

MEETING RECORD

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From the Private Secretary

30 July 1990

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PRIME MINISTER'S MEETING WITH THE
FEDERAL GERMAN FOREIGN MINISTER

The Prime Minister had an hour's talk with Herr Genscher this morning. He was accompanied by the Federal German Ambassador and by his Private Secretary. The Foreign Secretary was also present.

Terrorism

Herr Genscher began by expressing sincere condolences on the murder of Mr. Ian Gow, M.P. It strengthened his conviction that the western countries should seek a commitment in the Helsinki process to co-operate against terrorism, so we could be sure that the terrorists had no haven anywhere in the 35 CSCE countries. The Prime Minister agreed that this was a good point and should be pursued.

German Unification

The Prime Minister observed that matters were now moving very fast on German unification, but a lot of details remained to be worked out before the CSCE Summit in the autumn. Many of them were matters for Germany herself, but we would of course help in every way we could. It was very important to get the small print right. One matter which would need to be resolved was the legal basis for the continuing presence of Allied forces in Berlin. There would need to be a clearly defined role for such forces, otherwise their morale would be affected. The Foreign Secretary pointed out that Britain had been the first of the Four Powers to say that we would be willing to keep our forces in Berlin.

Herr Genscher said that he was most grateful for the support which the Federal German Republic had received from the United Kingdom during the Two plus Four talks, and particularly for the helpful role played by the Foreign Secretary at the meetings in Berlin and Paris. Shevardnadze had recently telephoned him to say that the Two plus Four ministerial meeting in Moscow should be the last one. This was a clear indication that the Russians wanted to finish discussion of matters of substance, so that the details could be tied up in good time for the CSCE conference. The Prime Minister said that we were very pleased that the Two plus Four process was working so well.

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Options for Defence

The Prime Minister said that the Defence Secretary had made known our plans for reductions in our forces over the next five years, and she had sent Chancellor Kohl a message explaining them. We now looked forward to consultation in NATO. Other members of NATO, including of course the FRG, had already announced proposed reductions.

The Prime Minister noted in passing that the Soviet Union was continuing to place very substantial numbers of tanks behind the Urals, and to transfer aircraft from their air force to their naval aviation, as a way of avoiding limitations under the CFE Agreement.

East Germany

Herr Genscher said that All-German elections would take place on 2 December. A compromise had been found on the question of the electoral system. There were a number of practical problems arising from unification to be resolved, in particular the ownership of property in East Germany. All claims would have to be registered before January, and there would be compensation for those required to give up property or land which they were at present occupying. President Gorbachev had referred to the substantial property which the Red Army held in East Germany, and had made clear that the Soviet Union would be seeking compensation for giving up this. All this could be resolved: but, until then it was something of an obstacle to economic development. However, he did not wish to be pessimistic: people in East Germany were responding enthusiastically to the opportunities of economic and monetary union with the FRG.

The Prime Minister asked Herr Genscher to confirm that Article 23 of the Federal Germany Constitution would be annulled after unification. Herr Genscher confirmed that this would be the case. It would be made explicit that unification was the end of the story. The Prime Minister recalled that both German states had agreed to sign a Treaty with Poland as soon as possible after unification. Herr Genscher confirmed that this would be done.

Herr Genscher continued that he was sure that the elections on 2 December would produce a positive outcome for the Government. In response to a question from the Prime Minister, he said he thought the SPD would focus their electoral campaign on the social problems of unification. Within the Federal Republic, they would stress the heavy costs of unification: in the East they would claim that the Government was not spending enough. But trying to have it both ways like this would not carry much conviction. Herr Lafontaine had failed to recognise the historic nature of developments since last autumn.

European Community

The Prime Minister said that she was following developments in Europe's financial markets with interest. Italy and Spain, which had high inflation rates, faced a tremendous inflow of

money attracted by their high interest rates. They were rightly refusing to reduce the latter because their domestic monetary conditions did not warrant it, but were having to spend considerable sums to keep within their ERM bands. Their experience demonstrated the difficulties of trying to fix exchange rates while disparities between the economies of member states remained so great. In these conditions, a single currency could only be maintained by massive transfers between the better off and the less well off member states. The United Kingdom would join the ERM in order to use the Deutschmark as a sort of gold standard, which would help bear down on inflation. But the whole purpose of this would be lost if there was a single currency and a European Central Bank, whose governing board would be composed of representatives of countries who would not agree that the sole objective was to maintain the value of the currency. In her own view, there was no case for going further than the existing ERM for the foreseeable future. Europe needed time to adjust to the full consequences of the Single Market, and did not need the fresh turmoil which would be caused by attempts to move to a single currency.

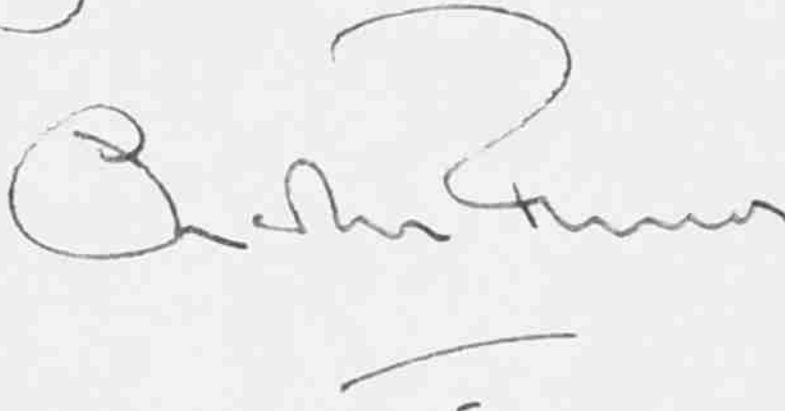
The Prime Minister continued that, despite these misgivings, we wanted to avoid a row in the Community. We had therefore agreed to go further than she herself considered strictly necessary or wise, by proposing a common currency and a European Monetary Fund. But this was as far as we could agree to go. A single currency simply did not make sense and would not be accepted by the British Parliament. She was particularly disturbed to see that the Italian Presidency wanted to accelerate the EMU and reach agreement in December. That would be deliberately divisive and unhelpful, when Britain was already making a major effort to avoid a row with its partners. The truth was that those who supported a single currency were not really so much interested in the economic aspects as in creating a federal Europe, which we could not accept. Our proposals represented a major effort to find an acceptable basis for what should follow Stage I.

Herr Genscher, who had found it somewhat difficult to get a word in, said Germany was determined that a European Central Bank would be like the Bundesbank and entirely independent of Governments. There was a chicken and egg situation: the best way to bring other European countries to adopt reasonable economic policies was to force them to submit to the discipline of a single currency and a strong Central Bank. The Prime Minister contested this view: she would have much more confidence in the discipline of the Deutschmark, based on the historic aversion of the German people to inflation, than in a Central Bank where Germany might find itself out-voted. Other countries could follow France's example of using the link with the Deutschmark to force down inflation. There was also the aspect of sovereignty: a national currency and national decision-making on economic and monetary policy were among the most substantial attributes of sovereignty in the modern world. Herr Genscher replied that Germany wanted Britain in whatever monetary arrangements were agreed for Europe. We were needed as a country which followed orthodox economic policies, and played a major role in Europe's economy.

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I am copying this letter to John Gieve (H M Treasury),
Martin Stanley (Department of Trade and Industry), Simon Webb
(Ministry of Defence) and Sonia Phippard (Cabinet Office).

Yours sincerely,


C. D. POWELL

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