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CONFIDENTIAL

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RECORD OF A DISCUSSION OF COMMUNITY ISSUES BETWEEN THE CHANCELLOR OF THE EXCHEQUER AND THE FEDERAL GERMAN FINANCE MINISTER: BONN 9.15AM, 9 NOVEMBER 1983

Present:

Chancellor of the Exchequer
Mr Unwin
Miss Pestell: British Embassy
Mr Kerr
Mrs Leslie: British Embassy

Dr Stoltenberg
Dr Tietmeyer ) Federal
Herr Wesselcock) Finance
Dr Heck ) Ministry

1. Dr Stoltenberg said that he was concerned that no real progress would be made at the Special Council in Athens on 10-12 November. The Presidency and Commission papers were not helpful. The omens for the December European Council were unfavourable, and failure then would produce a dangerous financial crisis in 1984.

2. All elements of the Stuttgart package must be settled together. Savings on the CAP must be secured and the growth of expenditure kept below the growth of the "own resources base" - some 8-10 per cent per year. The proposed oil and fats tax was inappropriate, and the Commission's proposals on feed substitutes unsatisfactory.

3. The development of new policies should be confined to those which did not involve large new expenditure commitments eg the internal market, the environment, and perhaps, in the medium term, limited initiatives in research and development. The Commission's ideas were far too ambitious: one way of handling them might be to agree to discuss them only as medium/long term possibilities for consideration now, and implementation only when the resources were available.

4. On the Budget, the prime German aim was to secure some enlargement of the club of net contributors. Finance Ministers should play a greater role in all decisions with budgetary implications, and

particularly those on agriculture. The Danish proposals for the correction of budgetary imbalances were unacceptable, because they envisaged a solution on the expenditure side of the budget, which was unrealistic. The French proposals too were unsatisfactory, though the Germans had found them more flexible in recent contacts. There was as yet no UK/FRG agreement on the detail but there was an identify of view of the underlying basic philosophy. Some flexibility would be needed in the run-up to, and at, the European Council.

5. The Chancellor agreed that it was desirable to reach decisions at Athens, and that neither the Presidency nor the Commission were being helpful. The UK and Germany would have to continue to give a lead. Both approached the 3 Stuttgart aims in the same way.

6. The key to solving the Community's financial crisis lay in controlling spending on agriculture. Adjustments to individual commodity regimes were necessary but not sufficient: an effective overall control was required. Neither the Commission nor the Agriculture Council could be relied on to implement non-binding declarations of intent: only a legally binding financial guideline would be effective. The Dutch shared this view. We could be flexible on the detail, but a strict financial guideline was for us an absolute requirement.

7. On new policies, our approach was the same as the Germans. New policies must be considered on their merits, must not entail large new expenditure, and must concentrate on opening up the internal market. He was interested in Dr Tietmeyer's suggestion at the October ECOFIN in Luxembourg that progress could be made on insurance by dealing first with large commercial risks. If the Germans had in mind a genuine liberalisation - we should be happy to look at proposals for a directive limited to major risks. But it would not do to envisage the present draft amended to delete provisions for consumer risks: that would not amount to a genuine liberalisation.

8. On the Budget, it was unfortunate that the FRG had tabled their paper on correction of budgetary burdens when they did. Other member States were showing some movement, and it was too early for the net contributors to offer compromises. He had however appreciated the German readiness to defer tabling the paper until further bilateral discussions had been held, and the changes that had been made. The cause of the disagreement between Bonn and London was that we were convinced that the only objective burden-sharing measure was net contributions. This had long been accepted by the Community, and the Commission's latest bizarre proposals demonstrated that the net contribution concept was the only rational or acceptable one. We welcomed the acceptance in the German paper of the desirability of measuring burden by reference to net contributions if the Commission's modulated VAT proposal were rejected. It would be rejected, not least by us, so we hoped that the Germans would rapidly revert to the net contribution concept. If it were not accepted, there would be no agreement at Athens.

9. We had analysed the illustrative examples which the Germans had put forward, showing how their scheme would work in practice. In 1982 it would have given the UK a rebate of less than half of its net contribution. That was quite inadequate. It was surely also unacceptable to both the UK and the FRG that if the burden of net transfers grew the German marginal rate of contribution would be 74-85 per cent, and the British 43-56 per cent. Yet these were the rates implied by the German proposals on the basis on which Herr Tietmeyer had originally formulated it. The UK could contemplate a small effective marginal rate of, say, up to 5 per cent, and the German Finance Ministry could be assured that this would be more than enough to give HM Treasury a strong continuing interest in controlling expenditure. It was a sticking point for us that reliefs should be related to net contributions, and applied on the revenue side. If other member States found the term "net contribution" offensive, we could

devise different terminology: but we would not drop the concept. And nor did we agree that we should contribute to our own refund.

10. Dr Stoltenberg said that with only a month to go before the European Council the Germans had felt it necessary to make some move. Heads of Government could not be expected to solve the problems in 24 hours at Athens unless proper preparatory work had beendone, and adequate papers were before them. The Chancellor agreed, but thought that the net contributors had a very strong hand to play, in that they could refuse an increase in own resources. They might have to raise the stakes. We had already made it clear that there would be no increase in own resources without satisfaction on our safety net - on which some progress had already been made - and on effective control of agricultural spending. Dr Tietmeyer thought it difficult to single out the Agriculture Council, and place it under a legally binding restraint. Dr Stoltenberg said that in essence he agreed with the Chancellor. The words "legally binding" were the problem. Discussion was continuing in the Federal Cabinet, and he would argue strongly for effective measures. He added that the Germans were very concerned by the Commission's proposals for automatic dismantlement of MCAs following EMS realignments. Clearly this would suit the French, but they did very well out of the EMS already. The right procedure would be to stick to the 'Gentleman's Agreement', made some years ago, for the gradual removal of positive MCAs. The Chancellor said that we understood this, and could agree to it; but we could not agree to the German proposal that new positive MCAs should be avoided by linking agricultural prices to the strongest currency at future EMS realignments. Its effect would be to increase inflationary pressures and the costs of the CAP. Dr Stoltenberg said that the Germans were not wedded to this idea: they would be content with the continuation of the 'Gentleman's Agreement". But they could not accept automatic dismantlement.

11. Dr Stoltenberg said that Germany would agree to discuss an increase in own resources only if the other elements of the Stuttgart package were satisfactorily settled. The Stuttgart Declaration had placed the question of an increase in the context of enlargement, which meant that an increase should not be implemented before 1986 or 1987. It should be small. The Chancellor said that it was premature to talk of timing or amount. The question had not yet been addressed in the Cabinet in London. We could not contemplate - or indeed secure Parliamentary agreement to - any increase in own resources without satisfaction on CAP spending and limits to net budgetary contributions. Once these issues were settled the details of any increase in own resources could be considered on their merits. However, the safety net system itself would have to come into operation in 1984, with no gap after the end of ad hoc solutions in 1983. Dr Stoltenberg repeated that the Germans would only agree to an increase in the context of enlargement; but he did specifically confirm that the Germans agreed that a safety net scheme would need to operate from 1984 onwards.
[At this point the Secretary of State for Trade and Industry and Graf Lambsdorff joined the meeting.]

12. Graf Lambsdorff stressed his concern about quotas on agricultural price support. They would only be acceptable if there were no exceptions to take account of particular national interest. The Germans were however aware of the special Irish problem in the milk sector, and might be prepared to make concessions in the Irish case alone. The Chancellor agreed that restraints in the commodity regimes should not be weakened. He said that measures against imported feed substitutes were also dangerous. The only way of tackling this problem was to reduce cereal prices. Graf Lambsdorff strongly agreed, and pointed to the political sensitivity of agriculture for the US administration. Graf Lambsdorff and

Dr Stoltenberg repeated their opposition to an oil and fats tax.

13. The meeting ended at 10.30am.

J O KERR

Distribution:

PS/Chief Secretary
PS/Economic Secretary
Mr Middleton
Mr Littler
Mr Unwin
Mr Fitchew
Mr Lovell
Mr Bostock
Miss Court
Mr Edwards
Mr Hall
Mr Ridley

Mr Coles: No 10
Mr Fall: FCO
Mr Lowson:MAFF
Mr Williamson: Cabinet Office
Mr McCarthy: DTI
Sir J Taylor: Bonn
Sir M Butler: UKREP
Sir J Fretwell: Paris
Miss Pestell: Bonn
Mrs Leslie: Bonn