PRIME MINISTER

MEETING WITH HERR GENSCHER

You are to see Herr Genscher on Monday morning for an hour. He is spending the weekend at Chevening with the Foreign Secretary, and going to Glyndebourne.

The media will be watching closely what is the first high-level meeting since Mr. Ridley's resignation and the leak of the Chequer's memorandum. Genscher is most unlikely to refer to either event: nor should you - the Germans would interpret it as weakness. You might say that you are looking forward to seeing Chancellor Kohl in the margins of the EDU meeting in Helsinki in late August.

The four main facts about the current situation in Germany are:

- a big row is going on about the method of holding elections. The CDU/CSU and de Maiziere want separate elections in the FRG and GDR with a 5 per cent hurdle in both. This is the only way that some of the smaller parties in the GDR have any hope of getting elected, thus reducing the size of the left's representation in the next Bundestag. The SPD and FDP have protested vigorously: and the Liberals in East Germany have left the coalition government. But the CDU/CSU have now modified their position to argue that either there should be a single electoral area with a threshold lower than 5 per cent: or the 5 per cent threshold should apply separately Land by Land. The whole thing is a rather distasteful piece of gerrymandering;

- meanwhile the CDU/CSU are well ahead in the polls (44:38);

- but concern is growing about the costs of unification;

- and it is not impossible that the GDR coalition government will collapse before December, forcing premature unification.

Genscher's main interest will be in talking about unification, which is about the only subject on anyone's mind in Bonn. You will want to move on to EMU-related issues.

On unification, you will want to congratulate Genscher on the undoubted achievement of the Stavropol meeting. You could also confirm that we are ready to keep forces in Berlin for another 3/4 years, provided the financial arrangements remain satisfactory. It should now be possible to complete the external aspects of unification by the early autumn. But you would be interested in his assessment of how severe the economic burden of unification will be, and its effect on FRG fiscal policy. You might also comment that the impression that West German commercial interests are stitching up the GDR market will not encourage British and other firms to compete.

You will want to mention our defence statement, and say that we shall of course consult with the Germans about the reductions in British forces. I would avoid TASM with Genscher: it's a subject for Kohl at the end of August.

You should touch on aid to the Soviet Union. The extra German credit has already been used up and the Germans are telling the Russians that they can do no more without an agreed EC or G7 package. But they remain determined to secure a major aid package in October or by the end of the year at the latest: and will certainly 'sneak' to the Russians on us if you contest this. The best course is to stick to your line that we can only know what would be effective when the EC and IMF studies are complete, and we reserve judgment until then. But of course we have no objection if the Germans want to go ahead on their own. (We are going to have to do something substantial in the end.)

You will want to put some tough questions to Genscher on a Central Bank and Single Currency, namely:

- is it not unrealistic to expect economies like those of Greece, Portugal and Italy to manage full monetary union in the short or medium term?

- what would happen if Stage 3 was to be implemented before convergence? Would there not be huge costs? Do the Germans relish paying these, as well as the costs of unification? (We certainly shall not contribute);

- do the Germans really want to see the Community break into two groups on monetary matters, when they place so much weight on the unity of the EC in other matters?

- in the real (as opposed to the rhetorical) world, is it not inevitable that Delors Stage 3 would produce a single currency which is weaker than the DM, and a Central Bank which is not as prepared as the Bundesbank to rule a tough monetary policy? Would the Germans really accept that they could be out-voted by those wanting to dilute German monetary policy?

C.D.P.

(C. D. POWELL)
28 July 1990

ccP.C
CBup

Foreign and Commonwealth Office

CONFIDENTIAL London SW1A 2AH

27 July 1990

Dear Charles,

Prime Minister's meeting with Herr Genscher

Your letter of 26 July asked for a list of questions the Prime Minister could put to Herr Genscher when they meet on 30 July. The following advice has been cleared with the Treasury.

On German Unification, the Prime Minister might wish to show recognition of the generosity of the GEMU exchange rate arrangements, and the scale of the burden the FRG has taken on in updating the GDR economy. She might ask how severe the short-term burden on FRG fiscal policy will be? How can UK firms best be encouraged to invest in the GDR? She might point to the disincentive to UK firms of the perception that their FRG counterparts are operating on an inside track, with eg the Allianz take-over of the GDR state insurance monopoly, and Ruhrgas and RWG bidding for GDR gas and electricity interests. Could the FRG do more to convince non-German business that the GDR playing field is, and will be, level?

On a Central Bank and Single Currency, the Prime Minister may wish to suggest that:

i) Stability is of overriding importance, and evolution better than revolution. We understand that the Germans want a short or non-existent Stage 2 in order to have as little duplication of authority for monetary policy as possible. But surely it is quite unrealistic to envisage eg the Greek or Portuguese economy - or even Italy - managing full monetary union with the DM in the short/medium term?

ii) What would happen to these economies if the step to Stage 3 were taken before the necessary economic convergence? Is Pöhl's monetary Schengen attractive to the FRG Government? How does Herr Genscher view the prospect of the Community breaking into two or more monetary groups, with implications for other EC business? What message would this send at a time when we are all working to complete the Internal Market and strengthen the Community's international voice?

iii) Could we realistically expect the Delors prescription to produce an ecu as strong as the D-mark, and a Central Bank prepared to run as tough a monetary policy as the Bundesbank? Is it not bound to be weaker than both? Our proposals, because of the repurchase obligation on Central Banks, make the hard ecu by definition as strong or stronger than the

Deutschmark.

The Prime Minister may wish to ask how Herr Genscher would envisage policy-making in a Central Bank. Would the Federal Republic really accept that they could be regularly outvoted by those wanting to dilute German monetary policy? Is Germany ready to accept higher inflation, imposed by other member states?

I am copying this letter to John Gieve (Treasury).

Yours,
Stephen Wall
(J S Wall)
Private Secretary

C D Powell Esq
10 Downing Street

SA -

cc PC
cc back-up

Foreign and Commonwealth Office

London SW1A 2AH

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27 July 1990

Dear Charles

Prime Minister's Meeting with Herr Genscher, 30 July

Herr Genscher will call on the Prime Minister at 11.00 am on 30 July. He will be accompanied by the FRG Ambassador and his Private Secretary, Frank Elbe, as well as an interpreter (Frau Notbolm).

Herr and Frau Genscher will be staying with the Foreign Secretary and Mrs Hurd at Chevening on 29 July and will be going to see "Falstaff" at Glyndebourne.

The meeting should enable us to convey a public message of business as usual in Anglo-German relations. By reaffirming our commitment to a speedy conclusion of the 2+4 process, we can encourage the Federal Government to keep us closely informed, and to take account of our views.

Herr Genscher's main concerns are likely to be German unification in the light of the troubles in the GDR coalition. The Prime Minister may also wish to discuss:

- consequences of German unification for the Alliance/security policy;

- the continuation of the Allied military presence in Berlin;

- EC implications of German unification;

- Soviet Union, Gorbachev's prospects, the nationalities and aid;

- developments in Eastern Europe, especially in Yugoslavia, Albania and Romania.

We shall be writing separately with the material you commissioned on 26 July.

FRG Internal and German Unification

The FRG CDU/CSU/FDP coalition is stable and well placed to do well on 2 December (although the CDU lost Lower Saxony

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to the SPD in the Land elections on 13 May, thereby losing control of the Federal Upper House). Latest polls give the CDU/CSU 44%, SPD 38%, FDP 9% and Greens 7%. The next Land elections will be in Bavaria on 14 October (CSU defending an overall majority).

The main debate (mainly in the GDR, but spilling over into the FRG) is over the arrangements for the all-German elections expected on 2 December. The GDR Prime Minister de Maizière (CDU) has been upsetting his coalition partners by insisting that separate elections be held in separate states, with unification to follow. Separate 5% thresholds in the FRG and GDR would help the faltering DSU (the GDR equivalent of the CSU) to win seats and, by encouraging voters of the GDR to believe it worth while voting for the smaller parties and the PDS (Communists), would split the left-wing vote. The Liberals withdrew from Mr de Maiziere's coalition in protest on 24 July.

The SPD (East) are now considering whether they should follow suit. Their decision is expected on 27 July. If they do pull out, de Maizière's government can still struggle on as a minority administration. But it would have to appeal to the SPD for the two-thirds majority needed in the Volkskammer for the constitutional amendments required to bring about unification. Its capacity to cope with the GDR's formidable economic difficulties post-GEMU would be further impaired. Faced with the SPD's threat, de Maizière has backed off somewhat in the last 24 hours, and has offered to accept a single electoral area, provided that the threshold can be lower than 5%. It is not yet clear whether the SPD will accept. The agreed arrangements are to be reflected in a second FRG/GDR State Treaty to be negotiated by the end of August. Pressure to accelerate unification cannot be ruled out if de Maizière's government does collapse.

On the external aspects of unification, the main problems have been resolved by the agreement between Kohl and Gorbachev at Stavropol on 16 July. The Russians have now agreed that a united Germany may belong to NATO, and that there should be no transitional period between unification and the lifting of Four Power rights and responsibilities. The way is now clear to wrap up the 2+4 negotiation at the next Ministerial meeting in Moscow on 12 September. The Prime Minister has agreed in principle to Kohl's request that Britain should contribute to a garrison in Berlin (where units of the Bundeswehr will also be stationed after unification) for the 3-4 year period in which Soviet troops remain in Eastern Germany. We do not yet know if (or how) the US and France have responded. Important detailed arrangements (eg costs, legal basis for stationing, adequate training facilities) will need negotiating.

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The Prime Minister could:

- seek his assessment of the prospects of the GDR coalition holding together until December;

- confirm our wish to contribute to a successful outcome of the 2+4 in the same time-frame as unification and before the CSCE Summit.

On the pol-mil aspects the Prime Minister might wish to:

- congratulate Herr Genscher on the Stavropol achievement and note that it showed the rightness of the FRG's call to partners over past months to speak out firmly about the united Germany's place in NATO; the UK played its part;

- note that Article 5 and 6 of the NATO Treaty will apply to the whole of German territory from unification;

The Prime Minister will wish to refer to the Defence Secretary's statement to the House on options for change and to underline that, as she made clear in her advance message to Chancellor Kohl:

- we are entering a phase of consultation, and that these are interim conclusions subject to further detailed work;

- we are keen to have particularly close consultations with the German Government not only about the future size of British forces in Germany, but also the consequences for our forces in Germany of German unification and the termination of quadripartite rights.

- we have, as Genscher will know, accepted in principle Chancellor Kohl's request to maintain a contribution to the allied presence in Berlin pending Soviet withdrawal; we need to agree on the roles and conditions for the contingent.

The Prime Minister might also refer to the NATO Strategy Review, emphasising that:

- it is very important that national decisions on force levels should be taken in a coordinated way which facilitates the task of NATO's defence planners;

- we hope the review of military strategy will produce early results;

- we should give the French the chance to play their part in the overall review;

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On the CSCE the Prime Minister might note that while we are strong supporters of the CSCE and recognise its major achievements, we should be on guard against allowing the Soviet Union to use the CSCE to undermine NATO. In particular, NATO's proposal for a security institution should initially be modest and centred on practical, confidence-building tasks.

On CFE, we have circulated to Allies some proposals on how the negotiation of measures to limit manpower in Europe proposed by the NATO Summit Declaration should be handled. Although the Germans have now offered to give a commitment on the manpower levels of a unified Germany at the time of signature of a CFE Treaty, they remain worried that they will thereby singularise themselves. They have (with Allied agreement) proposed in Vienna that the CFE Treaty should include both a declaration of intent by all 23 participants to set national manpower limits in the next round of negotiations, and an undertaking by all 23 parties not to increase their personnel levels in Europe pending entry into force of a further CFE Treaty. There is no need for the Prime Minister to raise this subject with Genscher but if he does so, she might take the line that:

- we agree that manpower will be the key issue for the next round of CFE, and that the German undertaking recorded in the NATO Summit Declaration was helpful in addressing one of Gorbachev's most pressing concerns;

- we did not believe that it would singularise the Germans, since their commitment was given in the context of the next round of CFE negotiations which will be focussed on manpower;

- we have no problem of principle with the idea of no-increase commitments. But there are a number of ways in which such a commitment could be framed, and it will be important for our experts to discuss the details.

EC/GDR

On the EC implications of German unification, the Commission are preparing proposals for limited, temporary derogations for the ex-GDR territory, and plan to submit them at the end of August. They have intervened helpfully on competition policy aspects of proposed takeovers by FRG companies of GDR state monopolies, and the GDR authorities have undertaken to avoid discrimination against non-German companies. They will also notify state aids to GDR industry as if the relevant EC rules already applied.

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Aid to the Soviet Union

The Dublin European Council invited the Commission, with the IMF, IBRD, EIB, OECD and EBRD to consult the Soviet Government and prepare "proposals covering structural reform". Delors and Andriessen visited Moscow on 19-20 July and found President Gorbachev keen for assistance for consumer goods, but opposed to conditionality. The Commission will report to the 27 October European Council. The Houston Summit asked the IMF to prepare a full report on the Soviet economy. The two exercises are separate, but we will wish to promote convergence, and to try to avoid Community decisions before the IMF study is ready. The Prime Minister might say:

- recognise FRG position is unique. Not seeking to persuade Bonn not to provide economic aid to Moscow;

- our own assessment is that the biggest shortage in Moscow is Know How. No shortage of resources there: but plainly huge problems in mobilising them;

- European Council will consider Commission report on 27 October. Need then to feed in our Community analysis into the IMF study requested at Houston;

- believe IMF-type conditionality basic to any financial support for the Soviet Union.

Eastern Europe: Yugoslavia, Albania, Romania

If time permits, the Prime Minister might sound out German thinking on recent developments in Eastern Europe:

Yugoslavia

- American Government very gloomy about prospects for Yugoslavia;

- survival of Yugoslavia a European interest. But we may not be able to ensure it. Outsiders' influence on events very limited.

Albania

- Regime appear to have weathered immediate crisis. Prospects will depend on Alia reforming fast enough to defuse continuing discontent, but without letting rising political and economic expectations sweep him away (cf Krenz or Pozsgay). Not easy;

- chances of further Albanian opening to the West?

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Romania

- satisfied with outcome of G24 Ministerial meeting on 4 July and 16 July FAC. After Summer French and others will press again for Romania to be treated leniently. Hope Germany will continue to take a vigorous line as long as doubt about commitment to reform continues.

I am copying this letter to Simon Webb (MOD).

Yours ever,

Richard Gozney

(R H T Gozney)
Private Secretary

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