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From the Private Secretary

18 May 1989

Dear Stephen,

PRIME MINISTER'S MEETING WITH THE VICE-PRESIDENT OF THE
COMMISSION OF THE EUROPEAN COMMUNITIES

The Prime Minister had a talk this evening with Sir Leon Brittan covering a number of European Community issues. The meeting was at Sir Leon's request.

I should be grateful if this letter could be given a very restricted circulation only, given the rather personal nature of the discussion.

The Prime Minister began by referring with appreciation to Sir Leon's work in Brussels and the considerable position which he had already built up there. Sir Leon said that the battle for the sort of Europe which he and the Prime Minister both wanted had to be fought at all levels. He wanted to give the Prime Minister his view on the best way to win that battle.

EMS

Sir Leon said that United Kingdom membership of the Exchange Rate Mechanism (ERM) clearly mattered very much to the other members of the Community. He would not presume to advise the Prime Minister on the economic arguments. But he believed there were strong political reasons for the United Kingdom to join. Membership would give us an important say on the next steps in economic and monetary co-operation. Indeed, he would say that it would enable us to dictate the pace and course of further progress in this area. He was reinforced in his view by a remark made to him by Monsieur Delors at a private dinner: "If she joins, she wins."

The Prime Minister said that no-one in the United Kingdom was seriously suggesting that Britain should join the ERM now. Our priority had to be to bring down the rate of inflation. Sir Leon interjected that he had not meant to suggest that Britain should join straight away. But we might go from saying that we would join when the time is right, to saying that we would join as soon as possible. The Prime Minister said that such a statement could well cause turmoil in the foreign exchange markets. There were many other arguments against membership on which she would not go into detail. But

was there not a question mark over the future of the ERM? If all Community countries abolished exchange control and freed their financial markets, it must be doubtful whether the ERM would survive, at least in its present form. As for the political arguments advanced by Sir Leon, she was not at all convinced. She did not believe that those who wanted to advance along the route mapped out by the Delors Committee would be deterred from pressing ahead by British membership of the ERM. One could argue that joining would actually deprive us of negotiating leverage. She was perfectly prepared to argue the Delors Committee recommendations from outside the ERM and believed that our views could prevail. At the same time, we were ready to take a number of practical steps, including some identified for the first stage of economic and monetary union in the Delors Report. Indeed we were further down this road than most other members of the Community.

Sir Leon repeated his conviction that a combination of the Prime Minister's prestige, Britain's achievements and sterling's international role would give us a decisive voice on these matters if we joined the ERM. Indeed it could enable us to block progress towards economic and monetary union beyond completion of the first stage. He thought the Prime Minister underestimated the impact that a decision by Britain to join would have in Europe.

UK approach to the Community

Sir Leon said that he had to fight constant battles in the Commission. He had won an important victory over reciprocity in the Second Banking Directive. He had been defeated over the Social Charter, on which he had been the only Commissioner to vote against. He believed passionately that the battle for an outward-looking, free market Community could be won. But the way to do it was to focus on the issues rather than attack the institutions of the Community and the members of the Commission. Indeed, he would go so far as to say that the Commission's decision on reciprocity would have gone the other way had it been taken following the last two weeks of public comment in the UK about the Community. If the Commissioners drew the conclusion that Britain was fundamentally opposed to the Community's institutions, they would not be responsive to proposals from the British Commissioners and the sort of free market thinking which Britain supported.

The Prime Minister said that it was not the institutions of the Community which worried her but the way in which they operated. Sir Leon's remarks confirmed her worst suspicions about the Commission. It was a sad commentary that he should have any difficulty in resisting protectionist proposals and promoting free market ideas. That was symptomatic of the way in which many Community governments seemed to think. In truth, there were fundamental differences of view between Britain and many of the other member states. We were concerned with limitation of government: many in the Commission were much more concerned with extending the powers of government and therefore their own powers. She recognised

that Sir Leon was suggesting she should be more tactful. But these were important issues of principle and Britain's voice had to be clear and forthright. Sir Leon said that he was suggesting that the tactics which had been appropriate for the fight over Britain's budget contribution needed to be adapted to the new situation in the Community which existed as a result of increased use of qualified majority voting. He did not deny that there was a battle for the soul of Europe, but he thought it could be won. The Prime Minister said that, in her experience, battles - including battles in the Community - were won by fighting hard. There were altogether too many examples at the moment of the Commission proposing unnecessary regulations and attempting to extend its competence into areas where it had no business to be.

EC Merger Control Regulation

Sir Leon said that he wished to raise a number of points about the EC Merger Control Regulation. The Prime Minister suggested that he should discuss this with Mr. Maude who was very well acquainted with all the details. She was not prepared to enter into a detailed discussion herself. Sir Leon said that he thought the proposal which was now on the table was what Britain's business and industry wanted. It was quite close to general agreement. There was only one major disputed point with the UK and that concerned the criteria. On this, he thought our interpretation was wrong. It would be a very positive step if the UK could give the draft regulation its support. The Prime Minister said her impression was that we had greater difficulties with the regulation than Sir Leon implied. It would be helpful if he were able to make proposals which met our concerns. The issue should be should be pursued further with Mr. Maude.

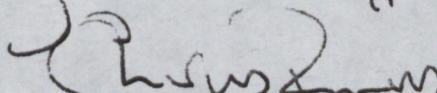
State Aids: Renault

Sir Leon said that he had to play the issue of state aid to Renault carefully. But he could assure the Prime Minister that he would not let Renault off the hook.

Harland and Wolff

Sir Leon said that he thought the Harland and Wolff application would be all right.

I am copying this letter to Alex Allan (H.M. Treasury), Neil Thornton (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

Yours sincerely,

C. D. POWELL

Stephen Wall, Esq.