

SUBJECT

file



cc: Hunt

DSG

10 DOWNING STREET

From the Private Secretary

20 July 1981

cc: Mester

Dear Brian,

THE ITALIAN PRIME MINISTER

The Prime Minister had a discussion with the Prime Minister of Italy, Signor Spadolini, earlier today. Signor Spadolini was accompanied by Signor Berlinguer.

At the outset of the discussion, the Prime Minister invited Signor Spadolini to visit the UK at a convenient time. Signor Spadolini expressed his thanks but did not suggest a date or, indeed, indicate any intention of proposing a visit in the near future.

After a brief reference to the discussions yesterday evening and this morning, which both Heads of Government agreed had been positive, the Prime Minister asked Signor Spadolini for his assessment of the effects of President Mitterrand's electoral victory and of his decision to take Communists into the French Government. Signor Spadolini said that the fact that there were Socialist Governments in France and Germany undoubtedly made Italy easier to govern. It lent strength to the Italian Socialists. Signor Craxi's policies were on the same lines as those of Chancellor Schmidt. Signor Spadolini had the full support of the Socialists on such issues as the stationing of cruise missiles in Italy.

As regards the entry of Communists into the French Government, Signor Spadolini said that in one sense it was a negative development in that it created a precedent. Much had been done in recent years to exclude the Communists from Italian Governments and to strengthen the position of the Socialists. However, Signor Spadolini had found the justification given to him in Luxembourg by President Mitterrand for his action persuasive. He accepted that the long term consequences would be a further weakening of the position of the Communist Party in France. President Mitterrand had made it clear that he was prepared to part company with the Communists if they did not adhere to his policies. Moreover, President Mitterrand's firm commitment to the Atlantic Alliance, to the need for a strong Western European defence capability and, in particular, to the need for

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a strengthening of the military posture of the United States, created real difficulties for the Italian Communists. So long as the French Communists remain in President Mitterrand's Government, they were committed to the policies which he advocated. The Prime Minister agreed with this analysis and noted how useful it was to her to be able to contrast the policies of the Socialists in France with those of the Socialists in the United Kingdom.

Signor Spadolini said that he thought President Mitterrand's only mistake had been to give the transport portfolio to the Communists. The Prime Minister agreed. The Minister of Transport was in an influential and sensitive position. More generally, she thought it would be difficult for President Mitterrand to control the flow of information to his Communist Ministers. Signor Spadolini commented that given the Presidential structure of the French Government, it might be easier for him than it would be in, for instance, Italy or the United Kingdom.

In a brief reference to this morning's discussion, Signor Spadolini said that in his view President Mitterrand's restraint in commenting on the consequences for Europe of the high interest rates in the United States showed his gratitude for the restraint which the US had earlier shown in commenting on his decision to have Communists in his Government.

The remainder of the discussion between the two Heads of Government was about the domestic problems of the Italian Government and in particular about the economic situation in Italy. Signor Spadolini said that his Government were struggling against inflation which was currently running at 21% per annum. The basic political problem was how to cope with the Communist controlled trade unions who set an unacceptable political price - the entry of the Communists into the Government - on their co-operation. No social pact was possible in Italy. Many of the trade unions were content to see inflation continued since it weakened the present structure of Italian society. Signor Spadolini invited the Prime Minister to reflect on the difficulties of running a country which, in addition to the inefficiencies of a large nationalised sector and of universal indexation, had a work force the majority of whose members took as their model the Soviet Union.

The Prime Minister asked Signor Spadolini whether he thought he could implement the cuts in Government expenditure which he was seeking in order to reduce demand. Signor Spadolini said "I hope so". But in order to do so he would have to make concessions to the trade unions on price controls. There would have to be controls on some of the staple items such as bread and pasta. There were signs that some of the trade unions would be prepared to join in the fight against inflation provided the real value of their members' wages was kept intact. In return for price controls and some reduction in taxation, some trade unions had agreed to a review of the indexation system, and in particular the escalator clause in wage contracts.

/ The Prime Minister

The Prime Minister asked where the cuts in Government expenditure were likely to fall. Signor Spadolini referred to health, education, social security, local government expenditure and "movement of personnel". He was hoping to secure a 4% fall in the inflation rate, i.e. from 21% to 17%. This would enable him to cut interest rates which were presently at 26%. It was vitally important that he should succeed in doing so because at present small businesses in Italy were choking to death. This, if it continued, would have a most damaging effect on the nation's economy.

I am sending a copy of this letter to John Wiggins (HM Treasury).

Yours ever

Richard Alexander

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Foreign and Commonwealth Office.