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**PRIME MINISTER'S  
PERSONAL MESSAGE**

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**SERIAL No. T179/73**

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TO FLASH BONN TELNO 572 OF 12 SEPTEMBER, 1973

FOLLOWING IS TEXT OF MESSAGE REFERRED TO MIPT.

1. I HAVE BEEN THINKING RECENTLY ABOUT THE WORK WHICH LIES AHEAD OF US ALL IN THE COMMUNITY, IF WE ARE TO COMPLETE BY THE END OF THIS YEAR THE PROGRAMME WHICH WE SET OURSELVES IN PARIS IN OCTOBER LAST YEAR. I BELIEVE YOU WILL SHARE MY VIEWS THAT FAILURE TO ACHIEVE A SUFFICIENT DEGREE OF PROGRESS ON THE MAIN AIMS WHICH WE UNDERTOOK AT THE SUMMIT MEETING WOULD BE A SERIOUS SETBACK NOT ONLY TO OUR ASPIRATIONS FOR THE DEVELOPMENT OF THE COMMUNITY, BUT ALSO TO OUR WIDER AIMS OF EUROPEAN POLITICAL CO-OPERATION.
  
2. I ACKNOWLEDGE THE PRIMARY PLACE OF EFFECTIVE PROGRESS TOWARDS ECONOMIC AND MONETARY UNION. AT THE SAME TIME YOU WILL, I KNOW, APPRECIATE THE POLITICAL IMPORTANCE FOR ME, AS WELL AS FOR OTHER MEMBERS OF THE COMMUNITY, OF PARALLEL PROGRESS IN REGIONAL DEVELOPMENT. I RECOGNISE TOO THAT THE SHAPE AND EXTENT OF THE SECOND STAGE OF ECONOMIC AND MONETARY UNION IS IN TURN LINKED WITH THE FACT THAT SOME OF US ARE STILL NOT PARTICIPATING IN THE JOINT COMMUNITY ARRANGEMENTS OF THE FIRST STAGE.
  
3. WHEN WE MET AT SCHLOSS GYMNIICH IN MARCH, YOU SHOWED GREAT UNDERSTANDING OF THE REASONS, WHICH I DESCRIBED TO YOU, WHY WE HAD NOT YET FELT ABLE TO COME BACK INTO THE SNAKE. SINCE THEN MUCH HAS HAPPENED IN THE CURRENCY FIELD, AND THE RELATIVE PARITIES OF THE MAIN INTERNATIONAL CURRENCIES NOW LOOK VERY DIFFERENT. THE DEUTSCHEMARK HAS OF COURSE APPRECIATED BY 19 PERCENT AGAINST THE WEIGHTED AVERAGE RESULTING FROM THE SMITHSONIAN AGREEMENT. STERLING ON THE OTHER HAND HAS DEPRECIATED BY 19 PERCENT BELOW THE SMITHSONIAN LEVEL.

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4. AT THAT TIME, LAST MARCH, I THOUGHT IT UNLIKELY THAT WE SHOULD BE ABLE TO SUSTAIN THE PARITY OF STERLING AS IT THEN WAS, GIVEN THE PRESSURES UPON OUR BALANCE OF PAYMENTS THAT WOULD ARISE DURING THIS PHASE OF OUR ECONOMIC POLICY. WE ALWAYS RECOGNISED THAT, WHEN THE EXPANSION OF THE ECONOMY WAS ESTABLISHED AND INDUSTRIAL INVESTMENT REVIVED, WE SHOULD SEE A SHARP RISE IN THE VOLUME OF OUR IMPORTS, AS MANUFACTURERS BUILT UP STOCKS OF MATERIALS AND BOUGHT NEW PLANT AND MACHINERY. THIS HAS INDEED BEEN HAPPENING, AND THE EFFECTS ON OUR BALANCE OF PAYMENTS HAVE BEEN AGGRAVATED BY THE SHARP RISE IN WORLD COMMODITY PRICES. ON THE OTHER SIDE, OF COURSE, THERE HAS BEEN A HIGHLY WELCOME AND SATISFACTORY IMPROVEMENT IN THE LEVEL OF OUR EXPORTS, AND THIS IMPROVED TREND IS CONTINUING. THE DEPRECIATION OF THE EXCHANGE RATE THAT HAS OCCURRED MEANS THAT OUR GOODS ARE NOW HIGHLY COMPETITIVE IN WORLD MARKETS.

5. OUR FORECASTS NOW SUGGEST THAT WE CAN EXPECT A RATHER LOWER, BUT STILL ACCEPTABLE, RATE OF EXPANSION IN THE ECONOMY NEXT YEAR CONSISTENT WITH MAINTAINING AN IMPROVEMENT IN THE LEVELS OF INVESTMENT AND OF EXPORTS. ON THAT BASIS WE CAN EXPECT TO SEE THE DEFICIT IN THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS DECLINE DURING THE COURSE OF THAT YEAR, AND IN DUE COURSE MOVE BACK INTO SURPLUS.

6. WE BELIEVE THAT THAT RESULT IS ATTAINABLE ON THE BASIS OF STERLING EXCHANGE RATES AT BROADLY THEIR PRESENT LEVELS. IN THE MEANWHILE, HOWEVER, WHILE WE CONTINUE IN DEFICIT, OUR EXCHANGE RATE IS LIABLE TO COME UNDER PRESSURE AND TO NEED TO BE SUPPORTED FROM TIME TO TIME.

7. FROM OUR OWN DOMESTIC POINT OF VIEW THE EFFECTS OF THE DEPRECIATION OF STERLING UPON DOMESTIC PRICE LEVELS HAVE BEEN UNWELCOME, NOT LEAST BECAUSE OF THEIR IMPACT UPON OUR ENDEAVOURS TO ESTABLISH AND MAINTAIN OUR COUNTER-INFLATIONARY PROGRAMME. WE THEREFORE HAVE NO DESIRE TO SEE THE STERLING PARITY FALL ANY FURTHER, GIVEN THAT STERLING IS NOW, AS WE BELIEVE, BY NO MEANS OVERVALUED. NOR DO I SUPPOSE THAT OUR PARTNERS IN THE COMMUNITY, OR OUR OTHER COMPETITORS IN WORLD MARKETS, ARE ANY MORE KEEN THAN WE ARE OURSELVES TO SEE THE STERLING EXCHANGE RATE FALL FURTHER.

8. WE HAVE THEREFORE LATELY BEEN INTERVENING MORE POSITIVELY AND SYSTEMATICALLY TO MAINTAIN THE RATE AND IT WILL BE OUR AIM TO SUPPORT THE RATE AND PREVENT ANY MAJOR AND CONTINUING DEPRECIATION DURING THE PERIOD BEFORE THE BALANCE OF PAYMENTS SWINGS ROUND. THIS WILL INVOLVE SOME EXPENDITURE OF OUR RESERVES AND, IT COULD BE, OF NORMAL IMF SUPPORT FACILITIES TO DO NO MORE THAN OFFSET THE EFFECT ON THE MARKETS OF THE CURRENT DEFICIT.

9. BUT WE HAVE ALSO TO ALLOW FOR THE POSSIBILITY OF DESTABILISING SHORT TERM CAPITAL MOVEMENTS. YOU WILL KNOW FROM YOUR OWN EXPERIENCE THAT THESE PRESSURES CAN BLOW UP LIKE A HURRICANE OUT OF A CLEAR SKY, AND ASSUME LITERALLY OVERWHELMING PROPORTIONS IN THE COURSE OF A FEW HOURS. ANY COUNTRY WITH LARGE FOREIGN-HELD BALANCES IS PARTICULARLY VULNERABLE TO THESE PRESSURES.

10. THERE IS, THEREFORE, QUITE APART FROM THE FINANCING OF OUR FORESEEABLE DEFICIT, THIS PROBLEM OF ENSURING AGAINST THE CONSEQUENCES OF SUCH MAJOR CONFIDENCE MOVEMENTS FOR ANY SINGLE CURRENCY OR COUNTRY - UNLESS AND UNTIL WE CAN COLLECTIVELY FIND AN ANSWER TO THE MANAGEMENT OF THE LARGE VOLUMES OF HIGHLY MOBILE FUNDS THAT EXIST TODAY. AS I SAID, NO COUNTRY CAN DEAL WITH THIS ON ITS OWN. CAN THE COMMUNITY DO SO COLLECTIVELY?

11. WHEN YOU AND I MET AT SCHLOSS GYMNICH WE DISCUSSED THE POSSIBILITY OF A SCHEME OF UNLIMITED MUTUAL SUPPORT FOR COMMUNITY CURRENCIES. WE WERE OF COURSE DISCUSSING THE GERM OF AN IDEA, NOT THE DETAILS OF A SCHEME, AND THE IDEA DID NOT SURVIVE THE SEVERER SCRUTINY OF OUR FINANCIAL EXPERTS. INDEED, WHEN THE CHANCELLOR OF THE EXCHEQUER SOUGHT TO SPELL OUT ITS IMPLICATIONS AT THE SUBSEQUENT MEETING OF COMMUNITY FINANCE MINISTERS IN PARIS, HE WAS WIDELY BUT UNFAIRLY THOUGHT TO BE SETTING CONDITIONS FOR STERLING'S RETURN TO THE SNAKE, WHICH WE KNEW PERFECTLY WELL TO BE UNNEGOTIABLE. BUT THE GERM OF THE IDEA WAS, IT STILL SEEMS TO ME, SOUND. IT WAS SURELY THAT, IF SUPPORT IS KNOWN TO BE UNLIMITED, THAT IS THE BEST POSSIBLE GUARANTEE THAT IT WILL NOT BE REQUIRED. SO LONG AS THERE IS A LIMIT, THERE IS SOMETHING FOR THE SPECULATOR TO BEAT: A POINT BEYOND WHICH THE COUNTRY (OR COUNTRIES) CONCERNED WILL BE

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FORCED TO ALTER THE RATE OF EXCHANGE AND CONCEDE THE SPECULATORS WHAT THEY WERE GAMBLING UPON. UNLIMITED SUPPORT WOULD OF COURSE BE A FEATURE OF A COMMON CURRENCY, WHICH IS OUR EVENTUAL AIM. IT MAY BE THAT UNLIMITED SUPPORT WAS, AND IS, TOO AMBITIOUS AN OBJECTIVE FOR THIS STAGE OF OUR COMMUNITY DEVELOPMENT, AND IT MAY WELL BE THAT AT THIS STAGE PROGRESS ON MUTUAL SUPPORT SHOULD BE LINKED WITH PROGRESS ON COMMUNITY CO-OPERATION IN ECONOMIC MANAGEMENT, BUT IT MUST SURELY BE THE CASE THAT WE SHOULD BE THINKING IN TERMS OF A SCHEME WHICH IS SUFFICIENTLY FAR-REACHING AND IMAGINATIVE TO CONSTITUTE A DETERRENT RATHER THAN A CHALLENGE TO SPECULATIVE MOVEMENTS.

12. I AM NOT SEEKING TO PUT TO YOU ANY SPECIFIC PROPOSAL AT THIS STAGE. MY CONCERN IS THAT THE THINKING THAT HAS BEEN GOING INTO THESE PROBLEMS AT OFFICIAL LEVEL HAS NOT BEEN GIVEN A STRONG ENOUGH POLITICAL IMPETUS, AND HAS NOT BEEN SUFFICIENTLY ALIVE TO THE POLITICAL NEEDS OF THE SITUATION, AS OPPOSED TO THE FINANCIAL AND TECHNICAL INTRICACIES. NO DOUBT THE INTRICACIES ARE GREAT. I DO NOT BELIEVE THAT THEY ARE INSUPERABLE, IF THE POLITICAL WILL EXISTS TO OVERCOME THEM.

13. I SHOULD LIKE TO BELIEVE THAT BOTH YOU AND I ARE THINKING ABOUT THESE PROBLEMS IN THE WIDER POLITICAL CONTEXT WHICH I KNOW THAT BOTH OF US HAD IN MIND WHEN WE DISCUSSED THEM LAST MARCH INCLUDING THE QUESTION OF OUR ATLANTIC RELATIONSHIPS WHICH WE ARE DISCUSSING SEPARATELY. I DID NOT BELIEVE IN MARCH AND I BELIEVE STILL LESS NOW THAT TIME IS ON OUR SIDE. IN THE BROADEST POLITICAL TERMS IT IS OF CRUCIAL IMPORTANCE TO MAINTAIN THE MOMENTUM OF THE DEVELOPMENT OF THE COMMUNITY AND SPECIFICALLY TO ACHIEVE THE AIMS WE SET OURSELVES AT THE SUMMIT CONFERENCE.

14. MR. CHANCELLOR, I SHOULD LIKE TO PROPOSE TO YOU THAT WE SHOULD NOW APPROACH THIS QUESTION OF MUTUAL CURRENCY SUPPORT WITH RENEWED POLITICAL DETERMINATION TO FIND A SOLUTION WHICH WILL ENABLE US TO MAINTAIN THAT MOMENTUM AND ACHIEVE THOSE AIMS. THE QUESTION MUST OF COURSE BE CONSIDERED BY THE COMMUNITY AS A WHOLE, BUT I BELIEVE THAT IT WOULD BE FRUITFUL THAT THERE SHOULD BE PRELIMINARY TALKS BETWEEN US ABOUT WHAT MIGHT BE POSSIBLE WHEN WE MEET HERE AT THE BEGINNING OF OCTOBER. IF THIS IDEA COMMENDS ITSELF TO YOU, I SHALL BE PREPARED TO SEND OVER TO BONN AS SOON AS POSSIBLE A VERY SENIOR OFFICIAL FROM THE TREASURY, TOGETHER WITH ONE OF MY OWN SENIOR ADVISERS WITH INSTRUCTIONS TO DISCUSS THE MATTER WITH THEIR COUNTERPARTS IN YOUR ADMINISTRATION, AND, IN ACCORDANCE WITH THE SPIRIT OF THIS LETTER, TO CRYSTALLISE POSSIBILITIES AND THEIR IMPLICATIONS AS A BASIS FOR OUR DISCUSSION WHEN WE MEET.

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15. AS I SAID AT THE OUTSET OF THIS LETTER, I HAVE VERY MUCH IN THE FOREFRONT OF MY MIND AT THE MOMENT THE IMPORTANCE OF THE NEXT MONTHS FOR THE MAKING OF THE COMMUNITY. I BELIEVE THAT DISCUSSIONS BETWEEN OUR TWO COUNTRIES COULD HELP TO PREPARE THE GROUND FOR THE POLITICAL DECISIONS THAT WILL HAVE TO BE TAKEN BY THE COMMUNITY AS A WHOLE.

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