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From the Private Secretary

2 February 1988

Dear Lyn,

PRIME MINISTER'S MEETING WITH CHANCELLOR KOHL

The Prime Minister had a talk this morning with Chancellor Kohl about the forthcoming European Council. Chancellor Kohl was accompanied by Herr Stavenhagen, State Secretary in the Federal Chancellery, and Herr Hartmann, also from the Federal Chancellery. The talk was generally good-natured and revealed a readiness on the part of the Germans to move towards us on a number of issues which will come up at the European Council. But it also revealed continuing substantial differences, particularly on stabilisers for cereals and oil seeds. The question of the United Kingdom's abatement was raised briefly and gingerly, without any attempt to link it to other issues. Following the meeting the Prime Minister and Chancellor Kohl gave a press conference, the transcript of which will be available to you.

European Council

Chancellor Kohl said that his meeting with the Prime Minister was very important and there were high expectations from it. The European Community had reached a watershed. There were major world problems which needed urgent attention. The Community must settle its housekeeping problems so that full attention could be given to these wider issues. The Community had to show some vision. Germany's net contribution was now some DM 8 billion. He had to be able to show that the Community was making progress on the wider issues if this was to continue. There was no point in a postponement of the Brussels Council. It would be even more difficult to reach agreement at Hanover in June. Four more months of argument about agriculture and future financing would preclude progress on the internal market. If the Community was to complete the internal market by 1992 - and he regarded that as its single most important task - the European Council must clear away subsidiary issues next week. He was prepared to do everything humanly possible to reach an agreement. But it would require a compromise in which everybody would have to move. Concessions would be painful for the German Governmnent but he was prepared to confront public opinion with the need for them. In his view, discussions in Brussels had gone on long enough. The moment had come to reach decisions both on agriculture and the budget. And it must be done in a

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Community spirit. There was no question of putting the burden all on to one country. Everybody must share the difficulties. He would be meeting with his Ministerial colleagues later this evening to decide what proposals to put to the European Council.

The Prime Minister said she was ready to take decisions at Brussels. Indeed, she had been ready to do so at Copenhagen. Unfortunately others had not been similarly ready. The nub of the matter was the need to reduce agricultural surpluses. The Community had been discussing this for at least eight years but had always failed to grasp the nettle. It was not a question of compromise. It required tough decisions which would actually get the surpluses down and not add to them. It was a choice between sense and nonsense. The Community could not go on putting more and more money into agriculture. Farmers were more realistic than Ministers: they knew that the problems had to be dealt with and they wanted a firm basis on which they could plan for the future. She agreed with Chancellor Kohl that the Community was at a watershed. She was ready to take decisions. But they must be the right decisions, equal to the scale of the problem.

Chancellor Kohl thought that the Prime Minister underestimated the degree of progress which had already been made. For instance tough measures had already been taken to curb milk surpluses. German farmers had accepted price reductions of twenty-five per cent for their main crops in recent years. Farm incomes in the Federal Republic had fallen substantially. He was ready to see further drastic reductions in surpluses. But it must be done in a way which gave people time to adjust. It must be a step by step process which was politically tolerable. Germany could not simultaneously be the largest contributor to the Community and be expected to inflict disproportionate hardship on its farmers.

The Prime Minister said that she understood Chancellor Kohl's worry about the size of the German contribution. But the most effective way to reduce that contribution was to control agricultural spending. She wished to make another general point: Germany benefited greatly in Europe from the efficiency of its manufacturing sector and ought not to penalise the efficiency of other countries in agriculture.

Agricultural Stabilisers

Chancellor Kohl said he had looked at the various problems which had been on the table in Brussels. There were a number of areas where he thought some adjustment was possible in the interests of agreement on an overall package. For instance he could accept that stabilisers on other products (ie all except cereals and oil seeds) should be agreed on the basis of the Presidency proposals in Copenhagen. On cereals, Germany could accept a Maximum Guaranteed Quantity of 158m tonnes. He understood that the proposed 20-tonne exemption under the co-responsibility levy caused difficulties. He could agree to a modification whereby an exemption applied only to small farmers. There were other points on which the German Presidency's proposals seemed to be misunderstood. For instance, on cereals the changes proposed by the Commission to the intervention arrangements would in effect amount to a price reduction in the first year. On oil seeds, no ceiling was proposed on price cuts. The co-efficient for price reductions was something that could be looked at. But equally there were points on which Germany could not move. The proposed MGQs on oil seeds and proteins and the price reduction and co-responsibility levy proposals for cereals were as far as he could go. He could accept the need for an effective brake on farm spending but it should not be used to make an emergency stop.

The Prime Minister said that she too would like to go through some of the details. On cereals, we disliked the co-responsibility levy which was a tax and not a stabiliser. Moreover, the proposed 20-tonne exemption would be highly discriminatory. Germany would pay less than half as much as the United Kingdom even though it produced the same amount of cereals. She noted that Chancellor Kohl had suggested a compromise. She was not in a position to judge the full implications of this. What she could not accept was a situation which penalised efficient producers while protecting the inefficient. There was no justification for a higher MGQ for cereals than the 155m tonnes proposed by the Commission at Copenhagen. This was above the level of the 1986 and 1987 harvest and contained ample headroom for the Community's traditional exports. You would never get surpluses down if you started by putting them up. Moreover, the proposals which had been discussed in Copenhagen had provided for in-year price cuts with no ceilings. This was essential if the surpluses were to be cut back. For oil seeds, the mechanism proposed by the Presidency was sound but the numbers were too high. The effect of the Presidency's proposals would be expenditure some 600m ecu higher than envisaged under the proposals considered in Copenhagen. There had been a vast growth in the production of oil seeds and protein products over the last ten years and the Community could not go on financing such an expansion indefinitely. She could agree that all the other stabilisers should be settled on the basis proposed in Copenhagen, even this though this caused considerable difficulties for our farmers. But major differences remained over cereals and oil seeds. She would never be able to get an increase in Community resources through Parliament unless she could demonstrate that effective action had been taken to reduce the surpluses and control agricultural spending. The Prime Minister added that we had gone out of our way to try and take account of German views over set-aside even though we had doubts about its effectiveness. Chancellor Kohl could present this as a considerable victory. But set-aside could never be a substitute for price cuts. The Prime Minister added that there was no question of our accepting the French proposal to put a time-limit of three years on stabilisers.

Herr Stavenhagen commented that an MGQ of 158m tonnes for cereals seemed a very restrictive figure to Germany. It was well below the trend of Community production. Predictions for the 1988 harvest were that it would be at least 158m tonnes, in which case stabilisers would come into force immediately. On oil seeds, Germany was prepared to give up a ceiling on price reductions and acknowledge that such reductions would be cumulative. That would be a deterrent to switching from cereals to oil-seeds. The Prime Minister came back to the point that it made no sense to say you were dealing with surpluses and then go right ahead and decide to increase production. We were prepared to accept a mix of price reductions and co-responsibility levies. But she did not want to blur the remaining differences between British and German positions. We wanted to see more weight given to price reductions both for cereals and oil seeds: the proposed co-responsibility levy for cereals was discriminatory: we still had difficulties with some of the details of the set-aside scheme: we thought MGQs for both cereals and oil seeds were set too high: and many of the savings claimed by the Germans were calculated on the basis of projected expenditure which was quite unrealistic anyway. We had been closer to a solution with the Commission's original proposals than we were now.

Chancellor Kohl said that he did not disagree with the Prime Minister on the broad objectives. He had been saying for years that the Community must reduce production. The CAP was badly flawed. It had been encouraging farmers to go in the wrong direction for thirty years. The tide was now beginning to turn. But he could not force through a complete adjustment in just one or two years. He had to have time. He would think over the points which the Prime Minister had made to him. The discussion had revealed discrepancies between British and German figures. These should be reconciled before the European Council, so that we were working on a common data base. Experts should get together to do this.

Agriculture Guidelines

Chancellor Kohl said that in Copenhagen there appeared to a considerable measure of agreement on a guideline of 27bn ecu, exclusive of old stocks, with provision for it to increase at 60% of the rate of GNP growth. The Commission were now arguing that this was not sufficient and that the base line would need to be higher and the rate of growth 100% of the GNP rate. He wondered whether an acceptable compromise would not be an 80% growth rate. The Prime Minister said that the Commission had said explicitly in Copenhagen that 27bn ecu with 60% growth rate would be adequate to finance the CAP and they could not now shift their ground. She was not prepared to move from this.

Monetary Reserve

Chancellor Kohl said there appeared to be near agreement on this at the Foreign Ministers conclave in Brussels. The Prime Minister said that a reserve must be limited to compensating for exchange rate movements. French concerns about the trade practices of other countries would have to be dealt with by other means.

Fourth Resources

Chancellor Kohl said that the German Presidency would agree to whatever produced a consensus. Germany ended up paying anyway. The Prime Minister said that this was not a prime concern for us. She had agreed in Copenhagen that we would not seek any additional benefit as a result of a fourth resource.

Own Resources Ceiling

Chancellor Kohl raised the size of the own resource ceiling but the Prime Minister cut him off, saying that it was premature to discuss this and anyway she had no authority from her colleagues to discuss figures until she could demonstrate that action had been taken to reduce the surpluses and impose strict financial discipline through binding regulations.

Structural Funds

Chancellor Kohl said that Germany had no problem with the United Kingdom's proposal for a 50% increase, but there was no chance of southern Member States accepting it. A compromise would have to be found somewhere between a 50 and 75% increase. The Prime Minister said that a very important point of principle was at stake. Unless any increase was contained within 1½ times the maximum rate for non-obligatory expenditure we would face constant problems with the European Parliament over the budget. This would be to the disadvantage of the southern States themselves. Provided Britain, France and Germany stuck together she thought that we could get our position accepted. It would enable the four least prosperous States to double their receipts from the Regional Fund and would also double the overall receipts of Spain and Portugal.

United Kingdom Abatement

Chancellor Kohl said that he assumed the Prime Minister wished the Fontainebleau arrangement to remain unchanged. The Prime Minister said that it had been justified in 1984 and was even more justified now. Our net contribution even after abatement had doubled since then. The abatement would have to be linked to the duration of a new own resources decision, just as it had been at Fontainebleau. Chancellor Kohl said that there might be some inclination to argue that our abatement should be degressive. The Prime Minister said that it was set as a percentage of the VAT/expenditure gap. If the gap declined so would our abatement. But you could not decrease the remedy unless you first decreased the size of the problem.

French Position

The Prime Minister asked Chancellor Kohl whether he thought the French were actually in a position to reach an agreement at Brussels given the imminence of their elections.

Chancellor Kohl said that it would be very difficult. But he thought that they would prefer a reasonable agreement now to postponement.

Press Handling

The Prime Minister and Chancellor Kohl agreed that they would say to the press that their meeting had been an interesting and constructive one in which they had made considerable strides towards narrowing differences. Both wanted to reach agreement in Brussels and would be prepared to work for that. Nonetheless, substantial differences remained on a number of agriculture issues.

East/West relations and Defence

The Prime Minister and Chancellor Kohl had a very brief exchange on East/West relations and defence. The Chancellor stressed that he did want to see a third zero option or a denuclearised Europe.

I am copying this letter to Alex Allan (H.M. Treasury), Shirley Stagg (Ministry of Agriculture, Fisheries and Food) and to Trevor Woolley (Cabinet Office).

Yours sincerely,
Charles Powell

C.D. POWELL

Lyn Parker, Esq.,
Foreign and Commonwealth Office.