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*Germany* (2)



Foreign and Commonwealth Office

London SW1A 2AH

28 September 1979

*Pamie Minister*

*Dear Michael,*

*Paul*

Chancellor Schmidt's Views on Britain

The Foreign and Commonwealth Secretary has received from H M Ambassador, Bonn, the enclosed letter reporting on a recent conversation with Chancellor Schmidt about Britain's role in the Community and other international economic issues.

I am sending copies of this letter to Mr J S Beverly (Bank of England), Martin Hall (HM Treasury) and to Martin Vile (Cabinet Office).

*Yours etc*

*Michael*

*Paul*

Paul Lever

*He is right.*

*about the C.A.P. It really does need more*

*than fiddling charges 2 or 3 times a year out,*

M O'D B Alexander Esq  
10 Downing Street

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BRITISH EMBASSY,  
BONN.

20 September 1979

The Rt Hon The Lord Carrington KCMG MC  
Foreign and Commonwealth Office  
London SW1*My dear Secretary of State,*

1. Chancellor Schmidt and his wife came to dine at the Embassy last night: an unusual occurrence, since he does not normally dine with Ambassadors. The occasion was an unusual one: Henry Moore, who had presented one of his major sculptures on long-term loan to adorn the grounds of the Chancellor's Office in Bonn, was staying with me and the Chancellor came to the dinner I gave in Henry Moore's honour. After dinner, while my wife and staff kept the rest of the guests amused, the Chancellor kept me for over an hour on a sofa whilst he unburdened himself of his thoughts on Britain, Europe and the world. He had come from talks with President Pertini of Italy, here on a State Visit; Pertini had impressed him with his grasp of affairs, but talked too much. Schmidt clearly expected me to pass on his thoughts to you, in anticipation of your visit to Bonn with the Prime Minister at the end of October and of the Dublin meeting of the European Council in November.

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2. Schmidt began by asking me about the current labour situation in Britain and I answered on the lines taken by Mr Cecil Parkinson when asked a similar question by a German industrialist at a dinner I gave for him last week. Schmidt said that the Trade Unions had brought down Ted Heath and Jim Callaghan and how Mrs Thatcher handled them would be decisive not only for the Conservative Government but also for Britain. He, like all Britain's friends, wanted her to succeed. She had made a very good start and he admired her for it: so, he knew, did his friend Giscard. Britain's decline must be arrested. If it went on, we should have been overtaken by the Italians in GNP per head in two or at the most three years. It would take, in his view, at least ten years for the country to be turned round and Mrs Thatcher should frankly tell the people that that was the dimension of the problem. Fortunately we had North Sea oil to give us the breathing space if we took advantage of it. He, as a lifelong admirer of Britain and one who firmly believed, still, in Britain's innate good sense, its resources of wisdom, its knowledge and experience of the world, would do all he could to help. But basically the remedy lay in Britain's own hands.

3. The Chancellor then turned to the problems of Britain in Europe. He quite understood our position on the budget: the situation needed remedy. But we should at all costs avoid giving the impression that we were engaged in a second renegotiation. Britain's performance in the Community to date

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ever since we had joined seven years ago had disappointed all her friends, including those closest to us, the Dutch. He and, he thought, all our partners had looked forward to Britain's entry to give a new impulse and sense of direction to the Community and a new political dimension. But what had happened? We had given little or no impulse to Europe's affairs. We had no vision of what we wanted the Community to be. Instead we had spent six years or more haggling like Italians for a little bit here and a little bit there. This was no way for a country like Britain to act. What if Britain's budget contribution did amount to £1 billion. No one could convince him that that was a make or break sum and that Britain would be sunk if she didn't get it. Compared with our real problems it was insignificant. And compared with the real problems facing Europe and the world, it was a distraction. Where was our sense of pride?

4. Wherever one looked in the Community, it was not Britain who had used her wisdom and experience to point in new directions or come up with answers to European or world problems. We seemed to have lost confidence in ourselves and to have turned inward upon ourselves. Take EMS. Here was an imaginative policy to try and bring some stability into at least part of the world's currency market and to relaunch Europe. But with her vast financial experience, what had Britain done? Half joined and half stayed out, but really played little or no active part in a venture which was the most  
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forward looking project for Europe for decades. Britain, by putting herself on the sidelines of the Community, had made her partners indifferent to whether she stayed in or out. Now with a second renegotiation on the budget, even a new Conservative administration, on which so many hopes had been placed, was in danger of following the old negative paths.

5. What mattered, said Schmidt, was the psychological approach. Get that right, and the rest would follow. Mrs Thatcher had made a good start and everybody had been impressed. We should join the EMS. Right away. We were strong enough to do so. If the other fiddling little currencies could manage, sterling certainly could. If we came in, eagerly, with a manifest desire to make it work, it would work, because all our partners would join together in ensuring that it did work. The approach, the psychology, was all. The technical detail would follow. But it was a dreadful thing to observe Britain uncommitted, unsure of itself, depriving itself of the possibility of shaping events. But events would happen and would shape themselves without us. All we needed was a psychological heave out of our present introspection.

6. We ought also to be taking the lead in reforming the CAP, not in order to make a few more pennies for ourselves, although that would happen too, but in order to stop the Community going on the rocks. We should be absolutely firm on the 1% VAT ceiling. If we were, he would be too. And if the British

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and Germans stayed together, they could get reform. His friend Giscard would have difficulties, but he knew that Giscard realised that something had to be done although he could not take the lead himself. The CAP and the way it distorted the Community budget and the member countries' economies had to be reformed. The matter had to be taken out of the hands of the agriculture ministers: they were concerned only with keeping farmers happy. The Foreign Ministers and Finance Ministers, responsible ministers with broader horizons, should tackle the problem with the help of the Heads of Government. This was a job for Britain; although he, Schmidt, would have trouble with his coalition and especially with Ertl, he would back us. So would the Benelux governments. But by so taking the lead, Britain would be acting positively in the wider interests of the Community. And, in their hearts, our partners would know it. But the essential thing was that Britain should be seen to be involved in a confident and creative way with the future of the Community. He kept referring to "confidence" throughout our talk.

7. This brought him to the state of the world. He was full of anxiety for the 80s. The world was getting into a /state



state where no one seemed to be able to foresee the consequences of their actions and all too many did not seem to care. He had three main fears - and here I compress his arguments.

8. First, "the Free World could not do without the leadership of America, but America had a President who did not know what to do to lead." At dinner, Schmidt had said to my wife without a trace of a smile "President Carter is the only American President to whom I have had to explain how the American economy works." (I here recall that when Carter visited Bonn for the Economic Summit in the summer of 1978 he went on public record as saying that he had never learned so much about the world's economy from a foreign statesman as from Chancellor Schmidt.) Schmidt's opinions of Carter are too well known for it to be necessary for me to repeat them here.

9. Secondly, he was concerned about the enormous Eurodollar overhang. When I said that I thought the free world banking system had coped with the flood of petro-dollars very well, he said, "so far, yes"; but the problems increased in size from year to year, the bankers shuttled the money about, into sterling one month, out of sterling the next, and the whole system was totally unstable. There was no identifiable lender of last resort. There was no one responsible. The trouble was that no one seemed to understand what was happening. He had met only one man who did: the Deputy Governor of the Bank of Hungary whom he had met in Budapest

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recently, a man of Kissinger's type of intellect. No one in Germany knew. G<sup>u</sup>th (Chairman of the Deutsche Bank) had the intellectual capacity to understand it if he were to put his mind to it, but he was occupied with other things. Poehl, the next President of the Bundesbank, had the capacity to understand it, but was too easy-going and had too optimistic a cast of mind! He spoke well of Volcker, but said George Schulz had the best financial intellect in the USA (Schmidt has been his guest in California during this summer). But the capacity for major damage to the world economy of the volume and instability of petro-dollars was frightening.

10. Thirdly: oil: the amount of it. All the western industrial nations, were, except Britain, dependent upon the import of oil. And the oil existed in one of the most unstable areas of the world. We had seen what had happened to Iran. The consequences of something similar happening to Saudi Arabia were too terrible to contemplate. Germany could afford to buy oil, but it could not survive if there were no oil to buy. Some Americans talked of using armed force to protect oil supplies. A lot of good a raid on an oil field would do. It was stupid to talk of doing things you would not do and which, even if you did them, would not do you any good. It was in the physical shortage of oil, said Schmidt, that the main danger of nuclear war lay.

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11. Finally, Schmidt came to the subject of meetings of Heads of Government and described where, for him, lay their significance. Over the years, said Schmidt, he had formed a very close relationship with Giscard, a relationship, he could say, of total trust. This meant that when they met they told each other everything that was in their minds. They did not always agree. They could not always support each other - their national interests were sometimes too diverse. That did not matter. The essential thing was that they knew where they stood with each other, knew when they could rely on each other for support and when they could not. But even when they disagreed or could not support each other, the essential thing was the reliability and predictability of the reactions in given circumstances and this meant total frankness between them. The same thing applied to Ministers in the Government. Despite conflicts of interest, confidence existed between French and German Ministers over a wide field because they met regularly and worked together all the time.

12. Heads of Government needed to share each other's concerns and to be able to range over the whole spectrum of affairs, from petro-dollars to TNF modernisation, from Rhodesia to the Middle East, to discuss their American friends and their Russian friends. If there was agreement, fine: if not, it was essential to know the real impediments to agreement. There must be no holding back. Schmidt implied that he

/hoped



hoped in the course of time to develop with Mrs Thatcher the same close relations of confidence which he at present considers he has with Giscard. He told me, as if to illustrate his point, that when he was in London in May, Mr Callaghan had invited him to go to the Labour Party Conference. He had declined saying: "Jim, I am your good friend, but now that you are in opposition I cannot go to your Party Conference." Schmidt said that when he had told Mrs Thatcher this, the Prime Minister had at once replied that of course she would not go to the CDU Party Conference either. Schmidt was delighted and felt that this was the start of the sort of relationship he wanted.

13. This conversation lasted well over an hour. Schmidt does not waste his words, so he covered a lot of ground. He was critical, but it was the criticism of a genuine friend. I have left out much detail, preferring to concentrate on the central messages. The talk was anything /but a

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but a monologue, but this letter is already long and I am sure you would prefer to know what Chancellor Schmidt said rather than how cleverly your Ambassador replied.

A handwritten signature in cursive script, which appears to read "Oliver Wright".

Oliver Wright

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28 SEP 1979

