1. Mr Stowe (or)
2. Prime Minister
to note.
N.C.W.
1.6

12A

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K E Couzens CB
Second Permanent Secretary
Overseas Finance

30th May, 1978.

I think it might be well worth while having a summary on X before your Schmidt/Giscard breakfast at Bremen.
KRS

Yes I agree. Ch. I be told what are (a) the economic objectives of (b) the economic consequences for the U.K. of Mr Schulman's scheme?
6/6

SECRET AND PERSONAL

Dear Stowe

CHANCELLOR SCHMIDT'S PROPOSAL FOR EUROPEAN CURRENCY REFORM

I attach a report on a further discussion with M. Clappier and Herr Schulman in Washington on 26th ~~April~~ May.

We still do not have a fully elaborated proposal, but we will attempt now to make some assessment of the risks and merits of a scheme on the lines discussed for the UK and will report as soon as possible. We may be able to take account of M. Clappier's paper in the course of the preparation of our assessment.

I am copying this letter and its enclosure to the Private Secretaries to the Chancellor of the Exchequer, the Governor of the Bank of England, Sir John Hunt and Sir Douglas Wass.

Yours sincerely
G Ingham

PP (K. E. COUZENS)

K. Stowe, Esq.,
10 Downing Street,
LONDON, SW1

SECRET AND PERSONAL

RECORD OF DISCUSSION WITH M. CLAPPIER AND HERR SCHULMAN OVER DINNER AT THE HAY ADAM HOTEL, WASHINGTON ON 26 MAY 1978

At an early stage in the discussion I gave M. Clappier and Herr Schulman copies of the attached set of questions, directed to the record of our previous discussion at the Banque de France in Paris, which Herr Schulman had sent to us on 19th May.

2. However the main development at the meeting was that M. Clappier expounded his own proposal for a European monetary system and undertook to send us a short paper describing it within a week or ten days. The features of his proposal were:-

(i) A European Central Monetary Authority would function rather like a European version of the IMF but in addition would provide short-term credit for currency support on lines similar to swap agreements between central banks.

(ii) Each member country would have a quota and would pay a part of it to the Central Authority in dollars or gold (say 20%) and the balance in its own national currency.

(iii) Each country would acquire drawing rights to both short term and medium term credit. The short term credit would be for a maximum of one year, with no or minimum conditionality. The medium term credit might be in say four tranches. The first tranche (say 20%) would correspond with the dollar element of each country's quota and be unconditional. The second tranche would be subject to a minimum degree of conditionality and remaining tranches would attract progressively greater conditionality.

(iv) Drawings could be in EUA's.

(v) The arrangements would absorb and supersede the present EEC short and medium term credits. They would provide a doubling of the scale of these credits and an extension to one year of the period for short term credits.

(vi) For the rest the scheme would in general follow the lines envisaged in Herr Schulman's record of our Paris discussion of 12th May, but perhaps with a presumption that the margin for currency fluctuation would be small.

attached

(vii) It would be an object of the exercise to make the new system as unlike the Snake as possible. This would have important political advantages both in France and in the United Kingdom, as well as dissociating the new system from earlier failures with the Snake.

3. M. Clappier thought Herr Schulman's original suggestion of an issue of EUA's primarily against national currencies was open to the objection of creating too much additional liquidity. His own proposal envisaged substitution of dollars for the (unconditional) issue of EUA's. But this appeared to be a matter of degree since the extended short term credit was more or less unconditional and drawings of EUA's under the medium term credit would be balanced only by national currencies, even if they were subject to conditionality.

4. In the course of the discussion Herr Schulman elaborated somewhat his own proposal for EUA issues. He saw them as attracting interest like SDR's and recognised that this involved investment of the national currency counterparts to earn interest. This SDR-related approach did not appear to fit M. Clappier's scheme.

5. M. Clappier asked me whether the UK Government would be able to make progress in this field in advance of an election, which now

appeared more clearly to be an early prospect. I said I thought that if an election became imminent it might be difficult for the Government to enter a European currency union before the election, on constitutional, political and practical grounds. The right course might be for the UK to be closely associated with the elaboration of the scheme, on the understanding that a decision about joining it would be made soon after the election.

6. M. Clappier proposed to send us his paper by the first week of June with a view to a meeting in the second week of June.