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TO PRIORITY FCO
TELEGRAM NUMBER 566 OF 8 OCTOBER
AND TO ROUTINE EEC POSTS WASHINGTON UKDEL CECD

for Prime Minister

It would, of course, guarantee headlines for your Luxembourg speech if you felt able to go further on this subject: at the moment it says "our objective is to enter the mechanism when the position of sterling has stabilised sufficiently" in the form of words you used with Giscard. More importantly, it would help on the Budget.

ANGLO-GERMAN CONSULTATIONS: EMS
1. THE GERMANS HAVE TOLD US THAT SCHMIDT WILL WISH TO DISCUSS EMS WITH THE PRIME MINISTER AND WE KNOW FROM MY TALK WITH HIM ON 19 SEPTEMBER THAT HE HAS STRONG VIEWS ABOUT IT. HMG HAVE SAID THAT THEY FOR THEIR PART WILL TAKE A DECISION ON WHETHER TO BECOME FULL MEMBERS THIS AUTUMN. A VIEW FROM BONN MAY THEREFORE BE HELPFULL AT THIS STAGE.

Handwritten initials and date: *Handwritten*
- 9/14

2. SCHMIDT HAS ALWAYS SEEN AND STILL SEES THE EMS PRIMARILY AS A POLITICAL ACT OF WILL, THOUGH ONE WITH BENEFICIAL ECONOMIC CONSEQUENCES. AND HE SEES IT AS A JOINT POLITICAL ACT WITH HIS FRIEND GISCARD: TO RELAUNCH A EUROPEAN COMMUNITY IN THE DOLDRUMS AND TO ESTABLISH A DISTINCT EUROPEAN IDENTITY IN THE FINANCIAL FIELD. THE CREATION OF AN AREA OF EXCHANGE RATE STABILITY IN EUROPE AND TAKING OUT A FORM OF INSURANCE AGAINST THE INCOMPETENCE OF THE CARTER ADMINISTRATION AND THE RESULTANT YO-YO EFFECT OF THE DOLLAR ARE USEFUL FINANCIAL BONUSES. HERE IN BONN, SCHMIDT PUT IT THROUGH AGAINST THE COMBINED SCEPTICISM OF THE MINISTRY OF FINANCE, THE BUNDESBANK AND MOST OF THE GERMAN FINANCIAL ESTABLISHMENT. IT IS NOT FOR ME TO ASSESS GISCARD'S MOTIVES; BUT ONE CLEAR RESULT HERE HAS BEEN TO REINFORCE THE PRIVILEGED NATURE OF THE FRANCO-GERMAN RELATIONSHIP. SCHMIDT AND GISCARD NOW SEEM TO ENJOY THE SORT OF POLITICAL AND PERSONAL RELATIONSHIP WHICH COMES AFTER PEOPLE HAVE BEEN THROUGH FIRE TOGETHER AND COME OUT STRENGTHENED ON THE OTHER SIDE. LAST WEEK'S FRANCO-GERMAN SUMMIT IN BONN (MY TELNO 555 OF 3 OCTOBER) CONFIRMS THIS VIEW.

3. SCHMIDT HAS, IN THE EVENT, BEEN PROVED ON THE WHOLE RIGHT AND HIS FINANCIAL ESTABLISHMENT ON THE WHOLE WRONG. THE SYSTEM WORKS AND HAS CLEARLY COME TO STAY. THE DOUBTS OF THE FINANCIAL ESTABLISHMENT HAVE BEEN STILLED EVEN IF THEY ARE NOT WHOLLY PUT TO REST. FOR PRACTICAL EXPERIENCE OF THE WAY THE SYSTEM WORKS OVER THE LAST SIX MONTHS HAS, ON THE WHOLE, BEEN SATISFACTORY. IT HAS NOT, OF COURSE, DONE AWAY WITH THE PROBLEM OF THE STRONG D-MARK AND WEAK DOLLAR, BUT, THEN, NOBODY EXPECTED THAT IT WOULD. BUT THE SYSTEM HAS SURVIVED CONSIDERABLE

DOLLAR TURBULENCE FROM WITHOUT AND HAS DEMONSTRATED ITS CAPACITY TO MAKE THE NECESSARY INTERNAL ADJUSTMENTS. DESPITE MAJOR DIFFERENCES IN GROWTH RATES, INFLATION RATES AND BALANCE OF PAYMENTS OUT-TURNS, LIFE HAS BEEN EASIER BOTH FOR THOSE WITHIN THE SYSTEM AND FOR THOSE WITHOUT LIKE THE AUSTRIAN SCHILLING AND THE SWISS FRANC. NEITHER THE BELGIANS NOR THE DANES, THE WEAKEST PARTNERS OVER THE LAST SIX MONTHS, SEEM TO WANT OUT. MY VIEW IS THAT NOT ONLY SCHMIDT, BUT ANY FORESEEABLE ALTERNATIVE GOVERNMENT HERE, TOGETHER WITH THE GERMAN FINANCIAL ESTABLISHMENT NOW HAVE A VESTED INTEREST IN MAKING THIS QUOTE (NEXT TWO WORDS UNDERLINED) ACQUIS COMMUNAUTAIRE UNQUOTE WORK AND SURVIVE. IN OTHER WORDS, THE EMS IS DOING WHAT WAS EXPECTED OF IT - WITHOUT US. AS TO THE FUTURE, IS IS NOT CLEAR THAT THE EMS WILL LEAD AS QUICKLY AS PROCLAIMED TO AN EMF : BUT THAT IS FOR THE FUTURE AND WE SHOULD PRESUMABLY HAVE MORE INFLUENCE ON FUTURE DEVELOPMENTS FROM A POSITION FOUR-SQUARE WITHIN THE SYSTEM.

4. IT IS, I THINK, NO SECRET THAT THE REASON WHY BRITAIN DID NOT REPEAT NOT JOIN AT THE BEGINNING WAS ALSO PRIMARILY POLITICAL. THE FINANCIAL ARGUMENTS WERE ALWAYS, EVEN LAST WINTER EVENLY BALANCED. BUT THE THEN GOVERNMENT WITH THE WINTER OF DISCONTENT ON ITS HANDS AND AN ELECTION LOOMING, SIMPLY COULD NOT TAKE ON IN ADDITION THE TASK OF SELLING EMS TO ITS SUPPORTERS. WHEN THE POLITICAL DECISION NOT TO JOIN THE EXCHANGE RATE MECHANISM WAS TAKEN, THERE WERE NATURALLY PLENTY OF SOUND TECHNICAL ARGUMENTS TO BACK IT, JUST AS THERE WOULD HAVE BEEN PLENTY OF SOUND TECHNICAL ARGUMENTS TO BACK A DECISION TO JOIN HAD THAT BEEN THE DECISION. BUT THAT IS THE WAY OF POLITICAL DECISIONS WHEN THE TECHNICAL ARGUMENTS ARE EVENLY BALANCED. IT IS PERHAPS WORTH RECALLING THAT OUR MAIN FEAR AT THE TIME WAS THAT STERLING WOULD BE TOO WEAK TO STAY WITHIN THE SYSTEM WITHOUT INTERVENTION AND THAT WE MIGHT HAVE TO SQUANDER PRECIOUS RESERVES TO MAINTAIN THE RATE. THE FACT THAT PRECISELY THE OPPOSITE HAS HAPPENED PERHAPS DOES NO MORE THAN EMPHASISE THE DIFFICULTY OF DOUBLE-GUESSING THE MARKET.

5. THE ESSENTIAL POINT HOWEVER, AS SEEN FROM BONN, IS THAT IN CONCEIVING AND BRINGING THE EMS TO FULL TERM, SCHMIDT HAS COMMITTED AN ACT OF POLITICAL WILL, HAS BEEN JOINED IN THAT ACT OF WILL BY GISCARD AND TOGETHER THEY HAVE BEEN JOINED BY THE SIX AND THE COMMISSION. WE ARE ON THE SIDELINES, AS EVENTS OF THREE WEEKENDS AGO, WHEN WE WERE NOT EVEN INVITED TO THE REALIGNMENT

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MEETING, DEMONSTRATED. IT IS CLEAR FROM WHAT HE TOLD ME AT DINNER IN MY HOUSE ON 19 SEPTEMBER THAT SCHMIDT IS LOOKING FOR A SIMILAR ACT OF POLITICAL FAITH AND WILL FROM THE PRIME MINISTER. IT IS TRUE THAT GERMAN OFFICIALS AT ALL LEVELS DO NOT EXPECT US TO JOIN AND WILL BE RELAXED IF WE DO NOT. THAT MESSAGE WE ARE GETTING LOUD AND CLEAR. BUT IT IS NOT THE MESSAGE FROM SCHMIDT HIMSELF. SCHMIDT WILL NO DOUBT BE TOO POLITE TO SPEAK IN THE SAME TERMS TO THE PRIME MINISTER AS HE SPOKE TO ME: THE RELATIONSHIP IS NOT YET OF LONG ENOUGH STANDING AND IN ANY CASE AMBASSADORS EXIST (NEXT TWO WORDS UNDERLINED) INTER ALIA TO ACT AS SHOCK ABSORBERS. BUT WHILE HE ACCEPTS THAT, WITH THE ADVENT OF A CONSERVATIVE ADMINISTRATION TO POWER, MUCH HAS CHANGED FOR THE BETTER IN ATTITUDES TO EUROPE HE IS NOW, TO PUT IT VULGARLY, WAITING FOR US TO PUT OUR MONEY WHERE OUR MOUTH HAS BEEN SINCE MAY. FOR ONCE AGAIN, THE EUROPEAN TRAIN HAS MOVED ON WITHOUT US, AS IT DID AT THE FOUNDATION OF THE COMMUNITY. OR RATHER WITH US CLINGING TO THE OUTSIDE OF THIS PARTICULAR CARRIAGE.

6. IN BRIEF, IT SEEMS FROM HERE AS IF A DECISION TO JOIN THE FULL EMS SYSTEM IS A PREREQUISITE TO OUR COMING GOOD ON OUR FREQUENTLY PROFESSED AND AS FREQUENTLY WELCOMED DESIRE TO PLAY A FULL ROLE IN DETERMINING THE FUTURE OF EUROPE. WE CANNOT DO SO FROM THE SIDELINES. IT IS CERTAINLY A PREREQUISITE TO ESTABLISHING A STABLE EUROPE ON THE BASIS OF A BONN-PARIS-LONDON TRIPOD INSTEAD OF, AS AT PRESENT, A BONN-PARIS AXIS. IT IS ALSO CERTAINLY A PREREQUISITE FOR THE PRIME MINISTER'S ESTABLISHING WITH SCHMIDT THE SORT OF RELATIONSHIP OF CONFIDENCE THAT HE HAS WITH HIS FRIEND GISCARD. ALTHOUGH I COULD NOT CROSS MY HEART AND SAY THAT A DECISION TO JOIN THE FULL EMS SYSTEM WOULD MAKE IT EASIER TO GET WHAT WE WANT ON THE BUDGET OR THAT THERE IS ANY SUCH CONJUNCTION ON SCHMIDT'S MIND, IT IS AT LEAST CLEAR THAT IT WOULD TRANSFORM THE ATMOSPHERE.

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