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05JUN82 1640Z(1840FRA) – Reunión de Margaret Thatcher con Canciller Schmidt de Alemania Occidental.

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cc S. M. Palmer

10 DOWNING STREET

From the Principal Private Secretary

5 June 1982

Dear Bonn,

BILATERAL MEETING WITH CHANCELLOR SCHMIDT
ON 5 JUNE 1982

I attach a copy of the record of the meeting which the Prime Minister had with Chancellor Schmidt at Versailles today.

I am sending copies of this letter and of the record to John Kerr (HM Treasury), David Omand (Ministry of Defence), Robert Lowson (Ministry of Agriculture, Fisheries and Food) and David Wright (Cabinet Office).

Yours sincerely,

Brian Fall

Brian Fall, Esq.,
Foreign and Commonwealth Office
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CONFIDENTIALRECORD OF A MEETING HELD BETWEEN THE PRIME MINISTER AND CHANCELLOR SCHMIDT AT THE GRAND TRIANON, VERSAILLES, ON SATURDAY, 5 JUNE 1982 AT 1840 HOURS

Present:

Prime Minister

Chancellor Schmidt

Mr. Clive Whitmore

Herr Otto von der Gablentz

FALKLAND ISLANDS

The Prime Minister said that she was worried that when the Heads of State and Government had discussed the Falkland Islands the previous evening, she and Chancellor Schmidt had not been entirely at one. She thought that it would be helpful if they could talk the issue through now.

Chancellor Schmidt said he understood why public opinion in the United Kingdom was as belligerent about the Falkland Islands as it was. Nonetheless, he was worried about what was going to happen once Britain had regained the Islands. He thought that the fall of Port Stanley would be the turning point. He believed that Britain must distinguish between Port Stanley and "the last little bit of rock". He feared that once Port Stanley had been taken, a situation could rapidly develop where the United Kingdom appeared as the demandeur for an armistice. The Argentines might well respond by asking why they should agree to an armistice. They would say that they were being deprived of their right to the Islands, and they would go on to refuse an armistice. What would happen then? If, following the re-conquest of the Falkland Islands, nothing new happened and the UK asked for the continuation of economic sanctions against the Argentine, he believed that European Community solidarity would rapidly break up. His view was the same as President Mitterrand's and the other Heads of Government in the Community. He and they did not at present understand what the UK was going to do after the fall of Port Stanley and what she would ask of her partners.

The Prime Minister said that after the Islands had been repossessed, a period, which would probably be quite lengthy, would be needed so that the

/ Islanders

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Islanders could settle down again after their traumatic experiences and the work of rehabilitation could be undertaken. We should certainly want a cessation of hostilities which applied to the Argentinian mainland. To secure this we might find that we needed the Argentinian prisoners who would be taken at the fall of Port Stanley for use as a bargaining counter. We would be entitled, under the Geneva Convention, to keep such prisoners until there was a cessation of hostilities. The Heads of State and Government had agreed at dinner the previous evening that when Port Stanley fell, the Foreign Ministers of all the countries applying economic sanctions against the Argentine should contact each other to decide what to do about the lifting of the sanctions. This too was something that might be used in securing an armistice which applied to mainland operations. She wanted to emphasise that the United Kingdom had no quarrel with the Argentinian people and no wish to carry military operations to the Argentinian mainland. But if the Argentine continued hostilities after all their troops had left the Falkland Islands, a different kind of operation would then begin.

The Prime Minister said in answer to a number of questions from Chancellor Schmidt that she did not know how long the battle for Port Stanley would last. She hoped that it might take only 2 - 3 days, as Chancellor Schmidt had suggested, but it could be rather longer. We did not know a great deal about the composition of the Argentinian garrison. We suspected that they might have some of their special forces there but we did not know in what strength. Nor did we know how many conscripts were in the garrison but it was likely to be quite a large number. The Argentinians were continuing to get a few supplies through at night both by air and sea to their garrison in Port Stanley but they were not able to supply the quantities which a garrison of that size needed.

She doubted whether defeat in the Falkland Islands would bring about the fall of the Junta, though its membership might change. On the whole she believed that the Peronistas were worse than the Argentinian military. Terrorism under them had been appalling, and the military had had to use brutal methods to defeat it when they had taken over the Government. She also thought that if the Peronistas returned to power, they would be more likely to ally themselves with Cuba.

Chancellor Schmidt said that he believed that the greatest damage that had been caused by the Falkland Islands crisis was that done to the US position in Latin America. Yet President Reagan did not seem to understand this.

CONFIDENTIALUS ECONOMY

The Prime Minister said that she had tackled President Reagan about the US deficit. He clearly thought that he would get most of his present budget through Congress. He did not understand why it was that American interest rates were not coming down when inflation had dropped so much. Her view was that interest rates were remaining high because of the expectations of the markets.

Chancellor Schmidt said that he remained despondent about the prospects. He thought that US interest rates would remain high, and this would mean that European interest rates would also have to stay up in order to compete. Some work which he had had done recently showed that private savings in the United States were only 5% of private income, whereas the figure in the Federal Republic was 12 - 13%. So he did not believe that President Reagan could finance so big a deficit.

The Prime Minister said that President Reagan appeared to believe that when his tax cuts were implemented, they would go into savings and this would enable him to finance his deficit.

Chancellor Schmidt said that President Reagan was also saying that his tax cuts would go into increased expenditure on cars and houses. The fact was the money could not go to two places at once. If President Reagan did not join with the other countries at the Economic Summit to say publicly that deficits had to be cut, how could European Governments get their own expenditure cuts through their Parliaments? The Federal German opposition was asking why the Federal Republic did not adopt President Reagan's policy of cutting taxes. His answer to this challenge was to ask his opposition whether they wanted 10% unemployment. But this was an indication of the kind of domestic political consequences of US economic policy which European Governments had to face. It was a pity that the Prime Minister had not been able to have the talk with President Reagan which they had contemplated when they had met at Chequers, but he understood that the Falkland Islands crisis must have prevented this.

The Prime Minister said that although she had not been able to speak to President Reagan, she had taken the matter up with Mr. George Shultz. She had told him that while US interest rates remained so high, President Reagan would

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never achieve the expectation he was hoping for. Mr. Shultz had replied that President Reagan wanted to reduce his deficit as much as the Prime Minister did, but to do this he had to get his measures through Congress. She believed that President Reagan would also say that his deficit was high partly because he was increasing US defence expenditure and that that was something which his allies should welcome.

Chancellor Schmidt said that he doubted very much whether the Americans would be able to finance the expansion in their weapons programmes which they were now instituting. We all knew that defence costs rose much more than we initially expected. The Federal Republic was now taking delivery of weapons which had been ordered by Herr Leber when he had been Defence Minister, and they were having great difficulty in paying for these.

NATO SUMMIT

Chancellor Schmidt, in response to a question by the Prime Minister, said that he was not expecting to get anything very specific or very positive out of the forthcoming NATO Summit. His objectives were first, to prevent anything going wrong and second, to give the Ministers attending a chance to talk to each other. That was all. He had not convened the meeting. It was mainly for American consumption. Since President Reagan was visiting Paris, Rome and London, it was imperative that he should also visit the Federal Republic, and it made sense for him to combine a visit to Bonn with a NATO Summit.

The Prime Minister said that the meeting should demonstrate the unity of the Alliance.

Chancellor Schmidt agreed. He hoped they would show their solidarity, including solidarity on the Falkland Islands, though this might be more difficult now that Spain would be there.

The Prime Minister said that we were hoping to open talks with Spain about Gibraltar on 25 June. We also hoped that Spain would open her side of the frontier with Gibraltar on the same day. Gibraltar had many of the same features as the Falkland Islands. The Spaniards claimed Gibraltar in the same way as the Argentine claimed the Falklands, but the Gibraltarians all wanted to preserve their association with the United Kingdom, in exactly the same way as the Falkland Islanders had always done. The British Government could not ignore their wishes.

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They already had a form of self-government.

Chancellor Schmidt asked whether a way forward might be for Britain and Spain to exercise a condominium over a self-governing Gibraltar. Another possibility might be to determine the wishes of the people of Gibraltar by means of a referendum.

The Prime Minister said that our experience of condominiums was not encouraging. They never worked in practice. She would be ready to consider having a referendum, but we were in no doubt about what the Gibraltarians wanted. We had often told the Spanish in the past that what they should do was to make efforts to win over the Gibraltarians to the idea of joining Spain, but nothing had come of this.

Chancellor Schmidt said that it would be a good thing if Britain could show that it was ready to compromise in some way on Gibraltar. This would make clear that she was treating Spain and Gibraltar in a different way from the Argentine and the Falkland Islands. We should try to invest in the democrats in Spain. The King, Senor Suarez and Senor Gonzales were good and courageous men. They were something to envy. Senor Calvo Sotelo, on the other hand, was very conservative and belonged to the old political establishment. "He would not let himself be shot in the streets, if necessary, but the King would". The King, Senor Suarez and Senor Gonzales would fight if they had to. The King and the democrats in Spain needed some success to sustain them. That was why the Federal Republic had asked the European Community not to distinguish between Greece, Spain and Portugal over accession.

He had seen the Portugese Prime Minister recently. Portugal had been in NATO for 30 years, whereas Spain had only just joined. The Portugese had two strong wishes. First, they did not want any part of their mainland or their islands to come under a NATO command that was headed by the Spanish or was even partly under Spanish control. Second, they did not want their share of posts on SACLANT's staff to be reduced in order to make way for Spanish officers. Against this background he had suggested that Spain should fall under SACEUR's command. But it might be impossible to avoid the Canary Islands coming under SACLANT, and he thought that Spain might not like this.

The Prime Minister said that she agreed with what the Chancellor had said about the King of Spain and Senor Suarez. They had a very good political sense.

CONFIDENTIAL/ COMMUNITY MATTERS

CONFIDENTIALCOMMUNITY MATTERS

Chancellor Schmidt said that he was very happy that the dispute over farm prices and the UK budgetary contribution had been settled. If it had lasted any longer, a devastating situation would have arisen. But there were certain conclusions on both substance and procedure which had to be drawn for the future, and he thought it important that he should mention these to the Prime Minister. First, he wanted to make it absolutely clear that the Federal Republic wanted to maintain the Luxembourg compromise. The Federal Republic had taken a different view from the United Kingdom about whether the link between farm prices and the UK budget contribution was a matter to which the Luxembourg compromise could be applied. The German view was that the Luxembourg compromise should be maintained for use on matters of substance but not on matters of procedure. The German/Italian proposals for a European Act provided for the continuation of the Luxembourg compromise. But he believed that we should make it a little more difficult to invoke it, perhaps by requiring that reasons for its proposed use should be given in writing.

His second conclusion concerned farm prices. He had no time for American complaints about the Community's food surpluses. It was the Americans who had started the production of food surpluses 15 years ago, and they still produced large surpluses. Nonetheless, it was ridiculous that Europe produced more food than it needed and then subsidised the surpluses so that they could be sold to the Soviet Union. As an individual - and he did not know whether he could speak for his Government - he believed that the surpluses had to be reduced, and with them the share of the Community budget taken up by the CAP. "Something had to be done, though he was not sure what."

Third, he believed that it was impossible for the Federal Republic and the United Kingdom to continue to be net contributors to the budget, while all the other members of the Community were net beneficiaries. The two of us would soon be forced into a corner where we had to say "No" to further expenditure.

The Prime Minister said that she agreed very much with the Chancellor's third point. If the situation Britain and Germany were now in continued for much longer, the Community would be ruined. Britain had tried for two years now to change the structure of the budget but had got nowhere.

Chancellor Schmidt said that the difficulty about the British position on the budget had always been that it was not enough to say that the burden represented

/ by the CAP

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by the CAP was ridiculous and that it should be got rid of. The fact was that the CAP was the price that had had to be paid, however monstrous it was, from the beginning of the existence of the Community in order to obtain the adherence of some of its members. The French and the Italians, for example, would always say that they had joined the Community knowing that the CAP was there to help them.

The Prime Minister said that the structure of the budget and of the CAP had been wrong from the start. She accepted that it was now very difficult to make fundamental changes. But the accession of Greece, Spain and Portugal would all make further demands on the CAP. Yet she had always supported the accession of these three countries in order to strengthen the cause of democracy.

The next big test would be fish, where the present arrangements expired at the end of this year.

Chancellor Schmidt said that no major issues would be settled during the Danish presidency. The same would be true of the Greek presidency which would begin in July 1983. This meant that we had six months when the Federal Republic held the presidency in which to settle major questions.

The Prime Minister said that that meant that fish and the restructuring of the budget would both have to be dealt with finally during the German presidency.

Chancellor Schmidt asked whether it was possible for the Federal Republic and the United Kingdom each to give up one of their two commissioners.

The Prime Minister said that she was very ready to consider this suggestion. She believed that the Community bureaucracy as a whole was much too big. She would also like to reduce meetings of the European Council from three to two a year.

Chancellor Schmidt said that he agreed about the number of European Council meetings. He would also like to get rid of the meetings of Community Ministers on matters like justice and the environment.

The Prime Minister said that she agreed with the Chancellor on that too. In conclusion she would like to thank him again for being so staunch over the Falkland Islands.

The meeting ended at 1935 hours.

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