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RECORD OF A CONVERSATION BETWEEN THE PRIME MINISTER AND THE PRIME MINISTER OF ITALY AT 0935 HRS on FRIDAY, 27 JANUARY, 1984 AT THE VILLA MADAMA, ROME

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Present:-

Prime Minister  
Mr. A.J. Coles  
Interpreter

Signor Craxi  
Signor Badini  
Interpreter

Signor Craxi suggested that European Community matters should be discussed first. The Prime Minister said that if current problems were to be solved by March, there was much detailed work to be done. In some respects Britain and Italy had very similar interests. We both imported much food from the rest of the Community and paid higher prices than would have been the case but for the nature of the Community market. Thus we had a common interest in keeping down Community prices. In some other respects our interests were not identical. Although the United Kingdom was slightly less prosperous than the Community average, it was a very heavy contributor to the EC budget. If present policies continued, the Community would run out of funds this year. The United Kingdom and Germany were the two main contributors to the budget and could not go on contributing at the present rate. There could be an increase in own resources only if there was agreement on a different method of distributing the burden. In 1982 Italy had an unadjusted net receipt of 1,600 million ecus. The United Kingdom's unadjusted net contribution in that year was well over 2,000 million ecus. So the British contribution had to be adjusted. We could not continue with the present ad hoc system - we needed a fundamentally new and automatic system.

Signor Craxi said that he understood this argument but were we saying that there had to be a special system for Britain? The Prime Minister said that this was not our goal. We wanted a fundamentally different system for all member states. Article 200 of the Treaty of Rome laid down the original system whereby Italy, France and Germany each paid 28% of the budget. That system had been totally changed in 1970 to provide for Community resources based on 1% VAT contributions from all Member States together with import levies and duties. So the 1970 system was not part of the Treaty.



Just as the original Treaty system had proved unworkable for a Community of 10, so the 1970 system was now not working and would be unsuitable for a Community of 12. Other Member States were seeking to change the 1970 system by demanding an increase in the VAT contribution. Germany and the United Kingdom took the view that if that change were made, there had to be a change in the way in which the burden was distributed. There would be no change at all unless both these changes were agreed. It was not just a British problem. Nor did our requirements conflict with the Treaty of Rome.

Signor Craxi said that Italy was disposed to be reasonable. A solution ought to be found before the European Council in March. But it was necessary to take into account real economic costs as well as budgetary costs. It was true that Italy was a net beneficiary but because of the difference between Community and international prices Italy in effect lost a large part of its contribution - as much as 1,500 million ecus. In terms of real economic benefits and costs, Germany obtained great advantages from the Community. These considerations put budgetary imbalances in a different light.

The Prime Minister observed that Germany would expect to pay a large contribution to the budget. But our position was different. Not only were we a heavy contributor but we incurred large resource costs because we too were heavy importers of food from the rest of the Community (and the prices were much higher than if we purchased from outside the Community). Signor Craxi agreed that the distinction between Britain and Germany was well founded. The Prime Minister commented that Britain and Italy were similar in that neither was self-sufficient in milk production. If we simply looked to the national economy, we could expand output of milk to our own advantage.

A strict financial guideline was needed for all EC expenditure and for the various individual categories of this expenditure.

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Otherwise, agricultural spending would continue to take up a larger share of the budget and the funds available for other sectors would be too few. Signor Craxi said that this pointed to the need for an increase in own resources. The Prime Minister observed that whenever the Community had obtained increased resources in the past, agricultural expenditure had increased. This could not go on. We must have guaranteed thresholds. Otherwise, there would be great internal difficulties for the Community. We should also find ourselves competing with the USA in subsidising the sale of agricultural products. In that competition, America would win. And the whole world agricultural economy would be upset.

A solution must be sought before Brussels in bilateral talks. It would be necessary to achieve agreement on a strict financial guideline, incorporated in the budgetary procedures; on a more equitable distribution of the burden (otherwise there could be no increase in own resources), on guaranteed thresholds; and on a solution to the problem of MCAs.

She had discussed these matters with the President of France on 23 January. He was now aware of the scale of the problems facing the Community. He wanted a settlement in Brussels because he saw difficulties in facing the European elections without a solution. He was also very conscious that there might be severe pressures on the EC budget and consequent agitation by French farmers. She believed he would make an effort to reach a preliminary agreement before Brussels. But the difficulty of the task was not to be under-estimated. She had indicated our problems and our conditions for a settlement. How did Italy see the problem?

Signor Craxi said that the concept of the European Community as a mere agricultural community interested Italy less and less. The Community conferred limited advantages on Italy and considerable losses. He wanted a more balanced development of the Community. The 10 were a group of industrialised countries but they talked of nothing but agriculture. He wanted to find room for new areas of co-operation and development - in politics, law, science, industry and defence. He was willing to discuss the



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construction of a budgetary system which was satisfactory to all Member States. With regard to the agricultural sector, the Prime Minister had drawn attention to imbalances. But Italy was in an especially unfavourable position. On the one hand, it had to import food and at prices higher than international prices. On the other, its exports to the Community were not protected by Community preference. Spain exported to the Community 10 times as many oranges as Italy because Italian exports were not protected. The net receipts of Italy from the budget were of doubtful value in that general context. This unfavourable situation of Italy as regards agriculture was leading to a decrease of interest in the Community. But Italy understood the importance of ever wider co-operation between the countries of Europe. For the sake of the future, it was necessary to heal the budget wounds and correct the current absurd distortions in agriculture. Then, for the consolidation of the Community, we should look for co-operation in other fields.

The Prime Minister commented that she agreed with much of this. If we were to make room for other policies, we must spend less on agriculture. So the surpluses had to be tackled. There was a need for development in other fields. We needed a common market in services, e.g. in insurance and airfares. The political co-operation machinery worked fairly well. It was regrettable that there had been no time for discussion of political co-operation matters at Athens. She and Signor Craxi would have liked to discuss the Middle East at that time - and we had similar views on East/West relations and on Cruise deployment. A fresh impetus should be given to political co-operation. She was a little concerned at Signor Craxi's reference to a defence community. She believed it vital to keep a close connection between both sides of the Atlantic under NATO. It was essential to Europe's security that the United States remained firmly committed to NATO. Signor Craxi said that he entirely agreed. Continuing, the Prime Minister said that Europe must play its full part. Nearly 5 % of the United Kingdom's GDP went to the defence budget. But the arch across the Atlantic must be preserved. She regretted that France was not fully integrated into NATO. Although France had not, like Italy, Germany and the UK, had to deal with the INF stationing problem, President Mitterrand was absolutely staunch with regard to the need for the

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nuclear deterrent. We were grateful for his stand. Signor Craxi agreed that President Mitterrand's attitude was helpful - to Italy as well. NATO had to rest on two pillars - the United States and Europe. It was not fair that Europe should play less than its full part. A more equal partnership would help the United States. But he did not believe in autonomous European defence. That concept did not correspond to the real relationship of forces in the world. The Prime Minister said that our own views were similar.

Returning to the European Community, it was important that all the leaders should keep in touch before the European Council. Signor Craxi said that the date for President Mitterrand's visit to Rome was not yet settled. He agreed with the Prime Minister that the Community could not afford another failure in March. The very nature of European Councils made it difficult to reach agreement. Thus agreement should be reached before the Council. The Prime Minister commented that the contacts made bilaterally before Athens had not been at a sufficiently high level. For example, the ideas of the French Finance Minister on control of expenditure had apparently not been cleared with President Mitterrand.

Signor Craxi suggested that every country would have to make concessions. The Prime Minister replied that every country had its sticking points. For us, these were a new arrangement for burden sharing and a strict financial guideline. The real battle would come on the CAP. The farming lobby in every country was powerful. But the farmers would want to know that they would continue to receive money, albeit a smaller amount.

Signor Craxi said that he had already had to make many enemies by cutting public expenditure in Italy. The country was faced with an annual deficit of \$60 billion. The Prime Minister said that we too had had to take tough decisions about public expenditure and were concerned about the increasing cost of the welfare state. Since we were all having to constrain national budgets, we should insist on similar disciplines in the EC budget.

/Signor Craxi

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Signor Craxi then raised the question of East/West relations and asked the Prime Minister how she assessed the Soviet situation. Would Moscow wait until the US elections were over before changing its position? The Prime Minister replied that the Soviet position remained very rigid but recent Soviet pronouncements suggested there was uncertainty at the top. Their tactics over INF deployment had failed. Although claiming to be in favour of peace, they had withdrawn from the INF and START talks. There seemed to be a tactical minuet in progress between the United States and the Soviet Union. She believed that President Reagan was completely sincere in wanting more contact with the Soviet Union and in seeking a reduction in nuclear weapons. We did not see clearly the underlying situation in the Soviet Union. As a result of recent failures by the leadership, had the Soviet military gained more power? She noted that Andropov, in his Pravda interview, had said that, though he was ready for dialogue, the United States would have to make the first move. She did not believe there would be a summit before the US elections. Nor should there be, for it would raise too many hopes and more preparation and contact were needed. European countries could play a part in promoting that but must be careful how they went about it. We must not give the impression to Soviet or world opinion that we were weakening in our determination to defend our beliefs. We should indicate to the East that while we held to our beliefs we accepted that their system was different and that East and West had to live together. If we could obtain greater security at a lower level of weaponry, then we could both concentrate on economic improvement. Both she and Signor Craxi were to visit Hungary. We must be careful not to put Hungary in a difficult position. Signor Craxi said that Italy understood that the Hungarian Government was nervous at the prospect of receiving both himself and the Prime Minister. Soviet pressure had been applied. The Prime Minister commented that in that case we must be careful not to embarrass the Hungarians. The mere fact of visiting the country gave some support to the people of Hungary. Signor Craxi

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said that no Italian Prime Minister in modern times had visited Budapest. He considered that Kadar was a good governor but nothing more.

On the international scene, the Russians had not given up their policy of suborning one country after another - in recent years we had seen their advances in Cambodia, Laos, Afghanistan and Africa. Now they were working on other areas of crisis - the Lebanon and Central America for example. Their role in other crisis situations - Northern Ireland, the Basque country, Libya - was obscure. He believed that Soviet policy continued to be one of gradual expansion. Agreeing, the Prime Minister said that the non-aligned world now seemed to be much more wary of the Soviet Union.

Signor Craxi said that the weak point of the Soviet Union was that it had been shown to be unable to help economically the countries within its sphere of influence. It was difficult to predict what would happen in the Lebanon.

The Prime Minister said that the Lebanon was a classic area for Soviet opportunism. The Russians and the Syrians would like the MNF to leave. But, if the MNF left without alternative arrangements, this would be a defeat for the West. The situation was very difficult. Syria seemed to be preventing President Gemayel from achieving reconciliation. Signor Craxi said several times that he was very worried about the situation in Beirut. Italy had soldiers in the Lebanon but they were not a military force. He feared that if there was no solution in the coming months the MNF would be attacked. Italian public opinion was concerned and Parliamentary opinion was divided. He had said off the record that he did not have a majority in the Italian Parliament on this issue. The only strong argument available to him was that he could not be less than loyal to Italy's allies. A diplomatic initiative must be launched to compel Syria to put its cards on the table. The more time passed, the more dangerous the situation.

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The Prime Minister agreed that if there were another assault on the MNF, public pressure for its withdrawal would be strong. She had told both the United States and France that contingency plans must be made for an extended role for the United Nations. We should be ready to raise this matter in the Security Council. She believed that the Soviet Union would find it difficult to veto a UN force in the face of world opinion. But it would be a calamity if the MNF left without an alternative and slaughter followed in the Lebanon.

Signor Craxi asked whether the MNF could usefully be enlarged to include, for example, Yugoslavia and Tunisia. This would give the force better political cover. At present it was regarded as an American stalking horse. The Prime Minister said that she had doubts about an enlarged MNF. Any new troops should be under the United Nations. Syria was taking the line that if the 17 May Agreement was not abrogated, progress would not be made. So perhaps we should seek a wider agreement involving Syrian withdrawal as well.

Signor Craxi said that in his view there lay behind the Lebanese situation a determination by the Soviet Union to inflict another defeat on the United States. Moscow wished to prolong difficulties and wear us out. He had originally believed in the possibility of reconciliation. But he now considered that there was a strategic intention on the part of Moscow to inflict a defeat on the United States. The MNF could not simply withdraw. But some solution must be found, whether it was to reinforce the MNF, by linking it to the United Nations, or to enlarge it by including other countries. The Prime Minister again expressed doubt whether the participation of extra countries in the MNF would help. Was he sure that Yugoslavia would wish to be involved? Signor Craxi said that he had never discussed this idea with anyone but the Prime Minister. The Prime Minister reiterated that a UN force seemed the best alternative and Signor Craxi agreed.

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Two days ago he had had a meeting with the Argentine Foreign Minister at the latter's request. The Prime Minister interjected that she had seen reports in today's Italian press of what the Foreign Minister had said. She would be very interested in Signor Craxi's impressions.

Signor Craxi said that Argentine believed that the problem of the Falkland Islands would have to be dealt with over a period of time. The Argentine Government would be interested to have secret talks in order to exchange views with the United Kingdom. They also wished to examine small steps towards the normalisation of relations and the improvement of the present atmosphere. A dialogue in public would be more difficult for them because they would then have to request a discussion of the sovereignty issue. This would hinder a dialogue on smaller issues. They wanted a diplomatic contact in order to have deep exchanges and so that the position of each side might be understood. The Alfonsin Government had shown that the only road was the road of reasonableness. Hostilities had been completely unproductive. He himself did not wish to pronounce on the substance of all this, merely to reiterate that the Argentine Government was interested in contact.

The Prime Minister said that she saw great difficulty in secret talks. Signor Craxi said that perhaps "Confidential" was a better description. The Prime Minister commented that Argentina was aware of our position. We would not negotiate sovereignty. But sovereignty was all Argentina wanted. The Falkland Islands were ours and their people wished to stay British. She could tell Signor Craxi confidentially, but would not wish this to become public, that we had asked the Swiss, as the protecting power, to put to the Argentine Government the possibility of diplomatic contacts between Argentina and Britain to establish how far we could go in improving relations on commercial and other

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matters. We awaited a reply. But if it was agreed that confidential talks should take place, that fact would have to be publicly known and the limits to the contacts clear. We wanted normal commercial relations. We should like eventually to restore diplomatic relations. But there would be no negotiations about sovereignty. We had to continue our defensive preparations in the Islands, for example in connection with the airport. We had, after all, been invaded. And the airport would be needed anyway for commercial development. We had tried to help Argentina in the financial field. We had unblocked its assets in London and had not prevented British banks from joining a consortium to help Argentina on the assumption that the latter reached agreement with the IMF.

So if Argentina wanted confidential talks, the move we had made would facilitate that. Argentina might seek to impose conditions. The remarks of its Foreign Minister to the Italian press had not been helpful. Signor Craxi said that he had known Alfonsin before he became President, he was a democrat and a responsible and nice man. History had given Italy a special link with the Argentine. 53% of the Argentine population had Italian connections. The Falkland Islands were not among the priority problems facing Argentina. That problem could not be deleted from the agenda but it could be kept aside for the time being. It was right to seek the normalisation of relations, with each side keeping its views on sovereignty.

The Prime Minister asked whether democracy would last in Argentina. Signor Craxi said that he had been very surprised by Alfonsin's determination to attack the military caste. But Mr. Caputo had told him that Alfonsin was supported by the middle and upper regions of the army and that was why he had been able to take strong action. The main problem of Argentina was the economy. The Prime Minister asked whether the Alfonsin regime had the will

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to impose discipline in the financial and economic fields. Signor Craxi said that the will was there but were the means?

The Prime Minister repeated that if the Argentines were willing to talk we would talk directly to them in confidence. Signor Craxi recalled that when he had visited London he had told the Prime Minister that after a war, time had to pass. The Prime Minister added that no-one in the Falkland Islands or in Britain would ever forget the Argentine invasion and occupation of the Islands. Signor Craxi said that perhaps there was no solution for certain problems. The Prime Minister said that a glance at boundary problems in Southern America suggested that this might be true. The only way to handle some problems was to ignore them.

The discussion ended at 1105 when the Foreign Ministers joined the meeting.

A.J.C.

27 January, 1984.

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