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10 Downing Street  
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The Chancellor of the Exchequer, accompanied by Sir Douglas Allen, Sir Donald MacDougall and the Governor of the Bank of England, came here on Tuesday 13 March at 12.15 p.m. to discuss the minute which the Prime Minister had sent to the Chancellor the previous day. Mr. Hunt and I were also present.

The Prime Minister said that, following the recent currency crisis, the time had come for the British Government to work out a strategy, to define its objectives in the currency field in relation to other objectives, and the means by which the objectives could be achieved.

From the domestic point of view, it would be damaging if the pound simply floated down, because it would make the Government's counter-inflation policy impossible to handle. One reason for continuing to float was the fear for the balance of payments in the longer term; it was therefore necessary to consider whether radical action should be taken to stem the deterioration, and if so, what form it should take.

It was a widely held view that the arrangement created by the recent decisions in Brussels on a joint float by six of the Community countries would not hold for very long. The longer it lasted, without our joining it, the greater the danger that during that time the gap between sterling and the European currencies would widen. There was no advantage in our simply following the dollar down. Our wider interests in membership of the Community would suffer: our continued detachment from joint monetary arrangements would be politically damaging, and it would probably be impossible to bring forward developments, like that of a Community Regional Policy, which were expected to benefit us. In the longer term, the danger could be that of the disintegration of the Community.

It was for these reasons that he considered that the time had come to work out a strategy, and to see how it could be agreed and pursued.

The Chancellor said that, while he agreed that it was right that we should be thinking about a possible time scale and conditions for our joining a Community arrangement, he found it difficult to look at any particular date with certainty, unless the Government was prepared to contemplate drastic economic action. It would clearly be impossible to fix a parity with the industrial situation in its present uncertain condition; but, if the counter-inflation programme went reasonably well and if the trade balance did not deteriorate as seriously as had been expected, we might be in a better position to fix by

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the autumn. The German Finance Minister had recognised that it would be disastrous for the British to come into a Community arrangement and then to be forced to come out of it again. The Commissioners, and those who thought like them, had no conception of the problems that were involved. The Chancellor had been told that M. Ortoli was disappointed with the result in Brussels, not because of our failure to join the Community float, but because no one else in the Community was prepared to consider going ahead on the lines we had proposed.

The Governor said that the broader considerations which the Prime Minister had described were very much in his mind and the minds of others concerned with these matters. But to join a Community arrangement and then to be forced to come out again would have invited a disaster that would have made it more difficult to achieve the longer term objectives outlined by the Prime Minister.

In discussion, there was general agreement that there was a considerable amount of work to do, first on defining the domestic circumstances which would justify our joining in a Community arrangement and the action needed to bring those circumstances about, and secondly on the conditions (as to mutual support etc.) on which we could join such an arrangement. It was suggested that no system, however comprehensive and well devised, could guarantee protection against speculative movements if the economies of the countries concerned were not sound. But the Prime Minister could not entirely accept that proposition: the enormous speculative movements of recent weeks had not really been justified by the states of the economies concerned. Nonetheless, as was pointed out, those who ten days ago had speculated on a revaluation of the mark had in the event been justified.

Sir Douglas Allen said that he agreed with the Prime Minister's suggestion that in the coming period we should seek in practice to keep sterling in line with the other Community currencies: this would help us to foresee the problems which might arise if we joined a Community arrangement, and it would benefit the counter-inflation policy.

The Prime Minister, summing up the discussion, said that work should now be put in hand, both on the economic strategy to be followed, given the objectives to which he referred, and on possible conditions for a joint Community arrangement in which the United Kingdom could take part. He was clear that a joint Community arrangement including the United Kingdom would have to come into effect in due course, and we should prepare for it as a matter of urgency. He accepted the criticism that the Commission was not, as at present constituted, capable of providing the ground work. We should not get anywhere in the Community unless we ourselves put in a memorandum of specific proposals which would meet not only our own problems, but the needs of the whole Community. Once we had worked this out, and put a paper in, then we should make

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every endeavour to promote our proposals in other Community countries and in Brussels at all levels. Our proposals would need to cover the institutional arrangements which the Community would require if proper effect were to be given to a joint monetary arrangement. Urgent consideration should also be given to possible ways in which the Commission's capacity in this field might be strengthened.

I am sending a copy of this letter to John Hunt.

(SGD) R. T. ARMSTRONG

A. M. Bailey Esq.,  
H.M. Treasury.

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