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(43)

Record of a Conversation between the Prime Minister and the President of the European Commission, Mr. Roy Jenkins, at 10 Downing Street on 3 November 1978 at 1130

Present: Prime Minister Mr. Roy Jenkins
Mr. Michael Franklin Mr. Crispin Tickell
(Cabinet Office)
Mr. B. G. Cartledge

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EMS

Referring to his talks with Chancellor Schmidt during the previous week, Mr. Jenkins said that his impression was that EMS had not been discussed between the Chancellor and the Prime Minister in any great detail but that, on the whole, the Prime Minister had left the impression that the UK would stay out. The Prime Minister did not dissent from this interpretation but commented that current press reports of the discussion in Cabinet on 2 November were misleading. The position was that the Chancellor of the Exchequer would continue to negotiate for changes in the scheme but that no final decision would be taken by the British Government until after the Finance Council meeting on 20 November. The Prime Minister told Mr. Jenkins that he would be having meetings with Signor Andreotti and President Giscard during that same week. Mr. Jenkins said that he appreciated the political problems which EMS raised for the Prime Minister but did not believe these to be uppermost in the Prime Minister's mind. The Prime Minister agreed and said that the UK decision would not be taken on pro or anti European grounds but strictly on the merits of the scheme. This had been the pattern of Cabinet discussion. If, in the event, the UK decided either not to enter EMS or to postpone entry, this decision would not be put in an anti-Community context but in that of the UK's priorities.

The Prime Minister said that he did not know what would happen to the readjustment of rates after 1 January. Mr. Jenkins said that he assumed that the Prime Minister would not like the sterling rate to go down; he added that the dollar rate was now unrealistic.

5 | The Prime Minister agreed and said that the effective rate was the criterion which was used and that it remained steady. The Government could not, however, neglect the dollar rate altogether in view of the high proportion of the UK's trade which the US accounted for. The Prime Minister said that he did not wish to see any turbulence in the sterling rate, whether dollar or effective, during the next few months. Mr. Jenkins said that there could of course be argument over whether sterling would be more vulnerable inside or outside the EMS. The Prime Minister accepted this and commented that the two-tier arrangement now proposed might have the effect of making the franc more vulnerable than the lira. Mr. Jenkins said that Helmut Schmidt was sceptical about the two-tier arrangement but had clearly promised it to Andreotti.

The Prime Minister said that, if the Irish went in while the UK remained out, there would be problems for both countries. It would be necessary to have talks with the Irish about this, and soon. The Prime Minister repeated that the UK had no intention of attacking the EMS as a European conspiracy or anything of the sort. He wondered whether the option of joining the scheme at a later stage would be open to the UK.

5 | Mr. Jenkins said that he thought that the degree of agreement between Chancellor Schmidt and President Giscard might be less than the Prime Minister thought; all they were really agreed on was that they must agree. The UK still had a good chance of affecting the outcome, as Denis Healey had shown at the October meeting of the Finance Council. The Prime Minister said that it was for this reason that he did not want the Government to hurry into a decision; he wanted to give Denis Healey a chance to continue his work in the Council. The details of the scheme, however, were still unclear even at this stage, including the arrangements which were now envisaged for Italy. The Prime Minister asked whether, in a two-tier arrangement, it would be better for the UK to go into the upper or into the lower tier. Mr. Jenkins said that his own view was that the UK should enter the upper tier. The margin between the two would not in fact be so significant as some, including the Italians, thought. His own instinct would be to go for the psychological

advantage of the upper tier, both with regard to the effect on the markets and so far as the effect on public opinion was concerned. President Giscard invariably succeeded in putting on an act of supreme self-confidence and, through it, in pulling the French economy along behind him, despite the fact that France had a higher rate of inflation than the UK and a worse balance of payments. The Prime Minister agreed.

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The Prime Minister told Mr. Jenkins that the argument had been put forward in Cabinet that the gap between the highest and lowest inflation rates in Europe was now wider than it had been in 1972 and that the EMS could not, therefore, endure without a great deal of short-term indebtedness. Mr. Jenkins said that he thought that the trend, as distinct from the situation at any point in time, was towards the narrowing of the gap, whereas in 1972 the trend had been towards a widening. The small countries in Europe had lived quite happily in the Snake with inflation rates of up to 10 per cent; the effects of an inflation rate of this order on larger countries had not yet been decided and Mr. Jenkins thought that they could not sustain a rate of more than 10 per cent. The Prime Minister said that he had no intention of allowing inflation in the UK to rise above 10 per cent; if necessary, he would raise taxes, even though it was an election year, to prevent it. Mr. Jenkins commented that it was nonsense to believe that it was possible to devalue a country's way out of trouble.

Mr. Jenkins went on to say that the EMS was more than the Snake or could, at least, become so. The Prime Minister said that he was not sure that the proposed fund was large enough. Mr. Jenkins said that Chancellor Schmidt thought that he could win the argument with his Central Bankers on this point. The Prime Minister recalled that the Chancellor had told him that he was determined to "impose his will" on the German Cabinet over EMS.

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Mr. Jenkins said that he naturally hoped that the UK could go into the EMS. Chancellor Schmidt and President Giscard were clearly determined to stick to 1 January as the starting date. If, in the event, the UK decided not to enter the scheme, there should be no great difficulty in keeping the door open for entry at a later date.

He had, however, spoken to David Owen at Schloss Gymnich about the problem of what could be done for participating as opposed to non-participating countries as far as concurrent studies were concerned. He thought, for example, that it would prove possible to make dispensations for Ireland and Italy if they joined the scheme which would not be given to the UK if she stayed out. The Prime Minister indicated that this would not concern him very much but asked Mr. Franklin to comment. Mr. Franklin said that this approach would amount to using the EEC machinery in order to bribe countries to join the EMS. He saw some difficulty in, for example, allowing this issue to determine subsidised EIB loans. The UK might wish to stick to some benefits as were given to the Irish and the Italians. Mr. Jenkins said that if the UK wished to be in a position to enter the scheme at a later stage, it would nevertheless be important for the UK to co-operate in the kind of arrangements which he had in mind. The Prime Minister accepted this and commented that he had no desire to get across the EEC or to adopt a "dog in the manger" attitude. Mr. Jenkins said that this was exactly his point.

Mr. Franklin said that if the door was to remain genuinely ajar to the UK, it should not be necessary for the UK to go to the Council for permission to join EMS later. The Prime Minister commented that insistence on this could be the UK's prize for co-operating in preferential arrangements for the weaker countries which chose to join. He added that, given the hostility to the EEC which already existed in the UK, he had no wish to see the EMS negotiations break down through ill-will. It was a fact that there was considerable electoral capital to be gained through attacking the EEC on all fronts; but it would be important for the UK to keep the door to the EMS ajar. The only point of principle on which the whole Cabinet were agreed on this matter was that of belief in the value of monetary stability. The British Government had to bear in mind, however, the question of how much unnecessary inflation the EMS could force on the UK - this would mainly depend on FRC policies.

The Prime Minister asked if Mr. Jenkins thought that there would be a great many rate adjustments during the early months of the EMS. Mr. Jenkins said that there might be one or two for those countries which entered the scheme at the wrong rate. The Prime Minister asked what could be done about the situation in the United States. Mr. Jenkins said that one possibility would be to create an alternative reserve currency such as the ACU could provide or, alternatively, to create a tripod situation as the preliminary to a new Bretton Woods. Mr. Jenkins commented that the U.S. had so far shown no interest in world monetary reform.

CAP

The Prime Minister told Mr. Jenkins that he had noticed his comment to Dr. Owen that a freeze on agricultural prices would be the best means of effecting a transfer of resources in the Community; what were the chances of bringing this into effect? Mr. Jenkins replied that he thought that the prospects were quite good, although the position was complicated by the MCAs. There was a difficulty in the difference between the FRG and the Benelux countries on the one hand, and the devaluing countries on the other. After some discussion of the effects of the MCAs, the Prime Minister asked Mr. Jenkins whether he would be producing his paper on the CAP for the December meeting of the European Council. Mr. Jenkins confirmed that he would, but said that it would not be a compendious analysis. In general, he did not think that it would be a good idea to dismantle the CAP completely as the preliminary to putting it together again differently. What was needed was a tough policy in the surplus sector. He hoped to secure general endorsement from Heads of Government that their Ministers of Agriculture should proceed on that basis.

Mr. Jenkins went on to say that Chancellor Schmidt had told him that he could live with a freeze on real prices, i.e. he could accept that there should be no increase in German farm incomes, but that he could not accept a price reduction although, Mr. Jenkins said, it was a reduction which was really needed. The Prime Minister asked whether there would be pressure on the UK to reduce MCAs. Mr. Franklin said that Mr. Silkin did not anticipate this. The Prime Minister said that the Government would only act

in the national interest, but it found itself under the dual pressure for keeping farm prices up but consumer prices down. Mr. Jenkins said that the Commission would welcome some reduction in MCAs, at the time of the annual price fixing. Mr. Franklin pointed out that the UK's costs were rising faster than German costs.

Fisheries

The Prime Minister told Mr. Jenkins that he had asked John Silkin to reach a settlement on fish; he hoped that the Community would recognise that, despite the depth of feeling in the UK on this issue, the Government was genuinely trying to reach an agreement. He hoped that agreement could be achieved before the European Council in December.

Mr. Jenkins said that it would certainly be desirable to meet this target because, otherwise, the Danes would insist on putting fisheries on the agenda and it was not, in his view, a suitable topic for the Council. Mr. Franklin said that the will for an agreement seemed to exist on the German side as well and Mr. Silkin's latest talks with the Germans had been encouraging.

"Three Wise Men"

The Prime Minister said that he had noted the suggestion that the study of the implications of enlargement might be carried out by the four Presidents of Community institutions instead of by the three wise men. Mr. Jenkins agreed that this suggestion had been strongly backed at Schloss Gymnich but that he himself had taken a back seat. The Prime Minister said that he accepted that the problems of enlargement needed study; a great deal would depend on who the three wise men were. A possible UK candidate would be Mr. Heath, although he might be too closely associated with the European cause.

Mr. Jenkins recalled that President Giscard had suggested that the wise men should be people with experience of the EEC machinery. This suggested former Commissioners, such as Sir Christopher Soames or Lord Thomson. He had heard a rumour that M. Marjolin might be in President Giscard's mind as the French candidate. There had also

been talk of Garrett Fitzgerald as an Irish candidate. The Prime Minister said with emphasis that this would not be a good idea. A Danish candidate might be acceptable if he was good enough.

Energy

The Prime Minister said that North Sea oil remained very sensitive for the UK and that the Government was consequently concerned about continuing criticisms from the Commission of our North Sea policies. In practice, North Sea oil was flowing in substantial and increasing quantities to our Community partners; we thought that the development of a coordinated energy policy in the Community would be easier if the Commission eased off its pressure.

Mr. Jenkins commented that none of this was news to him. He thought that the outstanding case before the Commission could be settled quite easily given a small amount of good will from the British Government. Mr. Franklin said that M. Davignon had spoken to Sir Donald Maitland on the subject and had made some helpful suggestions. Mr. Jenkins commented that this seemed to be a case of either wanting to have a row or not wanting to have one. The Prime Minister said that Mr. Benn liked rows: he himself did not. The UK was not looking for rows unnecessarily and he would keep a close eye on the question. CQM would be considering our response to Davignon.

UK attitudes to the Community

The Prime Minister said that attacks on the EEC in the UK had not died away. Mr. Jenkins commented that they were not surging up either. The Prime Minister agreed but said that there was an underlying current of grumble. EEC "interference" aroused hostilities. If it were to be thought by the British public that the Government were following certain economic policies because of UK entry into the EMS, it would be more difficult to pursue these policies than it would be if they were introduced while the UK remained outside the EMS.

The Prime Minister asked Mr. Jenkins whether President Giscard thought that his Community policies strengthened his position with French opinion. Mr. Jenkins said that the President liked to be seen by the French people as a constructive leader. The Prime Minister commented that a forward Community policy would not help a British political leader - the UK was less Community minded than France. Mr. Jenkins said that President Giscard had a real problem over enlargement, and especially over Spanish accession with regard to agriculture and Portuguese accession with regard to migrant labour. The President thought that the problems of enlargement might be easier to handle if the French people retained a sense of the Community moving forward.

Mr. Jenkins said that Chancellor Schmidt was obsessed by the problem of the Turks and feared that any formula on the movement of population which might be worked out for the Greeks would eventually have to be applied to Turkey as well.

The Prime Minister asked when the process of enlargement was likely to be completed. Mr. Jenkins said that the Greek negotiation was nearly completed and that the Greeks should come in early in 1981 - although they were pressing for mid-1980. Spain and Portugal were about two years behind Greeks. All three applicants should be in the Community four years from now.

The conversation ended at 1245.