) in the most cost-effective way. The Prime Minister said that she recognised this factor. It would be necessary to dispose of the accumulated surpluses at the best possible price, and preferably not to the Soviet Union. People might be prepared to buy additional butter and milk powder for stock, if the price was right. She agreed with M. Davignon that it made no sense to go on paying refrigerating costs for butter. Mr. Williamson explained that the Community currently held stocks of about

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one million tonnes of skimmed milk powder, and one million tonnes of butter (equivalent to nearly a year's consumption in the Community). The Commission's proposal would reduce the butter price by 11%, and this could be expected to produce a switch from margarine and other fats to butter, without increasing overall consumption.

M. Davignon reiterated his view that the time was right for a fundamental reform. Community farmers realised that they could not go on producing just for intervention. The Prime Minister commented that the Italians were not showing any enthusiasm for reducing surpluses. M. Davignon said that in his view this partly reflected anti-German feeling in Italy. The Prime Minister agreed, adding that she was perhaps the only pro-German Head of Government. She did not believe that the new generation of Germans would accept a method of financing the Community which appeared resentful.

The discussion then moved to questions of information technology. M. Davignon said that US dominance in this field, which arose from their defence programme, was disturbing for Europe. If the Community did not act to counteract it, Europe was in danger of becoming merely a sub-contractor. He therefore attached importance to the ESPRIT programme. It would help to encourage more strategic thinking among small and medium sized companies; it would bring the universities and industry closer together; and, most importantly, it would underline the need for the Community to press for world standards. Without such standards, the danger was that Europe would simply have to accept what the United States laid down (as was already happening with IBM software). To achieve world standards, the Community would have to exercise its considerable purchasing power.

M. Davignon went on to refer to the automobile industry as another example of an area where sensible Community action was needed. It would be a great mistake if, in response to environmental pressures, Europe forced the adoption of US technology - not least because the technology itself was outmoded. More generally, there was a need to reassure investors in the Community about its future. They were uncertain about the closeness of relationships between countries, and the prospects for co-operation. It was essential that national programmes in the industrial field should fit well together. The market for high technology in any one member state might well be insufficient to support development costs. The Prime Minister commented that she hoped there would not be a proliferation of institutions. M. Davignon agreed - he suggested that more attention should be paid to evaluation by independent assessors. If they reported that a programme or institution was not justifying its cost, it should be closed down. On ESPRIT specifically, the Prime Minister said that she was not prepared to agree to the programme going ahead until it was clear where the money to support it was coming from. That meant finding a solution to the budget problem.

Turning to the future of the Community, the Prime Minister said that there was a need to turn the minds of member states to larger issues. The strategic thinking of Herr Schmidt and M. Giscard D'Estaing was missed. A fundamental change in the means of financing Community expenditure was needed not just to

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solve the UK's problem, but to provide an equitable basis for the future. Each country's contribution had to be related to its ability to pay. A compromise which failed to achieve this was simply unacceptable. M. Davignon said that the Commission was really saying the same, though (as the Prime Minister recognised) there would undoubtedly be a need for some safeguarding upper limit to the German contribution.

I am sending a copy of this letter to John Kerr (HM Treasury), Callum McCarthy (Department of Trade and Industry), Michael Reidy (Department of Energy) and to Richard Hatfield and David Williamson (Cabinet Office).

Yours ever,

David

David Barclay

Roger Bone, Esq.,
Foreign and Commonwealth Office.