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FILE TITLE:

Relations

SERIES

Germany

PART:

3

PART BEGINS:

23<sup>rd</sup> November 2001

PART ENDS:

7<sup>th</sup> March 2002

CAB ONE:

~~PART  
CLOSED~~

Labour Administration

**PART**

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<b>DATE CLOSED</b>	
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Series : GERMANY  
 File Title : RELATIONS  
 Part : 3

Date	From	To	Subject	Class	Secret
23/11/2001	PM	Germany/Chancellor	(H) Thoughts on moving forward A400M project	U	
27/11/2001	PPS		To Bernd Pfaffenbach, Kanzleramt : Follow-Up to No10/Kanzleramt	U	
28/11/2001	Germany/HME	FA/APS	Sigrid Krampitz	U	0
04/12/2001	FA/APS	FCO	(T) Telephone conversation with German Chancellor	C	
07/12/2001	Telegram/IN		Tel no 555: Germany internal can the opposition beat Schroeder	C	
18/12/2001	FA/APS	FCO	ISAF: Telephone Conversation with German Chancellor	C	0
19/12/2001	FA/APS	Germany/HMA	German Media Peace Prize	U	
21/12/2001	Germany/HMA	FA/APS	German Media Peace Prize	U	
07/01/2002	Cab Off	EU/PS	Visit by Jochem Schaefer, Kamzleramt, 8 January 2002	C	
14/01/2002	Telegram/IN		Telno 13 German Elections - It's Schroeder V Stoiber	R	
14/01/2002	Germany/HMA	FCO	SPD Party Meeting in the Embassy	U	
18/01/2002	FA/APS	Ch.Staff	David Marsh: UK- Germany Step Change	R	
18/01/2002	Ch.Staff	PM	Newspaper Articles - Germany's Economic Problems	U	
21/01/2002	Germany/HMA	FA/APS	Sigmar Gabriel	U	
23/01/2002	Telegram/IN		Telno 23 NOSEC: German Elections: Stoiber	R	
23/01/2002	Telegram/IN		Telno 24 German Elections: Stoiber and the Bavarian Economy	R	
23/01/2002	Telegram/IN		Telno 25 German Elections: Stoiber and the EU	U	
25/01/2002	FA/APS		British Chamber of Commerce in Berlin - Guest Speakers: Letter to J	U	
25/01/2002	Germany/HMA	FA/PS	German Foreign Policy : The view from the Kanzleramt	C	
25/01/2002	FA/APS	PM	Can Stoiber beat Schroder?	R	
25/01/2002	Germany/HMA	EU/PS	Relations with the Kanzleramt	U	0
28/01/2002	Germany/HME	FA/APS	German Media Peace Prize	U	0
29/01/2002	FA/APS		To Karlheinz Kogel: German Media Peace Prize	U	
29/01/2002	Germany/HME	FCO	German Elections	R	
29/01/2002	Telegram/IN		Berlin 41: German Political Backdrop to A400M Handling	R	
30/01/2002		PM	From Sigmar Gabriel, PM of Lower Saxony: The EU vision	U	
04/02/2002	FA/APS		To Philip Gould : whether Schroder can Win?	C	0
05/02/2002	Germany/HME	FA/APS	Stoiber	C	
06/02/2002	FA/PS	Ch.Staff	Germany : A400M	C	0
07/02/2002	EU/PS	Cab Off	Germany/EU: Franco-German Meeting	R	
08/02/2002	Telegram/IN		Berlin 69: German Economy: Kirch and Murdoch	R	
08/02/2002	Telegram/IN		Berlin 67: Germany/EU: Convention:Meeting with Glotz	R	
14/02/2002	PPS		To Dr Bernd Pfaffenback: Kanzleramt-No 10 Economic Working Grou	U	
21/02/2002	FCO	FA/APS	Stockholm Progressive Governance Summit, 22-23 February 2002: PR	R	
21/02/2002	EU/PS	PM	Bilaterals in Stockholm	R	
22/02/2002	Ch.Staff	PM	"Schroder, Murdoch meet in secret" - Financial Times Article	U	
26/02/2002	Telegram/IN		Tel no 91: EU reform Blair Schroeder letter Further reaction	C	
26/02/2002	Telegram/IN		Tel no 147: EU Blair Schroeder letter French reaction	C	
06/03/2002	FA/APS	PM	Photo call with PM of Lower Saxony	C	
06/03/2002	Germany/HMA	EU/PS	Possible PM meeting with Stoiber	C	
07/03/2002	FA/APS	FCO	(M) - PM of Lower Saxony	C	

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Faxed to HMA-Berlin ✓

From the Private Secretary

7 March 2002

Dear Mark,

**PRIME MINISTER'S MEETING WITH PRIME MINISTER OF LOWER  
SAXONY, 7 MARCH**

The Prime Minister of Lower Saxony, Sigmar Gabriel (SPD), had a photo call and brief meeting with the Prime Minister on 7 March. He was accompanied by three officials. Also present were Jonathan Powell, Sir Stephen Wall, Roger Liddle and me.

Gabriel passed on greetings from Schröder. The Prime Minister asked how he was doing. Gabriel said he was fighting, and was facing a difficult period with economic problems. Gabriel was confident Schröder would win in September; he was stronger than his party.

Gabriel raised the Blair/Schröder letter, about which people in Germany had been astonished. The Prime Minister said that the UK and Germany should work closely together on the future of Europe. We favoured greater integration in certain areas. We also needed to reassess how the Council and Commission worked. Gabriel said that the Commission should not govern in such detail. There had to be subsidiarity. The Prime Minister agreed.

Gabriel asked about the Takeovers Directive. The Commission seemed to be in a struggle against Volkswagen, ignoring the golden shares eg in the UK defence industry. This would be emotive in the elections and would be a problem for the SPD. Stephen Wall said that when the Directive fell in the European Parliament we lost something of importance for completion of the Single Market. The Wise Men's proposal to deal with this through the breakthrough clause was not ideal, but the Commission were on the right track. The playing field needed to be level, but we did not want to draw back from completion of the Single Market. Gabriel said that he would send further views to Roger Liddle, whom he hoped to see in Germany.

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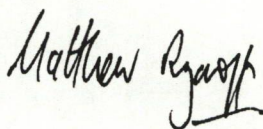
- 2 -

Gabriel said that there was a long tradition of UK/German school exchanges (he himself had spent four weeks in Rotherham aged 14 or 15), but the number of UK schools involved was decreasing. One reason was the lack of a regional partnership between Lower Saxony and a region in the UK. He asked the Prime Minister to find a region for an official partnership with Lower Saxony, for youth exchanges and scientific/economic links. The Prime Minister explained devolution in the UK and the role of the English regions. He said we would look at Gabriel's excellent idea (comment: Stephen Wall will pursue).

On the way out, Gabriel invited the Prime Minister to visit Lower Saxony, and met the Deputy Prime Minister briefly.

I am copying this letter to Andrew Allberry (Cabinet Office), and Sir Paul Lever (Berlin).

Yours,



**MATTHEW RYCROFT**

Mark Sedwill  
FCO

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FROM THE AMBASSADOR  
Sir Paul Lever

British Embassy

Wilhelmstrasse 70  
10117 Berlin

Tel: 20457 103  
Fax: 20457 571

6 March 2002

*Top,  
I think we  
need to ask  
TS - we was  
clear before*

*cc: DM  
Oho  
ma  
RL  
R.*

*MS Baker  
JSCW  
MAD  
MG  
RC*

Sir Stephen Wall  
No 10

*Sally Dear Stephen,*

**MEETING BETWEEN THE PRIME MINISTER AND EDMUND STOIBER**

1. Reinhard Bocklet, the State Secretary for European Affairs in the Bavarian Government (and Stoiber's principal adviser, as Minister-President, on European issues) telephoned me yesterday to ask formally whether it would be possible for Stoiber to call on the Prime Minister in London, perhaps in May or June. This follows approaches made in Munich by members of Stoiber's staff to Julian Farrel and Hugh Powell (Hugh's letter of 5 February to Michael Tatham). Bocklet said that Stoiber had already been to Madrid to see Aznar (22 February), was due to see Bush in Washington (12 April) and would hope to arrange a call in Paris after the French Presidential elections. He naturally hoped also to have the opportunity to meet the Prime Minister, for whom he had great respect.

2. To turn down Stoiber would be a deliberate snub. He is a leading European politician and would as Minister-President of Bavaria alone, merit a call on the Prime Minister. Although, seen from this Embassy, the odds remain that Schroeder will remain Chancellor after the next Bundestag election, Stoiber is far from being a no hope candidate. If the Prime Minister agreed to see him, a line to use in response to questions could be:

- Stoiber asked to call. Given his position it would have been discourteous not to see him.

- It is normal for leading politicians in Europe, whatever their party background, to want to exchange views with each other. The Prime Minister himself, when Leader of the Opposition, was received by Helmut Kohl (18 June 1996).

*Jonathan Powell & Sally Morgan*

*Matthew Rycroft*

*1/11/02 and 1/12/02 need for admit on Thursday, presumably Phil could ask him then?*

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*Chris*

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But it will be important to clear lines with Schroeder. He, or his advisers, may have views on timing or presentation of the request. Unless the Prime Minister himself wants to mention the issue the next time he talks to Schroeder on the telephone, someone speaks to either Steinmeier, Kastrup or Krampitz in the Kanzleramt. The aim would be to inform them that the request had been received, that the Prime Minister felt that he could not decently turn Stoiber down, but that he would want, before agreeing to such a meeting, to take on board any concerns which Schroeder might have.

Would you like me to speak to the Kanzleramt in these terms or would you prefer to do so direct from No 10?

*Yours ever*

cc: Sir David Manning, No 10  
Michael Arthur, Economic Director, FCO  
Karen Pierce, EUD(B), FCO  
Julian Farrel, Munich

- 2 -

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**From: Matthew Rycroft**  
**Date: 6 March 2002**

**PRIME MINISTER**

**Cc: Jonathan Powell**  
**Stephen Wall**  
**Roger Liddle**

### **PHOTO CALL WITH PRIME MINISTER OF LOWER SAXONY**

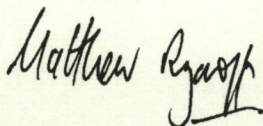
You have a photo call and short meeting with Sigmar Gabriel, Schröder's successor as SPD Prime Minister of Lower Saxony, from 1400 to 1415 on 7 March. Personality note attached.

The main purpose is a favour to Schröder, who requested the meeting. There are Land elections in February 2003. If re-elected, Gabriel would be favourite to succeed Schröder in due course as the SPD's chairman and/or candidate for Chancellor. You could ask him about the German elections.

Gabriel sits on the advisory board of Volkswagen. VW are the biggest opponents in Germany of the EU Takeovers Directive. Schröder attacked the Directive in a speech to VW staff last week. If Gabriel raises it, you could say that agreeing common rules for takeovers is a key part of economic reform.

Gabriel is one of the three German regional Prime Ministers most interested in EU issues, so you could also discuss the future of Europe and the Convention with him.

UK links: 30,000 Brits live in Lower Saxony; the capital Hanover has royal links; nearly 50 British companies have direct investments in Lower Saxony employing 14,000 people; the Duke of York is visiting later this month.



**MATTHEW RYCROFT**



## Leading Personalities Report

**GABRIEL, SIGMAR**



Prime Minister of Lower Saxony since 15 December 1999

Born 1959 in Goslar, Harz (Lower Saxony). An activist in SPD-related youth groups, he joined the SPD in 1977 at the age of 18. Studied politics, sociology and German at the University of Göttingen before becoming a teacher, working in adult education for 7 years.

Member of Lower Saxony state parliament (Landtag) for Goslar-Liebenburg since 1990. He was SPD home affairs spokesman in the Landtag from 1994-1997, deputy chairman of the SPD group in the Landtag from 1997-1998 and chairman from March 1998 until becoming Minister President (one of Germany's youngest ever) following Gerhard Glogowski's resignation after allegations of corruption.

Gabriel set his priorities as education, industry, employment, and Europe. Education is one of Gabriel's specialities, alongside home affairs and modernisation of government, and it is an issue that he believes can help him win the next Landtag elections in 2003. He has promised 2000 extra teachers by then and to fill all teaching posts promptly as they become free. On Europe, he is a keen supporter of subsidiarity and the principle of a Europe of the regions.

Fluent and engaging, Gabriel is self-confident and very much the politician. He is divorced but has a partner. He has a daughter from his former marriage. His hobbies are cycling, sailing and travelling in the Near East.

**From:** Rachel Cowburn  
**Date:** 7 March 2002

**JONATHAN POWELL**  
**STEPHEN WALL**  
**MATTHEW RYCROFT**

**SALLY MORGAN**  
**ROBERT HILL**

## **MEETING WITH SIGMAR GABRIEL**

The Prime Minister is meeting Sigmar Gabriel (Prime Minister of Lower Saxony) today. I met him briefly last night and attach a copy of a speech he gave to the LSE.

My main aspects of the speech were that:

- He pushed strongly for increased subsidiarity and states that “the overlapping of powers between levels of governments must be phased out, and the execution of European framework regulations must in principle be transferred to member states and regions”
- Clearly states that “there must not and will not be a European superstate”
- He spent a lot of time criticising ‘Brussels’ and pointless directives
- He did not agree with the election of the Commission President either by European wide elections or by the European Parliament
- Migration – “it will be necessary as far as possible to transfer powers so that basic authority rests with the Community as a whole instead of being at the inter-government level”.
- “The notion that there should be full co-ordination of types of tax and tax rates within the EU must be rejected”.
- “Europe requires two chambers at legislative organs. European Parliament members to continue to be directly elected and a second chamber to be organised along the lines of the Bundesrat (consisting of members of the national governments, directly elected under a European mandate).

**RACHEL COWBURN**

03.03.2002 10:10 INFO: STATISCHES BÜRO DER BUNDESREGIERUNG DEUTSCHLAND

## **The future political and constitutional structure of an extended European Union**

Views held by Sigmar Gabriel, Prime Minister of Lower Saxony

(Foto: Sigmar Gabriel, Member of State Parliament and Prime Minister of Lower Saxony)

**As a contribution to the current debate on the future of Europe, Prime Minister Sigmar Gabriel presented his views on the future structure of an extended European Union on 10 May 2001. The verbatim transcript of his address is given below.**

### **Starting thesis:**

A European Union (EU) which is set to encompass some 500 million inhabitants in the future cannot be run, governed or even administered centrally. Rather, it is necessary to preserve and develop the historical and cultural diversity of Europe by strengthening the member states and regions. The EU must therefore, in addition to its core powers, restrict itself to setting the regulatory framework for the central issues affecting Europe. The overlapping of powers between levels of government must be phased out, and the execution of European framework regulations must in principle be transferred to member states and regions. However, the EU must be granted expanded powers of regulation and sanction to be exercised in the event that member states fail to implement those measures required by the EU.

### **1. The citizens of Europe expect the EU to guarantee both internal and external security and to pursue an effective common foreign policy**

The goal of an integrated Europe can only be successfully achieved if, instead of being decreed "from above" by governments or anonymous administrations, it appeals to the hearts and minds of the people living there. It is therefore necessary that people grow to perceive themselves as "citizens of Europe", for without a "Europe of and for the people" the process of European unification will remain bland and technocratic and is ultimately doomed to failure. Each individual citizen must be able to personally convince him or herself of the benefits of integration; people need to feel that Europe is directly relevant to them and is a daily, tangible reality.

Specifically, this entails the following:

- For the citizens of Europe, an individual's national and regional identity is crucial – something they see as an inalienable right. It needs to be preserved and must remain recognizable, even in a united Europe. European integration cannot be allowed to mean the

approach of this kind can be in keeping with the diversity found within the European continent. To this end, those tasks which are (following careful examination) recognized as not being among the core functions of the EU are devolved back to the nations and regions.

Before the EU takes action, there should be a preliminary procedure of cooperation between member states, since certain political issues only affect specific regions within the Community; these matters include the herring fishery industry in the North and Baltic Seas and olive tree cultivation in the Mediterranean zone. Consequently, for example, Luxembourg would lose its decision-making powers with regard to shipbuilding subsidies, and Finland would no longer have a say in wine market regulations. The EU should therefore only act if and when the partners of an EU region fail to arrive at a solution. There is a pressing need for fields of activity to be more closely integrated in order that member states remain on good terms with their neighbours. This will remove the underlying cause of numerous contentious issues and much bureaucracy in Brussels.

I therefore call for a policy of sectoral and spatial differentiation.

This results in the following approaches for various important thematic areas:

**a. Single market**

Ensuring a well-functioning single market is the central role of the EU. In this capacity it should continue to actively regulate competition by ruling on mergers which affect intra-Community trade and by administering financial assistance, thus ensuring equal opportunities between the member states and regions. However, when overseeing financial aid programmes it must be ensured that the threshold values chosen are appropriate criteria for determining whether the EU should intervene. These levels could be set at € 500,000. It is imperative that Article 94 of the EC Treaty (concerning unification of laws within the single market) is amended to make provision for a majority decision; this will put a stop to the tendency towards decisions being made without reference to the actual issues involved; such decisions result from members' susceptibility to "blackmail" which arises from the rights of veto currently in force.

**b. Regional politics**

In order to avoid extremely large transfer payments in future, there must a sweeping reform of the structural fund: restriction of aid to Objective 1 regions (new: only the membership candidates), a switch from subsidies to loans, setting of deadlines for "catching-up processes", restriction of the duration of aid to a maximum of three funding periods. In the long term this means an end to restructuring aid (including the cohesion fund) for the countries currently comprising the EU region; the need for transition periods

receive powers to draw up framework legislation for traffic-controlling measures, e.g. a ban on transportation of goods by road for distances exceeding 500 km.

#### **f. Environment**

The EU needs to focus on safeguarding important transnational ecosystems. Its basic remit with respect to environmental law should therefore concentrate on the following main areas:

- Safeguarding the functioning of transnational water systems such as the Rhein, Rhone, Oder and Danube rivers;
- Ensuring the protection of seas adjoining EU countries: the Mediterranean, Atlantic Ocean, North Sea and Baltic Sea;
- Regulations covering protection against herbicides and other hazardous chemicals;
- Regulations on air pollution control with regard to the remote emission of air pollutants, and on global climatic protection;
- General responsibility for the designation and protection of nature reserves of outstanding European importance, e.g. the Wattenmeer mudflats, Coto Doñana, and the Po and Danube deltas;
- Transfer of authority for management of the Alpine region in so far as EU states are affected and not able to take intergovernmental action;
- The converse conclusion of this is: no Europe-wide regulations on bathing water quality.

#### **g. Agriculture**

The EU's agricultural policy must be reformed with the aim of forcing down the proportion of agricultural spending by the Community to around 25 per cent by 2010 (it currently stands at 42 per cent). This assumes that farmers are only able to offset their profit shortfalls (caused by the loss of EU subsidies) by recourse to the market. To this end, the quality of their produce – including ecological standards – must be increased on a sustainable basis, and farmers must be allowed to regionally market their products without interference from the EU. Following the recent BSE and foot-and-mouth scares, this would also serve the interests of the consumer.

#### **h. Internal funds**

To date the EU has been dependent on funds allocated by member states which are restricted in amount to 1.27 per cent of the respective gross domestic product (GDP). The EU and its member states should, however, become more mutually independent in their financial management, partly in order to avoid the procyclical processes aimed at enhancing or slowing down the processes of growth. The introduction of an internal EU tax is therefore proposed, based on cross-border movements of goods, capital and services. This would be beneficial since the more effective the functioning of the EU's single market

Armenia and Georgia, provided that they fulfil the Treaty's requirements. The central question in this context is:

**Is the EU – along with its inhabitants - willing and able to absorb these additional member countries into its fold?**

One could take the view that the question can be happily left unanswered for decades, based on the time frame during which these new countries might conceivably join the Union. Nevertheless, we do need to be thinking in these terms already. If a conscious decision were taken to limit the spatial extent of the EU - which, given the possibility of internal movements of workers and the widely differing cultural groups involved, would probably be unavoidable in the long term - then appropriate amendments would have to be made to the relevant provisions of the Treaty in good time.

At the same time, in a European community which is continuing to grow and to become a more close-knit entity, precautions need to be taken and conditions created in order not to economically and politically isolate those countries with no prospects of EU membership. One possible option in this regard would be to promote the formation of economic confederations (roughly comparable with the former EFTA) between certain states such as parts of the former CIS states or the Caucasus region, which, in close cooperation with the EU, could take part in and enjoy the benefits of the single market. With Russia, at least, only one of these forms of collaboration would be envisaged (similar to NATO).

governments, just as the Council is made up of regional government representatives in certain special cases. Directly elected senators would be elected under a European, as opposed to a national, mandate and would not have the means to examine proposed European directives for their implications at national level and the administrative ease of their implementation.

#### **7. A system of equal power sharing between both chambers is required**

The European Parliament must hold the balance of power only in respect of the European core responsibilities. In such cases, the second chamber would merely receive consultative rights. In all other areas, however, greater powers need to be firmly assigned to the second chamber.

#### **8. A constitutional treaty for Europe!**

The European Union needs to be developed along the lines of the core functions which I have outlined. However, this quite categorically does not mean the abolition of nation states or the creation of a central European state – no-one would welcome that. Instead, the future development of the EU should be oriented towards creating a common order. The bodies of the EU need to be protected from their preponderance towards unnecessarily detailed legislation, in order that the principle which the people have come to associate with Europe – namely hope – is preserved. The citizens of the reunited Europe should enshrine this optimism in a new Treaty, which will allay people's fears of an uncontrollable central authority in Brussels and cut back the duties of the EU, emphasising those functions which are required to ensure peace, prosperity and partnership.

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Foreign &  
Commonwealth  
Office

London SW1A 2AH

SE COS  
FA/ARS (RL)  
FA/ARS (MR)  
AC/Pres  
BUP

6 March 2002

Dear Stephen,

**Briefing for the Prime Minister's Bilateral with the Prime Minister  
of Lower Saxony: Thursday 7 March**

... I enclose briefing and a CV for the Prime Minister's meeting with Sigmar Gabriel, Schröder's successor as SPD Prime Minister of Lower Saxony.

Gabriel is visiting London, 6-7 March, to look at the British experience of PPP and to give a speech to a young audience at the LSE on "Germany and Britain: common approaches to EU reform". His meeting with the Prime Minister was fixed at Schröder's personal request. Both see it as an opportunity for Gabriel to increase his international profile with an eye to Land elections in February 2003, where the CDU are currently ahead in the local polls. If re-elected, Gabriel would be a serious candidate to succeed Schröder in due course as the national SPD's Chairman and/or Chancellor-candidate.

The meeting would be an opportunity for the Prime Minister to probe Gabriel for a solution Lower Saxony/Volkswagen could live with on the Takeovers Directive - Gabriel sits on the board of Volkswagen, which is the biggest opponent to the directive within Germany.

The Prime Minister might also briefly discuss the Future of Europe. Gabriel is one of the three German regional Prime Ministers most involved in EU issues - the Länder put the competences issue on the agenda and were the driving force behind the 2004 IGC. The Foreign Secretary's speech of 21 February has sparked

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interest in the UK's approach to the Convention. Gabriel is likely to focus on the ideas around competence, specifically the proposals for a statement of principles setting out who does what, and subsidiarity.

*Yours age,*  
*Mark Sedwill*

(Mark Sedwill)  
Private Secretary

Sir Stephen Wall KCMG LVO  
10 Downing Street

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THE PRIME MINISTER'S BILATERAL WITH THE PRIME MINISTER OF  
LOWER SAXONY, THURSDAY 7 MARCH

Checklist of Topics

**TAKEOVER DIRECTIVE**

- Schröder's recent comments at VW suggest that Germany might not support the proposed Takeovers Directive, even if we get rid of golden shares throughout the EU. Is that true?
- Agreeing common rules for takeovers a key part of creating single market. Can Germany work out solution which protects Lower Saxony's interest in VW, without blocking further progress on the Directive?

**FUTURE OF EUROPE**

- Convention a welcome opportunity to work together to ensure EU can deliver on issues that matter to the people, and make sure we will have effective institutions in an enlarged EU.
- Jack Straw set out some ideas on this in speech on 21 February, including:

Statement of principles setting out in clear, comprehensible terms who does what and where responsibilities lie. Happy to call this a constitution. What matters is content, not label.

One of principles should be subsidiarity. Need to look at how to enforce this better. Possible solutions include using ECJ or ad hoc meetings of national parliamentarians in a second chamber, or meetings of European scrutiny Committees

- Have not designed detail. Interested to hear your views.

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### THE PRIME MINISTER'S BILATERAL WITH THE PRIME MINISTER OF LOWER SAXONY: THURSDAY 7 MARCH

#### Background

#### TAKEOVERS DIRECTIVE

1. In a speech to Volkswagen staff on 26 February, Schröder delivered a sharp attack on the planned EU Takeovers Directive. Last year, the Germans helped to block agreement on the original draft of the Directive, following an eleventh hour change of heart. The justification they gave then was that the existence of golden shares etc in other Member States meant that there was not a level playing field within the Community. Schröder now seems to be suggesting that even if the problem of golden shares is resolved at EU level, the Germans could still use the existence of restrictions in third countries as grounds for blocking progress on the Directive.
2. When Gabriel took over from Schröder as Prime Minister of Lower Saxony, he also took his seat on the supervisory board at Volkswagen. The company is 20 per cent owned by the Government of Lower Saxony, and the Land exercises a disproportionate influence over decision making.

#### FUTURE OF EUROPE

3. The Länder have long sought a deal on competences which would secure their own position. Initially they had hoped for a catalogue of competences, spelling out exactly who does what. But this would be nigh impossible to negotiate, and would remove useful flexibility from the system. The Länder seem to have accepted the catalogue idea will not run, and may therefore be interested in our ideas.

#### LOWER SAXONY

4. Lower-Saxony is Germany's second largest state, after Bavaria, and has a population of 7.9 million (9.6% of the total German population). Over 30,000 British nationals live in the Land, over 18,000 of whom are with the British Forces or are family members. The capital is Hanover, which has historic links to Britain through the royal family.

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5. Land elections took place in Lower Saxony in March 1998, which gave the SPD an absolute majority (SPD 83 seats, CDU 62, Greens 12). Then Prime Minister, Gerhard Schröder, resigned following the general election later that year to become Federal Chancellor. Unemployment (10.2% Dec 2001) and reform of the education system remain the main political issues. Lower-Saxony continues to experience problems caused by reunification and the need to assimilate economic migrants from former Warsaw Pact countries.
6. The region's major employer is the automobile industry, accounting for 21% of employees, followed by the food and drink sector. Major companies with European headquarters located in Lower-Saxony include Volkswagen, Preussag and Continental. Exports to the UK in 2000 were DM 7.17 billion (approx £ 2.2 billion), imports DM 4.12 billion (approx £1.28 billion). There are nearly 50 British companies with direct investments in Lower Saxony, including Reckitt & Colman, BP-Amoco, Coats Viyella, RMC, and Vodaphone, providing employment for 14,000 people.
7. Hanover is an important trade fair centre: the Duke of York will be visiting the city later this month for CeBIT, the world's most important ICT fair.

*[Alison Pinto  
EUD(B) 3464]*

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## Leading Personalities Report

### GABRIEL, SIGMAR



Prime Minister of Lower Saxony since 15 December 1999

Born 1959 in Goslar, Harz (Lower Saxony). An activist in SPD-related youth groups, he joined the SPD in 1977 at the age of 18. Studied politics, sociology and German at the University of Göttingen before becoming a teacher, working in adult education for 7 years.

Member of Lower Saxony state parliament (Landtag) for Goslar-Liebenburg since 1990. He was SPD home affairs spokesman in the Landtag from 1994-1997, deputy chairman of the SPD group in the Landtag from 1997-1998 and chairman from March 1998 until becoming Minister President (one of Germany's youngest ever) following Gerhard Glogowski's resignation after allegations of corruption.

Gabriel set his priorities as education, industry, employment, and Europe. Education is one of Gabriel's specialities, alongside home affairs and modernisation of government, and it is an issue that he believes can help him win the next Landtag elections in 2003. He has promised 2000 extra teachers by then and to fill all teaching posts promptly as they become free. On Europe, he is a keen supporter of subsidiarity and the principle of a Europe of the regions.

Fluent and engaging, Gabriel is self-confident and very much the politician. He is divorced but has a partner. He has a daughter from his former marriage. His hobbies are cycling, sailing and travelling in the Near East.

21.JAN.2002 14:48

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NR. 948 S.2/2



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21 January 2002

FROM THE AMBASSADOR

Sir Paul Lever

*Wle*

Michael Tatham  
No 10

*WPO*

*Yes/No?*

*Michael Tatham*

*MT*  
*cc: JPO*  
*DM*  
*RL*  
*FC*  
*KK*

*1400-1415  
on Thu 7 March*

*cc SM*  
*Wle*  
*yes, photo - op.*

*John Michael,*

**SIGMAR GABRIEL**

Sigmar Gabriel is Schröder's successor as (SPD) Minister-President of Lower Saxony. He will be leading a team of economic experts to the UK from 5-10 March to study PFI/PPP.

Sigrid Krampitz (Head of Schröder's office) rang me today to pass on Schröder's personal request that the Prime Minister see Gabriel for 15 minutes or so.

There is no overwhelming case for doing so. But the balance of advantage favours fitting him in if possible. Gabriel is young (42), a close Schröder protégé, and key reformist ally. He would be on most commentators' short list as a likely future leader of the SPD and as a possible future Chancellor. He takes an interest in European issues and is an important voice in the deliberations among the Länder on the future of Europe.

Seeing him also offers a possible solution to the dilemma of how to handle Stoiber if the latter were to propose himself for a visit to London. I've noted previously Schröder's sensitivity about partners (cf. Chirac) receiving his opponents. But a meeting with Gabriel would establish a defensible precedent for the Prime Minister, should he wish to do so, to see A.N Other important German Minister-President who was in London.

Please let me know how to respond to Krampitz and Gabriel.

*Yours etc*

*[Signature]*

cc: PS/Secretary of State  
PS/Mr Hain  
PS/PUS  
Michael Arthur, FCO  
Kim Darroch, FCO  
Karen Pierce, FCO  
Roger Liddle, No 10

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*Prime Minister.*  
MDDPAN 3839 *Matignon*

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FM PARIS

TO IMMEDIATE FCO

TELNO 147

OF 261617Z FEBRUARY 02

INFO IMMEDIATE EU POSTS

INFO PRIORITY CABINET OFFICE, HM TREASURY, DTI

INFO PRIORITY CENTRAL EUROPEAN POSTS, NICOSIA, VALLETTA, ANKARA

INFO PRIORITY SOSFA, ACTOR, WHIRL

SUBJECT: EU: BLAIR-SCHROEDER LETTER: FRENCH REACTIONS

SUMMARY

1. Vedrine says the Prime Minister's contribution is good news for Europe. Privately, Matignon and Quai appear relaxed about the initiative and interested in the ideas; but, even though they are putting a brave face on it, they must be mildly annoyed, perhaps more with the Germans than with us.

2. Media reaction focuses on absence of France or Franco-German axis in the debate, with a few sideswipes at our contacts with Berlusconi and Aznar, but fair coverage of substance too.

DETAIL

Government reactions

3. Commenting on television last night, Vedrine commended - albeit in a slightly back-handed way - the Prime Minister's "good work" in trying to "make up the ground Britain has lost". He went on to say that no one should be surprised by the Prime Minister's higher profile on European issues, which "is good news for Europe, much better than for Britain to be stuck away in its corner". It was good that EU leaders were rivalling each other "in the good sense of the word" to make credible proposals to take Europe forward. Vedrine went on to note that, far from France being behind the game, some of the UK/German proposals had already figured in Jospin's May 2001 speech.

4. We asked Matignon (Ferrand), Moscovici's cabinet (Pic) and Quai's Director EU (Andriani) for their views. They professed to be relaxed about the initiative and welcomed the fact that it had been mentioned to Jospin in Stockholm. All made a point of noting that French thinking on these issues was pretty similar to ours. Andreani expressed strong approval of the thrust of your The Hague speech, and hoped for bilateral discussions soon (she may raise this with Darroch when in London on 4 March). Ferrand recalled

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that the announcement of Jospin's candidature had included an intention to make proposals on "political Europe". Work was under way, though timing was not fixed: Ferrand assured us the content would not be difficult.

#### Press reactions

5. The widespread press coverage focuses on the "deafening silence" (Figaro) on these issues in Paris and the supposed disappearance of the Franco-German axis as a factor in the discussion. Les Echos (=FT) notes that, on top of the Prime Minister's joint statement with Berlusconi on Barcelona, this is the second time France has been out of the picture in two weeks. La Tribune and Le Figaro note that Jospin was at Stockholm as well and could have been invited to sign the letter. (Comment: the obvious institutional problem for Jospin is that, even if he had been asked, he could not have joined in as French Prime Minister without Chirac's authorisation.)

6. Some of the newspapers use this as another opportunity to comment sarcastically about what they make fairly clear they see as the UK's alliances of convenience. Le Figaro attributes the initiative to a desire for publicity. La Tribune interprets it as another element of the Prime Minister's "rushed strategy to catch up in Europe", and a way of showing that the Franco-German relationship is weakened.

7. Nevertheless, the substance is covered fairly as well, though with a near-consensus that, with the exception of QMV, there is not much really new in the proposals. Le Figaro warns of the risk of the smalls being ignored if tours de table are abandoned; it is also sceptical about increased transparency in Council business which, though it plays well with "Anglo-Saxon and Nordic public opinion", is little more than cosmetic - anonymous quotes from European diplomats confirm that real negotiations take place in the corridors anyway. La Tribune is cutting about the objective of "efficiency", and Liberation uses the focus on the Council to confirm its suspicion that Britain's intergovernmental inclination is as strong as it always was.

#### COMMENT

8. Coming so soon after your speech in The Hague, this joint letter will help to erode the fixed idea in France that Britain is always a backmarker on European integration. Press scepticism over the Prime Minister's motives was predictable, and is eclipsed by the very thinly veiled criticisms of Jospin and Chirac for not being party to the initiative.



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9. Although the French are putting a brave face on things, they will be at least slightly annoyed - probably more with the Germans than with us - to have been wrong-footed in this way, as the ambivalence implicit in Vedrine's comments implies. Certainly neither Chirac nor Jospin will welcome renewed comment on the decline of the Franco-German relationship. And the episode will have reinforced in the minds of politicians and officials the disadvantages of cohabitation if France's aspirations for leadership in Europe are to be effectively pursued.

HOLMES

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PCLNAN 1549

NNNN

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*Facsimile 1.3.02*  
*Prime Minister*

MDDPAN 3779

*Matthew Rynne*

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FM BERLIN

TO IMMEDIATE FCO

TELNO 91

OF 261522Z FEBRUARY 02

INFO IMMEDIATE ACTOR, CABINET OFFICE, CGS GERMANY, EU POSTS

INFO IMMEDIATE HM TREASURY, WHIRL

*Good ✓*

Berlin telno 88

SUBJECT: EU REFORM: BLAIR/SCHROEDER LETTER: FURTHER REACTIONS

CABINET OFFICE PLEASE PASS TO NO 10 FOR WALL, PRUCE

CABINET OFFICE FOR BUDDEN

HM TREASURY FOR LAWRENCE, ROGERS

SUMMARY

1. Full and generally positive coverage of Blair-Schroeder letter. Praise for GB's constructive role in EU and comments on stalled Franco-German motor. Some criticism that letter is timed to undermine convention and show that governments are in charge.

DETAIL

2. The Blair-Schroeder letter on Council Reform has produced a thick wad of largely favourable German press cuttings. All the national broadsheets include detailed accounts and most provide comment as well. The letter also featured on yesterday's (25 February) main TV evening news.

Content

3. The press report almost universal welcome for the substance of the letter, with favourable quotes from Brok and Haensch, the German MEPs represented on the convention. The SPD spoke of "bold proposals" and the CDU/CSU opposition said the initiative went in the right direction. Frankfurter Rundschau (left-of-centre) comments that "the content of the letter... is spot on."

The constructive nature of British policy

4. Several papers note the increasingly constructive nature of British EU policy. Die Welt says that "Blair, his foreign Minister Straw and others recognise enlargement as an opportunity to turn towards Europe... and want to participate in shaping Europe." FT Deutschland says "in Blair, Britain has a leader who wants to anchor the UK firmly in a modernised EU and is also ready

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to share national sovereignty with other countries..." FAZ says "The fact that Blair appears as co-author of this letter so shortly after his deregulation initiative with Berlusconi and Aznar reveals the will to create a focal point for European progress.." Handelsblatt (economic, liberal) says " you only have to look at the Irish referendum on Nice to see how quickly the British euro referendum could become a referendum about the future of Europe. If the architects of the future of Europe do not want to overstrain Blair and the British they have to understand this connection better. Straw's speech showed that Great Britain is prepared to take on a constructive role in Europe. But it also shows that the tolerance threshold of the British - is more clearly formulated than elsewhere."

#### Criticism of timing and motive

5. Both Tagesspiegel (Berlin, centre) and die Welt (conservative) report suspicion in the CDU/CSU that the timing of the letter is aimed at undermining the convention. The Taz (left-wing) agrees - "there is a simple reason why some EU leaders have realised why Metternich-style diplomacy is no longer appropriate: If the Council doesn't reform itself a bit, the convention will do a more thorough job ..." Frankfurter Rundschau is also critical: "anyone who throws a paper of this weight into the European ring four days before the opening of the convention should not be surprised if some partners, above all the small ones, become mistrustful." The Frankfurter Allgemeiner Zeitung (centre-right) and others also comment that the UK's motive is to show that "governments, not the Commission, remain in charge of Europe."

#### The end of the Franco-German relationship?

6. The other prominent theme is the alleged death of the Franco-German relationship. Welt says that "London at Berlin's side is a European revolution. It is an admission that the Franco-German motor is not working..." FAZ says "the old Franco-German source of ideas is dry". And under a headline "Adieu Paris - hello London" the Sueddeutscher Zeitung (centre-left) says that in the letter the two leaders from Berlin and London have asked the question, who's in charge in Europe" adding that "the letter shows who has nothing to report on the continent at present - the French... until recently, such a detailed initiative would only have been conceivable as a German-French initiative. The German Chancellor has evidently lost his patience with the "traditional friends" on the other side of the Rhine..."

#### Kanzleramt reaction

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7. When we spoke to Silberberg (Director EU, Kanzleramt) on other business on 26 February he expressed delight at the positive coverage of the joint letter in the German media. It just went to show, he said, what you could achieve by close co-operation.

8. Contact: Susannah.Simon@fco.gov.uk Tel: 0049 30 20457 331

CRESSWELL

YYYY

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TSY SOLS//M C THOMAS	1	WELSH ASMB	1
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Financial Times  
22 Feb 2002  
Page: 28

# Schröder, Murdoch meet in secret

By Hag Simonian and Hugh  
Williamson in Berlin and  
James Harding in London

Gerhard Schröder, German  
chancellor, and Rupert Mur-  
doch, the News Corporation  
chairman, met for secret  
talks in Berlin this week to  
discuss the future of the  
embattled Kirch group.

Government officials  
declined to confirm that the  
meeting, understood to have  
been requested by Mr Mur-  
doch, had taken place,  
reflecting the acute sensitivi-  
ty about any hint of politi-  
cal intervention.

Mr Murdoch is understood  
to have been keen to calm a  
brewing national sense of  
crisis about the possibility  
that he would exploit the  
crisis at Kirch Gruppe to  
take a slice of the German  
media landscape.

The News Corp chairman  
is understood to have told  
Mr Schröder that what he  
has been saying recently in  
public is what he plans to do  
in private. This means that  
he is not interested in any of  
the assets owned by Kirch,  
which include Germany's  
biggest TV stations and a 40  
per cent stake in the Axel  
Springer publishing group.

Instead, Mr Murdoch rei-  
terated to the German chan-  
cellor that he wants to  
recoup the €1.7bn (\$1.48bn)  
invested in Kirch.

While officials have  
acknowledged the chancel-  
lor is following matters  
closely, they have consis-  
tently claimed he is not  
engaged in negotiations.

However, politicians from  
both Mr Schröder's Social  
Democratic party and the  
opposition made no secret of  
their concern should Mr  
Murdoch gain control over  
important Kirch assets,  
notably its 40 per cent stake  
in Springer, Germany's lead-  
ing newspaper group.

Eckhardt Barthel, SPD  
parliamentary spokesman  
on the media industry, said  
the government was still  
committed to a "national  
solution": "Mr Schröder is  
not interested in opening  
the door for Mr Murdoch."

Another member of parlia-  
ment said: "What would be  
best would be a solution  
which would allow us  
greater variety in media  
ownership, but also fit in  
with German culture and, as  
far as possible, be pro-Euro-  
pean as well. That doesn't  
sound like Murdoch."

Handwritten initials "JP" circled in black.

Handwritten notes: "Pm", "N see", and a signature.

A large handwritten checkmark.

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**From:** Stephen Wall  
**Date:** 21 February 2002

**PRIME MINISTER**

**cc:** Jonathan Powell  
Alastair Campbell  
Sally Morgan  
Jeremy Heywood  
David Manning  
Roger Liddle  
Geoff Mulgan  
Michael Tatham  
Sir Richard Wilson  
Sir Nigel Sheinwald  
(UKRep Brussels)  
Kim Darroch (FCO)  
Martin Donnelly (CO)

## **BILATERALS IN STOCKHOLM**

This brief covers Schröder (Friday evening, after dinner), Jospin (breakfast on Saturday morning) and Wim Kok (any available corner).

## **SCHRÖDER**

He will want to talk to you about the elections. Paul Lever's latest assessment is attached. On Europe, I suggest you cover:

- Barcelona. No sign yet of any stitch-up between the French and Germans this time. And we know Schröder has told Aznar he is up for language on labour market flexibility. Useful to confirm that the Germans are on board for a target date for liberalisation in the commercial energy sector. But that they, like us, will avoid paying too high a price to get the French on board. You should take Schröder's mind on whether the French will settle for language on

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services of general economic interest to help their domestic presentation and drop their demand for a directive, which would risk enshrining uncompetitive practices.

- On the Future of Europe, it would be useful to sign Schröder up for a suggestion his guy has made to me that after the French elections, we, the French and the Germans should quietly get together to work out positions for the Convention. In the meantime, you and Schröder will be signing a joint letter to Aznar (copy attached) on the Future of Europe. This is welcome public recognition by the Germans for the first time of the primacy of the European Council. It probably reflects Schröder's irritation with the Commission over their handling of the Stability and Growth Pact.
  
- The German cabinet will take a decision on Galileo next Wednesday (27 February). The German treasury, like ours, are still fighting to halt the project, but I doubt if that is possible. If you get the sense from Schröder that they will go along with the project, we need to get him, in turn, to agree to work with us on pinning the Commission down to the following conditions:
  - (i) **financial safeguards** governing the release of any additional public sector funding and movement to subsequent stages of the project;
  
  - (ii) a **management structure** that avoids conflicts of interest for the private sector; and
  
  - (iii) **no military application** for Galileo, which might compromise NATO's use of GPS and seriously upset the US.

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- Schröder may raise enlargement. Our policies are very close. They want to conclude with the candidates this year, including Poland. They (like us) think the Commission have been too generous in offering direct agricultural payments to the candidates and would like secure agreement that they should be digressive over time. The trick will be to secure this without being held responsible for delaying the negotiations and without giving the Spanish the pretext to open up other bits of the *acquis*, like the Structural Funds. We have effectively put the Commission on notice that if they want a deal on direct payment they must come up with good agricultural reform proposals in their July mid term review. To achieve this will require us to keep our nerve through the Seville European Council (21 June).
- Worth talking to Schröder about the Spanish plan for a Mediterranean Development Bank. The separate bank which they and the Commission want would be expensive, would compete with the EIB and undermine the African Development Bank. All the same objectives can be achieved (albeit without the flag waving the Spanish want) by an EIB subsidiarity or EIB facility.

On foreign policy issues, Germany is being helpful over Afghanistan and making clear it envisages keeping troops there after the UK stands down as lead nation. It would be useful to encourage Schröder to reinforce our efforts with the Turks. Schröder will be concerned about the signals from Washington on Iraq because of the capacity for any action here to complicate his election campaign (he would need to balance his pro-US instincts with the need to avoid upsetting the party faithful).



Other points: you should emphasise the strategic importance of the NATO/Russia proposals. Worth nudging Schröder to exert German influence on both sides in India/Pakistan. You could thank him for Germany's decision to extend its spell as framework nation for NATO's Amber Fox mission in Macedonia. Schröder may raise the Middle East (Fischer has just been there). You should also be aware that Schröder has just paid a two-day visit to Mexico.

### **BREAKFAST WITH JOSPIN**

/ Both Chirac and Jospin have formally declared their candidatures (see attached telegram from Paris on Jospin's announcement).

The main substantive issues to raise with Jospin are Barcelona and the lack of gendarmes to protect SNCF rail freight services through the channel tunnel. The French have shown us their own position paper for Barcelona, though it has yet to be cleared with Chirac and may get watered down. The main difficulty from our point of view is its emphasis on greater coordination of tax issues (though the French are, I think, right to raise the issue of the need for this in a single currency zone). We need to hear from Jospin that he is prepared to make a move on energy liberalisation, notably agreeing to a target date (preferably 2004, and certainly no later than 2005), for opening up the commercial sector in gas and electricity to competition. But he will be suspicious that we want to put him in a corner and score a victory over him, which would be damaging to him in electoral terms. So the move that we think he is prepared to make may have to be teased out of him. In exchange, he will undoubtedly want something on services of general economic interest (as above) allowing him to portray himself domestically as holding back the tide of Anglo-Saxon liberalisation. We could

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not agree to a directive, but we could agree to some language and will have something in our back pocket which we could share with his people if the discussion looks promising.

On rail freight, inadequate security at the Frethun freight yard means SNCF is still running severely reduced services. This is causing serious economic damage to UK (and French) firms. The Rail Freight Group says its members are losing £8m a week while EWS, which today called on you to raise the issue with Jospin this weekend, says it has lost £5m and that 8,000 jobs are on the line. SNCF have completed a perimeter fence around Frethun, but other security measures (eg CCTV) need urgent completion. SNCF and EWS also say that inadequate cover by the gendarmarie (only present between 2100 and 0300 nightly) makes it impossible to increase services. There are no signs that the French are addressing this, despite prodding from Stephen Byers and David Blunkett. You should prod again, particularly on gendarmes.

Poor security at Frethun means that the number of would-be asylum seekers on SNCF freight trains has risen again (100 entered the UK last week) and we may have to reimpose the civil penalty. No need for you to raise with Jospin, but if he raises it with you I think you should be pretty robust. These are people on French territory for whom the French government have to take some responsibility. Another reason for stepping up security.

On asylum, official level discussions have taken place with the French on the idea that we should try to process the asylum seekers in the Sangatte camp in exchange for the camp then being closed. We made little progress because the French are pushing a system that would involve the UK taking most of Sangatte's

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residents without reducing illegal immigration pull factors. Further talks are planned. You might make clear that any solution must deal with both issues.

You should also raise British beef imports. It is over two months since the court judgement and the French are absolutely clear that they are not going to make any move before the elections on lifting the ban. We are urging the Commission to take them back to the court so that fines could be imposed. The Commission will do this but are (understandably) not pushing the issue before the election.

Worth touching on the Future of Europe, where our ideas and French ideas are pretty close, and to suggest that after the elections it would be useful to have more detailed discussion of common positions.

Jospin may want to touch on foreign policy issues. On ISAF, the French are ready to stay on after we relinquish the lead but they are very chary about geographical expansion. Jospin is uneasy about the prospect of US military action in Iraq and possible consequences for the region – he may raise this.

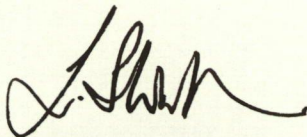
## WIM KOK

I gather he is mildly miffed that you did not take up the offer to deliver the Den Uyl memorial lecture at the beginning of this year. The general election in the Netherlands is on 15 May and, although Kok will stay on for several months thereafter during the formation of the new government, he is, of course, already on his way out and you may not want to invest much more time in the relationship. However, his chosen successor, Melkert, will probably be the next

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/ Dutch prime minister, so you might think of doing something in The Hague before mid-April. This would be *de facto* your last hurrah with Wim Kok and would give a boost to Melkert, but before the campaign opens and therefore in a way which will avoid you then having to see every other Dutch prime ministerial candidate.



STEPHEN WALL

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Foreign &  
Commonwealth  
Office

London SW1A 2AH

21 February 2002

*MT*  
*cc JPS*  
*Om*  
*RL*  
*Pres*  
*AVP*  
*JS*

Dear Michael,

**Stockholm Progressive Governance Summit, 22-23 February:**  
**Prime Minister's Bilaterals with Jospin and Schröder**

... The Prime Minister will have bilaterals with Jospin and Schröder in the margins of the Stockholm Summit this weekend. I enclose briefing. Briefing for the Prime Minister's other bilaterals and pull-asides is being sent separately.

**Jospin**

... I enclose Paris terno 130, which gives background to Jospin's candidacy for President. The Prime Minister will want to raise European issues, Afghanistan and the fight against terrorism, the NePAD/G8 Plan for Africa, immigration and asylum issues and the French beef ban. We understand Jospin might raise the UN Conference on Financing for Development.

The Prime Minister's meeting will provide an opportunity to explore French reactions to our ideas on the **Future of Europe**, raised in the Foreign Secretary speech in The Hague on 21 February. It is a chance to reinforce our commitment to reform of the Union and our aim to make a positive contribution to the Convention. On the whole, the French are thinking on similar lines to us on reform but, as ever, seek a high degree of centralisation (and French influence). The Prime Minister has not seen Jospin since he discussed these issues with Giscard on 4 February.

Despite a public commitment to **enlargement**, the French are clearly concerned about the financial and institutional implications, as the Prime Minister will recall from his meeting with Jospin at the UK-French Summit. Although we do not believe they are seriously interested in blocking enlargement, we could nevertheless take this opportunity to press Jospin to clarify French attitudes: what are their real difficulties? – purely financial, fears of weakening the institutions, implications for the CAP?



The French are signalling strongly that they are looking for a deal at **Barcelona** involving dates on industrial/commercial energy liberalisation, in return for recognition of the special character of public services, and maybe agreement on further reflection on economic government of the Eurozone. We should see how strongly Jospin pushes this (Chirac's views are not yet absolutely certain). But for the moment it is probably in our interest to respond fairly non-committally, to keep the pressure up.

The Prime Minister might want to seek continued support in persuading Turkey to take over as lead nation of ISAF in **Afghanistan**. He might also like to acknowledge French concerns over geographical expansion of ISAF, but make clear that there is benefit in considering the possibility carefully. In addition, the Prime Minister might consider encouraging strong political support for the Loya Jirga and the Interim Administration.

Both Jospin and Vedrine have been critical in public of US policy on the next steps in the **fight against terrorism** and President Bush's 'axis of evil' speech. The Prime Minister should persuade Jospin to pursue a more productive dialogue and make a real effort to engage with the Americans themselves, to understand where they are coming from, to express reservations where necessary, but also to offer ideas and constructive analysis if at all possible.

It would be useful if the Prime Minister could raise the importance of the **NePAD/G8 Plan for Africa**.

The Prime Minister should thank Jospin for recent fruits of UK/French co-operation on **immigration/asylum issues**, eg juxtaposed controls and increased prosecutions of facilitators. But the Prime Minister should make clear (Jospin will likely suggest it) that co-operation has not been one way – we have been willing to help French hauliers understand the civil penalty; offered security surveys of Eurotunnel and Frethun; and built and staffed a detention centre at Coquelles. Close co-operation benefits us both. The Prime Minister should also reiterate that adequate security measures (including extra gendarmes) should be put in place rapidly around Frethun both to allow urgent resumption of full SNCF freight services and to prevent illegal immigration.

The Prime Minister should ask Jospin about steps they are taking to lift the **beef ban**. They continue to defy the ECJ ruling.

We have heard via our Embassy in Paris that Jospin is increasingly interested in the **UN Conference on Financing for Development (FfD)**. In particular, he may raise French reactions to the EU's package of concrete measures (proposed by the Commission and discussed at the 18 February GAC).



If endorsed, the package will be announced at the Conference. The UK has played an active and important role in preparations for the Conference and is keen to see a success. But there are strong expectations from G77 and civil society that the EU will announce actions and commitments, which go above and beyond the Conference outcome document. It is vital, if the FfD process is to make the impact we want and lay the foundations for future development work in the UN, that the EU does so. Jospin will also be interested in UK attendance: Chirac is expected to go but not Jospin, so he might prefer that the Prime Minister did not attend (for French elections purposes!).

### Schröder

We expect Schröder to raise the Future of Europe debate/Convention, Enlargement/CAP reform and Afghanistan. The Prime Minister will also want to use this opportunity to raise the Barcelona agenda, A400M and to probe Schröder's views on the forthcoming German elections. He might also raise the NePAD/G8 Plan for Africa. The attached telegram (telno 83 from Berlin) focuses on the SPD's election prospects.

On **Future of Europe/EU Convention** the Prime Minister may want to probe Schröder for a reaction to the Foreign Secretary's speech in The Hague on 21 February. It will also be an opportunity to reinforce UK commitment to reform of the Union and our aim to make a positive contribution to the Convention. The Prime Minister might like to recall that Peter Hain went to the SPD/Labour Working Group this week, looking at the German elections.

On **Enlargement/CAP Reform**, the Prime Minister should seek to emphasise to Schröder that the German take on enlargement and CAP reform is the same as ours – the two issues should not be formally linked, but we need to force others to recognise the connection, and both issues need to be pushed hard in parallel this year. As traditional proponents of early CAP reform in parallel with enlargement, we will want to keep in close tactical contact with the Germans, the Dutch, and others, to ensure that direct payments are, at most, an end-game concession, and not a starting point in negotiations with the candidates.

On **Afghanistan**, the Prime Minister will want to get continued German support to persuade Turkey to take over as lead nation of ISAF. He may also want to welcome the German role in assisting the Afghan Police Force and encourage strong political support for the Loya Jirga and the Interim Administration.

The Prime Minister may want to use this opportunity to push Schröder to support the **Barcelona process**. The Germans have said they 'do not want another Stockholm'. Last year's last-minute French/German deal on energy has become a source of embarrassment to a government keen to sell its own brand of



liberalisation. But Schröder will come to Barcelona with an election on his mind. So we need to be aware of German sensitivities, such as pushing too much on labour market reform. This is also an opportunity to gauge Schröder's personal thinking on Galileo.

The Prime Minister may also want to raise A400M with Schröder and emphasise the need for an unqualified German commitment to the A400M contract as agreed through the Inter-Governmental Agreements (IGAs).

I am copying this letter to Sir Stephen Wall (No 10), Jonathan Sedgwick (Home Office), Peter Watkins (MOD), Mark Bowman (HMT), Bernadette Kelly (DTI), Anna Bewes (DFID), Sir John Holmes (Paris) and Sir Nigel Sheinwald (UKRep Brussels).

*Yours ever,*

*Patrick*

(Patrick Davies)  
Private Secretary

Michael Tatham Esq  
10 Downing Street



**STOCKHOLM PROGRESSIVE GOVERNANCE SUMMIT, 22-23  
FEBRUARY: PRIME MINISTER'S BILATERAL WITH SCHRÖDER**

**Checklist of Topics**

**Future of Europe/Convention**

- **Convention:** Enthusiastic. Looking forward to wide-ranging discussion. UK will be constructive, engaged, and open-minded. No UK blueprint. We shall contribute ideas, as in Secretary of State's speech, but will be open to others too.
- **UK objectives:** to make the EU more efficient and effective in delivering the benefits our citizens expect.
- **UK position** is more subtle than often represented. Not a case of classical inter-governmentalism over the Community method. We think *all* the institutions should be strengthened, and institutional balance maintained.
- But **European Council** is only body that can provide political impetus and strategic agenda. But it must work in partnership with other institutions to achieve these aims. We don't want to strengthen Council in order to weaken Commission and Parliament. Foreign Secretary's speech on Thursday brought up some of our specific ideas.
- **Council reform:** important to pursue through Solana report to Heads at Barcelona, as well as in Convention for those aspects needing treaty change.

**Enlargement/CAP Reform**

- Must get through the difficult budgetary issues in time to stick to our timetable of ending negotiations this year. Solutions must be affordable and sustainable, especially on agriculture.
- This means further CAP reform. Should work together closely to make progress on early CAP reform under the Danish Presidency, in parallel with the enlargement negotiations, making use of this year's mid term review. Your views?
- CAP reform should not be made a precondition of enlargement. This would only serve the interests of those that want neither CAP reform nor enlargement. But equally, nothing in the enlargement negotiations should impede CAP reform in 2002/3.
- We have a common agenda: budget necessity; economic logic; sustainable rural development; food safety and quality. And in addition to Enlargement, removing tariffs and subsidies essential for international development. What about French prospects after the election? Unreformed CAP will cost them too.
- Must keep Poland up to the mark, both in the negotiations (e.g. on outstanding issues such as Taxation, Free Movement of Capital and Fisheries) and on the ground in preparing to take on the *acquis*.

### **Afghanistan/Counter terrorism**

- In order to plan for ISAF hand-over we **need urgent confirmation** that the Turks will take over.
- Important to make clear to the Turks that their decision on the Lead Nation role is not connected to thinking on expansion of ISAF. ISAF will carry out existing mandate for the period April-June.
- Welcome Germany's assistance to the **Afghan Police Force**. The UK is glad to have been able to support the police in Kabul with the provision of communications and other basic equipment.
- The campaign against terrorism **will** be extended from Afghanistan to other countries of concern.
- We share the US commitment to address the global terrorist presence. But the campaign does not necessarily mean military action - diplomatic, financial and developmental measures can also help.
- Understand your concerns about extending action. It is for all countries to decide how best to contribute to and shape the campaign.

### **Barcelona/Galileo**

- Demonstrating the reform agenda is on track is key to building consumer and market confidence in the EU – and in the euro, which is in all our interests.
- Signs are that French will accept something on energy liberalisation – but this cannot be at any price, must retain ultimate goal of domestic liberalisation, even if no date. This is what we all agreed at Lisbon. Do you agree?
- Important we remember that overarching goal of Lisbon is job creation – should focus on this objective, and avoid excessive focus on different means of achieving it.
- Understand some in Germany ready to unblock Galileo decision. Can't delay indefinitely. But we still share concerns – e.g. on cost and military application. So important we work together on attaching tough conditions to any decision

### **A400M**

- We need unqualified commitment from Germany to the A400M contract through the Inter-Governmental Agreements (IGAs).
- The UK needs the contract set by 31 March 2002, to protect an already challenged UK In-Service date.
- We want to see this programme move forward. All our effort, with our partners, is on bringing the contract into force.

[If pressed]:

- Whilst UK is not actively considering other options, it could be forced to do so if A400M contract-let were to be delayed significantly.

#### **NEPAD/ G8 Plan for Africa**

- We attach real importance to building a new partnership with Africa through the G8 Africa Plan. An historic opportunity. Working with a new leadership. Are making clear to them that we need to see signs of real change on governance – not just words.
- Long term threat posed by Africa's growing marginalisation from the global economy.
- Want the G8 Plan to be the launch of a new relationship – long term. If African leaders are prepared to tackle the big issues (eg creating a serious peer review process) we should help too. That means aid and trade, but also help to create a good climate for investment.
- Trade issues must form a central part of the agenda – Africa accounts for only 1.5% of world trade. If African countries are to end their economic marginalisation we must make our markets more open to their agricultural products. EBA showed the way, but still work to be done within EU to improve access to our markets for African agricultural exports.
- Aid. It's vital that aid levels are maintained to help fragile African economies withstand the impact of 11 September. It's estimated that Africa stands to lose \$1bn in balance of payments. Much could be done to improve the quality of the aid the G8 already gives.

(Possible counter-arguments)

The Africans don't seem very serious, we have heard all this before.

- True that not all understand the NePAD process, but our interest is to work with those that do and demonstrate that Africa can make progress if their governments keep the right policies.

Africans are just asking for money. Government can't afford extra resources for Africa in an election year.

- The NePAD and the G8 Plan are not just about aid volume. There is much to do on improving the efficacy of the aid we do give. And much more we could all do to help Africa on trade etc.

**[If raised]:**

#### **Stability and Growth Pact**

- Very happy with this example of UK-German co-operation. The outcome was a triumph of common sense.

- We have very similar ideas both about the fundamental importance of the SGP and the need for an intelligent interpretation. Where countries are clearly pursuing appropriate policies, the Commission's analysis should reflect this.

## STOCKHOLM PROGRESSIVE GOVERNANCE SUMMIT, 22-23 FEBRUARY: PRIME MINISTER'S BILATERAL WITH SCHRÖDER

### Background

#### Future of Europe

##### The Convention:

1. The Convention will have its inaugural session on 28 February. The Laeken Declaration committed participants to a broad discussion of all possible proposals, with open questions, posed in neutral language, and agreement that the final report will reflect options (or recommendations where consensus is reached). The main body of the text includes an emphasis on delivery and reconnecting with the people.

##### Foreign Secretary's Speech:

2. The Secretary of State made a keynote speech on 21 February, laying down some of the Government's initial ideas on institutional reform. These included:

- **Council:** aim to improve Council's ability to set strategic agenda. Ideas include: elected Presidents of every Council formation for a longer term of office; possible extension of this idea to the European Council itself; reducing the total number of formations with rules for ensuring fair rotation system; annual strategic discussions of EU priorities in the European Council.
- **Commission:** no elected Commission President (must retain independence); reduction in size (UK prepared to contemplate not having a Commissioner for periods of time); formalisation of EP cross-examination Commissioners.
- **Parliament:** raise profile by building closer links with our national Parliaments; EP should look at ways systematically to cut down unnecessary EU activity and law.
- **Subsidiarity:** doubtful about a catalogue of competences, but see merit in a statement of principles.
- **Extension of QMV:** e.g. in asylum and immigration; and to the European Council itself.

##### German Views:

3. The German government's broad objectives are not too different from our own: to improve the EU's ability to deliver policy efficiently, particularly in an enlarged Union; and to improve the transparency and democratic legitimacy of its institutions. And they share some of our institutional concerns - e.g. the size of the Commission, the functioning of the Council (you are drawing up an UK-German letter on Council Reform with Schröder), the 6 month Presidency of the Council, the need for treaty simplification and the need to involve national parliaments more.

4. But German solutions - especially those from Fischer (Green) and the foreign ministry - are traditionally more integrationist and less intergovernmental than ours:

- Radical Council reform is traditionally lower down the agenda, with Germany wishing rather to alter the institutional balance in favour of the Commission and Parliament: the Blair/Schröder joint letter will therefore mark a new departure for the German Chancellery;
- Rhetoric in favour of more communitisation and fewer strictly intergovernmental practices, with the extension of QMV and co-decision: while the UK is not against these, Germany has tended to support them across the board;
- Strong support for incorporation of the Charter of Fundamental Rights into the Treaties and, eventually, for an EU constitution.

5. Schröder is not blindly committed to the European Project in the same way as his predecessors. His interest is in 'what works' and in policies meeting the German interest. Despite his recent combative relationship with the Commission, he has traditionally accepted more integration and the Community method as best placed to provide that.

#### **Enlargement/CAP reform**

6. The Commission tabled its framework paper on financing enlargement on 30 January, together with a more detailed paper on how to apply the CAP to the candidate countries. The Commission's proposals are generous. We have questioned whether some of them (e.g. on Structural and Cohesion Funds) make sense in the light of candidates' absorptive capacity. And we continue to make clear that while CAP reform is not a precondition of enlargement, neither should the enlargement negotiations prevent reform from proceeding in parallel.

7. Germany has taken a similar position to our own. As the biggest contributor to the EU budget (25%), Germany is reluctant to go beyond the agreement made at Berlin and extend CAP direct payments (income support) to the candidates. And Germany's current economic situation means that it is cautious about committing itself to future, increased, budget contributions. Germany has argued that, by raising the issue of direct payments now, the Commission has forced the debate on CAP reform. They, like us, are looking to the Mid Term Review for a signal to begin a separate, but parallel, debate on CAP reform which will include the phasing out of direct payments for the existing Member States. Their domestic pressures are similar to ours: on one hand driven by a surge in consumer concern resulting in calls for safer, higher quality food; on the other driven by budgetary restraint.

8. Co-operation between Mrs Beckett and her German opposite number (Ms Künast of the Green Party) has been good. Conversely the French have almost given up trying to pretend they have a common agenda with the Germans on CAP. Still, Länder pressure may inject some caution into the German position before the elections – which may mean discussion on the mid term reviews is curtailed until October/November. And even if a Red/Green coalition wins in September, there is no guarantee the Greens will keep Agriculture.

9. Germany shares both (a) our desire that Poland should be in the first wave and (b) our concerns about their slow recent rate of progress both in the negotiations and on

the ground in preparing for membership. We should encourage Schröder to send firm messages to the Poles.

10. The Germans have a particular take on Cyprus, given the domestic politics caused by 2 million Turks in Germany; in an election year, generosity to Turkey is not a vote winner. So Schröder may raise concerns about the EU offering 'something for Turkey' in exchange for their help in resolving the Cyprus problem before accession, in advance of September's elections. The timing should work; we don't want to hint at anything to the Turks until they have been helpful on Cyprus – and that may well not happen until after September.

#### **Afghanistan/Counter-Terrorism**

##### **ISAF Lead Nation**

11. Turkey has offered in principle to take over from the UK as ISAF Lead Nation after the first three months (in mid April). However, they have not yet formalised the offer, despite the Foreign Secretary's meetings with Prime Minister Ecevit and Foreign Minister Cem in Istanbul on 12 February. The Turks still have concerns over funding and logistics and are questioning whether the Interim Authority really wants the Turks to take over. During the Foreign Secretary's visit to Kabul on 15 February he pressed Karzai to telephone the Turks to make clear that he welcomed their assumption of the role as Lead Nation.

12. We need to receive a Turkish response soon, and would welcome **German assistance in pressing the Turks**. The MOD have set an internal deadline of 26 February for the Turkish decision. The Turks are not aware of this deadline: we have been careful not to give the impression that we have any doubt that they would take over. After that date, the MOD will have to make planning assumptions that the Turks will not take over. It needs handling tactfully: at one point, the Germans were interested in taking over.

##### **Expansion of ISAF**

13. The Afghan Interim Administration, and Kofi Annan and Brahimi, have been pressing ISAF to expand its mandate beyond Kabul. We accept that the potential benefits are huge, both in terms of increasing security and stability and of strengthening the transition process. However, there are also very large practical difficulties, as well as increased costs and troops numbers. FCO and MOD are discussing the options at present, in consultation with the US whose support is essential due to the immense practical difficulties in operating in such an environment.

##### **Security Sector Reform (SSR)**

14. At the Tokyo Conference, the UK was invited to lead on reform of the Afghan Army. At the same time, the **Germans offered to lead on reform of the police service**. The MOD are currently drawing up project proposals for a scoping study, led by Defence Advisory Team, to investigate Afghan security requirements, and report back by mid-April.

15. We have agreed to supply the Kabul police with communications equipment (£126,000) which will link the various districts with ISAF and the Ministry of Interior. This will improve the police's ability to do their job. In addition we are

proving assorted basic equipment to further enhance this ability (£64,000 for torches, whistles, notebooks, maps, etc).

16. It is essential that Security Sector Reform is looked at holistically, including a National Police Force, Border Control Force and Judiciary as well as the Afghan Army. It is important that the Afghans should feel that they are leading the process, in order to prevent any perception that foreign nations are imposing solutions on them. The FCO have drawn up a paper on the way forward on SSR, which is now being shared with the Americans to agree a joint way forward.

#### **Afghanistan - political**

17. Hamid Karzai's Interim Administration has a sixth month mandate, following which an emergency Loya Jirga (traditional Afghan council) will select a Transitional Authority which will administer for a further 18 months. Then a full Loya Jirga will choose a "permanent" government under a new constitution. But Karzai's position, and his administration, is fragile (as was demonstrated by the recent flare up of fighting in Gardez) and requires strong political support that strengthens the transitional process.

#### **Counter Terrorism**

18. 'Phase 2' of the campaign against international terrorism is already underway and proceeding on the right lines. The US has respected the wishes of the Yemeni and Philippine governments to confront terrorism themselves and is offering concrete support. We are also concerned about Yemen, Somalia, Indonesia and the Philippines as potentially lawless environments in which terrorism can flourish. Syria, Iran and Lebanon continue to sponsor terrorism and the Gulf remains an area for terrorists to raise funds. We will need to work with the governments in the region on better policing of terrorist finance.

19. The State of Union address was badly received in Berlin as a sign of increasing unilateralism by the US. The Germans should be encouraged to judge US policy on the basis of private discussion rather than bald statements for public consumption - such as the State of the Union address. In private the US position on Iran is more nuanced. The EU needs to be able to deliver on its commitments on international terrorism as agreed at Laeken, in order to influence US thinking.

#### **Barcelona/Galileo**

20. The readout from the most recent Franco-German get-together suggests that, unlike last year, there will be no pacts before the Spring summit. The Spanish are confident they have secured German support for progress on energy liberalisation, through their change of heart on energy taxation. But Schröder still has an election to fight, and will not want to take any chances with public opinion at Barcelona. With unemployment through the four million barrier, job creation is a good unifying theme.

21. German concerns about funding of Galileo were key to Laeken deferring a decision to the Transport Council after Barcelona. But a consensus is building in the German Government that Galileo cannot be delayed any longer. Other sceptical Member States are likely to take the same view. So without prejudice to a UK Ministerial decision, we are talking to allies about conditions we might secure to make Galileo more palatable. Being isolated at Barcelona would cut across our



broader objectives for the Summit. If isolated we might end up paying for Galileo through the EU budget without reaping any commercial benefits.

#### **A400M**

22. An A400M Special Policy Group Meeting was held on 31 January, following Germany's failure to secure Bundestag approval of its funding. All nations agreed to seek Ministerial signature of new side-letters to the Inter-Governmental Agreements (IGA) and contract thereby giving Germany until 31 March to finalise their budgetary approvals. The German MOD expects to obtain budgetary approval for around 40 aircraft during Feb/March and plan to secure the remaining sum (to cover the balance of 33 aircraft) in their 2003 budget (available for commitment from the end of 2002). In order to substantiate the commitment to the full 73 aircraft, Germany propose a new side letter to the IGAs that they should protect nations if this further funding does not materialise. All nations except Spain (yet to respond) have supported the proposed measures, although UK support is subject to Ministerial approval.

23. Publicly, the German Defence Minister, Scharping, has alluded to a distinction between the positive political will and the difficulties with legal method for committing fully to A400M. The UK considers the clear commitment to the IGAs as the only acceptable protection from the effects of a single nation defaulting. Relying on political will and introducing a further caveat to limit German commitment to €5.1bn (the first 40 aircraft) would require significant changes to the contract, and could not be implemented without re-negotiation of the IGA and contract, and is considered unworkable.

#### **NePAD/G8 Plan for Africa**

24. Africa is low on the list of German Foreign Policy priorities. German officials have been consistently sceptical about NePAD and non committal on increased aid. In contrast, Schröder's Personal Representative Dr Uschi Eid, Parliamentary State Secretary for the Federal Minister for Economic Co-operation and Development (Green party) plays a very constructive role in the G8 Africa group.

25. German imports from Africa \$6832m. Exports to Africa \$8034m. Supported EU Everything But Arms initiative. Broadly back CAP reform, including moves to phase out export subsidies – but domestic interests (food safety/environment) trump development concerns.

26. German aid budget was stable at 0.27% of GDP in 2000. 32% of it goes to Africa, amounted to \$1063m in 1999, of which \$908m to Sub Saharan Africa. Downturn in German economy poses risks of a reduction in aid levels.

#### **Stability and Growth Pact**

27. ECOFIN's decision not to issue early warning letters to Germany (and Portugal) followed intensive German lobbying. Schröder's dissatisfaction with the Commission's recommendation was very public, presumably with elections in mind, and criticised by many heavyweight papers and commentators. The Chancellor made his support for Germany clear, for which Finance Minister Eichel was grateful. The Chancellor disagreed profoundly with the Commission's opinion that the UK's plans to run small budget deficits, driven by the need for investment publi services, is

incompatible with the SGP. He obtained acceptable language at ECOFIN. Eichel supported him strongly.

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Cabinet Office - plse pass to No 10 for Wall & Manning

**SUBJECT: GERMANY - SCHROEDER'S ELECTORAL PROSPECTS**

#### SUMMARY

1. The German government, and Schroeder, have had a bad start to the year, and are in distinctly choppy waters.
2. But there are still seven months to go to the elections; and the opposition aren't shining either.
3. Schroeder still seems the likelier winner, but it looks close. Schroeder will focus increasingly on domestic, rather than EU or foreign issues.

#### DETAIL

4. A snapshot in advance of the Prime Minister's meeting in Stockholm on Friday with Gerhard Schroeder.

#### THE BAD NEWS

5. If the German government had wanted to get all the bad news out of the way to clear the decks for the forthcoming election campaign, then they couldn't have had a better January/February. There has been a tidal wave of bad news: depressing economic figures (high unemployment; low growth); Schroeder's damaging (though successful) efforts to prevent a warning letter from Brussels; the scandal over massaged Employment Office figures; a

series of blunders over A400M procurement; the undermining of the government's Constitutional Court case to ban the extreme-right NPD because of the widespread use of Security Service informants; and the crumbling of the Kirch media empire (though this last may prove more damaging for Stoiber and the opposition than for Schroeder).

#### THE GOOD NEWS

6. But after an initial ripple of euphoria at his selection as main opposition candidate, Edmund Stoiber (CSU - Bavarian Prime Minister) hasn't shone either. The CDU/CSU campaign shows no signs of getting off the ground, and there is no clarity yet as to what it will contain. The simplistic notion of Stoiber as a competent economic manager has started to take a few knocks as people look below the surface of the Bavarian "economic miracle". And Stoiber and other Christian Democrats haven't even begun to explain how they will improve Germany's economic performance, or how their budgetary sums will add up.

#### THE POLLS

7. Latest opinion polls show a clear (about 5%) CDU/CSU lead over the SPD (a reverse of last year's trend), though this shouldn't be giving Schroeder much cause for concern yet. But his coalition partners, the Greens, are clearly fighting for their parliamentary survival and on present form look unlikely to be a viable partner in the next government. The FDP (Liberals) are most likely to take on this mantle, and get into bed with whichever of the two main parties ends up in front.

8. Schroeder's personal popularity ratings remain high (second-equal most popular politician after Joschka Fischer), but he's slipped six points in the last month. Stoiber is not far behind - but has himself fallen four points in the last month. No-one doubts that Schroeder will continue to come across as the more "sympathisch" of the main candidates; so will Stoiber be able to compensate by maintaining higher ratings for economic competence?

#### THE BATTLEGROUND

9. Both Schroeder and Stoiber recognise that the election will be won on the centre ground. Which is one reason why Stoiber has been rather muted so far, evidently uncertain how to move away from the more strident and conservative posture which comes

naturally to him, and which goes down better in Bavaria than elsewhere in Germany. Schroeder this morning came out of the starting blocks with a speech to a party meeting entitled "Die Mitte in Deutschland" ("The Centre in Germany" - nb no longer "Neue Mitte" - the "New Centre", as in 1998). This was a pretty cautious pitch, calling for more adaptability, openness, tolerance, and modernisation but underlining - several times - that this must be balanced by satisfying people's need for job security, ie (stated explicitly) we don't want to go down the Anglo-Saxon route; with no serious mention of unemployment or lagging growth rates. Continuing reform, yes, but not in such a way as to upset people - not a radical agenda, in other words.

#### EU AND FOREIGN ISSUES

10. EU issues aren't in themselves vote winners or losers in Germany, so we wouldn't expect Schroeder to focus on them much over the coming months, though he will continue to be sensitive to criticism from Brussels. International affairs could become an issue. The government has managed - rather more easily than it feared - to take a more forward position in recent months on Bundeswehr involvement in Macedonia and Afghanistan; but if Iraq went live, the German political class at least will get into a lather. Schroeder will probably decide, both because it's right and because it's electorally safer, not to seem at loggerheads with the Americans, but this may well require an agile balancing act - of which Schroeder is quite capable - if he's not to upset the party faithful (let alone the Greens). In any event Schroeder, in statesman mode, cuts a more reassuring and authoritative figure than Stoiber.

#### THE MAN

11. Despite the current choppy waters, Schroeder looks chirpy enough. Maybe we should believe him when he says he looks forward to going head-to-head with Stoiber. Schroeder has just returned from a well-publicised visit, accompanied by a team of German captains of industry, to Mexico, Brazil and Argentina. And he showed off his footballing skills (not for the first time) yesterday when receiving a group of New York schoolchildren invited to Germany as a gesture of solidarity post-11 September. The international statesman, and the local-boy-made good.



10 DOWNING STREET  
LONDON SW1A 2AA

From the Principal Private Secretary

14 February 2002

**FAXED**  
Dear Bernd,

**KANZLERAMT-NO10 ECONOMIC WORKING GROUP**

We are looking forward to receiving you and your team here on 26 February for another meeting of our working group on economic policy. I attach a draft agenda on which we would welcome your comments.

Tom, J27

**JEREMY HEYWOOD**

Dr Bernd Pfaffenbach

No 10/Kanzleramt Talks, 26 February 2002

**Draft Agenda**

- Economic outlook in UK and Germany
- Domestic policy priorities
- The euro and the stability and growth pact
- Barcelona preparations
  - energy liberalisation
  - networks (energy, transport, broadband)
  - financial services
  - labour markets
  - education/training
  - better regulation
  - state aid
- Other issues
  - CAP reform
  - enlargement
  - trade (new round, EU/US issues)
  - shipbuilding aid
  - coal aid

RESTRICTED  
GERMANY/EU: CONVENTION: MEETING WITH GLOTZ  
From: BERLIN

TO PRIORITY FCO  
TELNO 67  
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INFO PRIORITY ACTOR, CABINET OFFICE, CEE POSTS, EU POSTS  
INFO PRIORITY HM TREASURY, WHIRL

Berlin Telno 49  
CABINET OFFICE PLEASE PASS TO NO 10 FOR WALL  
CABINET OFFICE FOR BUDDEN  
HM TREASURY FOR LAWRENCE

SUMMARY

1. Glotz's priorities for the Convention are improving the EU's ability to deliver policy and developing an effective CFSP.

DETAIL

2. Peter Glotz, the German government's Convention, called at the Embassy on 7 Feb (Glotz's CV).

3. Glotz underlined that he was the Chancellor's, rather than the government's, representative. He said he had been chosen partly because he was a convinced European, shared Schroeder's and Fischer's views on the EU and had a good network of contacts; and partly because the SPD at present had few active politicians with international experience. As Schroeder's representative he planned to keep in close contact with other Germans on the convention (from Bundestag, Bundesrat and the EP) and try to formulate positions with them.

4. I asked how Glotz thought the convention would operate in practice. He said that Giscard would try to centralise activities, keeping as much in plenary as possible. But the parliamentarians wouldn't let him, so he expected the convention to work like a parliament with sub-committees. The convention should present proposals to which the majority could agree, rather than a disparate range of contradictory options. Glotz would be happy with a constitution-style product, but doubted this could be achieved within a year. He stressed that Schroeder was not wedded to the term constitution. The point was to agree what the EU should be doing. Glotz added that he saw the biggest challenge in the fact that enlargement would precede the IGC. So the latter would have new members on it who had been present at the convention but without a vote.

5. Glotz said that the Convention faced two key issues:

i) How to make an EU of 25 or more able to operate efficiently and to deliver.

- Glotz said certain principles needed changing: the size of the commission, the 6-month presidency, the balance between the institutions, the number of Councils. Germany wanted to remove intergovernmental practices where possible, but accepted they

Susan YES.  
Has Stephen  
seen this? →  
Helen  
1812

Stephen  
Pa  
worth staying

✓  
we should work closely  
with him

✓



RESTRICTED  
GERMANY/EU: CONVENTION: MEETING WITH GLOTZ  
From: BERLIN

TO PRIORITY FCO  
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*Storlin*  
*[Signature]*  
*Pa*  
*work closely*

*[Signature]*  
*we shd work closely with him*

*[Signature]*

would still be necessary in some areas. He hoped everyone would agree that Nice wasn't the last word, but took my point that speaking too publicly about the unsatisfactory nature of Nice would play badly into the Irish referendum.

- Glotz acknowledged that some Germans were arguing for the Commission to become a European government. But this would be unachievable within the convention. Consensus could only be reached on both the Commission and Council retaining executive roles.

- Glotz did not think it was essential for the Commission President to be chosen by the European Parliament. He also commented that in his experience the EP was totally different from national parliaments. You could scarcely tell the difference between an SPD or CDU MEP - they were all convinced Europeans, far removed from national concerns (he gave immigration as an example). In Glotz's view, a chamber of national parliamentarians made a lot of sense, though he accepted that members of the Bundestag thought it was impossible to carry out two functions. I recalled the Prime Minister's idea of a second chamber/subsidiarity watchdog. Glotz said this was a plausible model, but would also meet with great resistance in the Bundestag.

ii) How to develop a CFSP which enabled the EU to handle its own affairs.

- Glotz said that after 9 September, the US had not asked for NATO's help but had approached the UK, France and Germany individually. What was the alliance's future? And how could the EU take responsibility for Macedonia and the Balkans? He wondered if separate Patten and Solana roles were viable in the long run or whether it made more sense to double-hat one person. But he added that to make progress in CFSP, EU leaders needed to play an executive role.

#### Competences

6. I asked how Glotz saw the debate on competences. He said (twice) that Schroeder did not think you could transfer German federalism to the EU level. But there were domestic considerations - the opposition's chancellor candidate for the autumn elections was the Bavarian Minister President. Glotz agreed that Laender demands on competences had less to do with the EU and more with their fear about being squeezed out of policy making by the Federal level.

#### Comment

7. Glotz has a reputation for being an intellectual and a conceptual thinker but, apart from his comments on national parliamentarians (which were more Fischer than Schroeder), he kept close to the Kanzleramt script. He does not see his involvement in the convention as a return to career politics, seeming genuinely interested in finding solutions which are achievable and best for Europe. He looked forward to meeting Peter Hain (which we are trying to arrange for 19 February) and the other British convention delegates.

#### LEVER

RESTRICTED  
 GERMAN ECONOMY: KIRCH AND MURDOCH  
 From: BERLIN

TO IMMEDIATE FCO  
 TELNO 69  
 OF 081552Z FEBRUARY 02  
 INFO PRIORITY ACTOR, CABINET OFFICE, DCMS, DTI, EU POSTS  
 INFO PRIORITY HM TREASURY, UKREP BRUSSELS, WHIRL

CABINET OFFICE PLEASE PASS TO DCMS  
 DCMS FOR  
 DTI FOR SAVILL  
 CABINET OFFICE FOR DONNELLY, K BAKER, CRABTREE  
 HMT FOR ROGERS, LAWRENCE  
 NO.10 FOR DEREK SCOTT  
 SUMMARY

1. Fear and loathing in Germany at prospect of Murdoch taking controlling interest in Kirch media group. A collapse or Murdoch buy-out would cause problems for both Schroeder and Stoiber. Probable cross-party consensus for "German solution".

#### DETAIL

2. The Munich-based Kirch group is one of Germany's most important media companies. Its structure is complicated and riddled with cross-holdings. But key elements are

- "Kirch-Media": 6 free-TV channels including Sat1 (11% viewer share) and ProSieben (8.5%) and film/TV rights including Formula 1 and the World Cup;

- "Kirch-Pay-TV": Premiere World pay tv channels;

- a shareholding subsidiary which owns 40% of Axel Springer Verlag (one of Germany's main newspaper publishers, including mass-circulation Bild) and shares in seven other companies. The 40% holding is a relic of a failed Springer takeover attempt by Kirch.

Kirch's free and pay-TV channels have in recent years had a total viewer share of 26-28 percent, making it the largest private broadcaster and drawing close attention from the media supervisor (KEK): according to the 1997 Media Law, no company may have more than a 30 percent viewer share. The 1997 Law has no rules on foreign ownership.

3. Leo Kirch is a secretive individual with (by German standards) pronounced right wing views: a rags-to-riches success story with a reputation as a canny strategist and a fighter. His rise has been encouraged by the Bavarian Government, in a (successful) bid to establish Munich as a media centre. Result: Kirch's biggest creditor is the Bavarian Landesbank, with loans of euro 2.2 billion. For Stoiber, Kirch is a key media ally in an election year.

4. Since August 2001, the Kirch group has been hammered by losses at Kirch-Pay-TV. The share price has collapsed from euro 17 to euro 5. In January Axel Springer Verlag (whose management see Kirch as a continued threat to their independence) triggered a crisis by demanding that Kirch honour a "put" option requiring

Kirch to buy back Springer's 11.5 percent holding in Kirch-Media price way over their present value. With debts estimated at euro 5.7 billion and most of its assets in baulk as collateral for loans, Kirch is threatened with collapse.

5. Step forward Rupert Murdoch. Murdoch controls (through News Corp) 2.5% of Kirch-Media and (through B SkyB) 22% of Kirch-Pay-TV. There is speculation that Murdoch wants to exploit Kirch's difficulties to take over Kirch-Pay-TV and become a major German media player. The German media themselves are aghast at this prospect, arguing that Murdoch-owned media elsewhere are politically partial and poor quality. On 6 February Schroeder's spokesman, Heye, said the Federal Government was keeping a close eye on developments, but would probably not take an active hand in reaching a solution. Behind the scenes, however, the Bavarian Government is widely believed to be trying to put together a "German" rescue package. If the banks cannot be persuaded to extend further credit, this would probably mean dismantling the Kirch empire.

6. Murdoch himself, meanwhile, said on 7 February that he had no intention of putting more money into Kirch. News Corporation executives say they may exercise their own put option on a further euro 1.6 billion of Kirch-Pay-TV shares due in October. Kirch say they do not have the money.

#### COMMENT

7. A Kirch collapse or dismemberment, or a foreign take-over, would be politically sensitive in an election year. Stoiber would face the loss of a key media ally and black marks against his economic competence, since the Bavarian Landesbank is under the control of the Bavarian Government.

8. The complexity of Kirch's organisation makes it hard to predict how all this will turn out. Analysts note that Leo Kirch, who has remained silent throughout, has recovered against impossible odds before. But there seems likely to be cross-party consensus - supported by much of the media - for a "German" solution to the Kirch crisis. This is not, in this case, primarily because of Germany's equivocal attitude towards big foreign takeovers. Rather, it seems that the German political classes - probably including Schroeder - have taken a look at the way in which Murdoch operates elsewhere in the world, including in the UK, and have decided they do not much fancy that happening in Germany.

#### LEVER

**Sent by BERLIN on 08-02-2002 15:52**  
**Received by No10 on 08-02-2002 16:14**

**From:** Stephen Wall  
**Date:** 7 February 2002

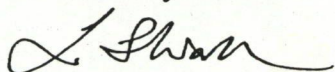
**MARTIN DONNELLY**

**cc:** Roger Liddle  
Michael Roberts  
Kirstin Baker  
John Bourne  
Alison Kerr  
Kim Darroch (FCO)  
Sir Nigel Sheinwald  
(UKRep Brussels)  
Sir Paul Lever (Berlin)

**GERMANY/EU: FRANCO-GERMAN MEETING**

/ Please refer to Berlin telno 55. I had a similar account from Silberberg, the only additions being the following:

- (i) Energy liberalisation. Jospin had been a bit vague about what date the French would agree for liberalisation in the commercial sector as between 2004 and 2005. Silberberg thought (and I agreed) that we would need to be very careful about the kind of social dimension language which the French would want in return.
- (ii) Enlargement. The Germans drew comfort from the fact that Jospin had reiterated the French commitment to concluding the enlargement negotiations by the end of the year. I got the impression from Silberberg that he thought agreement on the draft common position on agriculture (certainly on direct payments) would not be reached before the French elections.
- (iii) Shipbuilding. The French had agreed to support Germany. Not sure whether that is simply a confirmation of what we already suspected or something new. Do we need to look again at our own position?
- (iv) It had been agreed that Moscovici and Glotz would meet soon. Silberberg said that he would encourage Glotz to make contact with Peter Hain. I warmly endorsed.



**STEPHEN WALL**

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MDDPAN 7542

FM BERLIN  
TO PRIORITY FCO  
TELNO 55

OF 061109Z FEBRUARY 02  
INFO PRIORITY ACTOR, CABINET OFFICE, DEFRA, DTI, EU POSTS  
INFO PRIORITY HM TREASURY, WHIRL

HMT FOR ROGERS, LAWRENCE  
CABINET OFFICE FOR WALL, DONNELLY  
DEFRA FOR LEBRECHT

SUBJECT: GERMANY/EU: FRANCO-GERMAN MEETING

SUMMARY

1. Schroeder, Chirac and Jospin agreed on need to stick to acquis on direct payments for accession countries. But Kanzleramt doubts whether these can be resisted in the long-term. Germans not yet raising with French degressivity for EU15. French will seek Barcelona language on European social model as quidproquo for movement on industrial energy liberalisation.

DETAIL

3. We spoke on 6 February to Silberberg, Director EU, Kanzleramt and to Blomeyer, Deputy Head of the Enlargement Department in the Auswaertiges Amt about the Franco/German meeting in Schloss Glienicke on the evening of 4 February. It followed the "Blaesheim" pattern. Only principals (Schroeder, Chirac, Jospin, Fischer and Vedrine) were present.

4. As we have reported by e-mail, the press conference after the meeting produced little substance:

- Schroeder and Chirac noted the importance of keeping to the Berlin ceilings for the financing of enlargement;
- Schroeder and Chirac spoke of joint preparations for Barcelona and noted the importance of the European social model;
- Jospin and Chirac said Germany and France would work together on the future of Europe Convention to define a common strategy and prepare joint positions;
- in response to questions, Chirac said France was relying on Germany to buy 73 aircraft. In the past, France had always been able to rely on Germany. He had full confidence;

PAGE 1

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Schroeder said the stability and growth pact had not been discussed, but would be a key matter for discussion at ECOFIN.

5. Silberberg said the two main issues had been Barcelona and enlargement:

- on Barcelona, the French had confirmed that they would sign up to energy liberalisation for industrial users as expected. Silberberg did not think there would be a joint paper or letter before the Council, although France and Germany would co-ordinate positions closely. The comments at the press conference on the European social model reflected French pressure to secure wording at Barcelona on social issues in return for progress on energy liberalisation;

- on financing of enlargement, both sides were clear that the acquis did not provide for financing for direct payments for the accession countries. There was a general understanding however, Silberberg said, in Berlin and in Paris (and in London, he added) that in the real world, direct payments for the accession countries would probably be inevitable in the end. Germany was not seeking to raise with the French before their elections the question of degressivity of direct payments for the EU15. Rather, the formula they were employing with the French was that the likely inevitability of direct payments for the accession countries raised important questions about financing which would have to be addressed.

6. Silberberg said there had been no concrete discussions on future of Europe other than agreement that Moscovici and Glotz, the French and German government representatives to the Convention, should meet, as they did not know one another. There had been no discussion during the meeting of the Commission warning letter on the stability and growth pact; or of the A400M.

7. Blomeyer confirmed that nothing special on enlargement had been agreed at the meeting other than the importance of keeping within the financial perspective. In addition, the two sides had noted the need to ensure that enlargement took place in a socially just way acceptable to the candidates. This, he admitted, was a broad formula which did not yet add up to much.

8. Contact: Leigh Turner, Berlin: 0049 30 20457 301  
email: leigh.turner@fco.gov.uk

LEVER

YYYY

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JONATHAN POWELL

**From:** David Manning  
**Date:** 6 February 2002

**cc:** Sir Richard Wilson  
Sir Stephen Wall  
Tom McKane  
Michael Tatham  
Sir Paul Lever, Berlin

**GERMANY: A400M**

The German Ambassador phoned me this morning. He said that he had been speaking to Sir Rob Walmsley about A400M. He thought that Sir Rob was about to prepare a report for the Prime Minister. Before he did so, the Ambassador was keen that we should be absolutely clear about the German position.

The German Government "stood by" its order for 73 aircraft. But for budgetary reasons, it would have to acquire the aircraft in two tranches. Those who argued that Schroeder should go to the Bundestag and ask for a supplementary budget, so that all 73 could be bought at once, missed the domestic political point. If Schroeder opted for this course, he would be subjected to cross-examination about the criteria on which the original order had been based. This would include the rates of growth then projected, rates of inflation, etc. I would understand why Schroeder was not willing to do this.

The Ambassador thought that some of the pressure on the Germans was the result of mischief making by those who hoped that the A400M project would fail, and that the Prime Minister's advocacy of European defence would then be seriously weakened. I said that he should be in no doubt about the Prime Minister's continued support either for the A400M project or for enhanced European defence capabilities.

COMMENT

The Ambassador was very keen that the Prime Minister should be in no doubt about Schroeder's political commitment to the full German order for 73 planes. He emphasised that Schroeder would go back to the Bundestag for a second funding tranche when the time was right. (Ultimately, of course, Schroeder

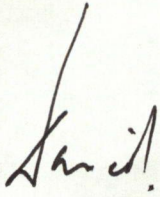
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- 2 -

cannot guarantee the parliamentary outcome, so an element of uncertainty is bound to remain, whatever his good intentions.)



DAVID MANNING

CONFIDENTIAL

44 20 72703314

*He*

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British Embassy  
Berlin

British Embassy  
Wilhelmstrasse 70  
10117 Berlin

Tel: (0049 30) 20457211  
Fax: (0049 30) 20457573  
E-mail: bugh.powell@fco.gov.uk  
www.britischesbotschaft.de

05 February 2002

Michael Tatham  
No 10

1. cc. also {  
JPB  
Sally M  
Robert Hill  
Rachel Gubman  
AC

2. BTM.

*Dear Michael,*

*MT. SW  
CYSM  
RC  
AC*

*Spide h TB. See S...  
part, co part of 1...*

*MA  
CL SW  
RL  
FC  
SPAC*

STOIBER

1. I have now been approached separately by four members of Stoiber's inner circle (including the head of his office, Eppinger) about the possibility of arranging an early meeting between Stoiber and the Prime Minister. They present the bid as standard procedure for the leader of the Opposition, and as part of a pre-election programme of Stoiber calls on i.a. Bush, Putin, Chirac and Aznar.
2. So we are now faced with the choice set out in Berlin telno 23. The Prime Minister's dilemma is more acute than other leaders', given the closeness of his personal as well as party relationship with Schröder. But not to see Stoiber, if (most of) the others do, risks given offence to someone who on present form has a 30-40% chance of being the next German Chancellor.
3. The Ambassador recommends that you continue to take a wait and see approach for the moment. If the Prime Minister were inclined to meet Stoiber, you would want to be sure that the other key players were seeing him too. Timing matters too - the Prime Minister should not be the first.
4. However, from here it looks probable that most others will meet Stoiber. The US Ambassador has strongly recommended that Bush receives him, and apparently the vibes from the NSC are that it will happen. The Spanish Embassy has also told us that a meeting is in hand. The French Embassy are not in the loop and have made no recommendation; but Chirac has already received Stoiber (after Nice), so is likely to do so again.
5. If the Prime Minister decides to meet Stoiber, then we recommend that you
  - (a) notify Schröder's office before fixing something definite. This should give them the chance to highlight any particular sensitivities. Probably best done on a more political

*JOP*

*① others happen to be right parties!  
② do only as part of a programme*

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*Sally*

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P. 03

**RESTRICTED**

than official net (Jonathan Powell ?), though we could do it from here if you prefer. Krampitz (head of Schröder's personal office) is the best contact point - not Kastrup (a-political) or Nowak (unreliable);

- (b) get it quickly on the record that the meeting is being held at Stoiber's request. Even if there were a firm prior understanding, I wouldn't put it past his spin doctors to put it about that Blair was eager to see him, provoking press stories unhelpful to us;
- (c) if possible make it happen after two or more other leaders have seen Stoiber, but before mid-June. Any later risks electoral sensitivities;
- (d) try to keep the meeting's profile low. We might present it as par for the course for the Prime Minister to see a senior German Länder Minister-President who happens to be in the same place at the same time and both have a gap in their programmes - cf. Biedenkopf (CDU), Gabriel (SPD). One possibility might be Man U versus Bayern Munich at Old Trafford on 13 March (Stoiber is a keen fan who would happily go if possible). If that doesn't work, we could try to persuade Stoiber's people to come up with a parallel programme in London as a pretext.

*your crew,*  
Hugh Powell

cc: Michael Arthur, FCO  
Kim Darroch, FCO  
Karen Pierce, EUD(B) FCO  
Ed Owen, FCO  
Roger Liddle, No 10  
Martin Donnelly, CabOff  
Julian Farrel, HMCG Munich

**RESTRICTED**

PERSONAL

file

233 Kennington Road  
London SE11 6BY

4 February 2002

Tel: 7587 0011  
Office: 7968 3202

Dear Philip,

Are you interested in whether Schröder can win? When I was in Berlin a week ago I was given the attached polling presentations prepared for the Chancellor by Wolfgang Novak (who is a senior Chancellery official, a political appointee, who is head of Schröder's Policy Unit). The SPD insiders are very nervous. They think Schroeder will win - but they're not sure. I also enclose a copy of a note I wrote for Tony about it all.

I think the SPD would welcome some ideas from you. They're so rich they might even give you a contract! If you're interested please give me a call.

I got a lot out of our discussion about Peter. You are the perfect friend to be the bearer of tough messages, something I often think I'm not terribly good at. The most striking thing you said was about Peter's need to invest in personal relationships. That is a message I have had the courage to convey!

It would be nice to get together again soon. Monica will call your office to fix lunch.

With all best wishes

Love

  
ROGER LIDDLE

Mr Philip Gould

PERSONAL

THE AMBASSADOR  
OF THE FEDERAL REPUBLIC OF GERMANY

London, 6 February 2002

Top: EUP/S  
✓ Cos  
FAAPS (MS)  
Diary Sec

The Rt Hon Anthony Blair, MP  
Prime Minister  
First Lord of the Treasury and  
Minister for the Civil Service  
No. 10 Downing Street  
London SW1A 2AA

*MT*

*A heavy agenda for a  
15 minute meeting!*

*Dear Prime Minister,*

I have the pleasure of forwarding the enclosed letter from Sigmar Gabriel, Prime Minister of Lower Saxony. A courtesy translation is attached.

*Yours sincerely,  
Ivan Hovlyts*

(Dr. von Ploetz)

1. *sec. f.i.* { *Hugh Powell, Berlin*  
*Karen Pierce, EUD(B), FCO*

2. *file.*

SKP 7/5/02



Sigmar Gabriel Niedersächsischer  
Ministerpräsident

Seiner Exzellenz  
dem Premierminister  
des Vereinigten Königreichs  
Großbritannien und Nordirland  
Herrn Tony Blair, M.P.

London

30.01.02

Sehr geehrter Herr Premierminister,

ich bedanke mich sehr herzlich für die Gelegenheit, mit Ihnen am 7. März  
zusammenzutreffen.

Ich möchte mit Ihnen über Ihre Vision einer Europäischen Union sprechen und für die  
Debatte in der deutschen Sozialdemokratie erfahren, welche politischen Perspektiven  
durch New Labour zusätzlich eröffnet werden.

Auf unser Treffen freue ich mich.

Mit freundlichen Grüßen

Handwritten notes in the top right corner, including "30 Jan 2002" and other illegible scribbles.

30 January 2002

Dear Prime Minister,

Thank you very much for agreeing to meet on 7 March.

I would very much like to discuss with you your vision of the European Union, a topic which is continually being debated amongst the social democrats in Germany. I would be particularly interested to find out which political perspectives New Labour is opening up in Europe.

I am very much looking forward to our meeting.

A heavy agenda for a 15 minute drop-in!

Yours sincerely,

Signature of David Blunkett

High Power, Berlin  
Klein, (EU/16), FCO

2. via.

**RESTRICTED**  
**GERMAN POLITICAL BACKDROP TO A400M HANDLING**  
**From: BERLIN**

TO DESKBY 291300Z FCO  
 TELNO 41  
 OF 291203Z JANUARY 02  
 INFO DESKBY 291300Z CABINET OFFICE, MODUK  
 INFO ROUTINE ACTOR, DTI, EU POSTS, HM TREASURY, HOME OFFICE  
 INFO ROUTINE NATO POSTS, TOKYO, UNSC POSTS, WHIRL

SIC A2H

MOD-DPA FOR XD1 AND A400-TL

CABINET OFFICE PLEASE PASS TO NO 10 FOR POWELL, CAMPBELL, MANNING,  
 WALL, LIDDLE  
 SUMMARY

1. The German government's terrible January has not produced yet a mood for change in the electorate. But domestic politics now febrile enough for some major embarrassment to catalyse an underlying shift against Schroeder. Our timing/handling of A400M needs to take this into account.

DETAIL

2. Schroeder is having a bad hair month:

- the stats have undermined attempts to re-build confidence in the economy and government. Growth for 2001 had to be revised down to 0.6%, and for 2002 down to 0.75%. Unemployment was predicted to rise to 4.3m (above the level Schroeder inherited);
- his attempts to look in charge and on top have foundered on the Trade Unions' and employers' inability to compromise on wage policy (my telno 37). Schroeder's trademark corporatist framework, the "Alliance for Jobs", now looks a dead duck. He may even face a wave of strikes;
- instead the government looks incompetent. Defence Minister Scharping has completely cocked up handling of A400M (my telno 33). And Interior Minister Schily is making a mess of the totemic legal process for getting the extreme-right NPD party banned by the constitutional court for neo-nazi links: including witness statements by security service informants has undermined the government's case. Meanwhile the headline immigration/asylum reform package remains stuck in the Bundestag;
- he has misjudged the Opposition. The SPD didn't take the threat from Stoiber seriously (my telno 13). They saw him as their dream opponent whom they could pigeon-hole as right wing. But Stoiber is managing to avoid that tag, while capitalising on his reputation for competent economic management;
- for the first time in over two years the SPD is behind (by 3-4%) the CDU in the polls, with only 8 months to go to the elections;
- to cap it all, Bild (Sun equivalent) is now accusing him of dyeing his hair. Schroeder has called in his lawyers.

3. Things look worse than they are. The government suffered and survived a similarly dreadful January last year (when Eichel and Fischer were in trouble). Bad news is crowding itself out. There's still plenty of time before the elections for the SPD to bounce back. In the 1994 election Kohl made up a bigger deficit. Stoiber

→ Jonathan Powell

Will you make sure  
 TB needs this?  
 Cancelling/pulling out  
 on the A400M is high  
 priority for Schroeder.

*[Handwritten signature]*





**RESTRICTED**  
**GERMAN POLITICAL BACKDROP TO A400M HANDLING**  
**From: BERLIN**

TO DESKBY 291300Z FCO  
 TELNO 41  
 OF 291203Z JANUARY 02  
 INFO DESKBY 291300Z CABINET OFFICE, MODUK  
 INFO ROUTINE ACTOR, DTI, EU POSTS, HM TREASURY, HOME OFFICE  
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SIC A2H

MOD-DPA FOR XD1 AND A400-TL

CABINET OFFICE PLEASE PASS TO NO 10 FOR POWELL, CAMPBELL, MANNING,  
 WALL, LIDDLE  
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- to cap it all, Bild (Sun equivalent) is now accusing him of dyeing his hair. Schroeder has called in his lawyers.

3. Things look worse than they are. The government suffered and

survived a similarly dreadful January last year (when Eichel and Fischer were in trouble). Bad news is crowding itself out. There's still plenty of time before the elections for the SPD to bounce back. In the 1994 election Kohl made up a bigger deficit. Stoiber may have peaked too early. Economic prospects should look up not down by the crucial summer campaign months. Schroeder remains ahead in the contest to be the next Chancellor.

4. But the SPD (and Greens) are still nervous. The last thing they want in present circumstances is to lose a Minister. Their two biggest worries are Schily and Scharping. Either could come under enormous pressure to resign if the NPD case fell apart, or the A400M project collapsed. Both scenarios would make the government look incompetent and chaotic. Schroeder's own standing would be undermined by collapse of the A400M project, given that he has in practice agreed Scharping's handling in detail.

5. The government think the UK holds the key to the second threat. They profess to be sure that the French and Spanish will settle, as long as we do, for a commitment to buy the additional 33 aircraft which is politically but not legally binding. And they suspect that some in the UK would not mind seeing the project collapse given that we have other options available.

6. So there are some obvious political sensitivities here. Schroeder won't thank us if we say things which exacerbate an already difficult situation for him (albeit one of his own making). I therefore recommend that, if Scharping cannot unequivocally un-caveat the MOU to our satisfaction by 31 January (which the Constitutional Court judgement due today/tomorrow may well not conclusively settle), for the short term we avoid any reaction which forecloses options about our future intentions.

LEVER

**Sent by BERLIN on 29-01-2002 12:03**  
**Received by No10 on 29-01-2002 15:50**

**RESTRICTED**

From: Hugh Powell  
Date: 29 January 2002

cc: Ambassador  
Mr Turner  
Mr Clements  
Mr Mehmet  
Ms Simon  
Mr Massey  
Ms Neale  
Ms Pierce, EUD(B)  
Ms Pinto, EUD(B)  
Mr Duddy, EUD(B)  
Mr Dixon, RAD  
Mr Liddle, No 10

RL  
cc: JPO  
JSW  
MT  
FC  
DM  
Press

To: Jeremy Cresswell

**SUBJECT: GERMAN ELECTIONS**

1. Over the last few days I've seen: from the SPD, **Meyer** (deputy Chairman Bundestag EU Committee, Convention Representative), **Heil** (Health Committee), **Gloser** (EU spokesman for parliamentary party), **Roth** (EU Committee), **Robbe** (head of Seeheimer Kreis, the biggest caucus within the parliamentary party) and **Sontowski** (Head of Schroeder's SPD office, a FROG from the Hanover gang); from the CDU, **Wissmann** (Chairman of Bundestag Economic Committee, potential Minister in a Stoiber govt), **Herz** (International Secretary, party HQ), and **Betzel** (new EU adviser to parliamentary party); from the FDP, **Kapferer** (head of strategy & campaigns, very close to Westerwelle); from the Greens, **Enslinn** (Head of Parliamentary Leader Schlauch's office, part of the secret "team Fischer" pulling together the Green election campaign behind the party's back); and the pollsters **Güllner** (forsa) and **Schlinkert** (dimap).
2. Much has already been reported separately (e.g. in the A400M telegram, various minutes on the Convention, and Roger Liddle's note on "can Stoiber beat Schröder?"). Stuff on the Franco-German relationship will go in an Angus Lapsley minute. Below are some additional, detailed points on the German elections for trainspotters.
3. **Stoiber vs Schroeder**: the view that Schroeder remains the favourite to win is almost unanimous. Both pollsters confirmed that the CDU's current poll lead does not equate to a mood for change: only if it were sustained through to May/June should the SPD panic. By shifting his profile to the political centre, Stoiber is reducing the opportunities to focus the campaign on issues. A campaign focussed on personality, everyone agrees, plays to

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Schroeder's big advantage. In particular with women voters: apparently Stoiber repels them, irrespective of age, income or geography. That is also a big bonus for the Greens, who are particularly well placed with women voters. Even the FDP claim already to be picking up support in the yuppie female segment. The CDU admit the problem, but believe a high profile Merkel campaign role will protect this flank. Schlinkert, a relatively objective observer, supports the SPD/Green/FDP thesis that the CDU/CSU have not, as they claim, overcome organisational and policy divisions, and that their disunity will eventually undermine Stoiber.

4. **Impact of Economy:** as Roger Liddle's note says, views differ on whether the economy could nevertheless win it for Stoiber. There are three issues:
- (i) timing of improvement. Wissmann claims that key Bankers (Deutsche, Dresdner) don't expect recovery before Q3. The others struck me as more unsure than hopeful of earlier recovery;
  - (ii) correlation with voting behaviour. The majority view is that delayed recovery could decisively swing the election to Stoiber. But Güllner argued that his data showed no straightforward correlation between voting intentions and economic expectations;
  - (iii) can Stoiber capitalise? A few SPDers argue that the electorate will realise he lacks a credible alternative economic strategy. But the majority view (including FDP/Greens) is that the image of Bavarian success is enough to give Stoiber the edge over Schroeder if the economy produces a mood for change.
5. **Election issues:** there is a constituency (including Güllner and the Greens as well as within the SPD) that thinks that Schroeder can only win with a modernisation message focussed on floating voters. But as significant are (i) its frustration that this view is not affecting the Kampa (SPD campaign HQ) strategy focussed on turning out core voters; and (ii) the belief that such a modernisation message must nevertheless be "balanced" with reassurance that the German social system will continue largely unaffected. Sontowski (an insider) confirmed this was Schröder's instinct too. They all think that there is nothing wrong with the West German model; it's just the East which distorts the stats. There is also an assumption that if the economy does not tank, then besides "personality", "lifestyle" will be the main issue. Hence family policy is likely to turn into a key electoral battlefield, because it so clearly defines and divides two different cultures (CDU focus on marriage & helping mothers stay at home, versus Red-Green focus on non-discrimination between types of partnership or family unit, and providing nursery/childcare to help mothers work). No one expects EU issues to play any role. But military intervention (e.g. rollovers of Amber Fox/ISAF in context of USA "phase two" attacks elsewhere in Middle East) could well stuff the Greens.

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6. **Coalition options:** as Roger said in his note, it is probable that the candidate from the party with the biggest % will end up Chancellor. But it isn't certain.
7. If the CDU end up ahead of the SPD, we can pretty confidently exclude (a) SPD-FDP or (b) traffic light (whether Red-Yellow-Green, or Red-Red-Green) to keep Stoiber out. On (a), although it might be easier for the FDP leadership to profile itself as liberal/reformist under SPD leadership, the pressure from backbenchers and activists would be too strong to return to an ideologically more comfortable centre-right coalition. And the pressure against Red-Yellow would be strong amongst SPD backbenchers and activists. On (b), co-operation with the Greens is not in the FDP's self-interest (they want to kill off not sustain the Greens as an alternative junior coalition partner; and would get squeezed by Red-Green caucusing). Schroeder would prefer coalition with the CDU to having his foreign policy subject to PDS constraints, and alienating a broad swathe of Wessi voters.
8. However, we can't exclude CDU-FDP even if the SPD end up the biggest party. Not only would the pressure from the FDP backbenches/grass-roots be strong. But also many (outside the FDP) doubt it will be able to sustain its current policy of equidistance up to election day. The more the campaign focuses on Schroeder versus Stoiber, the more the electorate will want to know which candidate their second vote (crucial for the small parties) will deliver. Stoiber not Schroeder appeals to the majority of potential FDP (or split) voters. So the FDP leadership could well be forced to declare for him, even if he falls behind Schroeder in the polls, to avoid a last minute landslip in their support.
9. That said, the majority seems currently to think that the electoral arithmetic will end up producing SPD-FDP. Not least because of the inner paradox of the Greens' strategy. The combined % of the Red-Green "Lager" is currently barely enough for a majority of seats: the margin is less than half a percent. In a tougher electoral environment than 1998, that overall share is likely to go down not up. The Greens, however, are focussing on survival: their campaign aim is to compensate for their disillusioned voters by picking up a slightly bigger share of fringe SPD voters within that shrinking slice. But that means the Greens can only get back in to government if the SPD are successful at increasing their share of the floating vote to compensate for the overall shrinkage of the centre-left Lager. The SPD focus, however, is not on this but on turning out their own core vote. So even a marginally smaller SPD could well end up having to coalesce with any party that got over 8%; and on current trends the FDP is the only one of the smalls likely to achieve that.
10. **The next Foreign Minister?** If the FDP do end up the junior coalition partner, then the current plan seems to be for Westerwelle to aim for the Interior Ministry on the grounds that it (i) plays to his alleged policy strengths, and (ii) offers a much better platform for domestic political profile than the AA. The belief is that they would be in a strong enough political position to get two senior Ministries. In which case Gerhardt would get the AA. Müllemann would be left to fight with Brüderle over a junior Ministry.

**RESTRICTED****11. Sachsen-Anhalt: the three key issues are**

- (a) whether the SPD retain control. Only that, not merely losing %, could have a big psychological impact on the electorate in the run up to the Bundestag elections. Most expect SPD-PDS to end up with just enough to form a government. No one thinks that Red-Red outside of Berlin would have a negative electoral impact on Wessi voters;
- (b) whether the FDP get over 5%. That would help position them as primus inter pares of the small parties, because the only one capable of winning at Land level in both West and East of Germany. Getting into government would in comparison bring only marginal extra political credit;
- (c) whether Schill does really well. The impression is that he would need to do significantly better than 5% to launch a Bundestag campaign (and thus undermine Stoiber's chances). But the expectation is that he will get under 5%.

Hugh Powell

DEC to Jte

99829  
In GR Matrix



10 DOWNING STREET  
LONDON SW1A 2AA

From the Private Secretary

29 January 2002

Dear Herr Kögel

The Prime Minister has asked me to thank you for your letter of 4 December. He is greatly honoured by this prestigious award.

Unfortunately the Prime Minister has a busy schedule next month and will not be able to attend the prize-giving ceremony. He sends his sincere apologies.

Yours sincerely

A handwritten signature in cursive script that reads 'Michael Tatham'.

MICHAEL TATHAM

Herr Karlheinz Kögel





28.JAN.2002 10:33

BRITISH EMBASSY PRIVATE OFFICE  
+49 30 20457571



NR. 991 S. 1/2  
**British Embassy  
Berlin**

Wilhelmstr. 70  
10117 Berlin

Telephone: (030) 204 57102  
Fax: (030) 20457 571

28 January 2002

Michael Tatham Esq  
No 10 Downing Street  
London SW1A 2AA

By fax

MT  
C: JPs  
SW  
Pm

*Dear Michael,*

**GERMAN MEDIA PEACE PRIZE**

1. We spoke last week about the Prime Minister's decision not to attend this prize-giving on 16 February. I enclose a draft reply, which I suggest you send.
2. You asked about whether we should send a representative to receive the prize. In the absence of a reply from the Prime Minister the organisers have already decided to award the prize to their second-placed candidate, Rudolph Giuliani, and issued a press release to this effect (without mentioning the Prime Minister).

*Best wishes,*

Jonathan Walters  
Private Secretary to the Ambassador



**DRAFT LETTER FROM MICHAEL TATHAM TO HERR KARLHEINZ KÖGEL**

Herr Karlheinz Kögel  
Sekretariat Deutscher Medienpreis  
Medium Centrum  
76520 Baden Baden

MT  
C:JH  
Sh  
P

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T

from me.

M.



**British Embassy  
Berlin**

Wilhelmstr. 70  
10117 Berlin

Telephone: (030) 204 57102  
Fax: (030) 20457 571

28 January 2002

Michael Tatham Esq  
No 10 Downing Street  
London SW1A 2AA

By fax

MT  
C: JH  
SW  
P

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*Best wishes,*

*Jonathan*

Jonathan Walters  
Private Secretary to the Ambassador



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Herr Karlheinz Kögel  
Sekretariat Deutscher Medienpreis  
Medium Centrum  
76520 Baden Baden

MT  
C:W/6  
SW  
P/...

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*Draft*  
*Should be all in that of [unclear]*  
*in the [unclear] state will*  
*drop above [unclear]*

+49 30 20457571



FROM THE AMBASSADOR

Sir Paul Lever

JSW  
cc JPO  
DM  
MT

British Embassy

Wilhelmstrasse 70  
10117 Berlin

Tel: 20457 103  
Fax: 20457 571

25 January 2002

Sir Stephen Wall  
No 10

Ms Baker  
cc OSW  
MO  
MR  
RG

Dear Stephen,

**RELATIONS WITH THE KANZLERAMT**

1. I called on Dieter Kastrup, Schroeder's new Foreign Policy Adviser, this afternoon. I am recording separately what he said on non-EU issues.
2. When I asked Kastrup what his own priorities would be, he said that of course EU matters would feature prominently and he needed to inform himself about a lot of the detail. But he saw his function differently to the way Michael Steiner had seen it. He regarded himself as a coordinator and a facilitator. He would provide personal advice to Schroeder in certain areas where he felt he had something particular to offer (by implication, though he did not say this explicitly, not on EU issues). But he had a good team in the Kanzleramt and he wanted to harness and exploit them effectively.
3. I described to him the structure of No 10, of which I had already sent him an organogram. I noted that you had an excellent relationship with Reinhard Silberberg and that you tended to deal with him directly on EU business. Was Kastrup happy for you to continue to do so? Emphatically, yes, he replied. He looked forward to meeting you in due course and he was of course happy to take a call any time you wanted. But Schroeder had great confidence in Silberberg and if you were happy to deal with him directly, he Kastrup would welcome this.

Yours truly

Silberberg told me that Schroeder  
was the Chancellor's structure would  
change to become more like a  
Stephen

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*Fla*  
*✓*  
*see memo for*

From: Roger Liddle  
Date: 25 January 2002

PRIME MINISTER

*I really  
must see Schroeder.*

cc: Jonathan Powell  
Jeremy Heywood  
Sir Stephen Wall  
Andrew Adonis  
Alastair Campbell  
Peter Hyman  
Sally Morgan  
Robert Hill  
Senior Policy Advisers  
Rachel Cowburn  
Patrick Diamond  
Francis Campbell  
Sir Paul Lever (Berlin)

*cc Philip  
Gould.*

**CAN STOIBER BEAT SCHRÖDER?**

Overnight in Berlin (for an excellent Future of Europe Conference Paul Lever had organised) I found my SPD contacts in an uncertain mood. I spoke to Nowak and Bucksteeg in the Chancellery, Sontowski, who heads Schröder's office in the party headquarters and three members of the Bundestag.

At the end of last summer holidays the polls had the SPD on about 37%, on a declining trend as a result of growing economic problems and government difficulties (as exemplified by Rudolf Scharping cavortings in the swimming pool). The aftermath of September 11 pushed up the SPD four points. But the **New Year has seen them go down again to 37/38%**, as the focus has shifted back to the Government's uncertain handling of the domestic scene.

Stoiber's emergence has meanwhile pushed up the CDU/CSU to 40/41%.

The smaller party vote is divided between:

*I think  
the CDU/CSU vote will  
be more than 40%.*

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- the **Greens** – on around the 5% threshold which they need to get back into the Bundestag: with Fischer as their standard bearer most people believe they will;
- on the **PDS**, ex-Communists, on 5-6% with growing support in the East: whereas the conventional wisdom used to be that in time they would literally die out, in the recent Berlin Land elections they drew the largest support of all parties among young Berliners from both East and West;
- and the **FDP**, who will get at least 6%, but possibly quite a bit more, according to the degree of disaffection with the larger parties: they are the swing vote.

Most people believe that **Schröder has to get more votes than Stoiber to remain Chancellor**. The FDP would be unwilling to come in as the third member of a Red-Green coalition to keep Schröder in power, if the SPD itself ended up with fewer votes than the CDU/CSU. Their hope would be to join an SPD led coalition without the Greens if Schröder beat Stoiber. So despite PR and coalition politics, the **head-to-head result will be what really matters**.

**Should Schröder worry then about his 4% deficit against Stoiber?** Manfred Gullner at Forsa, the Berlin polling company, told me:

- at 40/41% Stoiber is polling his maximum. He will not go any higher – but it is uncertain whether this CDU/CSU resurgence will prove a

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blip. Stoiber will have to defend himself against charges of inconsistency as he trims towards the centre;

- Stoiber has two big electoral vulnerabilities. He is unpopular in the East (where Bavaria has strongly opposed larger transfers to the East) and women strongly prefer Schröder's 'modern man' image to Stoiber's embodiment of traditional, catholic family values.

**Schröder's great strength is that a big majority of Germans believe him to be the right man to be their Chancellor.** He goes into the election with a sizeable 'Chancellor bonus' that Kohl surprisingly never enjoyed but Schmidt, Brandt and Adenauer did.

**He fits the modern part: self confident and assured, a relaxed manner, not at all 'above himself', steady under pressure and respected abroad.** At present his campaign strategy is to play on those **personal strengths** and devise a **matching story about the Government's record and plans for the future.**

Nowak told me he was working 14 hours a day in frustrating meetings with Cabinet Ministers and Departments trying to construct this story. The SPD are attempting a direct copy of **'a lot done, a lot more to do'**:

- in 1998 the SPD took over after years of Kohl stagnation;
- the SPD has taken the tough action to restore the Government's public finances. (Eichel is Schröder's biggest asset and the cutting of the fiscal deficit its most admired achievement);



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- the SPD has begun to modernise Germany (tax reform, pension reform, first moves on labour market reform);
- and will continue for the future, but how? (This is where Schröder's advisers are most uncertain and divided) ;
- Schröder is the first German post-war Chancellor to overcome the hang ups of the past and allow Germany to play its rightful role in the world. Stoiber is a second division provincial not fit for the big league.

**The Government however continues to let down the Chancellor.** They are in the middle of their own messy health row. Scharping moves from one disaster to the next, the latest over the fact that the Germans needed Dutch pilots and British planes to get their troops to Afghanistan, while confusion over the A400M still reigns. (The joke is that at Christmas, Scharping, with extraordinary political insensitivity, asked Schröder if he could go to Bermuda for a break, to which Schröder is said to have responded "*if you go, you go!*").

As for the party, the SPD's decision to form a coalition with the ex-Communists has needlessly opened a vulnerable flank.

Opinion is divided about **how much damage the economy will do to Schröder.** Unemployment is a less salient issue than in 1998 (down from 80% to 65%) even though it remains Germans' greatest concern. Economic confidence is beginning to rise again and seasonal factors will reduce unemployment over the summer. Stoiber will have difficulty in presenting a credible economic alternative.

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The SPD is very worried about **morale amongst Party activists and members**, and its impact on the Party's ability to mobilise its 'core vote'. A good TV campaign is not enough. **The polls suggest Schröder is strong amongst the SPD core, but differential turnout is far more damaging under PR than 'first past the vote', where we <sup>lose</sup> nothing as a result of low polls in safe seats.**

On the other hand, some pollsters and some Chancellery advisers are more concerned about the SPD's appeal among voters without traditional Party affiliations (nowadays up to half the German electorate, though in the present election, the pollsters reckon about a fifth of the electorate is still up for grabs). Here there is a **tension between those who argue Schröder won in 1998 with a strong modernisation message (which Bodo Hombach gave him) and the Party's more traditional espousal of "Security in [a world of] Change".**

Hombach's legatees in the Chancellery (Nowak and Bucksteeg) are bitterly disappointed by Schröder's timidity as a moderniser.

- Recently they prepared a plan for Schröder to become the '**champion of education**' in Germany as the route to a better life for all. But he rejected it on the grounds that "we don't have any money to spend and education's not a Federal competence!
- On **labour markets**, there is a gathering consensus for <sup>reform</sup> ~~return~~. Both the young SPD members of the Bundestag I met, said "we must do it". But Schröder has been extremely cautious, because of fears of setting off a row with trade unionists in the Party.

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The modernisers in the Chancellery argue that it is perfectly possible to sell reform ideas – on education and jobs– to the SPD's core vote as well as appeal to the 'undecideds' in the middle. The problem is the conservatism of the Party which Schröder has shied away from tackling.

Schröder's caution compounds the problem that **the electorate as a whole has a very unclear idea of what the SPD now stands for.** 60% say they know what the CDU stands for: but only 30% say the same about the SPD. This is not necessarily a disadvantage if significant elements of voters don't like what they know about a Party. The CDU is perceived as strong on the family, against crime, against immigration and this may well not appeal to significant elements in modern society. **But the SPD is not presenting a positive, countervailing sense of its fundamental purpose in the modern world.**

In a way this strongly mirrors our own problems with New Labour. The 1945 Government was about fair shares for the working class and the construction of the Welfare State. Gaitskell and Wilson were both about creating a 'classless', more equal society. We have no equally powerful concept of mission.

*Opportunities for all, very small*

In Germany, the SPD has failed to present a vision of its purpose today. It goes into the election with a record of competence that is just about credible. It still stands for defending the success of the German social model. But Schröder still has to find language to express its modern purpose today: to answer the question of what it means, as one of Schröder's people put it to me, **to raise the living standards, opportunities and horizons of the broad mass of people without the advantages of wealth, privilege and inheritance.**

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It would be so stimulating and useful if we could find a way for your and him to thrash this out together at your next private dinner – rather than spend the time on Europe or world affairs.

As for Schröder's chances, **my bet is he will make it. But it is not the certainty it has looked for the past two years. Luck needs to be on his side.**



**ROGER LIDDLE**

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02072702821



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FROM THE AMBASSADOR

Sir Paul Lever

DM  
cc: JPB  
MT  
RL  
EC  
Press

British Embassy

Wilhelmstrasse 70  
10117 Berlin

Tel: 20457 103  
Fax: 20457 571

25 January 2002

*Full JM*

*A 107*

Sir David Manning  
No 10

*Dear David,*

**GERMAN FOREIGN POLICY: THE VIEW FROM THE KANZLERAMT**

1. I called on Dieter Kastrup this afternoon to go over the ground before Schroeder's visit to Washington next week. Much of what he said echoed his comments at the EU Ambassadors' lunch yesterday (Berlin telno 31). But a few additional glosses.

Afghanistan/ISAF

2. Kastrup confirmed that Schroeder was more open to the idea of Germany taking over the lead nation role "after you leave" than was Scharping. One of the things that Schroeder wanted to do in Washington was to check that the Americans were confident that the Turks could do the job properly or whether they would genuinely welcome it if the Germans offered to do so instead. Kastrup added that he was not certain how easy it would be for Germany to do this. There were formidable technical problems which the military experts were now studying. And if the general view was that the Turks were well placed to take over, then Germany certainly had no interest in calling their competence into question. But Schroeder's mind was not yet closed.

3. I picked Kastrup up on his reference to our leaving. I said that our commitment to act as lead nation only until at the latest the end of April, did not mean that we would thereafter immediately pull all our assets out. We anticipated that there would be a continuing British presence in ISAF and we would be as helpful as possible in offering the next lead nation support. There would probably be several hundred British troops there for some time to come. Kastrup seemed surprised to hear this.

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4. Solana had been making a strong pitch for the EU to take on responsibility for Macedonia. Aznar had also pressed Schroeder about this recently in Madrid. Schroeder, unsighted, had probably given Aznar the impression that he was open to the idea. But the Germans were aware of the arguments against the EU taking this mission on as soon as March. It was important that the first ESDP operation was a success. It looked now as though the Italians would provide a replacement for the German Commander of the NATO mission. This would secure the position for the next six months.

A400M

5. As recorded in our telno 33 Kastrup expressed extreme frustration at the way this issue had been handled. He was genuinely not sure what would happen over the reference to the Constitutional Court. But the German Government was committed to procuring 73 of the aircraft and was aware of the importance of the 31 January deadline.

Middle East

6. Kastrup was wholly pessimistic. He saw no scope for the EU to do anything useful. Solana and Fischer were both active on the telephone, but neither had any influence. All the EU could do was urge the Americans to become more involved.

NATO Enlargement

*Balkic* 7. Schroeder was now more relaxed about a wider next round including the three Balkan states. Putin seemed personally not to be too fussed about this; but he needed to find a way of selling the idea to his military. There would be a German/Russian summit in April.

Relations with the Czech Republic

8. Schroeder had found Zeman's remarks about the Sudeten Germans offensive and unnecessary. He was not going to make a fuss about it in public. But he would not go to Prague as planned in March unless Zeman in some way "clarified" his remarks. Fischer was sorting it out.

Schroeder's Travel Plans

9. Apart from Washington next week, and a trip to Mexico, Brazil and (security permitting) Argentina in February, Schroeder would only do the minimum necessary travel before the election. The idea of a visit to Africa had had to be postponed.

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10. Kastrup doubted whether foreign or EU policy issues would feature in the election campaign. There was no sign, for example, that Stoiber would make difficulties over EU enlargement. It would be all about the economy and unemployment. But obviously the fact of the campaign would be a major constraint on Schroeder's time, resources and energy.

Schroeder and Foreign Policy

11. I asked Kastrup whether Schroeder really enjoyed foreign policy or whether it was duty. Kastrup said that it depended on the issue. Schroeder found EU meetings boring, particularly the time spent drafting texts. But his adrenaline got going when big issues, like 11 September/Afghanistan, came up. Schroeder had initially not realised how much of a role Germany was expected to play on the world stage. But he had got really interested and involved in it. Of all his Head of Government colleagues he found the Prime Minister the easiest to talk to.

Yours &C

cc: Simon Macdonald, PS/Foreign Secretary  
Peter Watkins, PS/Defence Secretary

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10 DOWNING STREET  
LONDON SW1A 2AA

From the Senior Policy Adviser

25 January 2002

*Dear Mr Allitt,*

Thank you for your letter of 7 January. Tom told me you were going to write.

I would invite Patricia Hewitt to Berlin and get Paul Lever to write simultaneously in support. It would be helpful if you were flexible on dates. If you send the letter to Patricia to me I will contact her office.

This may not work but it is worth a try. But it is a very useful initiative.

*Yours*

*[Signature]*  
ROGER LIDDLE

*Good to see we've travelled the same  
political journey!*

Mr Julian Allitt



Jazz Radio und Verlag GmbH Sophienstraße 20 / 21 10178 Berlin

7th January, 2002

Roger Liddle  
10 Downing Street  
London SW1

Dear Roger

**British Chamber of Commerce in Berlin – Guest Speakers**

I am writing to you at the suggestion of my friend Lord McNally. I am responsible for organising speakers for the British Chamber of Commerce in Berlin and I should be grateful for your good advice on whether we could approach any Cabinet Minister or other high Government figure.

The format would be a lunch or dinner at a top city centre hotel, with around 150 – 200 guests, mainly from British firms in Germany and German firms with British interests. We can be entirely flexible over dates and would also pay any reasonable expenses (for the speaker and/or guest).

I have been in Berlin for five years now, having formally worked in commercial radio in the UK and previous to that, for seven years, as a Lobby correspondent at Westminster with United Newspapers. Until recently, the British Chamber has had a fairly low profile in Berlin but, having seen the success of the American Chamber here, I and others have set out to bring about a revival of the British Chamber, with some initial success. I can say we have the strong support of the British Ambassador, Sir Paul Lever.

For background, I am a Labour Party member. I was also the SDP-Alliance candidate in Blackpool South in 1987. I have known Tom McNally for many years – we are both from Blackpool.

Kind regards

*Julian Allitt*

Julian Allitt  
Managing Director

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Email: [jallitt@aol.com](mailto:jallitt@aol.com) or [julian.allitt@jazzradio.com](mailto:julian.allitt@jazzradio.com)

*Monica  
Please can't speak to me  
Try to you better.  
Tom told me you were going  
to work.*

*I would write Patricia  
Hessitt to Berlin. I'm sure  
she'd be an ideal.  
Get Paul Lever to  
write me and I will contact  
the office.*

*May not work but  
worth a try. Very  
useful indeed!*

Jazz Radio und Verlag GmbH

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[www.jazzradio.net](http://www.jazzradio.net)

Geschäftsführer: Julian Allitt  
Sitz der Gesellschaft: Berlin  
Amtsgericht  
Berlin-Charlottenburg  
HRB 54 109



conservative in the UK sense. He is closer to a traditional French-style Gaullist, combining social conservatism (pro Church, anti abortion, permissiveness and multiculturalism) with a statist and interventionist approach to economic management. Despite his calls for "less state", the Bavarian economy is supported with more subsidies, bail-outs, state holdings and cronyism/patronage than in almost any other German Land (analysed further in first MIFT).

5. That model has delivered absolute CSU majorities in the last 10 Bavarian elections, and brought Bavaria from the bottom to the top of the economic, IT, education, safety and quality of life leagues in Germany. It is the basic formula for success Stoiber will bring to the national stage.

6. But Stoiber is not another Chirac. He is not instinctively protectionist or mercantilist: he believes in free rather than "fair" trade and competition (though partly because he dislikes level-playing-field type restrictions on government's ability to "partner" business). He sees regulation as restricting not creating freedom. Like most old school CDU/CSU, he is instinctively pro American. There is little whiff of personal corruption, and he has avoided direct implication in party funding or amigo capitalism scandals (though one can only survive so long near or at the centre of Bavarian politics by being ready and able to get hands dirty).

7. Nor is Stoiber a provincial hick. He comes to the national stage with far more international experience than Schroeder did in 1998. He is an habitual globe-trotter, with top level access (Jiang, Putin, Chirac, Sharon, Annan to name a few). He visits Brussels frequently, and understands the EU's byzantine architecture. He is a realist not idealist, for whom foreign policy is the pursuit of national interests not principles.

#### DIFFERENCES WITH SCHROEDER

8. The FT's line is that Stoiber presents a "stark choice" and "clear battlefield". That is exaggerated. Like Schroeder, he continues to believe that the Rhineland capitalism model is fundamentally sound, and that his job is to preserve not deconstruct the German social market economy.

9. In fact, from the UK perspective the similarities look greater than the differences. For example,

- policy mix: Stoiber would go for a slightly higher deficit in order to bring forward slightly lower taxes. There is a dash of voodoo in the claim that this would quickly become self-financing. His previous call to reduce public expenditure from 48 to 40% of GDP is not backed up with planned cuts, looks undeliverable and hasn't been repeated recently. Overall, the basic mix, including removing the budget deficit by 2006 and sticking to Growth and Stability Pact ceilings, would remain the same as Schroeder's.

- labour market reform: Stoiber wants greater flexibility for plant-level pay deals within the German industry-wide pay bargaining system. And can afford politically to be a bit tougher with the Trade Unions. But, like Schroeder, he believes the basic structure remains fundamentally just and sound. He supports tax/benefit reform to encourage unemployed to take low-pay jobs,

but is no more likely to go for big cuts in welfare payments to coerce them to do so; or to tackle the co-decision system, or make it significantly easier to hire and fire;

- **state aids**: the present German positions on Services of General Economic Interest and higher competition policy thresholds are largely driven by Stoiber-orchestrated pressure from the Laender. They go to the heart of Stoiber's views on effective governance. Governments (including regional administrations) can and should pick winners, the way the Bavarian government successfully provided seed-corn for IT industry expansion. Stoiber might not as Chancellor try as hard as Schroeder to bail out coal and ship-building - but he would have his own list of "strategic" industries (aka voters) deserving of state support;

- **take-overs**: Stoiber is no less uncomfortable with foreigners running German companies. He will probably fight hard to prevent Murdoch taking over significant parts of the Kirch media empire (an important political ally already massively supported by the Bavarian Land-owned bank);

- **immigration/asylum**: internally this is a big difference between Schroeder and Stoiber. The former knows that Germany needs increased immigration in the medium term to fill labour shortages; the latter is committed, for social/cultural reasons, to reducing non-EU immigration. But this makes little difference to their external policy: both want to avoid development of any EU policy which restricts Germany's ability to pursue its own interests in this hyper-sensitive domestic political area;

- **foreign/defence policy**: Stoiber would raise the Bundeswehr budget a bit - but his commitment to preserving conscription precludes the necessary radical restructuring to release the resources necessary to transform German capabilities. Nor would he be likely to tackle the legal/constitutional restrictions on Germany's ability to act militarily, (though he would find it politically easier to participate if they were met);

- **EU issues**: second MIFT covers Stoiber's views in more detail. He knows there is no electoral mileage in euroscepticism (including on the euro). The CDU/CSU's overall strategy is to win credibility by outbidding the SPD/Greens on "more Europe". Differences with Schroeder are in the details (e.g. how to divide competences, which ones to repatriate) more than the fundamentals (EU integrated broadly on the German federal model with e.g. foreign policy run from Brussels). He seems to be closer to us than Schroeder on some key principles (continuation of intergovernmentalism, Member States to retain both legislative and executive functions, ECJ-enforced subsidiarity). Though in government he would come under pressure (from CDU colleagues and from apparatchiks) to follow an even more integrationist line. Like Schroeder he lacks any emotional attachment to the Franco-German motor, but is no more likely to court political trouble by reinventing the German approach to doing business in the EU.

LEVER

Sent by BERLIN on 23-01-2002 12:09

RESTRICTED  
 NOSEC: GERMAN ELECTIONS: STOIBER  
 From: BERLIN

TO PRIORITY FCO  
 TELNO 23  
 OF 231208Z JANUARY 02  
 INFO PRIORITY ACTOR, BANK OF ENGLAND, BONN, CABINET OFFICE  
 INFO PRIORITY CENTRAL EUROPEAN POSTS, DTI, EU POSTS, HM TREASURY  
 INFO PRIORITY HMGCS GERMANY, HOME OFFICE, MODUK, NATO POSTS  
 INFO PRIORITY SOSFA, TOKYO, UNSC POSTS, WHIRL

HMT FOR O'DONNELL, IVAN ROGERS, LAWRENCE  
 DTI FOR ALTY  
 BANK OF ENGLAND FOR BAILEY  
 HOME OFFICE FOR PALLETT  
 FCO PLEASE PASS TO FSA FOR RAIKES  
 CABINET OFFICE FOR DONNELLY  
 CABINET OFFICE PLEASE PASS TO NO10 FOR POWELL, CAMPBELL, MANNING,  
 WALL, LIDDLE

PART TWO OF TWO

2 MIFTS

10. Four big differences are, however:

(a) **personality**. The Prime Minister would find it more difficult to get alongside Stoiber than Schroeder, for personal far more than policy reasons. Although perfectly friendly, he is a bit stiff and dry, with none of Schroeder's irony or lightness of touch. He has long-standing relationships with Chirac, Berlusconi and Schluessel, who would be his natural partners if he got into power. Policy wonking is probably the best way to engage him: "give me a fat file instead of a thin blonde" is his only known joke;

Oh dear.

(b) **harmonisation**. Schroeder is a convert to "the European social model." He has come to be convinced that at least close approximation at European level of a whole range of economic, fiscal and social policies is necessary to prevent the welfare state being undercut. Stoiber's focus is on "l'exception allemande" - preserving his ability to run his own economic/fiscal and social policies with fewer EU-level restrictions. That could make him a potential ally on e.g. tax harmonisation. But it also drives his opposition to the Lisbon/Barcelona process, which he sees as extension not reinvention of EU competence for economic policy;

(c) **privatisation**. It has played a key part in the economic management of Bavaria (see first MIFT): the Land government has raised Euro 4.5bn by selling off 25 public companies over the last 10 years. But the model is more Jack Welch than Maggie Thatcher: the motivation is not to impose private sector management disciplines, but to realise capital for reinvestment (via state aid/support) in more economically profitable areas (such as IT). Otherwise Stoiber jealousy guards the power of public service patronage (cf. water) against liberalisation;

(d) **internal security**. Stoiber is prepared to go further than Schroeder/Schily in removing legal/constitutional restrictions on the police and security services, and in giving them new powers and resources.

IMPACT

11. The latest Economist argued that either Stoiber or even Schroeder could win the German election by turning into an economic liberaliser. That is wishful thinking. The campaign will be centred on economic competence, not reform. Both the SPD and the CDU/CSU are convinced that the key to success is reassuring the electorate they can improve the economy and preserve acquis without painful structural reform. So Stoiber's campaign is unlikely to pressure Schroeder's government into radical new directions between now and September, including on this year's big EU issues:

- CAP reform. Stoiber's core electorate includes small farmers. So he will oppose movement at the mid-term review. But that won't affect Schroeder's cautious support;

- Barcelona. The Lisbon process is not on Stoiber's radar screen. He is unlikely to press for e.g. more rapid energy liberalisation, or anything else which would change Schroeder's cautious, technocratic approach;

- Enlargement. Schroeder has bent over backwards to neutralise this an election issue. Successfully - Stoiber hasn't mentioned it once since becoming Chancellor candidate.

- ditto on Future of Europe.

12. Should the Prime Minister meet Stoiber before the election ? In December I advised against (Berlin telno 555), given Schroeder's sensitivities. That remains the best option, not least because a pre-election meeting promises us little head-start with a Chancellor Stoiber. But polls and the precautionary principle now point to avoiding risking offence to Stoiber if he himself pushes himself for a meeting. If so, we could use as cover the precedent of previous PM meetings with senior German Laender Minister-Presidents passing through London on other business. Or, if Bayern Munich again reach the Champions League final, we could engineer a meeting at Hampden Park (15 May).

13. Contact: Hugh Powell, firecrest or 0049 30 20457211

10. Four big differences are, however:

(a) personality. The Prime Minister would find it more difficult to get alongside Stoiber than Schroeder, for personal far more than policy reasons. Although perfectly friendly, he is a bit stiff and dry, with none of Schroeder's irony or lightness of touch. He has long-standing relationships with Chirac, Berlusconi and Schluessel, who would be his natural partners if he got into power. Policy wonking is probably the best way to engage him: "give me a fat file instead of a thin blonde" is his only known joke;

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**RESTRICTED**  
**GERMAN ELECTIONS: STOIBER AND THE BAVARIAN ECONOMY**  
**From: BERLIN**

TO PRIORITY FCO  
 TELNO 24  
 OF 231146Z JANUARY 02  
 INFO PRIORITY ACTOR, BANK OF ENGLAND, CABINET OFFICE  
 INFO PRIORITY CENTRAL EUROPEAN POSTS, CGS IN GERMANY, DTI  
 INFO PRIORITY EU POSTS, HM TREASURY, HOME OFFICE, MODUK  
 INFO PRIORITY NATO POSTS, SOSFA, TOKYO, UNSC POSTS, WHIRL

HMT for O'Donnell, Ivan Rogers, Lawrence, Connolly  
 DTI for Alty  
 Cabinet Office for Donnelly  
 Bank of England for Bailey  
 FCO please pass to FSA for Raikes  
 Cabinet Office please pass to No 10 for Powell, Campbell, Manning,  
 Wall, Liddle

MIPT  
 SUMMARY

1. Bavarian economic performance well above German average, due to combination of good fortune and sensible policies of Land Government. Active privatisation policy, balanced by state support for (mainly) high tech business. Stoiber an interventionist, rather than an economic liberal. The approach which has worked for Bavaria may not easily be applicable to economic policy at federal level.

DETAIL

2. Bavaria is a major economic powerhouse of Germany. In 2000, it grew by 4.3 per cent, well above the German average of 3.0 per cent. Unemployment, although climbing rapidly, was only 5.8 per cent in December 2001, comfortably below the German average of 9.6 per cent. Bavarian GDP per capita in 2000 was EUR 27,932, compared to a national average of 23,908.

3. One factor behind Bavaria's success is its "luck in starting poor". 50 years ago, it was among the most backward regions of Germany, with one-third of the population still employed in agriculture. Until the mid-1980s, it benefited hugely from the Finanzausgleich (the system of resource transfers among the Laender to equalise their income) which Stoiber now wants to change. Siemens' and the Allianz's decisions for reasons of security to move their headquarters from Berlin to Munich set off a process of rapid modernisation, in the course of which Bavaria moved straight to a high-tech and services-based economy, largely bypassing the stage of traditional industrial development - and subsequent structural problems - characteristic of other German regions.

4. Stoiber's Land Government and its (almost always) CSU-run predecessors can also take part of the credit for Bavaria's strong performance. Stoiber has run a fiscally tight ship, achieving substantial budget surpluses in 1999 and 2000. Bavaria boasts the lowest level of debt per capita of any Land, but the highest level of investment. Commentators have praised the Government for modernising its administration and for accelerating planning and approval procedures. The main thrust of economic policy has been to privatise in areas where state involvement is no longer necessary and to invest the proceeds in high technology growth

industries. Since 1992, the Bavarian Government has privatised 25 public companies, many in the electricity generating sector. Under the "Bavaria Future" initiative, it has invested around EUR 4.5 billion, mainly in high tech, but also in training, regional development and in improving the social and cultural quality of life.

5. Among the Bavarian Government's direct shareholdings are stakes in companies operating in the following areas: transport and infrastructure (including Munich and Nuremberg Airports); construction and land development; promotion of science and technology; media and the arts. There are few holdings in heavy industry, apart from minority stakes in three steelworks and a residual 4.5 per cent holding in the utility group E.on. In July 2001, the Bavarian Government realised EUR 479 million from the sale of E.on shares, which is being used to finance the next stage of the "Bavaria Future" initiative.

6. As well as direct participations in companies, the Bavarian Government provides support through a number of publicly owned financial institutions, including the LfA Foerderbank Bayern, which offers a mixture of loans (often at reduced interest rates), guarantees and venture capital. In 2000, the LfA provided support to 5,100 firms and approved new loans totalling EUR 1.3 billion. The LfA in turn owns BayernKapital, a venture capital firm established under the "Bavaria Future" initiative with an initial fund of EUR 77 million, to which the Government later added a further EUR 72 million.

7. The Bavarian Government also has a 50 per cent share in the Bavarian Landesbank, the remaining 50 per cent being held by the Association of Savings Banks (Sparkassen). Under the agreement reached by the Commission and the Federal Government last year, all of Germany's Landesbanks will lose the unlimited public guarantee they have enjoyed until now. But the new structure worked out for the Bavarian Landesbank involves a holding company which would, in the short term, continue to be 100 per cent publicly owned, although there might be scope later for a minority participation by the private sector.

8. This cautious approach on the Landesbank issue illustrates that **Stoiber is not an economic liberal**, but shares many of Schroeder's interventionist instincts. He has resisted reform of the administration of the national pension insurance system because of potential job losses in Bavaria; he has **fought against liberalisation of the water industry**, to protect local suppliers from competition; Bavaria has already signed an agreement to award public contracts only to firms paying wages at tariff norms set at sectoral level by negotiations between trade unions and employers - a measure still considered too controversial to be implemented at federal level; and on privatisation, it has ruled out of bounds firms which "embody a piece of Bavaria", such as the Weihenstephan brewery and Munich's Hofbraeuhaus. Stoiber is prepared to work pragmatically with the trade unions, agreeing an Employment Pact with them in 1996, although relations have cooled as Stoiber has indicated that he would repeal some of Schroeder's recent pro-union labour market measures.

9. Not all the Bavarian Government's recent investments have been a success. It has poured money into the Maxhuetten steel works, in the process - according to local Green politicians - losing EUR



260 million. Further embarrassment could lurk in the form of the Bavarian Landesbank's EUR 2.2 billion exposure to the troubled Kirch media group, where investment decisions were clearly influenced by political pressure from the Land Government. And there are pockets of unemployment in Northern Bavaria (former "old" industry areas, eg pottery) which match or exceed the national average.

10. These blemishes matter because economic competence is a key area where Stoiber thinks he can score against Schroeder; and because, based on that, Stoiber has made clear he wants to make the economy his central election theme. The success of the Bavarian economy should give Stoiber a head start. But a poll in this week's issue of the business weekly WirtschaftsWoche puts him only just ahead of Schroeder (44:42) in response to the question "Who can lead Germany of of the current economic crisis?".

11. To do better, Stoiber needs to make clear how he proposes to apply the Bavarian success model at national level. So far, his prescriptions are vague. His overall plan is the so-called "40-40-40" programme, whereby the top rate of tax, the public spending/GDP ratio and non-wage labour costs as a proportion of gross wages should all be reduced to below 40 per cent. But to hit these targets, particularly the reduction in the public spending/GDP ratio, would imply a sharp retrenchment in the role of the state; and Stoiber has not said how he will achieve this. The Stability and Growth Pact will limit his ability to reduce taxation without corresponding spending cuts. Until Stoiber can explain his blueprint for federal economic policy with a good deal more authority and conviction, he will struggle to make the most of what should be one of his strongest suits.

12. Contact: Mike Bolton, e-mail [mike.bolton@fco.gov.uk](mailto:mike.bolton@fco.gov.uk); tel 0049 30 204 57 321.

LEVER

**Sent by BERLIN on 23-01-2002 11:46**  
**Received by No10 on 23-01-2002 13:04**

UNCLASSIFIED  
 GERMAN ELECTIONS: STOIBER AND THE EU  
 From: BERLIN

TO DESKBY 231500Z FCO  
 TELNO 25  
 OF 231418Z JANUARY 02  
 AND TO DESKBY 231500Z CABINET OFFICE  
 INFO PRIORITY ACTOR, CENTRAL EUROPEAN POSTS, DTI  
 INFO PRIORITY DUSSELDORF, EU POSTS, FRANKFURT, HAMBURG  
 INFO PRIORITY HM TREASURY, HOME OFFICE, MODUK, MUNICH  
 INFO PRIORITY NATO POSTS, SOSFA, STUTTGART, TOKYO, UNSC POSTS  
 INFO PRIORITY WHIRL

CABINET OFFICE PLEASE PASS TO NO 10  
 NO 10 FOR WALL, TATHAM, LIDDLE  
 CABINET OFFICE FOR BUDDEN, DONNELLY  
 HM TREASURY FOR O'DONNELL, ROGERS, LAWRENCE  
 DTI FOR SAVILL  
 HOME OFFICE FOR PALLETT

BERLIN TELNOS 501 AND 536  
 SUMMARY

1. Like Schroeder, Stoiber has a practical attitude towards the EU. It has hitherto been dominated by a desire to maintain maximum freedom for Bavaria eg to determine its own regional and state aids policies. He has consistently resisted EU overregulation, while pushing the subsidiarity and competences delimitation agenda. His approach on institutions, CFSP and JHA is little different from the Government's.

DETAIL

2. Stoiber's views on the Future of Europe were set out in a speech in Berlin in November (first TUR) and were subsequently fleshed out in a CDU/CSU paper on Europe (second TUR), much of which was written in the Bavarian State Chancellery. As argued in MIPT, there are few fundamental differences of approach to Schroeder. Nor are the CDU/CSU likely to campaign on Europe.

3. Initially on the Euro-sceptic end of the spectrum - he once described the euro as "esperanto money" - on becoming Minister President of Bavaria, Stoiber was swift to recognise the EU's impact on domestic policy. Under him, the Bavarians have devoted huge capital and human resources to EU issues and have just spent 30 meuros on the purchase of a grand old building to house their Brussels office; they have been at the vanguard of the German Laender's fight against what they perceive as the EU's overregulation of and excessive intervention into the regions' affairs; and, more than any other Land, have pushed subsidiarity and delimitation of competences.

4. Like Schroeder, Stoiber's approach to Europe is pragmatic, not ideological. For him the central question is not how the EU's institutions should be organised but "what tasks an EU of 27 or 30 members must and can tackle together..." He rejects the Monnet method of "integration, wherever possible" since "not every problem in Europe is also a problem for Europe." His list of EU "essential" responsibilities includes CFSP, the single market and currency, a reformed CAP and JHA, transport, the environment etc, so long as there are cross-border dimensions. But education, health, employment and social security should remain firmly in the

hands of nation states and Stoiber is on record as opposing far-reaching harmonisation of direct taxes within the EU.

#### Division of Competences

5. The CDU/CSU paper gives a detailed and rather arcane account of how competences might be reordered. It includes: priority given to the subsidiarity principle; assumption that competences lie with Member States until proved otherwise; setting down precisely what sorts of action (eg harmonisation, co-ordination) the EU may take when and using which instruments (eg regulation, directive); recognition that intergovernmental co-operation will for the time being be inevitable and that enhanced co-operation and opting out are the appropriate methods - but not open co-operation, which the Bavarians view as EU creeping competences by another name.

#### Role of Nation State

6. Stoiber does not want a European superstate. He is clear that "the European level exists side by side with nation and region, it does not stand above them." For him the nation state is the political level with which people most naturally identify. He opposes any simplification of the treaties which would allow competences to be transferred to the EU without the consent of Member States. He has argued that the results of the 2004 IGC should be subject to an EU-wide referendum.

#### CFSP

7. In his Berlin speech, Stoiber accepted that only nations could decide on the deployment of troops. Yet when asked at a press conference on the CDU/CSU paper whether transferring responsibility for CFSP to the EU would eventually mean disbanding the Auswaertiges Amt and the Diplomatic Service plus the Defence Ministry and the armed forces, Stoiber answered "yes." As a first step he (like the SPD and also Fischer) advocates merging the Solana and Patten roles into one EU foreign policy representative. Stoiber, like most Germans, sees the key elements of nation state sovereignty as internal rather than external.

#### EU Institutions

8. Though not fascinated by the detail, Stoiber's prescription is in line with the rest of the CDU/CSU and not vastly different from the SPD: the Council and European Parliament should retain legislative responsibility, with each MEP representing the same number of citizens; no new chamber of national MPs; European Parliament and Commission to have right of initiative; Commission should be the executive and its President elected by Parliament, subject to Council approval; and Council to decide things by QMV (with few exceptions), providing there is a clear division of competences.

9. Stoiber is in favour of some sort of constitution, though he is aware that this term is unwelcome to some Member States. The CDU/CSU have opted for now for the description "constitutional treaty" which would include the Charter of fundamental rights, principles on competences, and financial and institutional arrangements.

#### Internal Market

10. The Bavarians want to delete the general treaty articles covering the internal market (94 and 95 TEU), on the grounds that these allow the Commission to take action in areas where the Treaties do not give them direct competence eg the tobacco advertising directive. Should this prove impracticable, they want more clarity about the limits to when articles 94 and 95 can be applied.

#### State aids

11. The CDU/CSU paper argues that EU state aids law must not prevent member states and regions from driving their own independent regional policies. State aids should only be disallowed where they perceptibly harm competition and trade within the EU.

#### EU enlargement/SCF Reform/CAP

12. Stoiber is not against enlargement, but the Bavarians have consistently complained that the project is underfinanced and Germany must not be the one left making up the difference. Hence Bavarian proposals on structural funds (net fund approach with greater freedom for recipients to decide how to spend the money, and the right of member states to make their own decisions about subsidising problem regions) and agriculture (cofinancing in place of direct payments). Schroeder's enlargement policies on Freedom of Movement of Persons and Transport already discount potential CDU/CSU objections in these areas.

#### Turkey

13. Stoiber quote from February last year: "Even if Turkey were a democracy on the French or British model, it has borders with Syria, Georgia, Iraq - and that is no longer Europe..."

12. Contact: Susannah.Simon@fco.gov.uk tel: 0049 30 20457331

#### LEVER

**Sent by BERLIN on 23-01-2002 14:18**  
**Received by No10 on 23-01-2002 15:19**

UNCLASSIFIED  
**GERMAN ECONOMY: GDP GROWTH SLOWS**  
 From: BERLIN

TO PRIORITY FCO  
 TELNO 22  
 OF 230810Z JANUARY 02  
 INFO PRIORITY ACTOR, BANK OF ENGLAND, BONN, CABINET OFFICE, DTI  
 INFO PRIORITY DUSSELDORF, FRANKFURT, HAMBURG, HM TREASURY  
 INFO PRIORITY MUNICH, STUTTGART, WHIRL

HMT for O'Donnell, Rogers, Ramsden, Perkins  
 DTI for Savill, James H Watson  
 Cabinet Office for Donnelly, Heardman  
 Bank of England for Bailey, Weeken  
 FSA for Conte  
 Frankfurt for Arrowsmith  
**SUMMARY**

1. Lousy 2001 GDP out-turn and poor outlook for 2002 put Schroeder on defensive as Stoiber says his campaign will focus on the economy and polls show CDU/CSU opposition ahead of SPD. A bad week for the Chancellor; but problems for Stoiber too.

**DETAIL**

2. Destatis, the Federal Statistical Office, published preliminary GDP figures for 2001 last week. While final figures are expected in March there is normally no major revision to the January data. The figures are as follows (real, percentage change on previous year):

2000 2001  
 GDP 3.0 0.6  
 Private consumption 1.4 1.4  
 Government consumption 1.2 1.3  
 Investment in mach+equip 8.7 -3.4  
 Construction -2.5 -5.7  
 Domestic demand 2.0 -0.5  
 Exports 13.2 5.1  
 Imports 10.0 2.0  
 Employment (in million) 38.7 38.8  
 Productivity (GDP/employee) 1.3 0.4  
 Average annual inflation 1.9 2.5

3. The collapse in GDP growth to 0.6 per cent in 2001 was a major disappointment after the strong 3.0 per cent of 2000. At the start of 2001 the Government still expected growth of 2.75 per cent, hoping that its tax reform would lead to a boost in private consumption. But with the world economic crisis deepening, and the oil price and FMD/BSE scares driving up consumer prices, the boost did not materialise. Instead, consumer confidence remained weak while domestic and foreign demand floundered. 11 September only made things worse.

4. The Government followed analysts in revising down its growth expectations in steps throughout the year. But even its latest revision in October (to 0.75 per cent) turned out to be too optimistic. 0.6 per cent is the lowest growth rate since the 1993 recession and - as the opposition have repeatedly pointed out - will place Germany at the bottom of the EU. What growth there was was based mainly on foreign trade: the large surplus contributed 1.1 per cent to GDP. Private and government consumption also recorded positive growth rates. But the decline in machinery and equipment and construction investments dampened growth; and stocks declined strongly.

*See para 10  
 overleaf.*

5. Meanwhile, average inflation in 2001, at 2.5 per cent, rose to its highest level since 1994. The public sector balance will record a deficit of 2.6 per cent of GDP, or euro53.8 bn. Employment increased only marginally, by 55,000 (or 0.1 per cent) and average unemployment barely fell, from 7.5 per cent in 2000 to 7.4 per cent in 2001.

6. Continued economic gloom has also forced the Government to revise down its growth forecast for 2002 to 0.75 per cent, bringing it in line with market consensus estimates. Until now the Government had maintained - eg in the December revision of the Stability Programme - its 1.25 per cent growth assumption, with the 0.75 per cent as a 'highly unlikely' worst case scenario. Meanwhile, the German press is speculating about the likelihood of Germany receiving an early warning letter from the Commission as the budget deficit comes perilously close to the 3.0 per cent Stability and Growth Pact limit.

#### Reactions

7. The Government has blamed the collapse in 2001 growth on the worldwide economic slowdown (particularly in the US), the rise in consumer prices and contraction in the construction industry (due to capacity adjustments in east Germany). The Finance Ministry says it expects the economy to gain pace in 2002, aided by falling inflation, low interest rates and a recovery in world markets.

8. The CDU/CSU opposition say the Government is wrong to blame outside factors, pointing out that other EU nations with similarly close trading links to the US are recording higher growth rates. The opposition instead blame the Government's tax, budget and labour market policies for putting Germany "bottom of the EU league".

9. Financial Times Deutschland (FTD, business daily) said that instead of concentrating on a balanced budget and Maastricht criteria the government would be better advised to focus its policy on economic growth and increasing employment. It accused the Government of lacking a 'coherent macroeconomic strategy'. It cited France as an example where the Government's concentration on job creation had resulted in impressive growth rates in recent years. In a separate article, FTD said that neither Schroeder nor Stoiber were displaying the grasp of the fundamental economic principles they needed to run the German economy.

#### COMMENT

10. The poor GDP figures, together with recent polls showing the CDU/CSU overtaking the SPD in the polls, add up to a fairly depressing week for Schroeder. But the elections are months away; and Stoiber has shown he is not invulnerable. Appearing solo on the influential TV programme "Sabine Christiansen" on 20 January (UK equivalent: Breakfast with Frost) he cut a poor figure: verbose, unfocused and - most important - unable to say how he'd run the economy better than Schroeder. Stoiber's TV image will be a key attribute with two televised debates with Schroeder - renowned for his good TV style - likely to be held during the campaign.

11. Contact: Carsten Ullrich, carsten.ullrich@fco.gov.uk, 0049 30 20457323.

#### LEVER

**RESTRICTED**  
**GERMAN ELECTIONS: STOIBER AND THE BAVARIAN ECONOMY**  
**From: BERLIN**

TO PRIORITY FCO  
TELNO 24  
OF 231146Z JANUARY 02  
INFO PRIORITY ACTOR, BANK OF ENGLAND, CABINET OFFICE  
INFO PRIORITY CENTRAL EUROPEAN POSTS, CGS IN GERMANY, DTI  
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Cabinet Office please pass to No 10 for Powell, Campbell, Manning,  
Wall, Liddle

MIPT  
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1. Bavarian economic performance well above German average, due to combination of good fortune and sensible policies of Land Government. Active privatisation policy, balanced by state support for (mainly) high tech business. Stoiber an interventionist, rather than an economic liberal. The approach which has worked for Bavaria may not easily be applicable to economic policy at federal level.

DETAIL

2. Bavaria is a major economic powerhouse of Germany. In 2000, it grew by 4.3 per cent, well above the German average of 3.0 per cent. Unemployment, although climbing rapidly, was only 5.8 per cent in December 2001, comfortably below the German average of 9.6 per cent. Bavarian GDP per capita in 2000 was EUR 27,932, compared to a national average of 23,908.

3. One factor behind Bavaria's success is its "luck in starting poor". 50 years ago, it was among the most backward regions of Germany, with one-third of the population still employed in agriculture. Until the mid-1980s, it benefited hugely from the Finanzausgleich (the system of resource transfers among the Laender to equalise their income) which Stoiber now wants to change. Siemens' and the Allianz's decisions for reasons of security to move their headquarters from Berlin to Munich set off a process of rapid modernisation, in the course of which Bavaria moved straight to a high-tech and services-based economy, largely bypassing the stage of traditional industrial development - and subsequent structural problems - characteristic of other German regions.

4. Stoiber's Land Government and its (almost always) CSU-run predecessors can also take part of the credit for Bavaria's strong performance. Stoiber has run a fiscally tight ship, achieving substantial budget surpluses in 1999 and 2000. Bavaria boasts the lowest level of debt per capita of any Land, but the highest level of investment. Commentators have praised the Government for modernising its administration and for accelerating planning and approval procedures. The main thrust of economic policy has been to privatise in areas where state involvement is no longer necessary and to invest the proceeds in high technology growth industries. Since 1992, the Bavarian Government has privatised 25 public companies, many in the electricity generating sector. Under the "Bavaria Future" initiative, it has invested around EUR 4.5 billion, mainly in high tech, but also in training, regional

development and in improving the social and cultural quality of life.

5. Among the Bavarian Government's direct shareholdings are stakes in companies operating in the following areas: transport and infrastructure (including Munich and Nuremberg Airports); construction and land development; promotion of science and technology; media and the arts. There are few holdings in heavy industry, apart from minority stakes in three steelworks and a residual 4.5 per cent holding in the utility group E.on. In July 2001, the Bavarian Government realised EUR 479 million from the sale of E.on shares, which is being used to finance the next stage of the "Bavaria Future" initiative.

6. As well as direct participations in companies, the Bavarian Government provides support through a number of publicly owned financial institutions, including the LfA Foerderbank Bayern, which offers a mixture of loans (often at reduced interest rates), guarantees and venture capital. In 2000, the LfA provided support to 5,100 firms and approved new loans totalling EUR 1.3 billion. The LfA in turn owns BayernKapital, a venture capital firm established under the "Bavaria Future" initiative with an initial fund of EUR 77 million, to which the Government later added a further EUR 72 million.

7. The Bavarian Government also has a 50 per cent share in the Bavarian Landesbank, the remaining 50 per cent being held by the Association of Savings Banks (Sparkassen). Under the agreement reached by the Commission and the Federal Government last year, all of Germany's Landesbanks will lose the unlimited public guarantee they have enjoyed until now. But the new structure worked out for the Bavarian Landesbank involves a holding company which would, in the short term, continue to be 100 per cent publicly owned, although there might be scope later for a minority participation by the private sector.

8. This cautious approach on the Landesbank issue illustrates that Stoiber is not an economic liberal, but shares many of Schroeder's interventionist instincts. He has resisted reform of the administration of the national pension insurance system because of potential job losses in Bavaria; he has fought against liberalisation of the water industry, to protect local suppliers from competition; Bavaria has already signed an agreement to award public contracts only to firms paying wages at tariff norms set at sectoral level by negotiations between trade unions and employers - a measure still considered too controversial to be implemented at federal level; and on privatisation, it has ruled out of bounds firms which "embody a piece of Bavaria", such as the Weihenstephan brewery and Munich's Hofbraeuhaus. Stoiber is prepared to work pragmatically with the trade unions, agreeing an Employment Pact with them in 1996, although relations have cooled as Stoiber has indicated that he would repeal some of Schroeder's recent pro-union labour market measures.

9. Not all the Bavarian Government's recent investments have been a success. It has poured money into the Maxhuetten steel works, in the process - according to local Green politicians - losing EUR 260 million. Further embarrassment could lurk in the form of the Bavarian Landesbank's EUR 2.2 billion exposure to the troubled Kirch media group, where investment decisions were clearly influenced by political pressure from the Land Government. And there are pockets of unemployment in Northern Bavaria (former "old" industry areas, eg pottery) which match or exceed the national average.

10. These blemishes matter because economic competence is a key



area where Stoiber thinks he can score against Schroeder; and because, based on that, Stoiber has made clear he wants to make the economy his central election theme. The success of the Bavarian economy should give Stoiber a head start. But a poll in this week's issue of the business weekly WirtschaftsWoche puts him only just ahead of Schroeder (44:42) in response to the question "Who can lead Germany of of the current economic crisis?".

11. To do better, Stoiber needs to make clear how he proposes to apply the Bavarian success model at national level. So far, his prescriptions are vague. His overall plan is the so-called "40-40-40" programme, whereby the top rate of tax, the public spending/GDP ratio and non-wage labour costs as a proportion of gross wages should all be reduced to below 40 per cent. But to hit these targets, particularly the reduction in the public spending/GDP ratio, would imply a sharp retrenchment in the role of the state; and Stoiber has not said how he will achieve this. The Stability and Growth Pact will limit his ability to reduce taxation without corresponding spending cuts. Until Stoiber can explain his blueprint for federal economic policy with a good deal more authority and conviction, he will struggle to make the most of what should be one of his strongest suits.

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LEVER

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UNCLASSIFIED  
GERMAN ELECTIONS: STOIBER AND THE EU  
From: BERLIN

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SUMMARY

1. Like Schroeder, Stoiber has a practical attitude towards the EU. It has hitherto been dominated by a desire to maintain maximum freedom for Bavaria eg to determine its own regional and state aids policies. He has consistently resisted EU overregulation, while pushing the subsidiarity and competences delimitation agenda. His approach on institutions, CFSP and JHA is little different from the Government's.

DETAIL

2. Stoiber's views on the Future of Europe were set out in a speech in Berlin in November (first TUR) and were subsequently fleshed out in a CDU/CSU paper on Europe (second TUR), much of which was written in the Bavarian State Chancellery. As argued in MIPT, there are few fundamental differences of approach to Schroeder. Nor are the CDU/CSU likely to campaign on Europe.

3. Initially on the Euro-sceptic end of the spectrum - he once described the euro as "esperanto money" - on becoming Minister President of Bavaria, Stoiber was swift to recognise the EU's impact on domestic policy. Under him, the Bavarians have devoted huge capital and human resources to EU issues and have just spent 30 meuros on the purchase of a grand old building to house their Brussels office; they have been at the vanguard of the German Laender's fight against what they perceive as the EU's overregulation of and excessive intervention into the regions' affairs; and, more than any other Land, have pushed subsidiarity and delimitation of competences.

4. Like Schroeder, Stoiber's approach to Europe is pragmatic, not ideological. For him the central question is not how the EU's institutions should be organised but "what tasks an EU of 27 or 30 members must and can tackle together..." He rejects the Monnet method of "integration, wherever possible" since "not every problem in Europe is also a problem for Europe." His list of EU "essential" responsibilities includes CFSP, the single market and currency, a reformed CAP and JHA, transport, the environment etc, so long as there are cross-border dimensions. But education, health, employment and social security should remain firmly in the hands of nation states and Stoiber is on record as opposing far-reaching harmonisation of direct taxes within the EU.

Division of Competences

5. The CDU/CSU paper gives a detailed and rather arcane account of how competences might be reordered. It includes: priority given to the subsidiarity principle; assumption that competences lie with Member States until proved otherwise; setting down precisely what sorts of action (eg harmonisation, co-ordination) the EU may take when and using which instruments (eg regulation, directive); recognition that intergovernmental co-operation will for the time being be inevitable and that enhanced co-operation and opting out are the appropriate methods - but not open co-operation, which the Bavarians view as EU creeping competences by another name.

#### Role of Nation State

6. Stoiber does not want a European superstate. He is clear that "the European level exists side by side with nation and region, it does not stand above them." For him the nation state is the political level with which people most naturally identify. He opposes any simplification of the treaties which would allow competences to be transferred to the EU without the consent of Member States. He has argued that the results of the 2004 IGC should be subject to an EU-wide referendum.

#### CFSP

7. In his Berlin speech, Stoiber accepted that only nations could decide on the deployment of troops. Yet when asked at a press conference on the CDU/CSU paper whether transferring responsibility for CFSP to the EU would eventually mean disbanding the Auswaertiges Amt and the Diplomatic Service plus the Defence Ministry and the armed forces, Stoiber answered "yes." As a first step he (like the SPD and also Fischer) advocates merging the Solana and Patten roles into one EU foreign policy representative. Stoiber, like most Germans, sees the key elements of nation state sovereignty as internal rather than external.

#### EU Institutions

8. Though not fascinated by the detail, Stoiber's prescription is in line with the rest of the CDU/CSU and not vastly different from the SPD: the Council and European Parliament should retain legislative responsibility, with each MEP representing the same number of citizens; no new chamber of national MPs; European Parliament and Commission to have right of initiative; Commission should be the executive and its President elected by Parliament, subject to Council approval; and Council to decide things by QMV (with few exceptions), providing there is a clear division of competences.

9. Stoiber is in favour of some sort of constitution, though he is aware that this term is unwelcome to some Member States. The CDU/CSU have opted for now for the description "constitutional treaty" which would include the Charter of fundamental rights, principles on competences, and financial and institutional arrangements.

#### Internal Market

10. The Bavarians want to delete the general treaty articles covering the internal market (94 and 95 TEU), on the grounds that these allow the Commission to take action in areas where the Treaties do not give them direct competence eg the tobacco advertising directive. Should this prove impracticable, they want more clarity about the limits to when articles 94 and 95 can be applied.

State aids

11. The CDU/CSU paper argues that EU state aids law must not prevent member states and regions from driving their own independent regional policies. State aids should only be disallowed where they perceptibly harm competition and trade within the EU.

EU enlargement/SCF Reform/CAP

12. Stoiber is not against enlargement, but the Bavarians have consistently complained that the project is underfinanced and Germany must not be the one left making up the difference. Hence Bavarian proposals on structural funds (net fund approach with greater freedom for recipients to decide how to spend the money, and the right of member states to make their own decisions about subsidising problem regions) and agriculture (cofinancing in place of direct payments). Schroeder's enlargement policies on Freedom of Movement of Persons and Transport already discount potential CDU/CSU objections in these areas.

Turkey

13. Stoiber quote from February last year: "Even if Turkey were a democracy on the French or British model, it has borders with Syria, Georgia, Iraq - and that is no longer Europe..."

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LEVER

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From: Roger Liddle  
Date: 18 January 2002

JONATHAN POWELL

cc: Jeremy Heywood  
Stephen Wall  
Martin Donnelly  
Derek Scott  
Francis Campbell

**DAVID MARSH: UK-GERMANY STEP CHANGE**

David Marsh, as you will remember, has now become a convert to British membership of the Euro. David has excellent German contacts following his time in Germany for the FT and his authoritative book on the Bundesbank. My thought was whether we could use him, and his British German Foundation, to forward the Prime Minister's wish for a step change in the UK-Germany relationship. He has come back to me with the attached paper.

The paper is a bit of a curate's egg from our point of view, but it does contain one interesting proposal: **the idea of a British/German observatory on European structural reform.** This would comprise independent economic institutes on the British and German sides co-operating together to produce an annual progress report on structural reform in our countries. This progress report would form the centrepiece for discussion at a conference of British and German business people and trade unionists.

The establishment of such a joint observatory would demonstrate real commitment by both Governments and both sides of industry in both countries to the economic reform cause. My proposal is that we should tell David that this idea has our blessing and get him to go and work up a detailed proposal after informal discussion with some of his informal German contacts. **But David**

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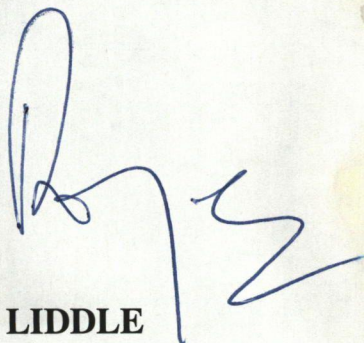
- 2 -

would need to know that in principle the Prime Minister is keen, would recommend it to Schroeder and that the two of them would hopefully attend a launch event after the German elections.

What do you think?

At the same time, David would like the Prime Minister to speak at the next London Conference of the German/British Forum on 17 October this year. This conference attracts a very high quality audience of British and German participants and it would obviously be a sell-out if the Prime Minister agreed to speak. It might even be the launch pad for the Joint Observatory.

I have also had a request from Norbert Walter, the chief economist of the Deutschebank, about whether the Prime Minister would be prepared to speak at their annual Bankers Conference in Frankfurt at the end of October. The subject would be the Euro and economic reform. Given the highly prestigious nature of this event and the fact that the topic may be well to the forefront of our minds by October, what do you think about putting forward these ideas for the diary?



ROGER LIDDLE

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**Memo to Roger Liddle  
From David Marsh  
4 January 2002**

**Britain, Germany and EMU: 10 economic and political points to remember**

***1. EMU has turned into a quagmire for politicians***

The road towards EMU is studded with unexpected turnings that have led to a quagmire for many politicians. None of the main instigators of EMU over the past decade – Helmut Kohl, Francois Mitterrand, Jacques Delors, Giulio Andreotti – has emerged with his reputation enhanced. The two previous British Prime Ministers, Margaret Thatcher and John Major, were badly wounded in currency jousting linked to EMU. Gerhard Schröder, the present German Chancellor, was a long-time EMU sceptic who forecast (before he came to power in October 1998) that EMU would not take place on time and said publicly (and correctly) in Germany in April 1998 that the euro would be a “sickly, premature child”. In a reference to his four marriages, Schröder told me in May 2000 that he was “an expert in bringing up children whom I have not fathered.” As his New Year declaration to the German people on 31/12/01 made clear, Schröder is now the chief guardian of the new currency.

***2. Germany has made some costly miscalculations***

Kohl deserves credit for vision and persistence in bringing off EMU. When I asked him at the Hanover summit in June 1988 – which set up the “Delors committee” of central bankers laying down a path to EMU – whether monetary union would take place by the end of the century, he said he was “90 per cent certain” that it would. However, Kohl also made key miscalculations:

- Political union, which Kohl said frequently around the time of the Maastricht summit in December 1991 was an essential accompaniment to monetary union, has not taken place, nor is it likely to materialise. The “stability pact” designed, at the behest of the Germans, to limit fiscal deficits, is a poor substitute for more thoroughgoing economic coordination.
- Faltering progress towards EMU during the 1990s, reflected in the missing of the first deadline for EMU at end-1996, caused Kohl to stay on for a disappointing final term in 1994-98. Had Kohl stepped down before 1994, his party would have avoided the eclipse of the September 1998 elections.
- Kohl was wrong that “pressure from the City” would drive Britain to join EMU. (Following a discussion I had with him in Maastricht in December 1991, we agreed a bet – 6 bottles of English or German wine – on whether Britain would be in EMU by end-1996. Kohl paid up in February 1997. I still have 2 bottles.) Scepticism is needed about claims that financial markets make British entry “inevitable”.
- Kohl’s determination to bring about EMU by 1999 arguably deflected the German government’s attention from the task of structural economic reform. These miscalculations make Germany less well-placed to meet the challenges of the next decades.

- From the point of view of EMU advocates, the mishandling of the economics of German unity had one important positive side-effect. The deterioration relative to other European countries in Germany's growth, fiscal and inflation performance from the mid-1990s onwards allowed widespread European convergence – but at a less exacting level than in previous years.

### ***3. The Maastricht treaty was designed to protect Europe from German economic strength, but Germany during the 1990s has been economically weak***

German unification in 1989-90, confronting Europe with the spectre of an over-powerful economic behemoth, provided the main catalyst to EMU. However, now that EMU is in place, one of the main factors impeding European cohesion is Germany's economic weakness, not its strength. The Maastricht treaty ratified the deal between Kohl and Mitterrand in April 1990 under which Germany would relinquish its dominant currency status in Europe in return for French support for German reunification. However, after a one-off unification-induced boost to German growth in 1990-92, Germany quickly returned to its previous low-growth path.

France's growth and inflation performance has been better than Germany's since the mid-1990s. As a result of the deteriorating German economy, the D-Mark would have been weak anyway during the second half of the 1990s, even if EMU had never been invented. If the push to EMU had not happened, the Bank of France might by 2002 have successfully challenged the Bundesbank's monetary dominance in Europe, and people in Germany might be complaining about monetary policies "made in Paris".

### ***4. Germany's economic problems make the EMU area a low growth zone.***

There is nothing new about Germany's economic problems. The structural weaknesses assailing the economy – insufficient labour market flexibility, high indirect labour costs, weaknesses in innovation, shortcomings in deregulation, poor climate for business start-ups, over-reliance on older industries, the reliance on a pay-as-you-go pensions system that is badly hit by Germany's poor demographic picture – were all diagnosed during the 1980s. Since 1992, the pattern of the 1980s has been repeated, with German growth lower than the EU average for every year since 1993.

#### *Annual % changes in real GDP: Industrial countries compared with EC/EU average*

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Germany	<b>5.0</b>	3.0	4.2	4.7	0.2	-1.4	<b>5.6</b>	<b>2.7</b>	<b>3.3</b>	<b>4.0</b>
France	<b>5.7</b>	<b>5.4</b>	<b>5.9</b>	5.4	<b>3.2</b>	<b>0.2</b>	<b>5.2</b>	<b>3.0</b>	<b>3.8</b>	<b>3.3</b>
EC/EU	4.6	3.5	4.4	6.0	1.8	-0.9	4.9	2.4	3.1	3.2
UK	2.2	2.7	2.2	<b>7.9</b>	-1.1	<b>-0.7</b>	3.8	1.0	<b>3.8</b>	2.2
US	-0.2	3.4	<b>5.7</b>	5.8	-0.6	-1.2	<b>5.4</b>	<b>5.5</b>	<b>5.3</b>	2.5

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Germany	<b>1.5</b>	0.0	-1.0	<b>1.5</b>	<b>2.8</b>	2.0	2.3	1.5	3.7	3.6
France	1.0	<b>0.5</b>	<b>1.8</b>	0.7	1.6	1.5	2.3	2.5	4.2	<b>4.3</b>
EC/EU	1.0	-0.2	0.5	1.4	2.4	2.5	2.7	2.8	4.2	3.6
UK	-2.3	-1.2	<b>1.2</b>	<b>3.6</b>	2.4	<b>3.8</b>	<b>4.2</b>	<b>4.2</b>	<b>5.2</b>	2.2
US	-0.2	<b>1.9</b>	-2.5	<b>3.6</b>	<b>7.3</b>	<b>3.8</b>	<b>3.4</b>	<b>3.4</b>	4.2	3.5



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Germany	<b>5.7</b>	<b>5.0</b>	<b>2.2</b>	-1.1	2.3	1.7	0.8	1.4	2.0	1.8	3.0	0.7
France	2.6	1.0	<b>1.3</b>	-0.9	1.8	1.9	1.1	1.9	<b>3.5</b>	<b>3.0</b>	3.2	<b>2.0</b>
EC/EU	3.1	1.8	1.2	-0.4	2.8	2.4	1.7	2.6	2.9	2.6	3.3	1.7
UK	0.8	-1.4	0.2	<b>2.5</b>	<b>4.7</b>	<b>2.9</b>	<b>2.6</b>	<b>3.4</b>	<b>3.0</b>	2.1	2.9	<b>2.3</b>
US	1.8	-0.5	<b>3.1</b>	<b>2.7</b>	<b>4.0</b>	<b>2.7</b>	<b>3.6</b>	<b>4.4</b>	<b>4.3</b>	<b>4.1</b>	<b>4.1</b>	1.1

*Projections for 2002 and 2003 (OECD Economic Outlook, No. 70, November 2001)*

	2002	2003
Germany	1.0	2.9
France	<b>1.6</b>	<b>3.0</b>
EC/EU	1.5	2.9
UK	<b>1.7</b>	2.5
US	0.7	<b>3.8</b>

*Source: OECD, IMF*

Figures in bold indicate the country's growth out-performs EC/EU average

Data for Germany before 1991 are for western Germany only

The OECD figures underline the relatively high synchronisation of the US and UK economies on the one hand, and the French and German on the other. The gap between the Anglo-Saxon and Continental economies has grown in the last 15 years. During 14 of the last 20 years since 1982, US growth has exceeded the EU average. In 13 of these years, UK growth has been above the EU average. Germany and France have respectively outperformed the EU average in five and six years out of 20. The UK has emerged relatively unscathed from the world's economic problems in 2001, and this is expected to continue in 2002, according to the OECD, before more convergence becomes apparent in 2003. If the OECD's projections are correct, much more balanced international growth in 2003 would make that year a propitious time for a referendum on British membership of EMU..

### ***5. Britain needs policies on EMU that promote structural economic reform***

In recent discussions in Germany, including a one-on-one public debate in Berlin (organised by the public sector financing agency Kreditanstalt für Wiederaufbau) with Finance Minister Hans Eichel on 11/12/01, as well as a national German TV programme on 16/12/01, I have developed the theme that the EU needs more structural reform to allow Britain to join EMU. In the debate with Eichel in Berlin, I encapsulated this in three points:

- More comprehensive economic reform, particularly in Germany, would boost the euro and allow sterling to decline, giving Britain a better chance of reaching a sustainable exchange rate for EMU entry.
- Reform is the key to improving the EMU area's growth rate and cutting unemployment, enabling the British people to believe they are joining "a winning team".
- Reform will have a self-fuelling effect in increasing the self-confidence and motivation of European governments and citizens alike, again increasing the attractiveness of the euro area for the British.

Eichel did not disagree. This underlines how Britain does not need to be defensive on EMU. Rather the Blair government can put forward positive-minded policies on EMU that would make our entry easier and also support policies that the EU needs to enact in its own self-interest.

Jean-Claude Trichet, the Governor of the Bank of France, made the point to me (on the margins of a Deutsche Bank conference on 29/11/01 in Frankfurt, at which we were both speaking) that structural reform is badly needed to make EMU a success, yet this finds no place in the criteria for EMU entry. Trichet suggested that some form of independent assessment of reform progress across Europe, more detailed than the reports supplied by the European Commission and the OECD, might be useful.

In my view, Britain could take a leading role in promoting such an "Observatory", perhaps in the form of a joint venture between independent German and British institutes. (I would suggest the London School of Economics and the new European Research Institute at Birmingham University from the British side, with German participants drawn from the government's independent Council of Economic Advisers, aided perhaps by the Economics Ministry's advisory council and the Kiel Economic Institute.) Such an initiative would be a concrete way of showing that Britain "means business" over structural reform. This "Observatory" would, of course, have to be totally free from political influence and would need to be even-handed in its criticisms of individual states' reform policies.

#### ***6. Negotiating the entry rate will take time and patience***

Bringing down the exchange rate to an acceptable rate for euro entry without provoking a deterioration in Britain's relatively low inflation rate and a counter-productive increase in interest rates will be a difficult task. The Government is right to highlight the lack of forethought with which the Thatcher government entered the ERM in October 1990. Far more time and patience will be needed this time round.

A telephone call on 5/10/90 between John Major, then Chancellor of the Exchequer, and Karl Otto Pöhl, then president of the Bundesbank, went as follows:

Major: "We are coming in at DM2.95."

Pöhl: "That is unrealistic. That is not possible."

Major: "But it has been decided by the Prime Minister."

Pöhl: "I don't care about your Prime Minister."

(Source: Karl Otto Pöhl, quoted on page 158 of my book *Germany and Europe: The Crisis of Unity*, 1994).

This underlines the difficulty of matching British and German views about the entry exchange rate. In 1990, the Germans thought – rightly – that Britain was entering the ERM at too high a rate. On the cusp of reunification, the German authorities were far more worried about maintaining an anti-inflationary firm D-Mark than about keeping their own exchange rate low to promote exports. More than a decade later, after nine years of economic under-performance, and unemployment of 4 million, the position is very different: the Germans will be worried that Britain is joining at too low a rate that will make German exports uncompetitive. Don't forget that Britain is the EMU area's biggest trading partner. (I said to Eichel, in jocular fashion, that we would enter straight away if the Germans agreed to DM 2.70.)

### **7. *The rest of Europe is not clamouring for Britain to join***

Unlike in the debates about ERM membership in the 1980s, there is no public campaign on the Continent for Britain to join EMU. Many Continental politicians now understand that Britain is *sui generis*. Any initiative from abroad to drag the UK into EMU is likely to prove counter-productive.

Ernst Welteke, the Bundesbank president, told me on 20/12/01 British membership was not a topic that had come up in any recent conversations at the ECB. He also voiced irritation at British criticism of the ECB's operating procedures, over non-publication of minutes and the ECB's inflation target. However, there is little doubt that, in private, senior Germans, from Chancellor Schröder downwards, would welcome British membership as a means of strengthening EMU's longer-term resilience and countering French influence. In private, Eichel and Caio Koch-Weser, his financial State Secretary, both give strong support for British membership.

Eichel told me he had offered his services to Gordon Brown to come to the UK to campaign for British membership – no doubt a well-meaning offer, but a gesture that needs to be treated with care. (As a cautionary sign of how the British press can exaggerate the impact of foreigners' statements, Eichel's remarks on 28/12/01 in an interview with *Der Spiegel* on the possibility that the euro would become a parallel currency in the UK were given over-inflated significance.)

### **8. *Britain can take some practical steps to enhance ECB reform***

By adopting discreet rather than megaphone diplomacy, Britain can achieve considerable headway in the goal of reforming some operating procedures of the ECB. Much anti-EMU criticism in the UK is directed towards the unaccountability and lack of transparency of ECB decision-making, as well as on the alleged deflationary bias of its policies. The Government and the Bank of England could do more to explain to Continental governments, and audiences in general, the functioning and achievements of the Bank's shift to operational independence after 1997. In particular, it could explain the difference between the Bank of England's mode of operation (for instance, on inflation targeting) and that of the ECB. I mentioned this to Eichel on 11/12/01 and suggested that British officials might take part in a private seminar at the Finance Ministry to discuss these questions in a non-adversarial way with their counterparts. Eichel indicated this was a practicable idea.

One of the other main issues at the ECB, the row over the succession to Wim Duisenberg, looks like being resolved. Both Eichel and Koch-Weser indicated he will agree to step down in 2003 – although there seems to be no agreement that his successor would necessarily be a Frenchman.

### **9. *There is no alternative to rigorous interpretation of the Treasury's economic tests***

If foreign exchange markets believed that the Government was not taking these tests seriously, and wanted to push sterling into EMU at all costs, then sterling might suddenly become vulnerable. This would necessitate an early rise in interest rates at a

time when the economy will anyway be slowing. In addition to the Treasury's five economic tests, the Government should take seriously some additional tests put by outside commentators, e.g. Business for Sterling. (In a recent paper, the group has argued that five further tests – concerning labour market reform, a better European fiscal policy framework, ECB reform, the exchange rate and a new “constitutional settlement” for the EU – are necessary.) Now that the Germans have lost their edge in arguing for monetary and fiscal discipline, Britain would be foolish to throw away the chance of appearing the most stringent economic policy practitioners in Europe.

#### ***10. Hitch-free transition to euro cash brings no need to change policy***

People forget that one widely-held view in Maastricht in December 1991 was that notes and coins could be introduced six months after fixing of exchange rates. I remember at Maastricht Pierre Berezgouvoy, the then French Finance Minister, outlining the plan for exchange rates to be fixed in December 1996 (the first deadline for the third stage of EMU) and for notes and coins to be introduced six months later. It soon became clear that this timetable was unrealistic in view of the immense industrial and logistical challenges of the planned currency conversion. In fact, EMU countries have had three years, not six months, to prepare for cash conversion following the fixing of exchange rates in January 1999, so it is not surprising that the operation has gone according to plan. As has been frequently stated in the last few days by Eddie George and others, the hitch-free transition is not the main argument to consider, and brings no immediate need for a change in Britain's policy.

#### ***Relevant David Marsh meetings in November/December 2001***

##### *In the last two months I had one-on-one meetings with*

Hans-Friedrich von Ploetz, German Ambassador to UK (London, 13/11/01)  
 Karl Otto Pöhl, former Bundesbank President (Frankfurt, 29/11/01)  
 Hans Eichel, German Finance Minister - public debate, with one-on-one discussion before and afterwards (Berlin, 11/12/01)  
 Ernst Welteke, Bundesbank President (Frankfurt, 20/12/01)  
 Helmut Schlesinger, former Bundesbank President (Frankfurt, 20/12/01)  
 Hans Reckers, President of Land central bank of Hesse (Frankfurt, 20/12/01)

##### *I saw for shorter conversations on the fringes of larger meetings*

Caio Koch-Weser, State Secretary at German Finance Ministry (London, 15/11/01)  
 Otmar Issing, Directorate Member, European Central Bank (London 17/10/01, London 14/11/01, Berlin 16/11/01)  
 Jean-Claude Trichet, Bank of France Governor (Frankfurt, 29/11/01)

##### *I also held meetings with the following*

Peter Hain (London, 7/11/01)  
 Denis MacShane (London, 26/11/01)  
 James Bevan (London, 4/12/01)  
 Sir Paul Lever (Berlin, 12/12/01)  
 Ed Balls (London, 19/12/01)



DRAFT FOR ROGER LIDDLE, 4 JANUARY 2002  
THIS DRAFT IS A PROVISIONAL OUTLINE DRAWN UP FOR  
PLANNING PURPOSES

*Seventh Annual Conference*

## **Leadership in Europe**

### **Euro – Enlargement - Economic Reform**

*London*

*Thursday 17 October 2002*

The seventh annual conference of the German-British Forum investigates the key economic and political issues influencing Europe today. The aim is to look at the inter-linked challenges resulting from the establishment of Economic and Monetary Union and of the move towards European Union enlargement. The common denominator is the need for structural economic reform across the continent, which will make both EMU and enlargement more effective in promoting jobs, growth and investment, and thus more politically and economically attractive.

The conference investigates these issues primarily from a business and economic perspective, with the aid of key decision-makers from Britain, Germany and other countries, including the US.

The conference will provide a platform to enhance debate on the further progress of European integration - including the question of British membership of EMU – in a way that keeps in focus the requirement for a flexible and dynamic European economy.

#### **Organisers**

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## CONFERENCE PROGRAMME

- 9.30 Registration and coffee**
- 10.00 Welcoming remarks**  
*Rt. Hon. Lord Hurd of Westwell, Chairman, German-British Forum*
- 10.05 Keynote speeches**  
*Rt. Hon. Tony Blair MP, Prime Minister, United Kingdom - REQUESTED*  
*Leszek Miller, Prime Minister, Poland - REQUESTED*  
  
*Session chairman - UNDER REVIEW*
- 11.00 Coffee break**
- 11.30 Is Europe following the right agenda for economic reform?**  
*Statements followed by discussion*  
*Bernd Pischetsrieder, Chief Executive, Volkswagen AG - REQUESTED*  
*Other participants - UNDER REVIEW*  
  
*Session chairman: Lord Simon - REQUESTED*
- 13.00 Lunch**  
*Lunch speaker: Charles Kennedy, Leader, UK Liberal Democratic Party - REQUESTED*  
  
**Presentation of German-British Forum 2000 Awards**  
*with President, German-British Forum Awards Jury*
- 14.30 Will enlargement strengthen or weaken Europe?**  
*Statements followed by discussion*  
*Participants - UNDER REVIEW*  
  
*Session chairman - UNDER REVIEW*



16.00 **Coffee break**

16.30 **Should the UK join EMU by 2005?**

*Debate with*

*Ian Duncan Smith, Leader, UK Conservative Party - REQUESTED*

*Martin Taylor, Chairman, WH Smith plc - REQUESTED*

*Sir Niall Fitzgerald, Chairman, Unilever plc - REQUESTED*

*Rt. Hon. Peter Mandelson MP - REQUESTED*

*Session chairman: Jim Naughtie - REQUESTED*

A vote on the motion will be taken among the audience before and after the debate

18.00 **Closing remarks**

*Prof. Willie Paterson, Director, Institute for German Studies, Birmingham University*

18.30 **Reception**

19.30 **Dinner**

**Welcome**

**Speakers**

*UNDER REVIEW*

22.00 **Closing remarks**

*Lord Hurd of Westwell*

+49 30 20457571

FROM THE AMBASSADOR

Sir Paul Lever



British Embassy

Wilhelmstrasse 70  
10117 BerlinTel: 20457 103  
Fax: 20457 571

21 January 2002

MT  
cc-JPO  
DM  
RL  
FC  
KK

Michael Tatham  
No 10

*Dear Michael,*

**SIGMAR GABRIEL**

Sigmar Gabriel is Schröder's successor as (SPD) Minister-President of Lower Saxony. He will be leading a team of economic experts to the UK from 5-10 March to study PFI/PPP.

Sigrid Krampitz (Head of Schröder's office) rang me today to pass on Schröder's personal request that the Prime Minister see Gabriel for 15 minutes or so.

There is no overwhelming case for doing so. But the balance of advantage favours fitting him in if possible. Gabriel is young (42), a close Schröder protégé, and key reformist ally. He would be on most commentators' short list as a likely future leader of the SPD and as a possible future Chancellor. He takes an interest in European issues and is an important voice in the deliberations among the Länder on the future of Europe.

Seeing him also offers a possible solution to the dilemma of how to handle Stoiber if the latter were to propose himself for a visit to London. I've noted previously Schröder's sensitivity about partners (cf. Chirac) receiving his opponents. But a meeting with Gabriel would establish a defensible precedent for the Prime Minister, should he wish to do so, to see A.N Other important German Minister-President who was in London.

Please let me know how to respond to Krampitz and Gabriel.

*Yours etc*

*Paul*

cc: PS/Secretary of State  
PS/Mr Hain  
PS/PUS  
Michael Arthur, FCO  
Kim Darroch, FCO  
Karen Pierce, FCO  
Roger Liddle, No 10





## 10 DOWNING STREET

pm (F)



To note Gerring's  
increasing economic problems

The Commission is pressing

for Gerring to be given a

formal "warning" under the

stability & growth pact of

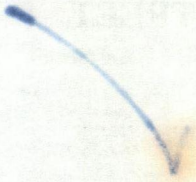
the Eurogroup on Monday

night. This will be highly

embarrassing for Schroeder as

there will be a big row.

But it is in our interests



(9)

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## 10 DOWNING STREET

that countries do not  
run excessive deficits  
if we are to join the  
Euro. Germany is setting  
very close to the 3%  
ceiling now because of the  
failure to retract in the  
early Schroeder years.

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# Lowest growth in decade plagues Schröder

GERMAN ECONOMY SEPTEMBER ELECTIONS PRESENT CHANCELLOR WITH A DAUNTING TASK IN THE MIDDLE OF A DEEP RECESSION

By Haig Simonian and  
Hugh Williamson in Berlin

Gross domestic product in Germany rose by a lower than expected 0.6 per cent last year, leaving growth at its lowest level for nearly a decade and increasing Chancellor Gerhard Schröder's political problems.

The figures showed the economy had contracted for the third quarter running at the end of 2001, confirming the depth of the slowdown and underlining predictions that unemployment would soon breach the politically sensitive 4m mark.

With growth not expected to revive until the second or third quarters and elections due in September, Mr Schröder faces a daunting task convincing voters to back his economic policies.

In a setback for the chancellor, the European Commission yesterday signalled that it was likely to send Berlin an "early warning let-

ter", to make sure that Germany's fiscal position did not deteriorate any further.

The Commission indicated that, while it did not intend to censure Germany when it assessed the country's fiscal performance this month, it remained concerned about the budget deficit.

Under the European Union's stability pact, countries have to keep deficits below 3 per cent and aim to balance their budgets over the medium term.

The Commission acknowledged that because of the world economic slowdown, Germany's deficit "widened by much more than planned", reaching 2.6 per cent in 2001, 1.1 points more than expected.

Hans Eichel, finance minister, brushed aside concerns that Germany was in danger of exceeding the 3 per cent deficit criterion this year.

"We will be clearly below," he told the Financial Times. "We won't exceed the limit, that is already clear."

The government has forecast growth of 1.25 per cent this year. However, the official prediction is expected to be revised down when the government issues its annual economic report at the end of this month.

In response to current economic conditions, the chancellor last night said he would use a high-level meeting next Friday between government, trade union and employer representatives to call for moderation in pending wage negotiations.

In contrast to Germany, France and the Netherlands appear to have avoided falling into recession last year, according to official French and Dutch reports yesterday.

The Bank of France estimated GDP growth last year

at about 2 per cent, making it the seventh successive year that France has achieved higher growth than Germany.

In the Netherlands, economic growth data were revised upwards to show that Dutch GDP was unchanged in the third quarter of 2001 rather than having shrunk by 0.4 per cent, as initially estimated.

Dutch growth for the whole of 2001 is expected to have been about 1 per cent.

■ Mr Schröder last night proposed two televised debates with Edmund Stoiber, his conservative opponent. He suggested one should be held at the beginning of the formal election campaign and one shortly before the elections.

*Additional reporting by Daniel Dombey in Brussels and Tony Barber in Frankfurt*

## German growth at worst for eight years

By Gary Duncan  
Economics Correspondent

GERMANY'S economy has marked its worst performance for eight years after official figures yesterday confirmed that it shrank for the third quarter in a row in the closing months of 2001.

The German authorities confirmed that Europe's former economic powerhouse saw growth over last year of just 0.6 per cent — down from a 3 per cent expansion in 2000,

and the worst figure since a 1.1 per cent slump in 1993.

The data did not give a precise figure for Germany's contraction in the final quarter of last year, but analysts said that it appeared to have suffered a 0.5 per cent decline in output. That followed smaller falls of 0.1 per cent or less in the second and third quarters.

The news added to the economic woes facing Germany's Chancellor, Gerhard Schröder, as he prepares to

fight national elections this year.

Herr Schröder was forced to admit that Germany's jobless count is now set to rise further from its current level of about four million to as high as 4.3 million in the next few months — a far cry from the Chancellor's pledge to cut unemployment to 3.5 million by the end of his first term of office.

His Government yesterday sought to put a brave face on the economy's slide, insisting

that it will rebound this year on the back of cuts in taxes and interest rates.

"Economic activity should stabilise again and the momentum of growth should significantly speed up," the German Finance Ministry said.

Germany's powerful unions meanwhile added to Herr Schröder's troubles. Despite employers' calls for pay restraint, an arm of the giant IG Metall engineering union demanded a 6.5 per cent pay hike.



## THANKS, BUT NO THANKS

Germany's experience should make Britain wary of the euro

The advice of Hans Eichel, the German Finance Minister, to the United Kingdom on the euro is not quite as misplaced as that suggested by France in 1940, when she recommended that Britain sue for peace, but it is almost as inappropriate. Herr Eichel offered a eulogy to the single currency in an interview on Wednesday and insisted that if Britain did not sign up to it soon both the domestic economy and Europe as a whole would suffer.

His words will be ridiculous to those who are swelling Germany's lengthening unemployment register. It is all but certain that many more than four million of Herr Eichel's fellow citizens will be jobless soon, as he himself may be by September. Unemployment in Britain remains below one million. The Finance Minister is outlining less the path to a Promised Land than the solidarity of shared misery.

The current German economic dilemma can be summarised in a single word, uncompetitiveness. The exchange rate at which the mark was locked with other eurozone members was simply too high to support its exports. The present interest rate set by the European Central Bank, 3.25 per cent, might appear low but it is at least half a percentage point higher than it should be to inspire a dynamic economic recovery. And there is little that the country can do to stimulate demand via tax cuts or spending increases because it is constrained by the strictures of the inappropriately named Stability Pact. These are all consequences of euro membership and none of them can be altered by German politicians or voters.

An economic downturn will still have significant political implications. For a long time, Gerhard Schröder seemed set to win a second term as Chancellor. His assets were, not unlike Tony Blair in this

country, a benign economy coupled with a divided, apparently hopeless, Opposition. A surge in unemployment will obviously undermine him on the first front while the emergence of the charismatic Edmund Stoiber, Prime Minister of Bavaria, as the candidate of the conservative Opposition could prove fatal on the other. The polls, like the economy, are turning against the Social Democrats.

If Herr Stoiber is to make the most of his chance, however, he needs to appreciate that the economy, not immigration, is the central issue. The German system of proportional representation renders politics a form of poker. The Christian Democrats will need a political partner if they are to form an administration. An alliance with either the PDS (the former Communists) or the Greens is out of the question and a "Grand Coalition" with the Social Democrats is improbable. The logical suitors for Herr Stoiber are the Free Democrats, but they are as passionately liberal on matters of nationality and immigration as he can be conservative. If he wants to be Chancellor then his slogan will have to be the German equivalent of the famed Clinton approach: "It's the economy, stupid."

The outcome of the German elections is of considerable importance to Britain. But even if Herr Schröder survives on the basis of Free Democrat backing, as he may well do, Mr Blair needs to consider why his Social Democratic colleague has run into trouble. Herr Eichel dismissed British opposition to the euro as a "national eccentricity" which would harm its own interests. Yet for a nation to enter an economic arrangement which is palpably at odds with its own interests, simply for political reasons, is surely the height of eccentricity.

# Economic downturn originates from home

By Tony Barber in Frankfurt

Germany's sharp economic downturn last year was caused to a large extent by domestic factors and would have been even more severe if exports had not come to the rescue, according to official data released yesterday.

The federal statistics office said exports had risen at an annual rate of 5.1 per cent in 2001, well below the 13.2 per cent achieved in 2000 but enough to ensure that overall gross domestic product growth was positive.

At 0.6 per cent, German GDP growth was the lowest since the recession of 1993, when GDP shrank by 1.1 per cent. It was Germany's second worst performance since unification in 1990 and is likely to mean that Germany grew at only half the average eurozone rate last year.

"Taken together, the data imply that net exports made a sizeable contribution to overall GDP growth last year, while slower inventory building and domestic demand weighed on overall economic performance," said Elga Bartsch, economist at Morgan Stanley.

Germany's ability to maintain export growth in a year marked by a global trade recession was attributable partly to the euro's persistently low level against the dollar on currency markets.

Although German and other eurozone policymakers have often expressed a desire to see a stronger euro, this could work to Germany's disadvantage in the short term, especially if the European Central Bank keeps interest rates at a level too high for Germany's

needs.

But the data for 2001 show that low domestic demand and investment were at the root of Germany's problems. Private consumption grew by only 1.4 per cent, the same rate as in 2000.

Investment spending on machinery and equipment fell by 3.4 per cent, after an 8.7 per cent rise in 2000, and investment in the construction industry fell by 5.7 per cent after a 2.5 per cent decline in 2000.

Construction has been depressed since a post-unification boom in the early 1990s.

The figures suggest that, contrary to government hopes, the tax cuts implemented at the start of 2001 did not translate into higher spending. This was partly because annual inflation was

relatively high in the first half of last year, briefly rising above 3 per cent before falling so that the average for 2001 was 2.4 per cent.

But another factor lay in savings rates. Although household disposable income rose by 3.6 per cent last year, up from 2.8 per cent in 2000, Germans put much of their extra money into savings. The savings rate went up last year for the first time in a decade, to 10.1 per cent of disposable income from 9.8 per cent in 2000.

Germany's economic downturn and the tax cuts combined to push the budget deficit up to 2.6 per cent of GDP. This was twice the level recorded in 2000 and brought Germany close to the 3 per cent limit set out under the European Union's stability and growth pact.

# Eichel explains as Germany nears breaching euro growth rules

By GEORGE TREFGARNE  
IN LONDON  
AND TOBY HELM  
IN BERLIN

GERMANY is almost certainly in recession and perilously close to breaching the key euro Growth and Stability pact, according to official figures yesterday.

The news is an embarrassment to Hans Eichel, German finance minister, who told *The Daily Telegraph* this week that Britain must join the euro or its economy will weaken. As it stands, the German economy is suffering most and Britain is the fastest-growing among the G-7 advanced nations, with the lowest unemployment.

The German Federal Statistics office said the euro zone's biggest economy grew at only 0.6pc in 2001. It was the worst performance since 1993.

Economists fear Germany is

now the "sick man of Europe", a status held by Britain in the 1970s. Robert Prior-Wandisforde of HSBC said: "We expect German growth to pick up from here, but there is no doubting its structural problems."

The euro has been under severe pressure in the past week and dropped below 88 cents to the dollar yesterday, before recovering slightly to 88.07. Against the pound it slid 0.2p to 61.29p.

The technical definition of recession is two quarters of negative growth and it is already known that Germany shrank 0.1pc in the third quarter of last year.

No breakdown will be given for the fourth quarter until March, but the statisticians said it was "similar to the third" and economists calculated it shrank by at least 0.1pc again.

The fate of the German economy could have grave consequences for the single currency. There are growing concerns that the country is in danger of breaking the rules of the EU's tough Growth and Stability Pact, made to strengthen the euro.

Under the pact's rules, no euro member may run a government deficit of more than 3pc of gross domestic product. The European Union is already forecasting that Germany's weak tax revenues mean it will run a deficit of 2.7pc this year.

Yesterday, the Federal Statistics Office admitted Germany's deficit was 2.6pc last year.

The pact precludes the kind of radical reform many believe is needed in Germany. Tax cuts and deregulation in Britain and America in the 1980s were initially funded by higher govern-

ment borrowing. Germany holds elections in September and the economy and rising unemployment are set to take centre stage. If the deficit hits 3pc, Germany could be fined by the EU up to Eu10 billion.

Yesterday, Mr Eichel said the rules would not be broken: "We're close to it, that's clear, but we're not going to breach it."

Mr Eichel dismissed embarking on American-style reforms and made clear his preference for the German social democratic model.

He said: "It is worth studying American strengths but there are also remarkable weaknesses. The social system is inefficient, the health system is expensive and inefficient, the balance of payments deficit is a problem, as are the debts of private households and the extremely high dependency on the stock market."



## Germany's debt puts the skids under eurozone

BY IMRE KARACS  
in Berlin

THE EUROPEAN Commission is considering warning Germany over its vast public debt, which threatens to weaken the euro and undermine business confidence on the Continent.

No EU state has been ticked off for breaking the budget deficit limits imposed by the legally binding rules for membership of the single currency. The mere hint emerging from Brussels yesterday that Europe's biggest economy was already perilously close and faced a reprimand sent the euro on the slide and sparked frenzied activity in Berlin.

According to official figures released yesterday, growth in Germany slumped in the past year to 0.6 per cent, the smallest in eight years, and far lower than budgeted for. To make up the shortfall, the government was forced to borrow heavily, raising the deficit to 2.6 per cent of gross domestic product.

The deficit limits, foisted on

other European countries by Germany as a means to underpin the euro, impose a 3 per cent deficit limit. Breaching the limit triggers huge fines.

Last year, Germany cleared it with 0.4 of a percentage point to spare but, with no end to its economic woes in sight, this

year has even worse in store.

The Commission's official estimate, which proved to be grossly over-optimistic last year, sees the German deficit rising to 2.7 per cent in 2002.

Michaele Schreyer, one of the German commissioners in

Brussels, told the newspaper *Die Welt*: "The situation in Germany, saddled with a relatively high level of indebtedness, is undoubtedly critical."

The Commission has been examining the economic performance of the 12 states bound together by the euro, and passed most of them with flying colours. Germany and Portugal have not made the grade.

On 30 January, Brussels will produce a report, which, according to the German financial daily *Handelsblatt*, would

sound the alarm bells. A commission spokesman insisted yesterday that no decision on Germany's "yellow card" had so far been taken.

The government in Berlin is desperate to avoid such an ignominy in an election year. Chancellor Gerhard Schröder's opponents would seize on any criticism from Brussels as evidence of his mismanagement.

But even if Berlin escapes a formal telling-off, the EU's largest country and the euro are in for a bumpy ride in the coming months. When the economy starts to recover is anyone's guess.

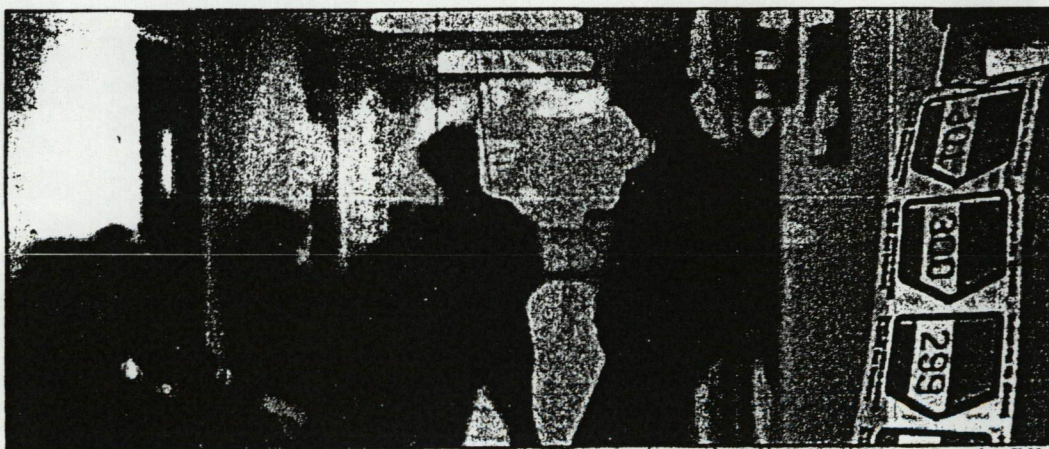
Unemployment is soaring, with the headline figure expected to reach 4.3 million by March. When Mr Schröder came to power just over three years ago, he made only one specific promise, namely that he would bring unemployment down to 3.5 million by the end of his term. He sensibly ditched that pledge last year, for it now appears that the jobless rate on election day in September will be almost identical to the figure-

bequeathed by Helmut Kohl four years ago.

In the climate of mounting economic crisis come signs of industrial unrest. *Ig Metall*, the country's most powerful union, has put in for a 6.5 per cent pay claim. *Ig Bau*, the building sector union, is going for 4.5 per cent. A summer of discontent looms.

The tangible feeling of uncertainty makes a mockery of the Eurocrats' formerly confident assertions that they are able to calculate this year's budget deficit to the decimal. The timing and strength of German recovery are unknown, as are the future wage costs of the country's industry.

Not least, there might well be a new government in place by the end of September. The conservative opposition, energised by its new leader, Edmund Stoiber, has already moved five points ahead of the Social Democrats in the polls. And the worst economic news looks likely to be ahead.



Queues at employment offices in Germany have not shortened since Gerhard Schröder took office three years ago, despite his election promises to cut the number of jobless

# Germany faces EU rap on economy

John Hooper in Berlin and  
Andrew Osborn in Brussels

The European commission is considering issuing an unprecedented written warning to Germany, architect of the eurozone's tough budget rules, over the deteriorating state of its public finances, EU sources disclosed yesterday.

Officials in Brussels fear the rapidly widening gap between Germany's income and its outgoings could soon begin to undermine the euro and are preparing a damning analysis of its economic policies for later this month.

Germany's budget deficit has opened up alarmingly after Europe's biggest economy slowed down and then contracted. Figures published yesterday showed that in 2001 it had its worst year for almost a decade, with growth down to a mere

0.6%, and that it was almost certainly already in recession.

Its economy, once the continent's powerhouse, has now been growing more slowly than those of its big European rivals since the mid-1990s, with most analysts expecting it to fare no better in 2002.

With unemployment soaring to just under the psychologically crucial level of 4m and the unions poised to stoke inflation with stiff wage demands, Chancellor Gerhard Schröder faces a nightmare run-up to the general election in September. A public warning from Brussels, coupled with unsolicited advice on how he should be running the economy, would substantially compound his problems.

It would be humiliating as Germany, in the 1990s, insisted on writing into the plans for economic and monetary union

the very fiscal restraints it is now in danger of busting. Successive German finance ministers and Bundesbank governors, scorning "spaghetti money", warned that a curb on budget deficits was needed to stop Mediterranean countries with a history of overspending from destabilising the euro.

Yet, according to statistics made public yesterday, Germany's own budget deficit overshot the government's forecast, coming in at 2.6% of national output (GDP). Officials in Brussels felt that was worryingly close to the EU's 3% ceiling.

Berlin has been caught between shrinking tax revenues and Germany's generous welfare system and the subsidies the government extends to nationalised industry. But critics have argued that this uncomfortable squeeze could have

been avoided had the chancellor shown a greater readiness to deregulate and liberalise.

"Even though there is no threat of Germany breaching the 3% threshold, that would not stop an early warning being issued," said one official in Brussels. "Our forecasts are that the deficit may reach 2.7% of GDP in 2002."

It would be the first such warning from the commission since the launch of economic and monetary union in 1999.

An official of the employment ministry has said the number out of work could surge to 4.3m this month.

Concern is also being expressed about inflation. Leaders of the giant metalworkers' union, IG Metall, which is seen as a bellwether, called yesterday for whopping 6.5% annual pay increases in two of Germany's biggest states:

The Mirror  
18 January 2002

## Trade chief backs euro

By OONAGH BLACKMAN 2

TRADE and Industry Secretary Patricia Hewitt yesterday piled on the pressure for euro entry, saying she wanted Britain to join.

She said: "Of course I want to see us in the euro and I think there will be huge benefits for consumers as well as industry."

TUC general secretary John Monks, speaking in Bristol last night, backed the minister.

He said: "We need this message to be the consistent message coming from Government."

**RESTRICTED**  
**GERMAN ELECTIONS - IT'S SCHROEDER V STOIBER**  
**From: BERLIN**

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Cabinet Office please pass to No 10 for Powell and Manning  
 SUMMARY

1. Stoiber the CDU/CSU Chancellor-candidate for September election. Economic competence will be his chosen battleground. Stoiber will give Schroeder a good run for his money. Schroeder still looks favourite, but the gap is narrowing.

DETAIL

2. As seemed increasingly inevitable since Christmas, CDU leader Angela Merkel conceded the joint CDU/CSU Chancellor-candidate position to Bavarian Prime Minister and CSU leader Edmund Stoiber after a tete-a-tete breakfast at his house on 11 January. Merkel put a brave face on events: the decision was always going to be based on who had the better chance to beat Schroeder, and recent opinion polls and internal party soundings pointed to Stoiber rather than to her. She called on the CDU to give solidarity to Stoiber (comment: something they have singularly failed to show her over recent weeks). She and Stoiber would head up the CDU/CSU campaign.

3. Stoiber immediately made clear that the economy would be the main battleground. He would challenge Schroeder on economic competence, including unemployment and growth, without which the social state could not be properly maintained. He would make sure that the new Laender were properly incorporated.

4. The scene is now set for a head-to-head campaign between the two most impressive German politicians of their generation. Schroeder (57) claims he will relish the challenge and that having Stoiber as his main opponent will present a clear choice to the electorate. His people tell us that this is the outcome they wanted: Stoiber is a polariser, and his candidature is the best way of maximising the SPD turnout.

5. Stoiber (60) has been Bavarian Prime Minister since 1993. Highly intelligent and a lawyer by training, he has been prominent in the Christian Social Union since the 1970s. Ascetic, self-disciplined, apparently humourless - not your typical jolly Bavarian at all. Initially a protege of Franz Josef Strauss (the last Bavarian CDU/CSU Chancellor-candidate, who lost to Helmut Schmidt in 1980), he subsequently stepped out of Strauss's shadow, becoming Bavarian Interior Minister in 1988. He has mostly (though not wholly) succeeded in keeping his nose clean in a party which was a by-word for dodgy dealings in the past.

6. Stoiber is instinctively conservative. Married for 33 years and with three grown-up children he preaches family values and a tough line on crime, immigration and welfare. He was a bitter critic of EU measures against Austria (indeed he publicly supported Schuessel over the entry of Haider's party into the Austrian Government) and he invited Berlusconi to attend his party conference. But his conservatism is linked with modernity - Bavaria's combination of "laptop and lederhosen". Building on

fu

Prime Minister

para 5-10 for  
 analysis of Schroeder  
 Stoiber's personality +  
 politics.

Michael D...

✓

Bavaria's striking transition to become the most modern and dynamic state in Germany, he will moderate his tone further to broaden his appeal politically and geographically: he knows he has to take votes in the centre ground to win. Being a Bavarian is probably less of a hindrance than ever before, though he will have to work hard to convince many northern and eastern Germans.

7. Stoiber's social and economic policies are more corporatist than neo-liberal. The CSU is a broad-band party and the Bavarian Government a massive shareholder and provider of subsidies. To keep the CDU on board, he will tame his instincts on subjects such as immigration. His views on Europe have so far reflected Bavarian interests. He is a critic of the Commission which he accuses of meddling too much in local and regional affairs. But he recently put his name to a paper which, as he explicitly recognised at a press conference, envisaged the eventual abolition of the Bundeswehr and the Foreign Ministry and their absorption into European structures. He is cautious about enlargement to central and eastern Europe, let alone to Turkey. (But foreign and EU policy is unlikely to figure significantly in the election.)

8. Will the CDU back him solidly? Now, compared with a few months ago, the party thinks it has a real chance of defeating the SPD. So expect internal squabbles to be kept under wraps. The young(er) pretenders in the CDU will be pleased to have someone of the older generation, a lesser threat to their own long term ambitions, as their candidate.

9. But while vastly experienced in Bavaria - where he has easily won both the Land elections in which he led the CSU campaign, getting more than 50% on each occasion - a national election campaign is uncharted territory for Stoiber. He's never held any national office nor been a federal MP, though he has served in the Bundesrat (upper house) as a Bavarian representative. He has been developing his international profile recently. He called on John Major while on a sponsored visit to London in 1996.

10. Stoiber's nerve will be severely tested by Schroeder, who will relish the challenge of provoking Stoiber into more right wing positions than he will want to espouse for tactical reasons. Schroeder is the better performer on the stomp. Stoiber, if he is to succeed, will have to make up for it in other ways.

#### COMMENT

11. The CDU/CSU have chosen the best candidate available in the present circumstances: over her almost two years as Chairman, Merkel did well to lead the CDU party out of the rut of the Kohl party financing scandal, but she simply didn't generate enough clout or steam to command or gain the real support of a party still dominated by West German men in grey suits.

12. While the electoral advantage should still lie with the incumbent government, how the economy performs over the next few months is going to be crucial. Schroeder would prefer to continue the SPD/Green coalition, but it looks increasingly unlikely that together they will have an adequate majority: so an SPD/FDP (Liberal) coalition - which would entail inter alia a new Foreign Minister - is on the cards. So too is the prospect of a CDU/CSU/FDP coalition: although Schroeder personally is ahead of Stoiber, at the party level the CDU and SPD are now neck and neck.

#### LEVER

Sent by BERLIN on 14-01-2002 14:29



JPO  
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FROM THE AMBASSADOR

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14 January 2002

Kim Darroch  
 Director – EU Affairs  
 FCO

*David Kelly,*

### SPD PARTY MEETING IN THE EMBASSY

1. The SPD held an internal parliamentary party meeting in this Embassy on 9 January. The Financial Times (copy attached) mentioned it in its gossip column. You might be interested in the background.
2. It was a Klausursitzung – a closed meeting – of the presidium of the fraktion (parliamentary party) which consists of around 35 members of parliament, plus supporting staff. The fraktion holds two such meetings a year: their purpose is to review parliamentary business for the coming six months and to have a general discussion of the political situation. All parties hold such events, sometimes in exotic, awayday-type locations. But the SPD normally meets in its Bundestag premises: this was, so far as we know, the first time they had done so elsewhere.
3. The request to hold the meeting at the Embassy came from their side: Wilhelm Schmidt, the Chief Whip, was taken by the building and intrigued by the notion that we really were “open for business”. They asked only for conference facilities, but I also gave them lunch in the Wintergarden. This was an excellent opportunity to mingle with senior SPD figures, who included 4 serving Federal Cabinet Ministers (Walter Riester, Labour; Ulla Schmidt, Health; Kurt Bodewig, Transport; and Werner Müller, Economics); Peter Struck, the Parliamentary Party Chairman; Franz Müntefering, the Party Secretary-General; and Wilhelm Schmidt, Chief Whip. All those I spoke to were impressed by the building and seemed to enjoy the novelty of meeting in such unusual surroundings.
4. At our suggestion Gisela Stuart MP came out and attended the lunch as well as, at the SPD's invitation, part of the meeting.



5. There was considerable media interest. Comment focused more on the figures attending rather than the location. But it was amusing to see on television that evening the SPD Parliamentary Party Chairman being interviewed on ARD (BBC1 equivalent) in front of the Embassy's dancing columns (and the strains of the Embassy singers, at their weekly rehearsal, wafting in the background). The Financial Times snippet was however not quite correct in one respect; the SPD had offered to make a financial contribution, but we exercised our right to waive the hire fees on the grounds that the event was a perfect fit with our objectives. If other (respectable!) parties want to use the building for similar purposes, we shall of course treat them the same.

Yours ever

cc: Jonathan Powell, No 10  
Roger Liddle, No 10  
Sally Morgan, No 10

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...ants AP

...lenger taking on the big boys," he says.

Some business leaders who are closely associated with their businesses are less suited to supporting the brand, Mr Smith says. Mohamed Fayed, the controversial owner of Harrods, the London department store, probably falls into that category. "A great, great self-publicist - but how much he adds to Harrods' [brand] I would question," Mr Smith says.

Companies that want to limit their vulnerability to their charismatic leaders' death, retirement or disgrace need to have two things. They need to be solid businesses and they have to have credible succession plans in place.

Mr Smith argues that one of the reasons why Lord

...what happens is a matter of concern for the employees rather than the shareholders. Listed companies need greater reassurance. Jack Welch, the former head of General Electric, became one of the world's best-known businessmen. But his succession plans, focused on three senior executives, were so well publicised and understood that there was little concern when he announced Jeffrey Immelt as his successor.

The difficulty is that hard-driving leaders often find it hardest to let go. Mr Murdoch, for example, shows no sign of retiring and it is not yet clear which of his children is to succeed him, although he has signalled that Peter Chernin, president of the company, would be expected to run the business in the short term.

The lesson of Thomas and Wendy's is that boards need to insist that succession plans are ready at all times - and never more so than when the public and the markets regard the company and its leader as one and the same.

...prime minister in 1996). And he had a good year last year, first as president of the European Union, and then in taking a firm stance in the war against terrorism.

So far, so Blair. But perhaps most crucially, Persson has shed his image as a bullying power-broker. A softer side has been cultivated, including chat show appearances and revelations about his love of practical jokes. One prank apparently includes jumping out from behind the door at cabinet meetings.

It goes down well in Sweden, apparently. And Persson's standing may yet be the crucial ingredient that persuades Swedes to join the single currency.

### Urbanised

Gianfranco Fini, leader of Italy's radical right National Alliance, is bidding to be the country's next foreign minister. But few in Rome believe he will get the job.

Prime minister Silvio Berlusconi was brueque, saying only that "Fini's a candidate". And the historical link between the National Alliance and Italy's former fascists would be a problem internationally.

More likely to get the job is Giuliano Urbani, the culture minister. He helped Berlusconi found his Forza Italia party and is an ally of Giulio Tremonti, the increasingly powerful finance minister.

A professor at Bocconi university, Urbani claims to be good friends with EU competition commissioner (and ex-Bocconi rector) Mario Monti.

How Urbani would perform as foreign minister is anyone's guess. But he may have to wait. Arriving at the foreign ministry last night, an excited Berlusconi (who has taken on the job temporarily) said: "I'm the right man in the right job."

### Prodi prodded

Mario Monti intervened in the debate on Europe in his native Italy with characteristic élan this week. But his compatriot, Romano Prodi, the Commission president and another great European, has held well back.

Probably wise. Prodi is better known for gaffes than glorious interventions. Two

...NR 909am is 5.4/4 biggest in its home market and, unlike in past banking bids, there is no domestic white knight waiting in the wings.

### Angela angst

With Edmund Stoiber, the Bavarian Christian Social Union's leader, the frontrunner to challenge Chancellor Gerhard Schröder in September's election, the question is: what to do with Angela Merkel?

Much thought is being applied to find a face-saving formula allowing Merkel, the chairman of the much larger Christian Democratic Union, to back out. It is all sensitive because the CDU leader would normally have first say over whether she wanted to run or not.

All sorts of possibilities have been aired, ranging from offers to make her a cabinet minister to lining her up as the country's next president.

None would be easy. Merkel has already held two ministerial posts - for family issues and for the environment - so a higher profile position would be necessary. The presidency will not be available until 2004, and CDU leaders are unable to promise it now.

But Merkel's critics - and there are many who say she has been a weak leader - argue that a promise merely to allow her to retain CDU party leadership should be enough to secure her retreat.

### Room mates

...is a new, "special relationship" emerging between the UK's Tony Blair and Germany's Gerhard Schröder?

Senior parliamentarians in Schröder's Social Democratic party yesterday held their new year's conference not in SPD headquarters - but in the new British embassy in Berlin.

A cultural divide remains, however. The SPD said it wanted to strengthen ties with the UK and the embassy's avant-garde architecture was "interesting".

A British official said the embassy could "make a bit of extra money" by renting out its facilities.

...boulevard@ft.com

## Admir

...might persuade India to change its approach

conflict - and the continual failure of India and Pakistan to reach an agreement - the international community has a right and a duty to mediate between them and to seek a solution based on both Indian sovereignty and Kashmiri and Pakistani interests.

Unfortunately, India is far from admitting any of this or pursuing a genuine peace process over Kashmir. Instead, like Israel, Turkey and Russia in their ethnic conflicts, it is using the slogan of a "war against terrorism" to avoid seeking a political solution or allowing any formal international role. And while international leverage on a weak and shaken Pakistan is now considerable, influence on India is much more limited.

There is, however, one incentive that a united international community could offer India in return for a real willingness to seek a Kashmiri settlement: the possibility of a permanent seat on the United Nations

Security Council. This is a passionate Indian desire; and is also justified in principle by the size of India's population, the historical depth and grandeur of Indian culture and the record of Indian democracy (Kashmir excepted).

I advance this suggestion with great hesitation, being fully aware of the immense difficulties involved in any such approach. But if the UN Security Council is to retain any relevance in the long term, it cannot be monopolised *in perpetuum* by the victors of 1945. It also seems fair and rational that a link should be made between a great advance in India's formal international prestige and a significant increase in Indian responsibility and moderation over a key issue of international concern.

The writer is a senior associate at the Carnegie Endowment for International Peace in Washington DC

www.ft.com/kashmir

Financial Times, Thursday 10 January

FROM: John BOURNE  
DATE: 7 January 2002

**STEPHEN WALL**

cc: Martin Donnelly  
Martin Hurst  
Jo Simons  
Rachel Green (minute only)

*Sile*

**VISIT BY JOCHEM SCHAEFER, KAMZLERAMT, 8 JANUARY 1100**

**Papers**

- A. Account of Schaefer/North/Bourne meeting in February
  - B. BE Berlin letter of 20 December
  - C. Minutes of DEFRA/BMVEL bilateral on 7 December 2001
  - D. Summary of BMVEL draft paper on CAP reform from December
  - E. Franco-German declaration of July 2001
- (You also have the mass of papers on CAP reform I gave you before Christmas)

**Objectives**

- To discover the state of German thinking on CAP reform and the MTR, to identify common ground and to influence German thinking
- To agree further discussions (perhaps interdepartmental as well as centre to centre) including persuading Tiemann to visit here (or we to visit him)

**Background**

Schaefer, 20 years in the then Agriculture ministry, works in Abteilung 3 of the Chancellery under Tiemann as the desk officer on agriculture. The embassy view Abteilung 3 as less reform minded on the CAP than Silberberg's team. Schaefer will be stronger on pure CAP reform and weaker on the enlargement complications. He is meeting you at 1100, then Martin H and I will take him to lunch with a call on David Hunter afterwards (Andy Lebrecht is away). I have arranged an interpreter (Schaefer understands English but prefers to speak in German)

Flag A reports our February discussions, which were very general. However since then the Germans have progressed their thinking and held



interdepartmental discussions which continue. Silberberg says (**Flag B**) that the revised BMVEL (consumer ministry) paper (**Flag D**), with toned down references to degressivity and the abolition of milk quotas, has been rejected by the Kamzleramt. It appears to have been too strong on improving food quality and not strong enough on budget discipline. One aim for this meeting should be to get a good grip on what balance between these issues the Chancellery want.

Margaret Beckett is meeting Kunast this month in the context of Berlin Green week.

### **Process of reform**

Feb 02 – first Commission proposals for draft DCP on Agriculture in enlargement working group

June/July 02 – Commission makes first MTR proposals

- EU15 agreement on DCP on Agriculture according to roadmap

Dec 02 - end of accession negotiations with first wave

- possible end of MTR

March 03 - EU 15 agreement on negotiating modalities for WTO according to Doha timetable.

### **Outcomes of CAP reform**

Rather than go through the traditional DEFRA list on CAP reform (degressivity, modulation etc) You may prefer to cover some/all of our desired outcomes for CAP reform, before looking at the tools with which to achieve them. You might wish to discuss the delivery tools in terms of prioritisation, negotiability and timing of reform ie in the MTR or later (**Flag B** suggests expectations for 2005).

### **Food quality/safety**

- Of key importance to Kunast and Germany. Making farmers more market sensitive should support this aim. But also requires measures not related to CAP reform eg food labelling, assurance schemes, European Food Authority etc.
- Danger is that Germany may want to regulate and to protect markets (how do we ensure quality of LDC imports?). UK only wants regulation where food safety is concerned, not food quality.

### **More sustainable farming**

- Need to delink support from production and concentrate support on the three pillars of sustainability – social, economic and environmental. Probably

requires a rethink of the details of the 2<sup>nd</sup> pillar. Impact of German farming lobby pre-election will be important.

### **Decreased economic distortion**

- Given the elections probably not of major concern to the Germans. But worth mentioning the adverse impact on rural reform in the candidates and the long term consequent costs to the EU net contributors. Can be seen as part of our wider economic reform agenda.

### **Better Market Access**

- Partly covered by **Everything but Arms**.
- German concern is likely to be focused on the food quality issue eg GMOs, BSE, hormones in beef, organic standards. The same concerns are expressed here by eg the NFU, and some consumer organisations.

### **WTO**

- Schaefer and Abteilung 3 are likely to be less impressed by WTO pressures than eg Silberberg. And our assessment is that Fischler will not want to be seen to be responding to WTO pressures.

### **Budget Discipline**

- Provided the enlargement ceilings are respected there is no immediate threat to the FP pre 2006.
- But the next FP will be much more expensive if the current CAP applies to EU25
- So MTRs need to set a clear direction. Germany should agree.

### **Tools for delivery**

- Reduction of 1<sup>st</sup> pillar market support measures (ie reduce intervention prices, allow world prices to predominate, and eliminate other constraints eg production quotas & import quotas/tariffs).
- Focus support on social, economic and environmental aspects of sustainability through the second pillar through modulation & degressivity of direct payments. Germany would welcome increased national flexibility in the 2<sup>nd</sup> pillar.
- Degressivity of direct payments to provide headroom for compensation for decreased 1<sup>st</sup> pillar support and to provide the cash for the expanded second pillar. Degressivity needs to be significant to keep enlargement related costs in check, and to keep the impact on national exchequers neutral since the 2<sup>nd</sup> pillar is co-financed.

- But she may well not support radical change publicly until after the elections especially in sensitive regimes (eg market support for rye, eliminating milk quotas).
- Silberberg reports that BVMEL want to switch 100% of savings from degressivity into the second pillar but that the Chancellery have rejected this: the co-financing requirement of the 2<sup>nd</sup> pillar would make it very expensive. He says the Chancellery want a budget neutral solution.
- Germany should support us on not wanting modulation/degressivity based on farm size.

### **Enlargement**

- How does Germany see agreement on direct payments to the candidates coming out? Schroeder has said (as have the Dutch) that if any direct payments for candidates are agreed, then there must be agreement on EU15 degressivity at the same time. How firm is this German position and what concerns do they have over making enlargement conditional on wider CAP reform?
- What is likely to be negotiable with the candidates?

### **Expectations for the MTR**

- What are German expectations? And Priorities? And on what regimes? Do they want beef/sheep included? Milk quotas? **Flag C** gives details on latest BVMEL thinking on the main regimes.
- What are the German sensitivities: eg rye, sugar, milk quotas.

### **Governance**

I note the Consumer Association has drawn attention to the anomalies in agriculture decision making in the EU and has asked that that they be reformed to give eg a greater role for the EP, to eliminate the Agriculture Council and have a food/consumer Council etc. I assume we would agree that governance could be improved. Do we wish to discuss with the Germans?

### **Possible Conclusions**

- Further centre to centre talks in eg April. Tiemann to be involved
- Possibly interdepartmental talks (Food/rural affairs, Finance, Foreign Ministries plus/minus centres)
- Possibly separate talks on the enlargement issues (between whom?) to look at how to ensure we get enlargement and CAP reform

RECORD OF DAVID NORTH'S AND JOHN BOURNE'S MEETING WITH  
JOACHIM SCHÄFER, CHANCELLERY, BERLIN, 7 FEBRUARY 2001

**Summary**

1. A friendly meeting with Schäfer from Abteilung 3 (his Director, Tieman was unable to attend). It showed Schäfer that the UK had faced the same need as Germany for new policy responses on food safety and agricultural issues. Schäfer did not give a clear indication of how Germany would jump on the main policy choices of interest to us, ie as between using cross compliance or second pillar as main vehicle for achieving quality-oriented policies. But he seemed aware of the WTO constraints affecting the former and frequently affirmed that second pillar was the way to go. Schäfer said he was ready to continue the dialogue in further meetings and we will need to follow up, perhaps with an invitation to talks on the use of quality seals and labelling.

**Detail**

Introduction

2. Schäfer began by explaining that he shadowed the Agriculture, now Consumer Protection, Ministry in the Chancellery. Before that he had been 20 years in the Agriculture Ministry. He welcomed the UK's interest in how Germany was re-shaping its agriculture policy following the BSE crisis. David North said he was responsible for Home Affairs at No 10 covering health, agriculture and food safety - also originally from the Agriculture Ministry. John Bourne explained his central coordinating role in the Cabinet Office, covering agriculture, food safety, enlargement and other areas.

The New German Policy

3. Schäfer said that the Chancellor's response to the appearance of home-grown BSE cases in Germany had been to initiate a change in policy towards a more quality-oriented agriculture. His call to get away from factory farming meant the method of production, not any particular size of farm. (He later added that agricultural economists in Germany had misunderstood the thrust of the change. The call to get away from "factory farming" did not mean small was necessarily beautiful: small Bavarian holdings could be as intensive as any - they had been just as exposed to BSE - and high ecological quality standards could be sought on large-scale holdings.) Germany was now filling out the concept and the Agriculture Ministry would be making a statement the following day to explain the immediate practical impact.

4. There were two areas where Germany wanted to make changes:

- policy on support payments

- a new openness to and awareness of consumer concerns. They wanted to use the crisis to get consumers to go for quality rather than cheapness in their food shopping.

### Quality-oriented Agriculture

5. Schäfer proceeded to talk almost exclusively about the second of these two areas. In achieving an agriculture that was sustainable, environmentally aware and safe, organic agriculture occupied the position of "ideal solution". But they recognised that it was not practical to have organic as the sole target. In practice there would be three types:

- organic (currently 3% of holdings and could be grown to 10%)
- conventional (currently 85%, the segment that could be influenced by modifying support)
- the ones that could get by on world markets without help (perhaps 12%).

6. The decisive potential for action lay in moving the large middle group towards greater sustainability. The existing legal scope using cross compliance and modulation had not been fully exploited, and Fischler seemed disposed to do more in this area too.

7. Schäfer referred to a round table meeting the previous day with Länder and trade associations at different levels in the food chain which had confirmed the generally positive public reaction towards working out quality standards. (He later said that Minister Künast had invited this group to look at quality standards for meat, and report back by April.) This way of working represented a fundamental shift of approach for many, including the farmers' unions. They had had to take two substantial u-turns:

- on specified risk materials and feed controls;
- on accepting the financial pain of direct payments being made subject to conditions - the details of which had still to be worked out.

### UK Experience

8. David North said that it was particularly interesting to hear about how Germany was encountering the need to move towards quality, sustainability, and consumer-orientation, as the UK too was grappling with this, though against a different background. BSE had been such a major crisis in 1996 that we had had to deal with it in isolation. But in the last year or two, following the worst agricultural crisis for 50 years, our emphasis had been towards developing a sustainable strategy for farming. The Farming Strategy which the PM and Mr Brown had launched, had two main parts:

- improving quality of production, increasing diversification of income
- reducing unnecessary burdens in the form of bureaucracy.

9. Just as Schäfer had described for Germany, the UK industry had had to adjust its sights away from volume production (which had caused the crisis) and onto quality and diversification. The debate had broadened to rural development as a whole and the jury was still out on whether we had yet developed the appropriate instruments.

10. David North went on to describe the Prime Minister's interest in the question of how the continuing UK policy of reforming the CAP was to be reconciled with the new emphasis on sustainability under the UK's new Farming Strategy. We had concluded that there was no conflict. The vision of quality production and diversified income was to be realised through the second pillar of the CAP. We were interested in how to move support from the first pillar to the second, and how much the German vision of change had in common with our own.

#### First or Second Pillar of CAP?

11. Schäfer said that he saw things going in that direction too. He recalled that WTO had imposed a lot of pressure. The Government had told German farmers that they had to adapt, to become competitive. Now some were critical that the Government's new Agriculture Policy initiative represented a change in tack. How could farmers become efficient and competitive whilst respecting the multi-functionality of agriculture and Germany's new emphasis on quality and consumer safety first? We had to make sure that what we did now was WTO-compatible. All this pointed to the second pillar being the only way to organise changes. And indeed, as Fischler had pointed out, Germany had not yet used all the scope that was provided under the second pillar.

12. David North said that on WTO grounds developing the second pillar was more fruitful than the mechanism of putting new quality and environmental conditions on the old payments. Schäfer agreed (at this point in the discussion – he was less clear later) and said that although Germany had been reserved hitherto on Fischler's ideas for bringing a number of commodity regime reviews together into a general mid-term review package, the positive view had to be that such a review offered Germany an opportunity to see these ideas implemented. On modulation, Schäfer was non-committal, saying that there had always been lots of arguments against adopting it in Germany.

#### Influencing Consumer Attitudes

13. Schäfer was interested in the UK approach to the problem that consumers were often ready in theory to favour high quality standards, but in practice chose

on price criteria. David North cited four ways in which we had tackled this problem:

- creation of the FSA
- educating consumers
- labelling
- the "red tractor" logo.

14. In the discussion around these topics Schäfer remarked that Germany had too many quality labels at present. What was needed was fewer labels, but better understanding of what they meant. He felt that the German federal system complicated the issue of a separate Food Standards Agency here as well as the appearance of an EFA. John Bourne and David North described the advantages we had found in a separate national agency (credible voice on national questions such as need for import bans – appropriate level for dealing with national health scares). Schäfer said the issue would be settled when the Frau von Wensum Commission reported in the Summer.

15. On quality standards the UK side described the interplay of controls, whether regulatory, retail but under government supervision, or the more disparate farm assurance schemes.

16. On the issue of attaching conditions to direct payments - cross-compliance - Schäfer spoke at a general level, wondering aloud whether farmers would remain onside when they had to accept new conditions to receiving subsidy. John Bourne pressed him on whether use of cross-compliance was as promising a way forward given WTO pressures on those subsidies, but Schäfer remained non-committal, pointing to the new Minister as the one who would have to decide the emphasis.

17. Both sides agreed that the discussion had highlighted how circumstances were pushing Germany and the UK – and indeed other countries - along similar roads in the evolution of their agricultural policies. Schäfer agreed readily to further meetings, to compare notes on developing solutions to common problems, accompanied by the relevant experts as appropriate.

18. After the meeting the UK side agreed to write to Schäfer summarising the heads of agreement and inviting him to a follow-up meeting in London (or Berlin if Schäfer preferred) where the main topic might be quality seals and labelling.

**Gareth Steel**  
 EU & Economic  
 British Embassy, Bonn Office  
 9 February 2001

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20 December 2001

Andy Lebrecht  
Director-General  
DEFRA  
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*Dear Andy*

**CAP REFORM: COMMENTS BY KANZLERAMT**

1. I discussed CAP reform with Silberberg (Director EU, Kanzleramt) on 19 December.
2. I asked Silberberg how we should interpret the noises coming out of the Consumer Protection, Food and Agriculture Ministry to the effect that they were re-thinking their approach to CAP reform (our telno 575). Did Germany still expect a substantive reform before 2006?
3. Silberberg said that Germany did indeed still endorse reform before 2006. It should, for example, be possible to take action on some of the regimes at the 2002-3 mid-term review. Germany would also support the abolition of milk quotas. It was true that France would be difficult. But there was useful work going on on the SPD/PS (French socialist party) net. Paris realised that without CAP reform, it would be impossible to finance enlargement. Indeed, the fact that there was an EU/Latin America and Caribbean summit in May, and that Spain wanted to make progress on the Mercosur Agreement and close the EU-Chile agreement before then, would have implications for the CAP. This might mean the subject having to be raised with the French before the presidential elections.
4. Silberberg said it was true that the BMVEL had re-worked their earlier paper on CAP reform toning down references to degressivity and the abolition of milk quotas. But the Kanzleramt had told them that the new paper was unacceptable and must be re-worked again. While it remained the case that Germany was interested in improving food quality as well as budgetary savings, the latter were important: otherwise, enlargement could not take place.
5. Other points:

*in  
what  
way?*

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(i) Silberberg said the latest BMVEL paper proposed that 100% of the savings from modulation should be spent on the second pillar. This would not work, because it would increase pressure on the German budget (via co-financing). The answer was to spend a lower proportion of the savings in this way so that the overall effect was budget neutral;

(ii) Germany remained concerned that the January 2002 Commission paper would propose the phasing in of direct payments for the accession countries. This would amount to changing the acquis. Germany would therefore insist that no decision could be taken on this except by the European Council;

*meaning what?*

(iii) we discussed what would happen when the Financial Perspective ran out in 2006. Silberberg commented that the Austrian Presidency, in the first half of 2006, could clearly not bring about CAP reform. The second half of the year would be crucial. It was therefore invaluable that, at Laeken, Germany had agreed to swap its Presidency (which had been due then) with Finland. The justification for the swap was the fact that Germany would face elections at that time. But it would make it much more feasible to bring about the right outcome on CAP reform (comment: because the Germans argue their HI 1999 Presidency made it impossible to push hard for a tough outcome at the Berlin Council).

*Leigh*

Leigh Turner  
Counsellor (EU & Economic)

*ie they are  
thinking about  
further CAP  
reform =  
2005-6.*

cc Stephen Wall, No 10  
Martin Donnelly, Cabinet Office  
Michael Arthur, Director Economic, FCO  
Kim Darroch, Director, EU  
Simon Featherstone, EUD(E)  
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Gareth Steel, Bonn  
Tony Ford, Vienna  
Alyson Bailes, Helsinki  
David Frost, Paris

C

## Agenda 2000 MTR + Enlargement: Minutes of UK-Germany Bi-lateral 07/12/01

### Key points:

- **CAP Reform** – Privately, Germany's shift towards UK agenda consolidated; but will take time for this to emerge publicly.
- **Mid-Term Review** – Germany prepared to be radical after September 2002 elections.
- **Horizontal measures** – Germany suggests a combined degressivity / modulation approach.
- **Beef regime** – Officials to exchange thinking on decoupling of headage payments, focusing on a potential grassland premium scheme.
- **Enlargement** – Officials to continue to discuss negotiating positions with aim of putting issue high on 2<sup>nd</sup> half 2002 Agriculture Council agenda.

### Attendees:

UK represented by Andy Lebrecht, David Hunter, Tom Eddy (DEFRA) and Gareth Steel (UK embassy, Bonn). Germany represented by Erhard Schwine and colleagues (BMVEL).

## Agenda 2000 Mid-Term Review

### General

- German (Ger) agriculture ministry developing a MTR policy paper. Paper currently out for consultation with other ministries.
- Ger asked UK to understand political constraints of Ger's September 2002 elections. No significant negotiating decisions to be expected until after elections.

### Arable regimes

- Ger explained its short and long-term priorities:
    - a) Short-term, reduction in intervention prices and end to compulsory set-aside, extent of which to be judged in light of WTO negotiating pressures and market developments, and preparing ground for a shift towards 'safety net' intervention.
    - b) Long-term, abolition of set-aside and intervention (except for soft wheat) with uniform compensation levels, with the possible exception of the protein seed sector on which Ger's policy still evolving.
  - Ger highlighted internal importance of rye regime. Ger would countenance downward pressure on rye intervention price only if proposal packaged with similar regimes, such as the durum wheat regime. Requested UK support for this approach.
  - UK agreed durum aid was anomalous.
- why?  
?

### Beef regime

- **Action Step:** UK + Ger experts to share thinking on decoupling options.
- Ger emphasised need to retain Agenda 2000 agreement on beef. In contrast to France, Ger not hankering for an increase in the intervention price. In the longer-term, Ger keen to develop a grassland premium scheme as part of the decoupling of livestock headage payments. They had been encouraged by Commissioner

Fischler's interest in such a scheme, and had noted significant interest from France and Eire. Commission aware of Ger's thinking.

- Ger aware of structural changes that such a reform would entail. They are concerned not to frighten off MS concerned at potential for structural change, and were therefore keen not to elaborate publicly on a potential grassland premium scheme. But they are considering potential for a national envelope scheme through which funding would be progressively switched to the grassland premium. Prepared to see some national discretion in how such a system would be used provided no trade distortions ensued.
- UK in broad agreement. UK & Ger agreed that respective experts should meet to take forward thinking on subject.
- UK suggested that resistance to decoupling and the grassland premium approach should not be underestimated. Eire had expressed concerns at possible shift away from beef production; while UK's shift from headage to area payments in Less Favoured Areas had triggered a significant negative reaction from farmers.

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slow  
progress*

#### Dairy regime

- Ger's decision on MTR milk-quota negotiating position would be made following the September 2002 elections. Ger's research suggested that quotas could be phased out through a 25% reduction in support prices and the decoupling of direct payments. However, Ger expects milk quotas to be extended to accession states, and for pressure for their abolition to emerge from the administrative difficulties accession states would face when implementing them.
- UK concerned that this would see abolition of quotas pushed beyond 2008, and that a decision needed in next 12 months on transitional compensation and price cuts to meet 2008 timings. Emphasised that meeting 2008 a UK priority.

#### Ethyl - Alcohol regime

- Ger re-stated hope that current Agriculture Council dossier proposal be dropped.

#### Sheep regime

- Ger will support Presidency deal at December Council on proposal to create national envelope for the ewe premium.

#### Sugar regime

- Ger concerned about impact of market liberalisation from 2009 on Less Developed Countries (LDCs). An issue on which Ger Agriculture Minister took a close interest. Stressed that this not driven by protectionist instincts, but concern that certain LDC Governments might take opportunity to significantly increase sugar production to the detriment of their wider economies.
- Ger could consider a cut in sugar intervention prices after their September 2002 elections.

#### **Horizontal measures**

##### Degressivity/modulation

- UK re-stated that degressivity, with partial re-direction of funds to 2<sup>nd</sup> pillar, our priority. UK would look to increase its share of CAP's 2<sup>nd</sup> pillar funding,

channelling it into new and existing agri-environment and rural diversification schemes.

UK concerned about idea of compulsory EU-wide modulation if it meant redistributing receipts away from countries with large farms to those with small farms. Also:

- a) Range of schemes on which modulation receipts can be spent should be extended.
  - b) Modulation must be administratively simplified.
- Ger suggested the first 2% reductions should be regarded as "degressivity", (ie funds to be recouped by Finance Ministries), while the reductions between 2% and approximately 5% should be part of a "modulation" approach, (ie kept available for re-deploying on second pillar expenditure with co-financing). **On the UK's concerns:**
    - a) Not against principle of compulsory modulation as long as receipts spent in the MS of origin.
    - b) Co-financing rules should be reviewed given restrictive nature of obligation to match-fund modulation receipts.
    - c) Range of schemes should be extended, possibly to cover all 2<sup>nd</sup> pillar funding.
    - d) Administrative simplification necessary.
  - Ger concerned that some EU-15 MS might try to resist uniform modulation. They could pursue EU-wide schemes that fell principally on certain types of farm structure predominantly found in certain MS. This could have a damaging effect on the competitiveness of those MS.

#### Cross-compliance

- UK explained that cross-compliance applied in UK to livestock premiums to tackle over-grazing; but that Policy Commission may recommend extending modulation and cross-compliance for England.

#### **Other Business**

##### Enlargement

- **Action Step:** Continue to exchange information/ideas since positions close.
- Direct payments and quotas Ger's two principal enlargement concerns. Ger expects that these issues would only be resolved in final stages of 2002 Copenhagen Summit deal. Deal will almost certainly see EU-15 direct payments reduced, while accession states receiving gradually increasing direct payments. This necessary to avoid social and political tensions within an enlarged EU. Ger's estimates that current CAP budget savings would finance accession state direct payments at 30% of EU-15 rate.
- UK shared view that direct payment and quotas the key agriculture enlargement issue, and pressed case for putting reform high on 2002 Agriculture Council agenda in advance of Copenhagen Summit.
- UK argued that accession states CAP payments should be targeted through 2<sup>nd</sup> pillar payments, thereby facilitating 1<sup>st</sup> pillar degressivity; but that degressivity should apply across all regimes. UK concerned that southern MS might attempt to

limit scope of degressivity so that burden of reductions fell principally on other MS.

- Ger shares view on importance of degressivity, but they would only push case post-September 2002 elections.

MTR timetable

- Ger + UK agreed that pressure should continue to be applied on Commissioner Fischler to present substantial MTR proposals, though Ger more confident that Fischler would deliver on this.

CAPRI

- Ger reiterated that it would not join CAPRI, but would attend meetings as and when dossiers of interest came up. UK expects Denmark to convene next meeting in early 2002.

Berlin Green Week

- UK stressed importance of Kunast-Beckett bi-lateral in margins of January 2002 Berlin Green Week.

Jean-Christophe Gray  
SASD  
21.11.01

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## Main Points of the paper: Cornerstones of a Reform Policy

### ECKPUNKTE EINER REFORMPOLITIK

#### Mid-Term Review

1. The paper sets out the findings of a Consumer Protection Ministry working group dedicated to preparing for the Mid-Term Review. Details of the calculations and analyses are not given: only the outcomes. A first section sets out the context and the market situation as well as the standpoints of the other EU players (divided into three groups: reform-oriented, conservative and southern), the paper sets out in the second section a brief description of Germany's objectives (to orientate the CAP to the interests of the consumer, ie to be more market-oriented and respect social, environmental and health considerations). The paper sets out in its third and final section the building blocks for a reform policy under the following headings:

- 3.1 Step-by-step dismantling of classical instruments of market support;
- 3.2 Step-by-step decoupling of premium payments;
- 3.3 Continuation of the milk market reform;
- 3.4 Introduction of obligatory degressivity;
- 3.5 Increased support for rural areas via modulation;
- 3.6 Environmental improvements predominantly via incentives and sectoral regulations.

The main points are as follows:

#### 3.1

Producers can react better to market signals if the classical instruments are progressively dismantled. The long-term aim should be to follow this path in all product areas, including those where the market is currently regulated by a quota system. Collective insurance schemes are put forward for consideration.

Sector by sector:

- Beef is on the way to having the classic regime dismantled.
- On cereals, the working group examined two main options - further price cuts, step-by-step abolition of intervention. The abolition of rye intervention, as suggested by the Commission, is only acceptable to Germany in a context

of reforms in other market regulations. Intervention should be reduced to a safety net function everywhere except for soft wheat, where it should be maintained for the time being. Set-aside should be set at zero. Both intervention and set-aside could then be abolished in the longer term.

### 3.2

Decoupling can take the following forms: introduction of area payments, binding payments to historical data (payments related to the person or to the farm), direct payments relating to employees, socially-oriented direct payments. Sector by sector:

- the first step for cereals should be for feed crops to have premium extended to them. Arable premia could then be unified. Protein crops should also see a strengthening of the alternative support possibilities under the Second Pillar;
- for beef, the production incentive from premium should be reduced;
- the introduction of a grassland premium instead of other livestock related premia would serve the same purpose and help the development of the rural area. The long-term aim of a single agricultural area payment is sketched in.

### 3.3

Price reductions foreseen in Agenda 2000 from the year 2005 should be brought forward. Value of quota should be reduced by this price reduction and by decoupling of direct payments from the milk quota, for example converting premium to grassland premium and preserving the remainder as dairy cow premium linked with a stocking density regulation. Milk quotas should be abolished in 2008. These measures should be made public as quickly as possible to prevent misguided investments. The AC quota model should not be pursued.

### 3.4

Differentiation of payments according to social criteria like size and numbers employed should be done in the framework of obligatory modulation. If there is no additional financing available for enlargement, a linear degression of 2% (reaching 16% by 2012) will be necessary from 2004 (budget effect 2005).

### 3.5

Germany should press for obligatory modulation which takes such social aspects into account as farm size, number of employees and volume of premium receipts, so as not to be unfavourable to Germany (especially the new Länder)

and therefore detrimental to the German net payment position. There should be reasonable scope for Member States to vary the extent to which their direct payments were modulated. A possible model would be for only half the finance freed up from the First Pillar to be diverted to the Second Pillar. The second half would be savings in the EU budget, thus reducing Member States' contributions. These savings could then be used for co-financing. This would allow a switch from the First to the Second Pillar without raising agricultural expenditure overall compared to the financial framework of Agenda 2000. The working group suggests obligatory modulation at 2% in addition to the linear deggression of 2%, ie a total of 4%. Model calculations for the enlarged EU show €700 million in 2005 rising to €8,500 million in the year 2013 being moved from First to Second Pillar by this means. Germany's share would be in 2005 €100 million and in 2013 a good €1,000 million (including national co-financing). If the amounts exceeded the ability to spend them under the Second Pillar, the reductions should be reduced. On a constant pattern, the total reduction of direct payments would be around 34% by 2012 (with a budgetary effect in 2013).

### 3.6

Improvements in environmental animal welfare and consumer protection to be achieved by developing the relevant regulations and through targeted incentives, for example agri-environmental programmes. This should be harmonised as much as possible. Cross compliance can be used as an additional element, but not used as a major way of complying with the WTO. WTO would be better met by degressivity.



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Bonn Office

6 December 2001

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Fax: (0228) 9167 163  
E-Mail: [gareth.steel@fco.gov.uk](mailto:gareth.steel@fco.gov.uk)

*Dear Tom*

**GERMAN IDEAS ON AGRICULTURAL REFORM**

1. Further to my letter of 30 October, I have now obtained from Heynen (please protect) a copy of the internal paper on which the FAZ article was based. I have done a slightly fuller summary than the AgraFacts article and enclose a full copy of the article in German.
2. Andy and David will have an opportunity at tomorrow's video conference to ask Schwinne where things stand on the internal debate. It will be best to refer to this internal paper only as the one "covered by the FAZ article in October" and not acknowledge that we have had it in our hands unless Schwinne makes it clear he assumes we have seen it.

*Gareth*

Gareth H Steel  
First Secretary (Agriculture, Fisheries & Food)

copy (letter and summary only):

Andy Lebrecht, DEFRA  
David Hunter, DEFRA  
James Kariuki, EUD(I), FCO  
John Bourne, Cabinet Office  
Richard Brown, HMT  
Ms Richards, FSA  
Sir Paul Lever, Berlin  
Trevor Denham, FSA  
Leigh Turner, Berlin  
Hanna Garcke, Bonn

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DOCUMENT ATTRIBUTES SECTION: DO NOT MODIFY TEXT ABOVE

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06 December 2001

Roddy Drummond  
UKRep Brussels

*Dear Roddy,*

**RELEX: ASSET FREEZE INSTRUCTIONS**

1. The Presidency has really out done itself **this time** - going round in circles for two months and then springing last minute changes to the texts. I have not had time to consult more widely, but initial thoughts on the texts are below – much of this you will know already. Although a little annoying after all the effort we put into negotiating it, I think we can live with the death of the long common position.
2. Overall, I think you need to sound a slightly sceptical note about the texts with these new changes. We can manage perfectly well without any community action and we will continue to do so, if community action means extending competence or legal uncertainty (as the Presidency changes will).

**Common Position**

3. **Art 1.2/1.3** – This kind of detail is really bizarre in a CP. The regulation rightly offers a definition. Art 4 says that definitions for the third pillar will be contained in the third pillar, so why do we need a definition here?
4. **Art 1.4** – There will not be any asset freeze lists beyond those on the UNSCR 1333/1267 lists. We already have a regulation (467/2001) implementing UNSCR 1333 in the EC. This regulation does appear to have a slightly wider scope for the assets freeze but the best way to bring the two in line is to amend the 1333 regulation. Attaching those on the 1333 list to this regulation will lead to unnecessary confusion for financial institutions implementing asset freezes. You should note that UNSCR 1333 expires on 19 January 2001. The Security Council has not yet discussed a rollover but given the changed circumstance it is likely a very different SCR will emerge to replace 1333. So a new regulation will in any case soon be needed. We are happy to consider amending the

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existing CP / Regulation on 1333 if need be but not by incorporating it into these measures.

5. **Art 1.5** – We are happy to have a regular review but less so about the 6month limit. Is this 6 months after names are added? Will we need a new CP in 6 months? Will the Union only fight terrorism for six months?
6. **Art 2/3** - As drafted, this applies to all the persons and entities listed in the annex including EU internal terrorist. We have a clear understanding that only external terrorists can be covered by the Community regulation, and the internal by third pillar inter-governmental measures, so this is misleading. I see no need for the CP to specify this in this way. We should argue that the line ‘ through measures of the community acting within the limits of the powers conferred to it by the TEC’ be deleted. An alternative would be to have two annexes (an internal and an external one) with the internal one referred to in article 4 – but this might be difficult to construct.
7. **Art 4** – finally something I like, although HO has not yet pronounced.
8. **Small inconsistencies** -Art 1(1) refers to "the Annex" while elsewhere it is referred to as "Annex 1" (e.g. Art 2). Arts 3 and 4 refer to people and entities referred to in "Article 1" - presumably this is supposed to be "Annex 1"? Also a typo in Art 2 "conferred on", and the usual one in paras 4 and 5 of the preamble.

**Regulation**

9. **Recital 1** – The Regulation implements the Community not the CFSP bits. How do you tell which are the CFSP and which are the JHA bits of the CP.
10. **Recital 11** – We need to go back to the earlier language about Art 308 TEC. Art 308 is only used in combination with 60/301 and not in itself to cover entities not linked to third countries.
11. **Art 2.5/2.6** – Instructions as above for the CP. Don't like the six month duration and the link to UNSCR 1333.

*Wasim*

Wasim Mir

United Nations Department

cc: Martin Shearman, CFSPD  
Philip Barclay, CTPD  
Andrew Cannon, Legal  
Giles Montagnon, UND  
Ben Llewellyn-Jones, HO  
David Faulkner, HMT  
John Boune, CO  
Matthew Lodge, UKREP

Translation

**Paris and Berlin agree on main features of a new agricultural**

This text only appears in the German version. This text appears in the French version, or in a different form in the French version

The French Minister for Agriculture, Jean Glavany, and the Federal German Minister for Consumer Protection, Renate Künast, have drawn up and signed the following joint statement on the further development of EU agricultural policy:

What kind of agricultural policy do we want for Europe? We have both made frequent statements on this issue in recent months. Of course we have been prompted by the food safety crises which have brought this subject into the centre of public debate. As consumers and citizens our expectations of the farming industry have changed over the years. Today we want safe, diverse and high-quality production, a more environmentally friendly farming sector. The priority for the Common Agricultural Policy must be better rather than higher production, "quality not quantity". Each of us has recognised and stated this independently even before we sat down to formulate the objectives we want to set for a reorientation of the CAP. This reorientation cannot wait. Consumer protection and the CAP must be immediately reorganised so as to avoid any repetition of the crises we have been experiencing recently. This is in everyone's interest, especially the farmers but also all other sectors involved in the production and trade of foodstuffs. Of course we must also take account of the challenges facing us through EU enlargement and the WTO negotiations. We are confident of success. But it is not a matter of hastily conducting a complete reform of the CAP following the decisions of Berlin in 1999 on Agenda 2000. *Comits "Nous commençons tout juste à mettre en oeuvre ce qui a été convenu à Berlin en 1999. C'est un projet pour six ans"* The agricultural sector needs reliable rules. But we should both have preferred a more ambitious reform at the stage of Agenda 2000.

As a priority, *d'abord* we must reorganise relations between farmers, processors, traders and consumers. This must be the "Third Pillar" of our consumer and food policy. The food safety crises as well as the debate on genetically modified organisms and opposition to "mal bouffe" (junk food) have shown how disturbed these relations are. It would have been easier to deal with the BSE crisis if we had introduced full-scale labelling for cattle at an earlier stage. The foot and mouth epidemic would have been brought more rapidly under control if we had been able to secure the traceability of sheep in Europe as well. We shall only meet the expectations of our fellow citizens with regard to food safety if we have a labelling system which permits unbroken traceability throughout the production chain. Only then can risks be quickly identified. Only then is rapid intervention possible. If we want better production from the farming and processing industries in Europe, we need quality seals which offer

comparable guarantees for the whole of Europe. Organic farming is an excellent example of environmentally friendly farming. Let us encourage it to develop further and attain a larger share of overall consumption. Let us also encourage the conventional farming sector to raise its production standards in terms of quality, environmentally compatible production and improved animal husbandry. This will not cost any taxpayers' money. It will at most cost efforts on the part of the producers and processors. But efforts which are worthwhile because they can help to restore confidence between producers and consumers. We shall also launch a detailed debate on the reorientation of CAP aid for rural development and extensive farming. The aim of this reorientation will be to convert EU budget spending [Cete réorientation doit s'appuyer sur le mécanisme fondamental du basculement de l'effort budgétaire] from direct, production-related aid into support for diverse functions of the farming sector which society today recognises: environmentally-compatible production, promotion of rural development and employment in rural areas, quality and species-related animal husbandry.

Germany and France have used the option of applying the system of modulated aid at national level. We want to go further. A common and obligatory mechanism for modulation or degressivity of aid must be prescribed at European level. [Les modalités exactes de ce mécanisme devront faire l'objet d'une proposition de la Commission, et d'un débat entre les Etats membres. D'ores et déjà, on peut imaginer qu'il prenne une forme progressive dans le temps] It can be strengthened in the course of time. Regional particularities and problems of common financing of this second pillar of the CAP should be taken into account. We must also consider an adjustment and simplification of the instruments for rural development.

Finally, the further development of mechanisms for market control must also be reviewed. Priority action is required in two areas:

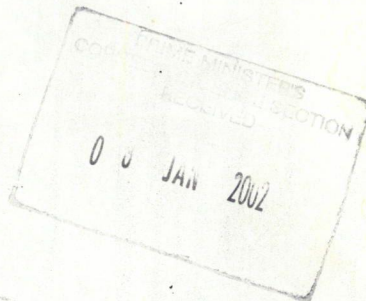
For beef, the common market organisation must develop towards greater promotion of quality, the environment, extensive production and the use of suitable areas. There are various possible measures, such as Germany's proposal to replace the current premium regulations for animal production with a uniform premium for grassland and forage crop areas. Furthermore, it is necessary to promote the production of protein crops in Europe in order to reduce our dependency on the imports of genetically modified products and contribute to a more diverse crop rotation. To this end the instruments of the Regulation on rural development should be utilised, the taxation of bio-fuels harmonised throughout Europe and set-aside areas used for this form of production. Other options must also be examined, such as the establishment of a safety net for oil seed production, an improvement in help for oil seeds and dried fodder and the possibility of excluding the production of protein crops from compulsory set-aside.

[Il est temps de passer du stade de la critique à celui des réponses]. Deep-seated consumer insecurity resulting from the recent food crises call for a reorientation of consumer protection policy and the CAP in the interest of everyone involved in the production, processing and marketing of food. We shall tackle this in close cooperation.



FROM THE AMBASSADOR

Sir Paul Lever



British Embassy

Wilhelmstrasse 70  
10117 BerlinTel: 20457 103  
Fax: 20457 571

21 December 2001

Michael Tatham  
No 10*Dear Michael,***GERMAN MEDIA PEACE PRIZE**

Thank you for your letter of 19 December about the award to the Prime Minister of the German Media Peace Prize.

It is indeed a serious and prestigious prize. It has only been going for ten years and is probably not that well known outside Germany. But it has a lot of resonance here. The jury which awards it comprises many of Germany's leading newspaper and magazine editors. Its Chairman, Stefan Aust, the Chief Editor of Der Spiegel, is one of Germany's most experienced, and best, journalists. The list of previous recipients is, as you will have seen, about as luminary as you can get.

The award of the prize would indeed provide a platform for a major speech in Germany. The grounds given for the award – your resolute commitment to fight terrorism in a considered but uncompromising manner – would provide an excellent basis for such a speech.

I know that the Prime Minister has already received a major German prize (Karlspreis in Aachen in May 1999) and he gave a speech in Germany, albeit in a party context, in November. Nonetheless, on the assumption that receipt of the award could be combined with a talk with Schroeder, my recommendation is that it would be a good use of the Prime Minister's time.

Most of the previous recipients appeared in person to receive the award. But Clinton in 1999 didn't. A ceremony was, I believe, held. If the Prime Minister can't attend we will discuss further with the organisers who might appropriately receive it on his behalf.

*Yours*



KOGEL K.

(MT)



7/1

10 DOWNING STREET  
LONDON SW1A 2AA

From the Private Secretary

19 December 2001

Dear Paul

### GERMAN MEDIA PEACE PRIZE

I attach a self-explanatory letter from the Deutscher Medienpreis informing the Prime Minister that he has been awarded the "German Media Peace Prize". The award ceremony is in Baden-Baden on 15 or 16 February.

It would be helpful to have some more background about this prize before we reply. Is it highly prestigious? Would it provide a platform for a major speech? I have to say that diary pressures argue against a visit to Germany at this time but if your answers to these two questions were emphatically positive we could think about using this as a peg for a further Blair/Schroeder session.

It would also be useful to know how the organisers would want to handle things if the Prime Minister were not able to attend. Could someone else collect the award on his behalf?

It would be helpful to have a reply early in the New Year given the imminence of the award ceremony.

Yours ever

MICHAEL TATHAM

Sir Paul Lever  
Berlin

Faxed 12/24  
by DCS.

REQUEST FOR VIEWS ON ATTACHED CORRESPONDENCE

PLEASE CIRCULATE QUICKLY

1. GARDEN ROOMS TO ACK+LOG LETTER AND COPY RECIPIENTS

✓ 7/12 No ack

✓ 7/12

2. Alastair / Sally for advice

KK 7/12

probably  
AZ

suppose so!  
Sally

15/16 Feb in Germany.

*[Handwritten signature]*

→ Stephen Wall — Can you help advice  
on if it's OK for the PM to accept the  
This award — Thanks Kate



by telefax in advance  
original by courier

Ms. Maggie Cleaver  
Events and Visits Department  
The Prime Minister's Office  
10 Downing Street  
London SW1A 2AA

Baden-Baden, December 4th, 2001

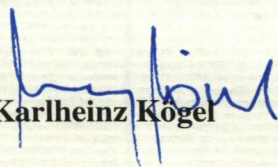
Dear Ms. Cleaver,

**Ref. German Media Peace Prize**

Upon recommendation from my friend Doug Band (who will call you in this matter) I would herewith like to forward to you an invitation for Prime Minister Tony Blair to receive the 2001 "German Media Peace Prize".

We would greatly appreciate your support in bringing the importance of this most prestigious award to the attention of Prime Minister Blair.

Yours sincerely

  
Karlheinz Kögel



**Rt. Hon. Tony Blair  
Prime Minister  
10 Downing Street  
SW1A 2AA  
London**

**Baden-Baden, December 4th, 2001**

**Dear Mister Blair,**

**It is with great honour that I am today able to inform you that the jury of the "German Media Peace Prize" has chosen you as the recipient of the 2001 award.**

**The "German Media Peace Prize" since its foundation 10 years ago has been the most outstanding and prestigious Media Award in Germany, it is the only award of its kind in Europe presented for outstanding engagement by the media itself.**

**The jury comprises of the 20 leading chief editors of German publications and is headed by Stefan Aust – chief editor of "DER SPIEGEL" – Germany's leading political magazine.**

**Please find attached a list of the previous years award recipients. Last year's award was presented to Chancellor Gerhard Schröder at a ceremony in Baden-Baden on March 13<sup>th</sup> 2001. Guests of honour on this occasion were President Nelson Mandela and President Bill Clinton.**

**The jury's unanimous decision to honour you with this award was made in recognition of your courageous determination to denounce injustices and your resolute commitment to fight terror in a considered but uncompromising manner.**



The jury stated that "as the most important European leader you embody the hopes and aspirations of all fair minded people of good will. Your courageous and consistent advocacy of the rights of the oppressed and downtrodden repeatedly testify to your rightful role as an exemplary model of outstanding engagement for a new peaceful world".

We would be honoured to present you the 2001 „German Media Peace Prize“ at the ceremony in Baden-Baden on February 15<sup>th</sup> or 16<sup>th</sup>, 2002.

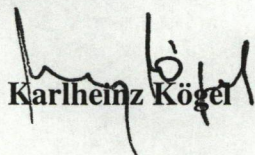
The ceremony itself is a one hour event open to the general media. In previous years all major international media networks have covered the event in Europe. A particularly valued speciality of the event is that a limited guest list of 100 personalities are invited from the fields of industry, politics and culture to attend an after award get-together completely excluding the presence of any press representatives.

In accordance to tradition it is usual that one of the previous years recipients would make the presentation speech to you. In this case this would be for example Chancellor Schröder, President Mandela or President Clinton, all of which will be in attendance. This choice is however, entirely at your discretion.

I might add that I had dinner with President Clinton in New York last Friday and he was full of enthusiasm and enthralled that this year's "German Media Peace Prize" be awarded to you.

As a devoted follower of your geopolitical leadership I look forward to hearing from you with respect to this invitation.

Yours sincerely

  
Karlheinz Kögel

MEDIA CONTROL

DEUTSCHER  
MEDIENPREIS

2001

1992

**Dr. Helmut Thoma**

Chairman of the Board RTL Television

1993

**Dr. Helmut Kohl**

Chancellor of the Federal Republic of Germany

1994

**François Mitterrand**

President of the Republic of France

Guest of honour: German Chancellor Dr. Helmut Kohl

1995

**Yassir Arafat – Yitzhak Rabin (posthumously)**

President PLO – Minister President of Israel

Guest of honour: German Foreign Minister Dr. Klaus Kinkel

1996

**Boris Jelzin**

President of the Russian Federation

Guest of honour: German Chancellor Dr. Helmut Kohl

1997

**King Hussein Bin Talal**

King of the Hashemite Kingdom of Jordan

Guest of honour: German President Roman Herzog, Yassir Arafat, Shimon Perres

1998

**Nelson Mandela**

President of the Republic of South Africa

Guest of honour: German Chancellor Gerhard Schröder

1999

**William J. Clinton**

President of the United States of America

2000

**Gerhard Schröder**

German Chancellor of the Federal Republic of Germany

Guest of honour: President William J. Clinton, President Nelson Mandela



**Rt. Hon. Tony Blair  
Prime Minister  
10 Downing Street  
SW1A 2AA  
London**

**Baden-Baden, December 4th, 2001**

**Dear Mister Blair,**

**It is with great honour that I am today able to inform you that the jury of the "German Media Peace Prize" has chosen you as the recipient of the 2001 award.**

**The "German Media Peace Prize" since its foundation 10 years ago has been the most outstanding and prestigious Media Award in Germany, it is the only award of its kind in Europe presented for outstanding engagement by the media itself.**

**The jury comprises of the 20 leading chief editors of German publications and is headed by Stefan Aust – chief editor of "DER SPIEGEL" – Germany's leading political magazine.**

**Please find attached a list of the previous years award recipients. Last year's award was presented to Chancellor Gerhard Schröder at a ceremony in Baden-Baden on March 13<sup>th</sup> 2001. Guests of honour on this occasion were President Nelson Mandela and President Bill Clinton.**

**The jury's unanimous decision to honour you with this award was made in recognition of your courageous determination to denounce injustices and your resolute commitment to fight terror in a considered but uncompromising manner.**



The jury stated that "as the most important European leader you embody the hopes and aspirations of all fair minded people of good will. Your courageous and consistent advocacy of the rights of the oppressed and downtrodden repeatedly testify to your rightful role as an exemplary model of outstanding engagement for a new peaceful world".

We would be honoured to present you the 2001 „German Media Peace Prize“ at the ceremony in Baden-Baden on February 15<sup>th</sup> or 16<sup>th</sup>, 2002.

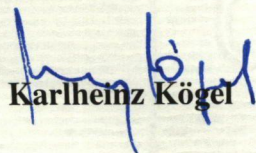
The ceremony itself is a one hour event open to the general media. In previous years all major international media networks have covered the event in Europe. A particularly valued speciality of the event is that a limited guest list of 100 personalities are invited from the fields of industry, politics and culture to attend an after award get-together completely excluding the presence of any press representatives.

In accordance to tradition it is usual that one of the previous years recipients would make the presentation speech to you. In this case this would be for example Chancellor Schröder, President Mandela or President Clinton, all of which will be in attendance. This choice is however, entirely at your discretion.

I might add that I had dinner with President Clinton in New York last Friday and he was full of enthusiasm and enthralled that this year's "German Media Peace Prize" be awarded to you.

As a devoted follower of your geopolitical leadership I look forward to hearing from you with respect to this invitation.

Yours sincerely

  
Karlheinz Kögel





**2001**

1992

**Dr. Helmut Thoma**

Chairman of the Board RTL Television

1993

**Dr. Helmut Kohl**

Chancellor of the Federal Republic of Germany

1994

**François Mitterrand**

President of the Republic of France

Guest of honour: German Chancellor Dr. Helmut Kohl

1995

**Yassir Arafat – Yitzhak Rabin (posthumously)**

President PLO – Minister President of Israel

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**William J. Clinton**

President of the United States of America

2000

**Gerhard Schröder**

German Chancellor of the Federal Republic of Germany

Guest of honour: President William J. Clinton, President Nelson Mandela



10 DOWNING STREET  
LONDON SW1A 2AA

**FAXED**

From the Private Secretary

19 December 2001

Dear Paul

**GERMAN MEDIA PEACE PRIZE**

I attach a self-explanatory letter from the Deutscher Medienpreis informing the Prime Minister that he has been awarded the "German Media Peace Prize". The award ceremony is in Baden-Baden on 15 or 16 February.

It would be helpful to have some more background about this prize before we reply. Is it highly prestigious? Would it provide a platform for a major speech? I have to say that diary pressures argue against a visit to Germany at this time but if your answers to these two questions were emphatically positive we could think about using this as a peg for a further Blair/Schroeder session.

It would also be useful to know how the organisers would want to handle things if the Prime Minister were not able to attend. Could someone else collect the award on his behalf?

It would be helpful to have a reply early in the New Year given the imminence of the award ceremony.

Yours ever

**MICHAEL TATHAM**

Sir Paul Lever  
Berlin

MEDIA CONTROL

DEUTSCHER  
MEDIENPREIS

2001

Rt. Hon. Tony Blair  
Prime Minister  
10 Downing Street  
SW1A 2AA  
London

Baden-Baden, December 4th, 2001

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The jury's unanimous decision to honour you with this award was made in recognition of your courageous determination to denounce injustices and your resolute commitment to fight terror in a considered but uncompromising manner.

DEUTSCHER  
MEDIENTPREIS



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URHEBERRECHTLICH GESCHÜTZT

**JÖRG BONGARTZ**

Wetzelstrasse 18 · 76530 Baden-Baden

Mobilephone D1: 0 17 18 38 13 86

Tel. +49-7221 · 39 25 92 · Fax 94 99 50

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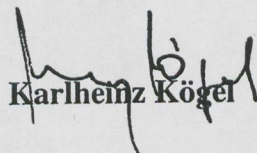
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Karlheinz Kögel

MEDIA CONTROL

DEUTSCHER  
MEDIENPREIS

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2000

**Gerhard Schröder**

German Chancellor of the Federal Republic of Germany

Guest of honour: President William J. Clinton, President Nelson Mandela

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10 DOWNING STREET  
LONDON SW1A 2AA

From the Private Secretary

18 December 2001

Dear Simon

**ISAF: TELEPHONE CONVERSATION WITH GERMAN CHANCELLOR**

The Prime Minister spoke to Schroder at 1345 today about the command and mandate for ISAF.

The Prime Minister began by apologising if these issues were causing political problems for Schroder. We had been doing our best to resolve the issues on a satisfactory basis but were up against some firm positions on the part of the US military. Schroder said he understood how things were. The UK had to sort this out to its satisfaction. But the same applied to Germany. He would have to present any arrangement to the Bundestag and he was not going to ask for a second vote of confidence.

The Prime Minister said he had spoken to Bush yesterday whose office had in turn spoken to Franks. The upshot was a form of words which we had sent to the Chancellery. We had now received back German comments and suggested changes. Some of these were more problematic than others, although all of this might be less sensitive if it could be treated as the basis for private understandings. In practice, the precise wording was less important than the reality of the military understandings reached between ourselves and the Americans.

Schroder said he had instructed his staff to produce a text as close as possible to the UK wording. If the text was to be treated as the basis for a private understanding he could probably go even further and accept back into the text the language about "the successful completion of Operation Enduring Freedom".

Schroder set out further German concerns: they wanted the force limited to Kabul and surrounding areas; it should be under Chapter VII, rather than Chapter VI; and they had doubts about limiting the force to a 90 day mandate - this might

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Handwritten notes in red ink: "EAY" and "File." with a checkmark. To the right, vertical text: "JP", "A", "D", "P".



become awkward if it proved difficult to find a new framework nation (Germany would certainly not be in a position to take this on given its existing commitments).

Schroder said he wanted his position to be clear. If the UK wanted a broader mandate for the international force this would create big political problems in Germany. He had to secure Bundestag consent. He wanted Germany to show solidarity and be part of the international force, but he did not want this simply for its own sake. Germany could only contribute under certain conditions. If it was not possible to meet these, Germany would be unable to participate and would have to show its solidarity in other ways (that might not preclude their coming in at a different stage under different conditions). Germany was ready to be part of a force but was not insisting and would not do so at any price. It had to do so under conditions that were tolerable for the government and sellable domestically. It would not cause political problems for him if German forces did not participate (on the contrary...).

The Prime Minister said we were agreed on Chapter VII and on limiting the force to Kabul and surrounding areas. On the 90 day mandate there was a balance to be found between unnecessary constraints and finding ourselves stuck in a very awkward theatre. The key issue was still to find a form of words that bridged German and CENTCOM concerns.

Schroder said he now found himself effectively negotiating on behalf of his Foreign Minister (he had a lingering suspicion as to why that was the case). He suggested that Fischer and the Foreign Secretary should discuss this and agree on wording. Once that had been done, he would make sure his Defence Ministry fell into line. The Prime Minister agreed to this course of action. Schroder said he would tell Fischer to contact the Foreign Secretary.

#### Comment

David Manning has since spoken to the Foreign Secretary and agreed that our aim should be to take ourselves out of this sandwich and let the Germans negotiate directly with the US. I understand a phonecall with Fischer is planned for later this afternoon.

For ease of reference I am attaching to this letter the text on ISAF that we negotiated with the Americans and the German variant of this referred to in the Prime Minister's conversation with Schroder.

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- 3 -

I am copying this letter to Peter Watkins (MOD), Admiral Sir Michael Boyce (CDS), Andrew Allberry (Cabinet Office), Sir Paul Lever (Berlin), Sir Christopher Meyer (Washington) and Sir Jeremy Greenstock (UKMis New York).

Yours ever

*Michael Tatham*

**MICHAEL TATHAM**

Simon McDonald  
FCO

CONFIDENTIAL

TEXT AGREED WITH US

The International Security Assistance Force has a particular mission authorised by a UNSCR that is distinct from Operation Enduring Freedom. The United Kingdom, as lead nation, will exercise command of the International Security Assistance Force. It will include troops and equipment contributed by other nations and will have the support of the US.

In respect of the relationship between the International Security Assistance Force and forces operating in the Afghanistan theatre under Operation Enduring Freedom, and for reasons of effectiveness, CENTCOM will have authority over the International Security Assistance Force to deconflict International Security Assistance Force and Operation Enduring Freedom activities and to ensure that International Security Assistance Force activities do not interfere with the successful completion of Operation Enduring Freedom.

## GERMAN VARIANT TEXT

The International Security Force has a particular mission authorised by a UNSCR that is distinct from Operation Enduring Freedom. The United Kingdom will be the lead nation of the International Security Force. It will include troops and equipment contributed by other nations and will have the support of the US.

In respect of the relationship between the International Security Force and forces operating in the Afghanistan theatre under Operation Enduring Freedom, and for reasons of effectiveness, CENTCOM will have authority to deconflict International Security Force and Operation Enduring Freedom activities and to ensure that activities of ongoing operations do not interfere.

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Prime Minister

M7.

Go to the press / this  
MDDPAN 0895

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FM BERLIN  
TO PRIORITY FCO  
TELNO 555

Detailed background on the  
pre-electoral scene in Germany  
Michael Patton

OF 071713Z DECEMBER 01  
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INFO ROUTINE EU POSTS, HM TREASURY, MODUK, MOSCOW  
INFO ROUTINE NATO POSTS, PEKING, TOKYO, WHIRL

Re

SUBJECT: GERMANY INTERNAL: CAN THE OPPOSITION BEAT SCHROEDER ?

CABINET OFFICE PLEASE PASS TO NO 10

SUMMARY

1. Schroeder's biggest political advantage - the Opposition's weakness - is declining. His head-to-head with the CDU/CSU choice for Chancellor-candidate will, in the absence of major policy differences, be crucial to the Bundestag election battle. Could be either Merkel (CDU leader) or Stoiber (Bavarian CSU leader). SPD's "dream opponent" Stoiber is probably the bigger threat. But Schroeder still looks to have the beating of either.

DETAIL

2. In Germany elections are lost by governments not won by oppositions. But as the economy gets worse, the more the electorate is focussing on how the competition matches up. So what and who is Schroeder up against ?

3. Up till now the Opposition's weakness has been Schroeder's greatest strength. The donations scandal and loss of Schaeuble's experienced leadership at the end of 1999 were massive blows to the CDU. Since then

- the Union has looked split every which way: old (Kohlite) guard versus new young leadership, CDU versus CSU, Headquarters versus parliamentary caucus, federal versus Laender leaders, (poor, centrist) North against (rich, conservative) South;

- the new leadership triumvirate of Angela Merkel (CDU Chairman), Edmund Stoiber (CSU Chairman, Minister-President of Bavaria) and Friedrich Merz (CDU/CSU Parliamentary Leader) has looked uncoordinated and divided. Merkel in particular has failed to impose her rule;

- it has failed to articulate a coherent political alternative. Instead it has been out-flanked and -manoeuvred by Schroeder on

PAGE 1

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tax, pensions and (thus far) immigration reform. In the process it has alienated its traditional business support;

- as a result the Opposition have failed to make any political headway over the last two years. Their vote has gone down in all but one of the last 4 Land elections. They have remained a steady 4-6% behind the SPD in the polls.

4. Recently, however, the Opposition have looked in better shape. They have at last started to make some political capital out of the government's problems with unemployment, the budget, health costs and military deployments. Their competence scores in polls are edging up. Against the backdrop of a failing economy, it is easier for them to win profile as a managerial rather than policy alternative. And they appear to have rediscovered discipline at last. The CDU's recent Dresden party conference (4 December) was a triumph of televisual unity. It has quashed (for now at least) doubts over Merkel's continued leadership. There is a new confidence in the rank and file that an "it's the economy, stupid" campaign offers them some hope of competing next year. The media no longer assume that Schroeder can win the Bundestag election by default.

5. But previous CDU fresh starts have petered out. Their widely diagnosed fundamental problem is the lack of a clear leader. That is an in-built source of disunity, and handicap in competing with Schroeder for profile with the electorate. Furthermore, the traditional German focus on party is giving way to personality politics, in particular at a time when policy differences are in practice small. Hence the media and political class focus on the "K-Frage", who will be the CDU/CSU's candidate for Chancellor (Kanzlerkandidat) in the up-coming elections ?

Merkel or Stoiber ?

6. There is speculation about a come-back by Schaeuble, or a premature bid by Koch (CDU Minister-President of Hessen). But in practice there are only two realistic candidates: Merkel and Stoiber. She definitely wants it; he only if there is a reasonable chance of winning the elections. However, the when, how and who of selection are still unclear:

- on the "when", Merkel and Stoiber have agreed it should be "early next year." That has been endorsed by the CDU conference. It could mean any time between January and March. Both candidates would prefer later: that gives Merkel more time to catch up in polls, and allows Stoiber to put off a decision until CDU/CSU chances are clearer. They also hope to repeat Schroeder's 1998 trick of riding the momentum from a late nomination through to

polling day. But media and internal party pressure for an earlier decision will be strong. The powerful Baden-Wuerttemberg party has already tried once a pre-emptive coup against Merkel, and might well try to force the pace again;

- on the "how", there is no formal procedure beyond adoption of a "Chancellor-candidate" at a special pre-election party conference. Merkel and Stoiber have said they will make a joint recommendation. The other party barons, and the parliamentary caucus, are unlikely to allow themselves to be completely sidelined and on balance back Stoiber. But in practice two factors favour Merkel: the difficulty of (i) forcing the leader of the senior party unwillingly to stand aside; and (ii) getting the broad majority of the CDU party machine and activists to work for the leader of the junior CSU party. Stoiber is determined to avoid (then CSU leader) Strauss' disastrous performance in 1980, when Kohl's CDU failed properly to campaign for him;

- on the "who", the race is nevertheless still open. All polls suggest that Stoiber has the better chances. He outshone Merkel at her own party conference last week. He is acknowledged to be the better campaigner. His competence ratings are far higher. He does better than Merkel in direct match-ups against Schroeder. A majority of voters and even CDU members want him not her to be the Opposition candidate. As one wag put it, "if you're up against Real Madrid, would you rather be represented by Bayern Munich or Cottbus (Bolton equivalent)?" But no Bavarian has ever succeeded in becoming Chancellor. They are seen as too conservative, catholic and chauvinistic to appeal to voters in the liberal and protestant/secular North and East. Which is why the political class remain split on whether Stoiber will in the end go for it, and the CDU accept him. Merkel could end up the default Chancellor-candidate.

How big a threat does Schroeder face ?

7. SPD and Kanzleramt contacts argue that Merkel is the more dangerous, because difficult to attack and has a headstart with the Ossi and female vote. Whereas Stoiber is their dream opponent; he would polarise the campaign, making it easier for the SPD to turn out its core blue-collar electorate in the Ruhr, and for Schroeder to compete for the political centre floating vote. But this may be too simplistic. Merkel doesn't have the inner beef or political skills to project herself as an alternative national leader to Schroeder. Stoiber on the other hand looks more credible: his Bavarian stewardship is at or near the top of most regional German and EU league tables (lowest unemployment and crime, best education system, most high-tech industries), at a time when a Schroeder-run federal Germany looks like being at the

bottom of most EU and OECD league tables (growth, deficit, unemployment etc).

8. The bigger picture remains, however, that Schroeder still looks to have the beating of either. That is what the polls and pollsters say. His own campaigning skills are formidable. The media will have a bigger role than in 1998, which plays to his strength. And his big advantage at head-to-head level is his ability to attract all segments of the German electorate - South and East as well as North, business as well as unions, women and men, young and old, floating and core voters. Merkel or Stoiber could beat him in some categories, but both are handicapped by the lack of a similarly broad appeal.

What should we do ?

9. Standard operating procedure 10 months before an election would be to think about covering our bets by establishing senior contact with the other side in case they win. But even though the odds on that have shortened slightly, we shouldn't in this case. Schroeder is thin-skinned about foreign colleagues receiving his opponents. He continues to hold against Chirac the latter's contacts with Stoiber. The damage to the Prime Minister's relationship with Schroeder from meeting Merkel or Stoiber outweighs the potential costs of not doing so in the still unlikely event that either becomes Chancellor. Neither will accept being handled beneath prime ministerial level. So we will have to focus our reinsurance efforts on more junior figures. This Embassy is already cultivating potential kitchen cabinet members. But it would also be worth Ministers occasionally making time to see any key CDU and CSU party figures who travel to London.

LEVER

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10 DOWNING STREET  
LONDON SW1A 2AA

RECEIVED  
4 DEC 2001

From the Private Secretary

4 December 2001

Dear Simon

### TELEPHONE CONVERSATION WITH GERMAN CHANCELLOR

Schroeder telephoned the Prime Minister this evening to discuss the situation in the Middle East.

Schroeder said it would be useful for the Foreign Secretary, Fischer and Vedrine to meet up soon and agree on a common position. The Prime Minister said this would be a good idea. The present situation was disastrous. Serious Israeli retaliation had been inevitable. With no process in place, things were set to spiral downwards. We needed to find a way of injecting security calm into the situation so that there was space for a process to start. He had emphasised to Bush that whatever the difficulties, a process was needed. Schroeder agreed.

Schroeder said it was also necessary to signal to the Israelis that, although we understood the reasons for their response, there was a limit to what they should do. Taking action that would lead to the political destruction of Arafat would be crossing a line. The Prime Minister said there was a danger of the Israelis thinking it was no longer worth engaging with Arafat. That would be a serious mistake. Schroeder agreed: there was no alternative to Arafat. At the same time, however, we needed to put a lot of pressure on Arafat to stop using the intifada for his own tactical purposes. The Prime Minister said that at a minimum Arafat should start arresting those responsible for terrorist acts and ensure that they were properly locked up. Absent that, retaliation would just intensify.

Schroeder said he would ask Fischer to contact the Foreign Secretary and Vedrine so that a common position could be worked up which could then be taken to the public and to the US. There could be no solution without US involvement. He would telephone Chirac and get his support. This all needed to happen quickly. It could not wait until Laeken.

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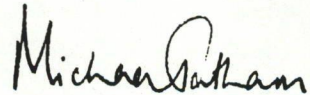
AB

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- 2 -

I am copying this letter to Andrew Allberry (Cabinet Office), Sir Paul Lever (Berlin), Sir John Holmes (Paris), Sir Nigel Sheinwald (UKRep Brussels), Sir Christopher Meyer (Washington), Sherard Cowper-Coles (Tel Aviv) and Geoffrey Adams (Jerusalem).

Yours ever

A handwritten signature in cursive script that reads "Michael Tatham".

**MICHAEL TATHAM**

Simon McDonald  
FCO

CONFIDENTIAL

+49 30 20457571

**MATRIX**

From: Ambassador  
Date: 28 November 2001

To: Hugh Powell

cc: Jeremy Cresswell  
Pat Ramsey  
Roger Liddle, No 10  
Sally Morgan, No 10

**SIGRID KRAMPITZ**

1. I gave Sigrid Krampitz, the Head of Schroeder's private office, a tour round the Embassy on Saturday. She had her partner (an architect) and four or five other members of her family (several also architects) in town. They had just done the Kanzleramt. They all said how impressed they were with the building.
2. She also said that the Prime Minister's speech in Nürnberg had not only pleased Schroeder enormously because of what the Prime Minister had said about him and about Germany and the SPD. But because all the speech writers in the Kanzleramt admired its drafting and construction. They were now, she said, crawling through it to gain tips on how to do better themselves!

pp Beam.

28. NOV. 2001 16:21

BRITISH EMBASSY PRIVATE OFFICE

NR. 698

S. 3/3

+49 30 20457571

**BUNDESREPUBLIK DEUTSCHLAND  
DER BUNDESKANZLER**

Leiterin des Kanzlerbüros

10557 Berlin, **27. November 2001**  
Willy-Brandt-Straße 1

Briefanschrift:  
11012 Berlin  
Telefon 018 88 / 400 - 2004  
oder (030) 40 00 - 0 (Vermittlung)  
Fax 018 88 / 400 - 2353

Seiner Exzellenz  
Herrn Botschafter  
Sir Paul Lever  
Wilhelmstraße 70 - 71

10117 Berlin

Per Telefax: 030/20457 571

Sehr geehrter Herr Botschafter,

Ich möchte mich auf diesem Wege noch einmal ganz herzlich für die interessante Führung durch Ihr eindrucksvolles Botschaftsgebäude bedanken. Sie haben mir und meinen Gästen damit eine ganz besondere Freude gemacht. Der Besuch bei Ihnen war eindeutig das Highlight auf unserer Architektur-Tour durch Berlin.

Ein herzliches Dankeschön dafür, dass Sie sich an einem Samstag persönlich Zeit genommen haben! Bitte lassen Sie mich wissen, wenn ich einmal etwas für Sie tun kann.

Mit freundlichen Grüßen

*S. Krampitz*  
Sigrid Krampitz



10 DOWNING STREET  
LONDON SW1A 2AA

FAXED  
28/11

file

From the Principal Private Secretary

27 November 2001

Dear Bernd,

**FOLLOW-UP TO NO 10/KANZLERAMT ECONOMIC WORKING  
GROUP**

My letter of 1 November promised we would send you more information following our last discussions in Berlin.

**Energy liberalisation**

Energy liberalisation remains of course a top priority for both our Governments and it is important that we get it right. I know that our experts are keeping in close touch on this issue. I attach a short note about the problems UK firms encounter in the German energy market. In addition, I thought it also might be helpful if I were to try to explain how we thought some of these problems might be tackled.

Firstly we recognise of course that Germany is already taking action to deal with the complaints from players seeking to enter the German energy market. We welcome the establishment of a division in the Bundeskartellamt (BKA) to handle grid and pipeline access complaints. As you know, the length of time taken to settle access disputes is a complaint that we often hear from our companies, and increasing the BKA's resources should help here. The planned changes to the German legal framework, to reverse the burden of proof in access cases, and to give the BKA's decisions immediate effect, would both help things enormously.

The transfer of Hans-Peter Schultz from the BKA to the Ministry of Economic Affairs to head up a task force on network access is another very positive development. We understand that he will be seeking to identify barriers to network access and draw up a "code of best practice" for network owners, including the principles on which fees are charged. This is exactly the kind of improvement we think is necessary. When we stress the importance of ex ante

regulation we do not mean that the regulatory authority should fix access tariffs, but that the principles underlying their calculation should be approved by a regulatory body in advance. In this way, new entrants to a market can have confidence that they are being treated in the same way as incumbents, particularly vertically - integrated incumbents.

Another way to give new entrants confidence that they are being treated fairly is by having published access tariffs binding on all players. The system of negotiated access currently used in Germany is not able to guarantee non-discrimination - quite the reverse. We know that you are reconsidering this issue and we hope that you will decide to move to non-discriminatory third party access.

To sum up, we see the following as essential prerequisites for a properly functioning market in energy: a supervisory authority independent of the industry responsible for developing, publishing and enforcing rules governing the issues connected with network access; published network access tariffs, actually applied in a non-discriminatory way; and legal separation of network businesses from production and sales. We believe that all this could be achieved in Germany working within the present institutional framework and, indeed, that the steps that have been taken in recent months have been very positive in this regard.

#### **State aid/Services of General Economic Interest**

Experts from the Treasury and DTI had a useful meeting with their Finance and Economics Ministry colleagues earlier this month and will continue to stay in close contact. It is clear that we are developing much common ground, both on state aid reform and on Services of General Economic Interest.

I promised to send you a copy of a letter we sent the Commission over the summer on the application of state aid rules to the private provision of public services. This is an important issue and, like you, we think the Commission's interpretation of ECJ rulings in this area has been too wide. We therefore very much welcome the recent decision on the Ferring case which I understand confirms that where there is no over-compensation Article 87 does not apply. Clearly we will now need to work with the Commission on how over-compensation might be defined and policed.

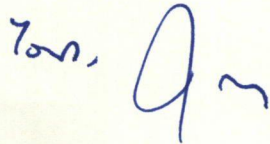
**Economic Reform: Barcelona**

We also owe you comments on your interesting paper on priorities for Barcelona. As I said in Berlin, we see much in this that we can agree with as a sound basis for furthering the economic reform agenda. Our experts are currently working on more detailed comments and we will let you have these in the next few days.

**Taxation of Capital Income**

Gordon Brown will give a presentation at ECOFIN on 4 December on the measures we are taking in respect of overseas territories. I will arrange for you to receive this as soon as possible.

Martin Donnelly will be happy to discuss these issues further when he meets Kanzleramt colleagues in January in advance of our next session.

A handwritten signature in blue ink, appearing to read "Tom, Jm".

**JEREMY HEYWOOD**

Dr Bernd Pfaffenbach  
Kanzleramt

## **UK NOTE ON PROBLEMS EXPERIENCED BY NEW MARKET ENTRANTS TO THE GERMAN ELECTRICITY AND GAS MARKET**

The problems described below have been experienced and reported to the Department of Trade and Industry by Enron, TXU, Centrica and EFET (the European Federation of Energy Traders).

### **Discriminatory terms and conditions**

“Association Agreements” laying down terms and conditions for access to networks (including a requirement for the publication of “indicative” charges for access) have been concluded between Germany’s gas and electricity industries and large consumers, but they have no legal force and many Stadtwerke (municipal authorities) do not respect them. This exposes new entrants to the risk of unforeseeable costs. The considerable variations in approaches to pricing and terms of access mean that new entrants have to negotiate access with individual network owners. This lengthy negotiation process is not only costly, but it sometimes takes so long that by the time an agreement has been reached the original deal between the new entrant and German customer has fallen through. It also prevents trading on the spot market. This, coupled with the lack of transparency on network access charges and information on available capacity, gives network owners ample opportunity for discriminatory treatment. For example:

- The network operator requests information from the new entrant that he cannot easily provide, eg gas pressure at a transfer point, or informs him at the last minute that the transfer point cannot be used and he must seek an alternative route. Such information is of course already available to the network operator.
- The network operator only offers interruptible capacity in the pipeline as 100% of the non-interruptible capacity is set aside for his own supply business. The number of customers interested in interruptible contracts is limited.
- Transport contracts attract a fee. In the absence of proper unbundling, it is not clear that the integrated incumbent’s own supply business pays this fee.



### Inflated Charges

No body exists with the power to fix or approve access charges for German networks. Some UK companies believe German network owners are using their dominant positions to charge excessive access fees, particularly for gas. There is no legal requirement to publish charges, while those that are published are significantly higher than in comparable EU member states. This means that companies sometimes find it impossible to draw up commercially viable supply contracts. For example:

- Charges for access to gas pipelines are often for a minimum of one year even though the supply contract is for a shorter period. New entrants generally want to contract for shorter periods so they are disadvantaged by this practice. In one case a new entrant was denied access to capacity leased for the minimum year after completing a supply contract in less than twelve months.

Prices for balancing electricity and gas are also high: the Cartel Office recently considered taking four German companies to court over what it called "unreasonable and partly fictitious costs". Hourly gas balancing is often required where daily balancing would be sufficient: this limits the type of customer that can be served, as customers have to be capable of managing their loads.

### Insufficient Unbundling

There have been reports of network owners using delaying tactics, such as in the provision of paperwork, in the course of this negotiation process, during which time the supply business of the vertically integrated incumbent approaches the contested customer offering them a better deal or even threatening them. This strongly suggests a leakage of information within vertically integrated companies.

There are also strong suspicions that cross-subsidisation takes place. Network charges are set at a level so close to the incumbent's retail price that supplying smaller customers proves to be unprofitable for new entrants.

### Obstacles to customer switching

The rate of customers switching supplier is low in Germany, with on average fewer switching in one year than switch in two weeks in the UK.

Customers in Germany are deterred by factors such as switching charges, threats of disconnection and difficulties involved in transferring their accounts due to the lack of an automated registration system. This has hindered the development of supply-side competition. Another deterrent is the widespread practice of double contracts where grid access contracts are required with both the new supplier and the customer wishing to switch. The customer is told that once the new supply contract expires, he will have to continue contracting for network access (this is usually subsumed in the final bill).

#### Unsatisfactory Dispute Resolution Procedure

The situation is made worse by the lengthy and expensive dispute resolution procedure which exists in Germany. All disputes have to be referred to the Federal Cartel Office and settled by court action. The likelihood of such disputes arising would be lessened by the existence of more ex ante rules which are transparent and applied to all market players without discrimination.

November 2001



20 July 2001

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## INITIAL COMMENTS ON THE APPLICATION OF EUROPEAN STATE AIDS LAW TO PRIVATE PROVISION OF PUBLIC SERVICES

During the multilateral meeting of state aid experts from the Member States on 7 June, which focused on European law and practice relating to Services of General Economic Interest (SGEI), the Commission asked for written comments on the matters discussed.

The Commission requested that comments be submitted rapidly and my authorities understand the Commission's need to act quickly to be able to present an appropriate paper on this issue at the Laeken summit in December. This response has therefore been produced relatively fast to feed into your policy debate and indicate the direction of our thinking. However, given the importance and complexity of the issues and the range of interested parties within government on these issues, the finalisation of the UK position will take time. I have been asked to stress that this initial response is preliminary and to note that we may submit further points and expand on existing points as the policy process develops.

### Overall Comments

My authorities are very concerned about the Commission's apparent view that the state aid rules now apply to all cases where the state pays an undertaking to supply services to the public.

The UK, like many other Member States, considers that in many cases public services can be more efficiently delivered through the input of commercial skills and market disciplines alongside the service ethos of the public sector. The application of state aid rules every time there is public-private partnership in service delivery would, however, act as a disincentive to the innovative use of such mechanisms. This would have the perverse effect of **reducing** competition, in favour of continuing state monopolisation of service delivery. It would, moreover, be contrary to Article 295 of the EEC Treaty for public ownership and delivery to be so clearly favoured over contracting out and public/private partnership.



**The recent cases of the European Court of Justice relating to the provision of SGEIs do not, and should not, lead to the conclusion that all payments by a Member State to a private sector provider of public services constitute an “aid” under Article 87 of the Treaty. It must be remembered that in all of the cases considered, the service provider received an economic advantage that it would not have obtained under normal market conditions. The economic advantage was related to the imposition of broad public service obligations on specific, selected undertakings operating in a commercial environment. In our view the Commission should limit the application of these cases to their SGEI context, hence promoting legal certainty and avoiding a flood of unnecessary notifications.**

Substantive comments in this letter are divided into four parts:

1. the importance of this issue and an explanation of the context of private sector involvement in public service delivery in the UK;
2. the UK’s interpretation of the recent European Court rulings in the “La Poste” case and in the cases following on from it;
3. the limitations which my authorities believe must be placed on the application of state aid law to the provision of public services;
4. procedural steps, which my authorities believe should now be taken to resolve major uncertainties and ensure minimal disruption to public services, whilst protecting fair and free competition within the commercial sector across Europe.

### **1. The importance of private provision of public services**

Many public services in all Member States are delivered by “undertakings”. A growing number of such undertakings in all Member States are privately owned and commercially managed. In several, critical sectors (e.g. electricity, gas, postal services, telecommunications, air transport) former monopoly or oligopolistic suppliers of vital public services have been forced to compete for customers and become more commercial in their operations.

The UK has always supported, and continues to strongly support, such market liberalisation in the firm belief that in these commercially-oriented sectors, market disciplines can be wedded to public service roles and obligations for the benefit of customers of the services (and often of taxpayers). We also accept fully the need for rigorous enforcement of state aid rules in relation to commercial undertakings operating in these sectors. We expect market liberalisation of some public services to be extended in future, leading to increased commercialisation and the need for state aid rules to be applied strictly.

However, not all public services lend themselves to fully competitive market disciplines. Our view is that commercial skills can enhance the operation of these public services too, but that in these cases, full privatisation may be inappropriate and the role of the private sector may be more contractual and restricted to defined and



contained projects and roles. We are therefore expanding private sector involvement in new areas such as the building and management of prisons, the delivery of healthcare and the supply of education. We are anxious, however, at the same time, not to lose the valuable public sector ethos and traditions, which have prevailed in these sectors for many years. We are therefore continually investigating new forms of public private partnership to improve service delivery and invest in public services in a cost-efficient manner.

Public private partnerships (PPPs) are a key element in the UK Government's strategy for delivering modern, high quality public services. They cover a range of business structures and partnership arrangements, from the Private Finance Initiative (PFI) to joint ventures and concessions, more simple outsourcing and contracting out and the sale of equity stakes in state-owned businesses. Under PFI, in particular, the public sector contracts to purchase quality services on a long term basis so as to take advantage of private sector management skills incentivised by having private finance at risk. This includes concessions and franchises, where a private sector partner takes on the responsibility for providing a public service, including maintaining, enhancing or constructing the necessary infrastructure. PFI has been used quite extensively, for example, to build and run river crossings, hospitals and schools.

**Not all of these cases of private involvement in public services present risks for competition or "subsidy" concerns. In most cases, the relationship between public and private sector is contractual, with an appropriate element of risk, or based on commercial risk-sharing, rather than based on subsidy. The involvement of the private sector (including many firms from other Member States) is usually based on full, competitive procurement and commercial pricing of services. Many cases relate to local provision of services and have negligible potential impact on intra-Community trade. In most cases, the net effect is to increase competition, rather than reduce it.**

## **2. The legal doctrine**

The critical legal issue appears to be the interpretation of two cases, known as "La Poste" and "RTP". My authorities believe that these cases must be interpreted in their proper context of SGEI only. General principles of state aid law will still apply to other types of private provision of public services and the next section examines how such principles should apply more broadly. This section explains the basis for a limited interpretation of the "La Poste" case law.

The Commission has referred to the judgement of the CFI in Case T-46/97 SIC v Commission (the RTP case). That case concerned a number of obligations imposed on RTP by its concession agreement granted by the Portuguese Government. It received grants by way of compensation which were intended to finance the burden of public service obligations that private television channels did not undertake. In Case T-106/95 FFSA v Commission (La Poste) La Poste was required to carry out certain public service obligations such as to ensure the presence of post offices through the national territory. For this it received a tax concession.



In paragraph 84 of its judgement in the RTP case the court said:

*“As the case-law shows, the fact that a financial advantage is granted to an undertaking by the public authorities in order to offset the cost of public service obligations which that undertaking is claimed to have assumed has no bearing on the classification of that measure as aid within the meaning of Article 92(1) of the Treaty, although that aspect may be taken into account when considering whether the aid in question is compatible with the common market under Article 90(2) of the Treaty (FFSA, paragraphs 178 and 179, confirmed by the order in Case-174/97 P FFSA v Commission [1998] ECR I-1303, paragraph 33). It should be noted that, in this case, unlike the FFSA case, the Commission did not apply the derogation allowed for by Article 90(2) of the Treaty in its Decision, nor, a fortiori, did it apply the specific conditions laid down by that provision, which, moreover, it does not claim to have done”.*

It can be seen that the Court referred to the FFSA case as authority. For the Commission to expand the statement in the RTP case to include all cases where payment is made to an undertaking to supply services to the public is to take the statement of the CFI out of context. Indeed, in the RTP case, the Court defined State aid as follows:

*“77. The Court has consistently held that the aim of [Article 87(1)] is to prevent trade between Member States being affected by advantages granted by public authorities which, in various forms, distort or threaten to distort competition by favouring certain undertakings or certain products (Case C-387/92 Banco Exterior de España v Ayuntamiento de Valencia [1994] ECR I-877, paragraph 12, SFEI, paragraph 58).*

*78. In order to determine whether a State measure constitutes aid, therefore, it is necessary to establish whether the recipient undertaking receives an economic advantage which it would not have obtained under normal market conditions (SFEI, paragraph 60; Case C-342/96 Spain v Commission [1999] ECR I-2459, paragraph 41; Case C-256/97 DM Transport [1999] ECR I-0000, paragraph 22).”*

Paragraph 78 highlights the crucial factor of whether the recipient undertaking receives an economic advantage, which it would not have obtained under normal market conditions. In the La Poste and the RTP case the undertaking concerned did receive an advantage that it would not have obtained under normal market conditions. In the case of RTP it received a grant and other benefits and in the case of La Poste it received a tax concession.

**Our view is that the case law in “La Poste” and “SIC/RTP” (case T-106/95 and case T-46/97) applies only to situations where undertakings, whether public or private, have been granted special and exclusive rights and are subsidised (“granted an economic advantage, which [they] would not have obtained under normal market conditions”) in order to fulfil public service obligations. The key elements in all the cases including and following on from “La Poste” have been the existence of public service obligations and non market-based economic advantages for**



the undertakings for meeting the costs of those obligations. These elements justify the applicability of article 86 of the EEC Treaty. We accept that as a result of this case law, when these elements are present, there is a notifiable aid.

**This does not mean, however, that all cases where the state pays an undertaking to perform a service to the public automatically involve aid.** In most cases, the state simply pays the undertaking on a contractual and commercial basis for specific services rendered. Even if the undertaking provides the services to the public, at the state's request, rather than to the state itself, it is still providing a contractual service to the state. As long as the undertaking is selected following a competitive process and the full market price is paid, there can be no over-payment and therefore no element of subsidy and no distortion of competition. Even when no competitive procurement is possible, independent verification of commercial pricing ensures that there is no over-payment.

In cases of simple, contractual payment on market terms, where there are no special and/or exclusive rights and no "public service obligations" on the undertakings involved, the case law in "La Poste" and "RTP" does not apply because there is no "economic advantage, which [they] would not have obtained under normal market conditions" and no applicability of article 86 of the Treaty. These contractual service cases involve simple application of the principles of Article 87 and my authorities no basis in law for the extrapolation of concepts deriving from the interaction between article 86 and article 87, to cases involving solely article 87.

We would make the point in relation to the case-law in "La Poste" and "RTP" that those cases all related to situations where aid was paid to specific undertakings, where no competitive selection process had been invoked to select the undertaking worthy of support. These cases can be distinguished from cases where there has been a competitive selection procedure to decide which undertaking should receive the state funding on commercial terms.

Finally, it should be borne in mind that the Advocate General, in case C-53/00, concluded in paragraph 63 of his opinion that public measures strictly necessary to compensate for additional costs arising from the performance of the public service obligation do not constitute aid within the meaning of Article 87.

### **3. Limitations on the application of state aid law more broadly**

As stated above, my authorities accept fully that as a result of the case law, non-competitively-tendered state payments to specific undertakings for the provision of SGEI are aid. When dealing with such SGEI aids, they accept the obligation to notify and the basis upon which such aid can be approved, as set out in the Court cases and in Commission Communication COM(2000) 580 final. Of course, however, such SGEI aids will not be caught by Article 87 where there is no "economic activity" and/or where there is no impact on competition or impact on intra-Community trade. This is true also, in respect of all other types of payment to undertakings for the provision of public services.



My authorities would add that cases, where there is genuine competitive procurement of public services and the market price is paid for such services, are also excluded from the scope of Article 87, because there can be no "economic advantage not received under normal market conditions" and no distortion of competition arising. As explained above, we do not believe that the "La Poste" series of cases changes this long-held position.

Set out below are some ideas relating to the scope of these three limitations on the applicability of Article 87 more broadly, with particular reference to its application to public service provision.

### **3.1 The concept of "non-economic" activities**

We welcome the Commission's agreement to attempt to clarify the scope of this exception from the state aid rules. Such a clarification is extremely important, because uncertainty leads to a *de facto* extension of the application of state aid rules, as operators seek to minimise the risk inherent in decision-making.

Although Commission Communication COM(2000) 580 final offers some valuable clarification of the scope of this exception, my authorities remain uncertain, at present, about the Commission's view of the legal root of the concept of "non-economic activities" in terms of the application of state aids law. We can see three potential ways of interpreting this exemption from the state aids rules.

The understanding in the UK for some time was that the root of the concept lay in the concept of "an undertaking" under European law. According to this view, only aid to "non-undertakings" could genuinely be said to be provided for "non-economic activities" in terms of the state aid rules.

A more recent view is that the doctrine outlined in "La Poste" and "RTP" does not apply where the services to be provided under the public service obligation are not "economic" in nature, regardless of whether the service provider is an "undertaking" or not. As we understand it, this would be because of the presence of the word "economic" within the SGEI formulation in article 86 of the Treaty. According to this interpretation, we assume that the Court rulings in "La Poste" and "RTP" can be distinguished from situations where an undertaking is compensated for the fulfilment of a public service obligation, as long as the activity in question is "non-economic" in nature. This would only be justifiable, in our view, if such aid to undertakings could always be ring-fenced to prevent any aid escaping into the "economic" activities of the undertaking.

An alternative view would be that Article 87 of the EEC Treaty should be interpreted purposefully, as excluding regulation of non-economic activities, even when these are provided by undertakings. According to this view, some entities (such as universities, for example) might be undertakings, but do not operate commercially and should therefore not be subject to the state aid rules.

If the second or third interpretation is taken, "non-economic activities" would have to be properly defined. It would be essential to clearly distinguish any such "non-economic activities" from "economic" public services, where undertakings act





commercially and compete, including across frontiers. Such "economic" public services would include water supply, transport, postal services, energy and communications, for example. All of the SGEI cases heard so far in the European Courts relate to these sorts of economic public services and we support the need for rigorous state aid procedures in relation to subsidies in these areas.

A last point in relation to "non-economic activities" is that Article 295 of the Treaty must apply when deciding whether certain activities are "non-economic" or not. Our view is that where public performance of a given activity would be considered "non-economic" (e.g. provision of security services for business, or management of schools, for example) the contracting out of the task to the private sector should not automatically render the service "economic". As long as payment for the service can be ring-fenced from the undertaking's commercial activities and abuse is prevented, the provision by undertakings of services that would fall within the public sector, non-economic remit should be considered non-economic as well. Only if the public service remit changes and competition between undertakings emerges in relation to the activities concerned, should the question of whether the activity is "economic" be reopened.

### **3.2 Commercial supplies at market prices**

It is inherent in the concept of state aid, that the recipient of funds must receive a financial or economic advantage not received under normal market conditions (or "subsidy") in order for aid to be present and that there must also be distortion of competition.

Where the state procures goods, works or services competitively, it pays a commercial, market price for the goods, works or services in question. The successful contractors responding to such public procurement are not considered to receive a financial advantage in such cases, because they are paid a market price. Moreover, there is no distortion of competition in such cases, because there is open competition for securing the public contract on equal terms.

There is no reason why this logic should not apply when the state competitively procures the delivery of public services from the private sector, especially where there is no charge made to the public for the service in question. There is nothing in the "La Poste" and "RTP" cases to overturn such basic application of the principles of Article 87 of the EEC Treaty, especially since these cases were both concerned with payments to undertakings, which were not selected following competitive tendering.

Where the state pays a market price for a commercial service, therefore, we consider that there is no aid. The best way to display that a market price has been paid is to ensure competitive procurement. UK policy is to procure competitively wherever possible. In those cases where competitive procurement is not possible, however, but the relationship between state and undertaking is still a contractual, procurement-based one, it is still possible to ensure that no over-payment takes place, as long as there is genuine, independent verification of the appropriateness of the price charged.



### **3.3 The concept of impact on intra-Community trade**

In the case of many public services, service supply is designed for local residents, its effects remain extremely localised and there is no trade across frontiers whatsoever. In these cases there should be no issue of state aid procedures at EU level. My authorities are reflecting further on the general point of interpretation of the concept of impact on intra-Community trade and intend to raise it with the Commission on other occasions.

### **4. Procedural issues**

My authorities' current preference would be for the Commission to issue a clarificatory Communication on all these issues, followed, probably, by a Block Exemption in relation to SGEI aids in particular. This preference does depend, however, to some extent, on the legal interpretations to be given to the current state of play.

My authorities doubt whether there is enough legal certainty or enough defined parameters in this area at present for the Commission to be able to produce a balanced and meaningful Block Exemption straight away. More work is probably needed and perhaps clarification of some points from the European Courts will be required before such a Regulation should be drawn up. However, my authorities are not against the use of such an instrument in principle, and would welcome a balanced Block Exemption as soon as such a text can be drawn up with the necessary precision.

My authorities would not support a Council Regulation on these issues at all, as this might tend to undermine overall state aid discipline.

### **Conclusion**

My authorities are grateful to the Commission for giving us the opportunity to submit comments at this stage. My authorities hope that these comments offer constructive ideas, which the Commission can use when drawing up its paper for the Laeken summit, and are sure that there will be further opportunities to discuss this complex area of state aid law and policy before then. They look forward to continuing to make a constructive contribution to the policy process.

John Fiennes

First Secretary Industry and Competition



10 DOWNING STREET  
LONDON SW1A 2AA

THE PRIME MINISTER

23 November 2001

Dear Genl,

It was a great pleasure to see you in Nuremberg earlier this week. As I said in my speech, the leadership you have shown in ensuring a substantial German commitment to the coalition against international terrorism has done a great service to Germany and the world community.

When we met, I had hoped to exchange thoughts on how best to move forward the A400M military aircraft project. It is now more than a year since Germany, Britain and the other A400M partners committed themselves publicly to this project and it is almost six months since our Defence Ministers signed the Memorandum of Understanding at Le Bourget. Given the importance of improving Europe's military airlift capabilities, it is important that the contract for the A400M is signed by all the parties this year. If we fail to take this step, there must be a very real risk that the project will suffer further substantial delay or even be called into question altogether. A failure to bring the A400M project to fruition would mean that European claims of our commitment to improving defence capabilities and remedying critical short-falls as part of ESDP would risk sounding hollow.

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see JSh, Amy,  
JTB

MASTERS

I understand that at the most recent policy group meeting the German representative pressed for a further round of negotiations with the Airbus Military Company in an effort to secure an additional reduction in the price of the aircraft. I share the objective of reducing the cost of defence equipment wherever possible but in the case of A400M, the company quoted a price which formed the basis for our collective decision to go ahead with the project and have subsequently offered reductions to this price. I am told that there is no scope for a further substantial reduction in price.

I very much hope that Germany will be able to join with other partners in signing the A400M contract this year.

Yours ever  
Tony

SE Herrn Gerhard Schroeder