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RECORD OF A DISCUSSION BETWEEN THE CHANCELLOR AND THE FEDERAL GERMAN FINANCE MINISTER AT NO 11 AT 9AM ON 22 APRIL 1983

Present:

Chancellor	Dr Gerhard Stoltenberg
Mr Littler	Herr Schmitt
Mr Unwin	Dr Kudlich
Mr Kerr	Herr Alwes

I: COMMUNITY ISSUES

COMMUNITY AGRICULTURE EXPENDITURE

1. The Chancellor expressed serious concern at the Commission statement on 20 April that agricultural spending in 1984 would be between 16 and 17 ecu. Particularly disturbing was their apparent presumption that the 1 per cent ceiling might be broken. The statement seemed complacent and irresponsible; and might - if not challenged - provide the basis for suggestions that, by agreeing the price fixing, member States would have committed themselves to raising the ceiling. At the resumed Agriculture Council it would surely be essential for British and German Ministers to refute this, making it plain that there was no commitment whatsoever to any increase in the ceiling. Dr Stoltenberg said that he thought this was right, though he would have to discuss the idea of such a statement next week with his colleagues in Bonn. It was certainly already agreed in Bonn that there was to be no early increase in the Community's "own resources", though a decision to permit such an increase by the end of the decade was not to be excluded. There was a clear need to impose limits on agricultural spending forthwith.

TOTAL COMMUNITY EXPENDITURE

2. The Chancellor said that, while agricultural spending provided the major upward impetus, overall spending was out of control. The British and Germans, as the only two net contributors, were entitled to insist on the imposition of effective control. Dr Stoltenberg warmly agreed. The system must be improved well before the 1984 price fixing.

He envisaged a substantive discussion at the European Council in Stuttgart in June. Community expenditure was rising by 10 per cent a year, which was quite unacceptable, in political terms, for Germany, where the thrust of Government policy must be to reduce the national deficit. The German budget would increase by only 2 per cent this year, and 3 per cent in subsequent years. Heads of Government must commission a careful examination of all areas of Community spending, to determine how to improve efficiency, and stop cost escalation. The problem could not be left to fester, for it would worsen with enlargement. The Chancellor agreed that the European Council should be asked to issue instructions for a comprehensive review to be undertaken not on the presumption that the 1 per cent ceiling would be breached, but on the presumption that it was not to be breached. Further bilateral Treasury/Finance Ministry contacts might be desirable before the European Council.

COMMUNITY BUDGET CONTRIBUTIONS: LONG TERM SOLUTION

3. The Chancellor said that he understood that Ministers in Bonn were interested in our "safety net" ideas. The French too were interested, for they foresaw that, following enlargement, they too might become net contributors. The essence of the "safety net" approach was to try to do minimum damage to existing arrangements by concentrating on the net contributor countries, and imposing upper limits on their contributions. If faced with a net contribution in excess of its limit, a member State would be entitled to deduct the excess from its VAT payments. Such a system would be more effective than a refund system, for refunds would have to be agreed annually in competition with other expenditure. Under a safety net system excesses over the limit would never leave the contributors' hands. Ideally, of course, the safety net would never be used, if agricultural spending were restricted and other Community policies developed. Mr Unwin added that we did not see any conflict between our proposal and the Commission's ideas for the development of other policies. We were happy to explore all such ideas, and ruled out none. But we suspected that they might not solve the problem of

budgetary imbalances. If we were proved wrong, well and good; but if we were right, the safety net would be there.

4. Dr Stoltenberg said that he found the "safety net" proposal a very promising one. It was being seriously considered in Bonn. Further Anglo-German talks at official level might be appropriate. Would there be a formal UK proposal at the European Council? There might be advantage in suggesting to Heads of Government that the idea be included among those to be studied by the Commission. The Chancellor thought that the objective at Stuttgart might be to get endorsement of the "safety net" idea: Dr Stoltenberg agreed that this would be better still. /The Chancellor gave Dr Stoltenberg a short explanatory note - copy attached - on the idea./

COMMUNITY BUDGET CONTRIBUTIONS: INTERIM SOLUTION

5. The Chancellor then turned to the need to settle quickly on a specific interim solution for the problem of the British contribution in accordance with the agreement reached at the March European Council. The costs of Community membership were a live political issue in the UK, with the Labour Party committed to withdrawal: and the Government must be able to demonstrate that the budget problem had been, or was being, solved. Given the forthcoming Greek Presidency, it was essential to make progress while the Germans remained in the Chair. This meant that it was crucial that Foreign Ministers get a long way down the course on 25 April, so that COREPER could take matters further with a view to decisions by Foreign Ministers later in May. Mr Unwin added that Foreign Ministers would need to make progress on the reference figure, on the formula for refunds, and on the risk sharing formula; and to agree that the 1983 solution would apply if necessary for 1984.

6. Dr Stoltenberg said that Ministers in Bonn shared the UK concern to settle the matter, and in May. But since the German net contribution continued to increase, Germany would be able to contribute no more than 25 per cent of the UK refund. The "over-payment" issue would require a political decision. And the European Parliament's views would have to be taken into account.

7. The Chancellor agreed that the solution must be presented in a form acceptable to the European Parliament. But it was no less crucial that it should be in a form which would demonstrate convincingly to UK public opinion that our concerns had been met. Hence the need for a risk sharing formula. The "over-payment" problem certainly required a political solution, though it should be noted that the UK had already, in the arrangements for 1982, made a significant concession. As for the German contribution to UK refunds, the imposition of a specific ceiling caused major problems, eg with the Italians. He hoped that it would be possible for the Germans to avoid insisting a specific financial limit.

8. Dr Stoltenberg said that Herr Genscher had made it plain in 1982 that the German share of UK refunds must go down, since the German budget contribution was rising. That remained the German position, though he was open-minded on the detail.

II: WILLIAMSBURG ISSUES

9. The Chancellor outlined the British approach to the Williamsburg Summit. We were concerned that it should be, and be seen as, a success. Two areas of possible US/European disagreement had to be defused: East West economic relations and the strength of the dollar. On the former, we were encouraged by the apparent success of Chancellor Kohl's efforts to persuade the President not to make East West trade a major summit issue. On the later, we noted the latest evidence of renewed French concern, and thought it important to try to make something of the internationally-agreed Jurgensen report on intervention. The major summit issue, in our view, should be encouraging the convergence of national economic policies, and their mutual surveillance. The summit countries must demonstrate a commitment to make mutual surveillance meaningful. While hectoring the Americans at the summit about their deficit would obviously be a mistake, the G5/G7 meetings at the end of April provided the obvious opportunity to express disquiet to secretary Regan.

10. Dr Stoltenberg

10. Dr Stoltenberg agreed. It would be desirable that, on surveillance and on intervention, Finance Ministers should - following their Washington meetings - put to heads of government proposals on how best to tackle the topics at Williamsburg. The aim then should be to avoid dramatic US/European disagreements on monetary issues: this might well mean reigning in the French. The Chancellor thought that Williamsburg ought ideally to issue a clear and simple political message on convergence and surveillance, backed by more technical agreements on specific points which Finance Ministers could explain. Perhaps one way of tackling the US deficit issue would be to try to secure a more explicit agreement on the need for convergence of medium term policies. The summit, and next week's Washington meetings, might also have to consider the problem of debt, to which new solutions were offered daily by outside experts. It might be that none of these solutions would be appropriate, and that the best course would be for the international community to carry on as at present, but, if so, this would need to be convincingly sold at the summit. Dr Stoltenberg said that the Commercial Banks were making considerable profits:he was unattracted to "take out" ideas to help them. The best form of relief to debtor countries would be to secure lower US, and therefore world,interest rates, as a result of a lower US deficit. The key note of the Summit should be optimism and realism: world economic prospects were improving, but there was no magic overall-solution to the remaining problems, which would best be tackled by more informal cooperation within existing institutions.

11. The Chancellor, agreeing, thought it important to resist calls for concerted expansion programmes, which could only lead to higher interest rates and inflation. The key to sustainable growth lay in continuing to win the fight against inflation: a task for the Summit would be to get this across to public opinion. The task was to make virtue look tempting. Dr Stoltenberg said that the Germans had burnt their fingers with the "locomotive" theory in 1978, and would certainly not want to follow that course again.

12. The Chancellor

12. The Chancellor thought that the key issue at the Development Committee meeting in Washington on 28-29 April might be IDA VI. Secretary Regan had now begun to press strongly in Congress for the approval of the supplementary appropriation. It would be worth discussing with him in Washington whether a Summit statement of support for IDA would help. The question of a new SDR issue would no doubt also come up in discussions in the Development Committee, though no decision was due before the Interim Committee September meeting. Dr Stoltenberg said that the Germans had not yet decided their position on the SDR issue: they of course strongly favoured the US honouring its obligations to IDA.

13. The meeting ended at 11.15.

JOK.

J O KERR
22 April 1983

Distribution:

Chief Secretary
Financial Secretary
Economic Secretary
Mr Middleton
Mr Burns
Mr Littler
Mr Unwin
Mr Ridley
Mr Carey
Mr Hedley-Miller
Mr Kemp
Mr Fitchew
Mr Beastall
Mr Edwards
Mr Peretz
Mr Bottrill
Mr Hall

Mr Coles: No 10
Mr Fall: FCO
Mr Lowson: MAFF
Mr Power: ODA
Mr Hancock: Cabinet Office
Sir J Taylor: Bonn
Sir M Butler: UK Rep EC
PS/Governor: Bank of England

SAFETY-NET LIMITS ON NET CONTRIBUTIONS

Objective: to solve the problem of budgetary imbalances in the Community on a lasting basis which will -

(a) ensure that no member state can be placed in an intolerable financial position, before or after enlargment, and
(b) open the way for progress in the Community, while
(c) disturbing the Community's existing arrangements as little as possible and
(d) ending the appalling annual arguments about refunds.

A possible approach:

- Concentrate on where the shoe is pinching or likely to pinch - ie the net contributor countries - rather than trying to fix the net budgetary positions of all member states.

- Community to agree that there should be an upper limit on the net budget contribution which any member state should be expected to make.

- These limits, or maximum net contributions, to be expressed as a small percentage of the GDP of the member state concerned, the percentage being related to relative prosperity. (Purely by way of illustration, the limits might be set at zero for member states below (say) 85-90 per cent of average prosperity in the enlarged Community, rising to (say) 0.3 per cent of GDP for member states with 140 per cent of average prosperity; but other formulae and parameters would of course be possible.)

- Implement by allowing any member state which would otherwise be making a net contribution of more than its limit to deduct the excess from its VAT payments. (In contrast with a refunds system, such deductions could not be 'crowded out' if other expenditure used up all the available revenue within the own resources ceiling; the Parliament could not reduce or reject them; and other member states would not be obliged to make payments to Germany, France, the UK or any other beneficiaries of the limits scheme.)

- Solve the imbalances problem to the maximum extent possible at source, by firm containment of agricultural expenditure and development wherever appropriate of other Community policies. Limits through deductions from VAT, as discussed above, would operate only to the extent that the imbalances problem was not solved by these means; hence the term 'safety-net'.