

PRIME MINISTER

VISIT OF DR. KOHL

I attach briefs for the talks at 1200 noon. The main part was provided by the Foreign and Commonwealth Office; the supplementary brief by Conservative Central Office.

Dr. Kohl will be accompanied at the talks by:

Dr. Hartmann (Head of CDU International Department)

Herr Teltschik (Parliamentary Private Secretary to Dr. Kohl)

Herr Ruehe (CDU Member of the Bundestag with responsibility for British German Parliamentary Relations)

I will take a record. Would you like Ian Gow to be present? And would you like an FCO official - or do you intend to concentrate in the talks on domestic politics in Germany?

Dr. Kohl speaks no English so there will be an interpreter.

I also attach some notes on which you may wish to draw if you intend to make a short speech at lunch.

A.J.C.

22 January 1982

LIST OF GUESTS ATTENDING THE LUNCHEON TO BE GIVEN BY THE PRIME MINISTER
IN HONOUR OF DR. HELMUT KOHL, CHAIRMAN OF THE CHRISTIAN DEMOCRATIC UNION
OF THE FEDERAL REPUBLIC OF GERMANY AND FRAU KOHL ON MONDAY, 25 JANUARY
AT 1.00 PM FOR 1.15 PM

The Prime Minister

Dr. Helmut Kohl
and Frau Kohl

His Excellency the German Ambassador
and Frau Ruhfus

Herr Volker Ruehe

CDU Member of Bundestag responsible
for British/German Parliamentary
relations

Dr. P. Hartmann

Head of CDU International Department

Herr T. Teltschik

Dr. Kohl's Parliamentary Private
Secretary

Dr. E. Ackermann

CDU Press Officer

Frau Weber

Dr. Kohl's Personal Assistant

HM Government

Rt. Hon. John Biffen, MP
and Mrs. Biffen

The Hon. Nicholas Ridley, MP
and Mrs. Ridley

Parliamentarians

Sir Anthony Royle, MP
and Lady Royle

The Hon. Alan Clark, MP
and Mrs. Clark

Mr. Vivian Bendall, MP
and Mrs. Bendall

Mr. Peter Rost, MP
and Mrs. Rost

Mr. Frederick Tuckman, MEP
and Mrs. Tuckman

Business, Banking, etc.

His Grace The Duke of Portland
and Her Grace The Duchess of
Portland

Vice President of the German Chamber
of Industry and Commerce. Chairman
Bayer (UK) Ltd.

Herr G.Z. Steffens
and Frau Steffens

Chairman of German Chamber of
Industry and Commerce. Dresdner Bank

Herr E. Krampe
and Frau Krampe

Head of Mercedes-Benz (UK)

Media

Sir Robin Day	television broadcaster and old Koenigswinter hand
Herr Thilo Bode and Frau Bode	London correspondent Sueddeutsche Zeitung
Herr Wolf von Lojewski	London correspondent of ARD, German television
Miss Mary Goldring	journalist/broadcaster

Others

Sir Frank Roberts and Lady Roberts	Chairman of the Anglo/German Association
The Lord Croham and Lady Croham	Chairman-to-be of Anglo/German Foundation Board of Trustees
Professor Walter Laqueur and Mrs. Laqueur	Director Wiener Library
Sir Charles Troughton and Lady Troughton	Chairman, British Council

Foreign and Commonwealth Office

Mr. Julian Bullard	
Mr. P.W. Unwin	Minister (Economic), British Embassy, Bonn

10 Downing Street

Mr. Ian Gow, MP and Mrs. Gow	
Mr. John Coles	

DRAFT SEATING PLAN FOR LUNCH ON MONDAY, 25 JANUARY 1982

TABLE A

THE PRIME MINISTER
HER HELMUT KOHL
Frau Steffens
Sir Frank Roberts
Frau Ruhfus
Sir Anthony Royle
Lady Troughton
His Grace The Duke of Portland

TABLE B

RT. HON. JOHN BIFFEN
FRAU KOHL
The Lord Croham
Lady Royle
His Excellency the German Ambassador
Lady Roberts
Dr. P. Hartmann
Her Grace The Duchess of Portland

TABLE C

MRS. BIFFEN
Herr G.Z. Steffens
Lady Croham
Mr. Julian Bullard
Frau Weber
Sir Robin Day
Mrs. Bendall
Herr E. Krampe

TABLE D

THE HON. NICHOLAS RIDLEY
Frau Krampe
The Hon. Alan Clark
Mrs. Gow
Mr. P.W. Unwin
Herr Thilo Bode
Miss Mary Goldring
Dr. E. Ackermann

TABLE E

THE HON. MRS. RIDLEY
Herr Volker Ruehe
Mr. Peter Rost
Herr Wolf von Lojewski
Mrs. Tuckman
Mr. John Coles
Mrs. Laqueur
Sir Charles Troughton

TABLE F

MR. IAN GOW
Herr H. Teltschik
Mrs. Clark
Mr. Vivian Bendall
Professor Walter Laqueur
Mrs. Rost
Mr. Frederick Tuckman
Frau Bode



Foreign and Commonwealth Office

London SW1A 2AH

22 January 1982

Dear John,

Call by Dr Kohl on the Prime Minister: 25 January

Dr Kohl, Chairman of the CDU and Leader of the Opposition in Bonn (personality note at Annex A) is due to call on the Prime Minister at 1200 on 25 January. He is visiting the UK as a guest of HMG and his programme (Copy at Annex B) includes calls on my Secretary of State and the Chancellor of the Exchequer.

Although he has held his present party position since 1973 and is well-known in the Federal Republic, he has limited international experience and will be paying his first official visit to this country in his present capacity. He has been taking steps recently to raise his international profile, and his visit to Washington last October included meetings with President Reagan, Secretary Haig and Finance Secretary Regan. He undoubtedly sees this trip to London as a further step in this process. From our point of view the main purpose of the visit is to cement relations with the leader of a major party of our most important European ally. Dr Kohl is a strong contender for the Federal Chancellorship (for an assessment of the electoral prospects of the CDU/CSU and of Dr Kohl's own position, see Annex C).

On the international political front discussion will no doubt focus on Poland and the current state of East/West and West/West relations (Bonn Telno 48 at Annex D). In the Bundestag debate on 14 January Dr Kohl chose to break the consensus with the government which had emerged before Christmas and set out to demonstrate that Chancellor Schmidt had sacrificed Alliance interests to keep on terms with the Soviet Union. The Prime Minister may wish to sound out Dr Kohl on whether this decision to confront Herr Schmidt was taken for tactical domestic reasons (in anticipation of the important Land elections later this year) or because he believes that



FRG foreign policy is in danger of giving more weight to maintaining good relations with the East than with the FRG's Western Allies. It would also be useful to seek Dr Kohl's views on the state of the Alliance and of Franco-German relations. Is there a serious rift between the Europeans and the USA, in particular between Bonn and Washington? And how significant is the apparent weakening of the Paris/Bonn axis?

Economic policy is not Dr Kohl's forte - he tends to leave either Herr Stoltenberg or Herr Kiep to lead in this field - but his office have told us that the economic aspects that he would like to discuss in London are:

- the economic situation in the UK.
- the state of the world economy (including US interest rates)
- the British approach to the EC, particularly the Community budget.

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Briefs on these are enclosed at Annexes E - G. At Annexes H and I are background briefs on the current economic scene in the FRG and on CDU economic policy. The Prime Minister will no doubt wish to give Dr Kohl her assessment of prospects for the UK economy. It would be useful to take this opportunity to reaffirm the UK commitment to Europe and to explain to Dr Kohl the UK's position on the EC budget.

I am sending copies of this letter and enclosures to Private Secretaries to other ministers who will be meeting Dr Kohl in the course of his visit.

Yours ever.

Francis Richards

(F N Richards)
Private Secretary



ANNEX

- A Personality note on Dr Kohl
- B Programme for Dr Kohl's visit
- C Brief by the FCO on the CDU/CSU's election prospects and Dr Kohl's own position
- D Bonn telno 48 on Poland
- E Brief by HM Treasury on the UK economy
- F Brief by HM Treasury on the world economy (including US interest rates)
- G Brief by the FCO on the Community
- H Brief by HM Treasury on the FRG economy
- I Brief by the FCO on CDU economic policy

VISIT BY DR KOHL TO THE UK: 25-27 JANUARY 1982

OUTLINE PROGRAMME

Sunday 24 January

1210 Arrive Heathrow from Frankfurt

Monday 25 January

1200 Call on Prime Minister

1245 for 1300 Lunch given by Prime Minister at No 10

1530 Call on The Rt Hon Roy Jenkins, joint leader of the SDP

1630 Discussions at House of Commons with Conservative back-bench MPs

1800 Reception given by German Ambassador at FRG Embassy

Tuesday 26 January

am Visit Churchill's grave at Bladon, and Blenheim Palace

1230 Lunch at Oxford

1430 Visit St Anthony's College Oxford for round-table discussion with dons

2000 Dinner given by Chairman of Conservative Party

Wednesday 27 January

1000 Call on Chancellor of the Exchequer

1100 to 1200 Press Conference at FRG Embassy with German correspondents

1215 Call on Secretary of State for Foreign and Commonwealth Affairs

1245 for 1300 Lunch given by Secretary of State at Admiralty House

1515 to 1530 Interview with the BBC German Service at FRG Embassy

1530 to 1630 Press Conference at FRG Embassy for British Press

1800 Depart Heathrow for Frankfurt

VISIT BY DR KOHL TO THE UK: 25--27 JANUARY

BACKGROUND BRIEF ON THE CDU/CSU AND THE POSITION OF DR KOHL

1. The CDU/CSU enter the New Year in optimistic mood. The electoral tide seems to be flowing in their favour. Morale is good. Differences over policy and tactics undoubtedly remain both within the CDU and between the CDU and CSU. But the Union have had some success in playing these down and in presenting the electorate with a united front. Helped by the open divisions within the SPD, they have staged a remarkable recovery in popularity since their defeat in the 1980 elections. They now enjoy over 50% support in the opinion polls and their prospects for the four Land elections due this year are excellent. Although the odds can always change, the betting currently must be that the Union will form the next Federal government.
2. The main question mark hangs over when they are likely to do so. Increasingly they themselves are coming to accept the view, consistently argued by Dr Kohl himself, that it will not be before the end of the current legislative period in 1984. If the coalition's difficulties last year over economic and defence policy were not enough to bring it down, the Union see little else that is likely to do so. Certainly all the signs are that relations between the two Coalition partners have improved considerably since their nadir last autumn.
3. What hopes the Union have for an earlier change of government centre on the outcome of this year's Land elections. There are two possibilities, neither of which seems very promising. First, the FDP could do so badly in the elections as to conclude that further association with the SPD could only spell disaster for the 1984 Federal elections. The second opportunity lies in the fact that, if the Union can hold Bavaria and Lower Saxony (which should not be difficult) and win either Hessen or Hamburg (which is a real possibility), they will secure a two-thirds majority in the Bundesrat and be in a position to block all government legislation (although in practice they would probably decide not to exercise this blocking majority).
4. The Union's hopes last year that the FDP were on the verge of switching allegiance have on the whole given way to a resigned belief that the FDP cannot be expected to switch before 1984. At their Party Conference in Hamburg, the CDU made clear that their aim was to work for an absolute majority in 1984. But few people in the CDU are under any illusion that the task of securing an absolute majority in 1984 will be easy. Most hopes are therefore still pinned on the FDP.
5. As to the position of Dr Kohl, no one is in any doubt that, if the Coalition falls before 1984, he will be the next Federal Chancellor. Unless it falls soon, however he will have in 1983 to undergo the formal selection process to choose the Union's next Chancellor-candidate. He is then likely to face competition. But it is still Kohl who must be considered to stand the best chance. He is well-known in the FRG (if not outside) and the

/electorate

have got used to him. Although rating well behind the Chancellor and Genscher in the opinion polls, he is seen as solid and reliable. He has been on the course before, and done well on it: as Chancellor-candidate in the 1976 Federal Elections he only narrowly failed to obtain an absolute majority. Equally important, he has the advantage of being the current incumbent. He controls the Party machinery and, as its Chairman, dominates the CDU/CSU Parliamentary Party. He is, in short, still the most likely successor to Schidt as Federal Chancellor.

Foreign and Commonwealth Office

22 January 1982

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TO IMMEDIATE FCO

TELEGRAM NUMBER 46 OF 21 JANUARY

INFO ROUTINE WASHINGTON PARIS UKDEL NATO

INFO SAVING ANKARA ATHENS BRUSSELS COPENHAGEN THE HAGUE LISBON
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DR KOHL'S VISIT TO LONDON, 25-27 JANUARY: POLAND

1. WHEN DR KOHL COMES TO LONDON, THE GERMAN RESPONSE TO POLAND WILL BE AMONG THE SUBJECTS ON HIS MIND. YOU AND THE PRIME MINISTER MAY THEREFORE LIKE ADVANCE WARNING OF THE LINE HE IS LIKELY TO TAKE, AND OF THE DOMESTIC CONSIDERATIONS BEHIND IT.
2. LED BY DR KOHL PERSONALLY, THE CDU/CSU OPPOSITION HAVE BEEN CONDUCTING A FIERCE ATTACK ON THE FEDERAL GOVERNMENT'S POLAND POLICY. MY TELS 26,31 AND 32 TO FCO REPORTED THE BUNDESTAG DEBATE WHICH WAS THE MAIN OCCASION FOR THIS ATTACK. KOHL'S LINE HAS BEEN THAT THE CHANCELLOR, BY THE MILDNESS OF HIS RESPONSE TO THE MILITARY TAKE-OVER, HAS CREATED A CRISIS OF CONFIDENCE IN THE ALLIANCE. IN CONTRAST TO THE GOVERNMENT'S EMPHASIS ON OFFERING FURTHER ECONOMIC AID TO POLAND IF SHE REVERTS TO REFORM, THE OPPOSITION HAVE DEMANDED THE DISCONTINUATION OF ECONOMIC AND FINANCIAL HELP TO POLAND, AND PROGRESSIVE MEASURES AGAINST THE SOVIET UNION, IF THE WEST'S CONDITIONS ARE NOT QUICKLY MET.
3. KOHL'S DECISION TO ATTACK THE GOVERNMENT ON THIS QUESTION HAS NOT BEEN TO THE LIKING OF ALL HIS PARTY. SEVERAL PROMINENT MEMBERS OF THE CDU, INCLUDING KIEP AND THE SECRETARY-GENERAL GEISSLER, WOULD PREFER A MORE RESTRAINED POLICY TOWARDS THE EAST. BUT THERE HAVE BEEN LOUD VOICES IN THE CSU (WHOSE SUPPORT IS IMPORTANT TO KOHL) AND ON THE RIGHT OF THE CDU CALLING E.G. FOR THE BREAKING OFF OF RELATIONS WITH THE SOVIET UNION AND CANCELLATION OF THE GAS PIPELINE DEAL. CDU CONTACTS TELL US THAT KOHL'S MOVE SHOULD BE SEEN AS A TACTICAL ONE, DESIGNED TO STEER A MIDDLE COURSE BETWEEN THE OPINIONS OF THE TWO WINGS OF THE UNION.
4. THE TACTIC HAS SO FAR MET WITH LITTLE SUCCESS. SCHMIDT HAS BEEN ABLE TO COUNTER KOHL'S ATTACK BY POINTING OUT, WITH REFERENCE TO PUBLIC STATEMENTS, THAT THE FRG'S RESPONSE TO POLAND IS FOUR SQUARE WITH THOSE OF HER ALLIES AND PARTNERS. IN PARTICULAR HE HAS

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REFERRED TO HIS TALKS WITH THE US AND FRENCH PRESIDENTS. ON THE MAIN UNRESOLVED ISSUE NOW FACING THE WEST, THAT OF SANCTIONS, KOHL HAS BEEN UNSPECIFIC, AND ACCORDING TO OUR CONTACTS THE CDU/CSU HAVE DONE NO PLANNING ON WHAT SANCTIONS THEY WOULD LIKE TO SEE IMPLEMENTED, OR HOW. THEY CAN HARDLY DO SO WHEN THEIR OWN OPINIONS ARE DIVIDED. MOREOVER THEY MUST BE AWARE THAT IF, WHEN IT COMES TO THE NITTY-GRITTY, THEY TAKE A TOUGHER LINE ON SANCTIONS THAN THE FEDERAL GOVERNMENT, THEY WILL FORFEIT THEIR SUPPORT AMONG BANKERS AND INDUSTRIALISTS, WHO, WHILE SEEING THE NEED FOR ATLANTIC SOLIDARITY, ARE STRONGLY OPPOSED TO SANCTIONS. IN PRESENT CIRCUMSTANCES AT LEAST, THE SCHMIDT/GENSCHER POLICIES ON POLAND HAVE THE SUPPORT OF THE MAJORITY OF WEST GERMANS, AND KOHL IS UNLIKELY TO GAIN DOMESTIC ADVANTAGE FROM CONTINUING TO OPPOSE THEM.

FCO PLEASE PASS SAVING TO ALL EXCEPT BMG BERLIN EAST BERLIN AND CICC G

TAYLOR

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AIDE MEMOIRE ON THE UK ECONOMY

22 January 1982

PRESENT SITUATION

Most recent major outside forecasts (NIESR, P&D, CBI, LBS) assess fall in output ended in H1 1981, with some recovery thereafter (in range $\frac{1}{2}$ - $1\frac{1}{2}$ per cent for 1982). IFEM and OECD are more pessimistic; seeing further falls of output into 1982. Year-on-year inflation is forecast by most groups to fall further to a range of $9\frac{1}{2}$ - $11\frac{1}{2}$ per cent in 1982 Q4. Whilst some groups (ITEM and NIESR) see the possibility of further reductions (to 7-8 per cent), others see inflation remaining around 10 per cent in 1983. The industry Act forecast, of a 1 per cent rise in output in 1982, and 10 per cent inflation in Q4 1982 is broadly in line with this consensus. Unemployment (UK adult seasonally adjusted) forecast to reach around 3 million by end 1982.

GDP output estimate rose $\frac{1}{2}$ per cent in Q3 1981 the first rise for 7 quarters. In the 3 months to November 1981 industrial output rose $1\frac{1}{2}$ per cent while manufacturing output rose 1 per cent.

Consumers' expenditure fell by $\frac{1}{2}$ per cent in Q3 1981 returning to the level of Q3 1980. Retail sales in Q4 1981 rose about $\frac{1}{2}$ per cent. The volume of visible exports in the 3 months to November 1981 were 9 per cent above the average for January and February 1981. The volume of visible imports in the 3 months to November were 24 per cent higher than the average for January to April 1981. DI investment intentions survey conducted in October/November suggests volume of investment, by manufacturing, distributive and service industries (excluding shipping) will rise by about 2 per cent in 1982 following an estimated fall of 4 per cent in 1981. A large rise is tentatively expected in 1983. Investment by manufacturing (including leasing) is expected to rise during 1982, but for the year as a whole it is likely to be 1 per cent lower than 1981. An appreciable rise is expected in 1983. Manufacturers', wholesalers' and retail stocks dropped by £0.1 bn (at 1975 prices) in Q3 1981 compared with destocking of £1.0 bn in H1 1981 and £1.9 bn in 1980 as a whole.

Unemployment (UK, seasonally adjusted excl, school-leavers) was 2,781,600 (11.5 per cent) at December count, up 17,300 on November. Vacancies rose slightly to 107,500 in December.

Wholesale input prices (fuel and materials) were unchanged in December; the year-on-year increase fell to $15\frac{1}{2}$ per cent. Wholesale output prices rose $\frac{1}{2}$ per cent and are $11\frac{1}{4}$ per cent above a year ago. Year-on-year RPI increase was 12.0 per cent in December. Year-on-year increase in average earnings was 11.3 per cent in November. RPDI was flat in Q3 1981 following falls in the previous two quarters and a 17.5 per cent rise over the 3 years 1977 to 1980. The savings ratio rose 1 per cent to $14\frac{1}{2}$ per cent in Q3 1981.

PSBR £9.5 bn in the first half of 1981/82 and CGBR in April to December - £10.2 bn; but both distorted upwards by the civil service dispute. Underlying PSBR believed in line with Budget forecast (£10½ bn).

Sterling M3 estimated to have increased by 0.2 per cent in banking December.

Visible trade showed average monthly surplus of £135 million in the 3 months to November 1981 compared with an average monthly surplus of £525 million in the first two months of 1981. Invisibles surplus in first 11 months of 1981 estimated at £2.6 billion. Reserves at end-December \$23.3 bn. At the close on 21 January the sterling exchange rate was \$1.881 and the effective rate was 91.4.

INDUSTRY ACT FORECAST, NOVEMBER 1981

Table 1: Economic prospects for 1982

	Percentage changes		Average errors* from forecasts, relevant for 1982 per cent
	1980 to 1981	1981 to 1982	
A. Output and expenditure at constant 1975 prices			
Gross domestic product (at factor cost)	-2	1	1†
Consumers' expenditure	0	0	1†
General government expenditure on consumption and investment	-2	0	1†
Other fixed investment	-2†	2†	3
Exports of goods and services	-5††	2††	3†
Change in rate of stockbuilding as a percentage of GDP	-†	2†	1
Imports of goods and services	-4†	8††	2††
B. Balance of payments on current account			
	1981	1982	
	6†	3†	£ billion 2††
C. Retail prices index			
	Percentage changes		per cent
	4th quarter 1980 to 4th quarter 1981	4th quarter 1981 to 4th quarter 1982	
	12	10	3

*The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on government forecasts, notably in November 1978 (see *Economic Progress Report Supplement* or *Economic Trends* No 301, November 1978, and *Economic Progress Report*, June 1981). The calculations for the constant price variables are now derived from internal forecasts made during the period June 1965 to October 1979. For the current balance and the retail prices index, forecasts made between June 1970 and October 1979 are used. The errors relate to the figures after adjustment for the effects of major changes in fiscal policy, where excluded from the forecasts. Quarterly forecasts are grouped so as to be comparable with the changes between calendar years as shown. Thus for forecasts of constant price variables and the current account made in quarter 0 the errors relate to the forecast period (quarters 1 to 4) compared with the base year (quarters -3 to 0). For the retail prices index the margin relates to the percentage change between quarter 0 and quarter 4.

†The uncertainties caused by the absence of trade statistics for part of 1981 imply that the estimates and forecasts of trade and the current account are particularly uncertain in this forecast.

VISIT BY DR HELMUT KOHL, CHAIRMAN OF CDU:
25-27 JANUARY 1982

World Economy (Including US Interest Rates)

Points to Make.

1. GNP growth rate of OECD countries in 1982 likely to be modest, but quicken in second half of year.
2. Modest rate of recovery not wholly bad: should avoid surge in oil prices and reversion to unrealistic wage demands.
3. Most countries following firm fiscal and monetary policies, and pursuing long-term goal of reducing public expenditure's share of GNP. Recession delays attainment of goal but should persevere.
4. Risk of increased borrowing by US federal government colliding with tight monetary policy with result that interest rates revert to record levels. Damaging for Europe. Chancellor has voiced HMG's concern both publicly and privately. US has no alternative in short-term to increasing taxes.
5. Japanese macro-economic policy not helping us resist protectionism. With low inflation and low interest rates, they could tighten monetary policy and relax fiscal policy a little to increase domestic demand and let you rise.

Background

NB: Figures are for OECD area as a whole unless otherwise stated.

Output and Demand

1. Recovery of output in first half of 1982 is expected to be slow, but it should reach an annual rate of 3 per cent by the end of the year and then stay at around that rate in the first half of 1983. GNP growth of $1\frac{1}{2}$ per cent is forecast by OECD Secretariat for 1982 as a whole ie same as 1981. Japan and France are forecast to enjoy rather higher growth. The US will enter the year in recession, but should leave it growing strongly.

Prices and Earnings

2. Inflation rate of increase in consumer prices in major seven countries declined from 13 per cent in 1980 to 10 per cent in 1981. Further modest decline to 8½ per cent expected in 1982. Within the EC, Italy and France may have rates higher than the UK's.
3. While there can be no certainty that the moderation in wage behaviour seen recently will continue there are signs in some major economies, including the US and Germany, that workers in some key industries are now more concerned with job preservation than wage increases. The French government is developing a prices and incomes policy. OECD calculations show productivity as having increased by 1¼ per cent on average in the OECD area in 1981 and predict a 1½ per cent rise in 1982 - almost twice the 1980 rate.
4. Demand for most commodities, including oil and industrial and agricultural commodities has been weak, and many prices have declined in real as well as nominal terms. Some modest recovery of oil real price levels may occur later in 1982, continuing into 1983.
5. The OECD current account deficit is expected, on the assumption of unchanged exchange rates, to stabilize at an annual rate \$20-35 billion over next 18 months. Japan's surplus will probably grow rapidly: OECD Secretariat forecasts \$17bn for 1982 as a whole, and an annual rate of \$23 billion in first half of 1983. The position of the US may deteriorate rapidly and go quite deeply into deficit by mid-1983.
6. Imports by OPEC are expected to rise less rapidly in 1982, following the rapid expansion in 1981. This reflects the fall in demand for oil and the unlikelihood of major oil price rises in the near future.
7. Unemployment is expected to increase in all major OECD countries except Japan, the OECD average reaching 8 per cent of the labour force, or 28.5 million people, by the beginning of 1983. In Europe, unemployment could reach almost 10 per cent of the labour force. Unemployment among young people will continue to be particularly severe, with rates over 15 per cent in the US, France, the UK and Italy (29½ per cent).

Interest Rates

Prime lending rates have been stable in US at 15.75 per cent since

early December. In Germany they have declined from 14.50 per cent to 13.50 in two steps since mid-November. US three-month money market rates have risen from 11 per cent in late November to 13 per cent now; this rise is attributed to uncertainties over monetary policy. Over the same period long-term rates have also risen in the US, and France, but not in Germany.

Fiscal Policy

8. Most OECD countries (France being a notable exception) are pursuing the long-run objective of curbing government deficits and a number are committed to reducing the public sector's claims on GDP, but the effects of the recession, inflation and debt servicing costs have made it very difficult to achieve these objectives. To avoid being blown further off course, governments have had to take politically painful decisions, such as raising taxes, modifying wage indexation and cutting the value of social security benefits.

9. The UK has been one of the more successful in working towards these objectives, and Germany has displayed remarkable determination to the same end. The upshot is that the general government deficit for the seven OECD majors has in 1981 been held to 2½ per cent of GNP/GDP, the same as in 1980, in spite of the effect of the recession in increasing deficits.

10. President Reagan has admitted officially that he does not expect to balance the US budget by FY 1984. Priority is to be given instead to increased defence spending and reduced taxation. A 'raw' Administration forecast of this year's deficit is said to be \$109bn compared to the official target of \$43 bn. This may rise to \$152 bn in FY 1983 and \$162 in Fy 1984 unless further measures are taken. Given the President's order of priorities, the action most likely to be taken is an increase in indirect taxes. Secretary Regan said on 6 January that options for increases included excise taxes on beer and wine. The President's Annual Economic Report to Congress and his 1983 proposals are expected to be published on 8 February.

Monetary Policy

11. Most of the larger OECD countries including the US and Germany, are committed to firm control of monetary growth. In the early summer of 1981 the French, however, adopted a stance that was markedly less

restrictive than that enforced when M. Barre was Prime Minister.

Balance Between Fiscal and Monetary Policies

12. In Japan, a low inflation rate and low interest rates give the authorities some freedom of manoeuvre in fiscal and monetary policy. In their 1982 budget they have tightened their fiscal stance, at a time when monetary policy is relatively relaxed. This has the effect of keeping the yen's value on the foreign exchange markets down, thus increasing exports, restraining imports and building up a yet greater trade surplus.

13. In the US, the reverse situation has developed: monetary policy is tight and the fiscal deficit has grown. This, coupled with expectations of a resurgence of growth in the latter part of 1982, has led some respected unofficial forecasters, most notably Dr Henry Kaufman, to predict that the recent decline in interest rates will be reversed, perhaps in its entirety, in the course of this year.

CALL BY DR KOHL ON PRIME MINISTER: 25 JANUARY

COMMUNITY ISSUES

Line to Take

30 May Mandate

1. Government fully committed to membership of the Community. Hope British Presidency will have demonstrated our wish to see it develop and prosper.
2. Important for Community's future that early and lasting solution found to problem of Community Budget. Quite apart from resolving the unacceptable situation of the UK, we would like to see, as a long term solution, distributive effects of Community budget put on a rational basis. Present haphazard system entirely unsatisfactory and likely to get worse in view of enlargement of the Community.
3. Foreign Ministers meeting today: probably last chance to agree guidelines for a solution. Of course, even if guidelines are agreed, Community will still have to negotiate detailed arrangements on all 3 chapters of the Mandate - CAP Reform, development of other policies and the budget itself.
4. As two net contributors, FRG and UK major interests in common. Clearly not right that financial burden for any solution should fall mainly on Germany. Other rich member states should be prepared to forego some of their benefits. Of course, fundamentally inequitable that the UK, as a less prosperous member state, should be a major net contributor to the budget.

/Equity

Equity would suggest the contrary.

5. Also believe it essential to future development of Community that the Community takes effective action to remedy the defects of the CAP - especially the production of costly surpluses.

European Union : German/Italian Draft Act


6. [Welcome this initiative.] Willing to examine proposals constructively and in a positive spirit; many of them consistent with UK policy on further development of Community. Agree we must give impetus to Community development, not let it stagnate.

Election of Mr Dankert as President of the European Parliament

[If raised by Dr Kohl]

7. ~~As I said in my reply to your telegram of 15 January, I am anxious to see the European Democrats and the European People's Party cooperate as closely as possible in the European Parliament. The British Government had no standing in the election, however, and my own capacity to influence its conduct was very limited.~~


See Conservative Party International Office Note.



Background

30 May Mandate

1. As the Prime Minister will know, we have kept in close touch with the German Government on the Mandate negotiations and many of our views on CAP reform and the budget are shared by them. Dr Kohl will probably not want to talk about the detail of the negotiations on the Mandate texts to which he is not privy. The Prime Minister therefore might use the occasion to let him know in broad terms our views on the need for a more rational approach to the Community budget system and the CAP.
2. The European Council in November reached provisional agreement on guidelines for most of the issues in the Mandate. But four key issues were remitted to Foreign Ministers. There were: milk, Mediterranean agriculture, growth of CAP expenditure and the budget itself. Foreign Ministers met on 14/15 December and again on 14/15 January. Although they narrowed the areas of difference, they were unable to reach agreement. They meet again on 25 January. The main outstanding points are: on milk, the nature of the commitment to control the growth and cost of surpluses, the question of the continuation of the basic coresponsibility levy and the nature of any aid for small producers; and on the budget, the duration of the corrective arrangements for the UK (four or five years), the question of a review, the inclusion of the financial mechanism and, most importantly, degressivity (whether the amounts paid should be reduced automatically or only to the extent that the size of the UK's problem is reduced by improvements in the balance of the budget as a whole). There is less controversy about
/the texts



the texts on Mediterranean agriculture and CAP expenditure, on which our views and those of the Germans closely coincide.

3. If Foreign Ministers do agree guidelines, it will then be for the specialist Councils to implement them - agriculture falling to the Agriculture Council in the context of the price-fixing negotiations and the budget to the Foreign Affairs Council.

European Union : German/Italian Draft Act

4. The German CDU/CSU Parliamentary Party is strongly in favour of progress towards European Union and broadly supports the ideas contained in the German/Italian Draft Act.

Election of Mr Dankert as President of European Parliament

5. Mr Dankert (Dutch Socialist) was elected on 19 January on the fourth ballot. Sir James Scott-Hopkins (the candidate of the European Democratic Group) was eliminated after the penultimate ballot. Dr Kohl may express regret that a number of UK Conservatives voted for Mr Dankert in the final ballot rather than Herr Klepsch, the European People's Party candidate. He sent a telegram to the Prime Minister on 15 January urging close cooperation between the European Democratic Group and the European People's Party over the election of the new President.

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THE GERMAN ECONOMY

Points to make

1. (i) Do the CDU agree with OECD and Five Institutes forecasts for German economy? These suggest German economic prospects in 1982 relatively favourable by international standards, even though growth may be less than Germans used to and unemployment may continue to increase;

- (ii) Improving economic situation due to restrictive policies ie tough budgetary policy, tight monetary policy and a wage round bringing average increases below the rate of inflation; such policies painful particularly in a recession but Germany an example to European partners.

BackgroundOutput and unemployment

2. GNP probably fell slightly in 1981. A severe downturn was avoided by a strong export performance which compensated for depressed domestic demand. The OECD and the Five Institutes expect growth of about 1 per cent in 1981 with no significant upturn until mid-year.

3. Unemployment rose rapidly in 1981 from about 1 million to 1½ million. The authorities expect it to rise to 1.6 million this year but the Five Institutes expect it to be higher.

Prices

4. Consumer price inflation may have peaked at 6.7 per cent in the year to November 1981. Both the year on year rate and the underlying rate fell in December. A strengthening D mark and moderate wage settlements mean the prospect of a further decline is quite strong. The OECD expect a decline perhaps to about 4½ per cent on average in 1982.

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Balance of Payments

5. The current account deficit in 1981 is expected to have improved considerably from $\$16\frac{1}{2}$ billion in 1980 to about $\$8\frac{1}{2}$ billion. The OECD expect the current account to move into a small surplus this year although the Five Institutes are more pessimistic.

Exchange-rate

6. The Five Institutes expect the exchange-rate to strengthen considerably this year. Market perception of a return towards internal and external balance in Germany has already led to an appreciation of the $\$$ rate to around $\$2.30$ (21 January) from a low of more than $\$2.50$ in August. Rising US interest rate differentials have led to some depreciation over recent weeks. In October the D mark was revalued 5 per cent in the EMS where it is currently very weak.

Policies

7. The 1981 budget deficit was larger than originally planned at around DM 34 billion because of the recession. The Government has with great difficulty agreed to reduce this to about DM 27 billion this year, through cuts in spending, tax allowances, subsidies and transfers. The wrangle over the budget demonstrated significant divisions within the SPD and the Social Democrat and Free Democrat partners. The transfer of very large profits from the Bundesbank to the Government helped paper over the cracks. This has been severely criticised by the CDU as cosmetic and hindering fundamental adjustments needed to public finances.

8. Chancellor Schmidt is expected to announce a number of measures to improve investment and employment at the end of this month. Herr Matthoefer told the Chancellor last week that indirect taxes on energy were likely to be raised to produce revenue for new spending on energy - saving investment. Spending on direct job-creation was apparently unlikely.

9. The Bundesbank has kept monetary policy very tight over the last couple of years, partly in order to support the D mark and finance the current account deficit. It was relaxed for the first time in two years at the beginning of October when falling US rates allowed the Bundesbank to cut the special Lombard rate one per cent to 11 per cent without undermining the D mark. This has since been cut twice to 10 per cent in December. The scope for further interest-rate reductions may be limited at the moment by rising US rates.

GERMANY: MAIN ECONOMIC INDICATORS

	1980	1981 ^e	1982 ^f
GNP growth (% change over previous year)	1.8	$-\frac{1}{2}$	$1\frac{1}{4}$
Industrial production (% change over previous year)	0.2	$-\frac{3}{4}$	$1\frac{3}{4}$
Unemployment (% of civilian labour force)	3.4	5	6
Consumer Price Inflation (% change over previous year)	5.5	$5\frac{3}{4}$	$4\frac{1}{4}$
Hourly earnings growth (% change over previous year)	6.2	5	$4\frac{1}{4}$
Current account Surplus/deficit \$bn	$-16\frac{1}{2}$	$-8\frac{1}{2}$	$+1\frac{3}{4}$
General government deficit (% GNP)	-3.4	-4.4	-4.0

e = estimate

f = forecast

Sources: OECD and National Sources

VISIT BY DR KOHL TO LONDON: 24-27 JANUARY 1982

CDU ECONOMIC POLICY

BACKGROUND BRIEF BY THE FOREIGN AND COMMONWEALTH OFFICE

1. The CDU/CSU Opposition have been charged with lacking any real alternative economic policy. In the protracted debate on the 1981 and 1982 Federal budgets they tended to keep a fairly low profile. Although they made a general attack on the Government for soft-peddalling on the budget deficit and public expenditure, making a particular example of social security spending, their lack of a specific strategy to restimulate growth and reduce unemployment has laid them open to the charge of being negative, anti-union and anti-worker.
2. The theme of the economic debate at the CDU Party Conference in Hamburg last November was renewal of the social-market economy, harking back to the policies of Ludwig Erhard. The commitment of the CDU to the social component of the policy was carefully reaffirmed, the role of the family and individual responsibility was emphasised. Economic growth had to be restored to create more investment and more jobs. The main policy resolution agreed at the Conference contained demands for help for small and medium sized firms, for stimulation of new technology and for a reduction in taxes and contributions. State expenditure and subsidies should be reduced by 5%. More flexibility in allocating working time was needed as well as more part-time employment and job-sharing.
3. The main current economic policy issue is whether or not an employment programme should be introduced to tackle rising unemployment (1.7 million or 7.3% in December). While different voices have been

/heard

from various quarters in the party, the general CDU line is firmer than that of the present Coalition. Any short term stimulation will either produce nothing, or only a short burst of activity which will die away quickly. Inflationary pressures would be exacerbated. Increased funding for the budget deficit would further worsen the position of the already hard-pressed corporate sector. Unemployment can only be fought in the long term by structural improvements. A proper investment climate must be created and company costs (especially wage costs) must be kept down.

4. Despite their rhetoric, it is unlikely that a CDU/CSU Government would pursue a radically different economic course from that of the SPD/FDP. There would be greater attacks on certain social security benefits, particularly unemployment and sick pay, but state spending to help small and medium sized firms could be increased. There would be no change in monetary policy, but the emphasis would be more firmly in support of the Bundesbank's efforts to restrain inflation. The emphasis would tend to move away from direct social benefits towards a more market-orientated economy.

Foreign and Commonwealth Office
21 January 1982