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CABINET

CURRENCY CRISIS

NOTE of a Meeting held at Chequers
on SATURDAY 3 MARCH 1973 at 4.00 pm

PRESENT

The Rt Hon Edward Heath MP
Prime Minister

The Rt Hon Sir Alec Douglas-Home MP The Rt Hon William Whitelaw MP
Secretary of State for Foreign and Secretary of State for Northern
Commonwealth Affairs Ireland

The Rt Hon Lord Carrington The Rt Hon Sir Keith Joseph MP
Secretary of State for Defence Secretary of State for Social
Services

The Rt Hon Peter Walker MP The Rt Hon John Davies MP
Secretary of State for Trade and Chancellor of the Duchy of
Industry Lancaster

The Rt Hon The Earl Jellicoe The Rt Hon Sir Burke Trend
Lord Privy Seal

Mr J J B Hunt

THE PRIME MINISTER said that immediately on his return from Bonn he had discussed the currency crisis with the Chancellor of the Exchequer and the Governor of the Bank of England. The Chancellor had remained in London in order to complete work on his Budget Speech and to remain closely in touch with the proceedings of the Monetary Committee which was meeting in Brussels that day. He would be visiting Chequers for further discussion before flying to the meeting of Community Finance Ministers on the following day, but in the meantime the Prime Minister wished to acquaint some of his senior colleagues of the position and to seek their views on the action which could best be taken.

The Prime Minister said that when he arrived in Bonn on the evening of 1 March he had found that during the course of the day the Community countries had taken in \$3.5 billion of which the Germans had taken in no less than \$2.7 billion. The Dutch had also taken in more than $\$ \frac{1}{2}$ billion and the French and Danes a certain amount. He had completed his agenda of talks with the Federal German Chancellor and the discussions had generally been most friendly and useful. But the currency situation had been in both their minds throughout, and he had had three long talks with Herr Brandt about it. The Germans had felt that the situation was different from what it had been three weeks ago in that the Japanese were now floating and the Germans were in the front line. A number of possible courses were open to them. The first was to meet the challenge, take in whatever amount of dollars this implied and impose rigid controls. Although the Germans had the necessary powers it was doubtful whether this course would be effective and it was open to political objection vis-a-vis the United States. Furthermore even if successful it could have a serious effect on the German economy. A second possible course was a two-tier market but this was not practicable given the structure of the German balance of payments. A third alternative was to float the Deutschmark. This would be effective and would reinforce the Government's attempts to contain inflation. But it would be a great shock to the Community. The German float in 1971 had brought the Community near to breaking point, and for them to float unilaterally again would postpone the achievement of European Monetary Union for many years. It would also do particularly serious damage to their relations with France since other European countries would probably follow Germany in floating and the French would be isolated. This course had therefore been ruled out on political grounds. The Germans were accordingly in favour of a Joint Community float on the lines proposed three weeks earlier. They recognised that this caused problems for us, particularly in relation to the sterling balances. But they claimed they were ready to pay a high economic price for a solution which was politically acceptable to them. There had been some discussion of the conditions under which we might take part in a Community float including the pooling of reserves and the making of unrestricted support available free of interest and for an indefinite period. But in the latter stages of the visit the Germans had seemed slightly less forthcoming and were clearly looking forward to the negotiations which would take place over the weekend between the Community Finance Ministers. The latter was being preceded by a meeting of the Monetary Committee which had already started and the initial basis of discussion would be proposals drawn up by the Commission which seemed clearly inadequate. They were based on ideas of three weeks earlier and assumed support limited to one month with rates of interest to be negotiated. There was also an extremely objectionable provision for the blocking of foreign accounts, which, if it leaked, we should have to say was totally unacceptable in order to avoid a run on the sterling balances. We have now to decide whether it suited us best to let the Germans float unilaterally or to join in a serious attempt to establish acceptable conditions for a Community

float. On political grounds the Community ought to be able to act as a Community and to protect itself. A joint float seemed the only way of doing this and the Germans had repeatedly said they were prepared to pay a high price to achieve this. If agreement could be reached it would enable us to dispose of the long-term problem of the sterling balances. On the other hand acceptable conditions would not be easy to negotiate and we should in any case face a difficult decision in deciding the rate at which to repay sterling. In the short term we wanted a relatively high rate in order to keep prices down, but a lower rate would be desirable later for competitive reasons.

In discussion it was argued that there would be considerable advantages in a Community float on the right terms. Apart from dealing with the sterling balance problem, it would provide the Community with joint resources which should be sufficient to deal with speculations against any one of its members while the Community as a whole would be protected by the float. There were also powerful negative arguments. If agreement could not be reached the Community would move from one crisis to another and might begin to break up. There would be particular dangers in separate floating or a float in which not all members joined. The Common Agriculture Policy would become unworkable and irreparable damage might be done to Franco-German relations.

The Meeting was informed that both the Chancellor of the Exchequer and the Governor of the Bank of England were disposed to favour a Community float provided our conditions were met in full. The latter were being worked out in some detail and it would be important not to depart from them. It was also confirmed that a Community float was a technical possibility although urgent action would have to be taken to establish the required institutional arrangements.

In further discussion it was argued that agreement on these lines would represent progress in a matter of days or weeks which might otherwise have taken years. This was to be welcomed, but it had to be recognised that future changes of parity would have to be discussed in detail with the Community and there would be pressure for harmonisation of economic management. The Opposition would no doubt argue that it would represent a further undesirable shift of sovereignty and that the rest of the Community would have sanctions on our economic policy and our rate of growth. If therefore agreement were possible very careful attention would need to be given to its presentation in this country. It could fairly be pointed out that if this opportunity were not taken it would result in higher food prices, different trade policies between members of the Community and other effects which would be damaging to this country, whereas joint action would be helpful in the context of help for the regions and less favoured areas.

THE PRIME MINISTER, summing up the discussion, said that at this stage it was not possible to know whether we could obtain the conditions which had been judged necessary for us to participate in a Community float. The Meeting was however agreed that provided these conditions could be met a Community float would be the right course. The real problem was one of presentation and very careful preparation would be needed to put over the point that this was not a course which had been forced on us but one which had real advantages to us in terms of stability.

Cabinet Office

5 March 1973