

PRIME MINISTER

European Council Briefing Meeting: Monetary Reform

Those attending the meeting will be:-

Chancellor of the Exchequer
Sir Douglas Wass
Ken Couzens
Foreign and Commonwealth Secretary
Sir Michael Palliser
Chancellor of the Duchy of Lancaster
Sir John Hunt
Sir Kenneth Berrill
Bernard Donoghue
plus Secretariat

Ken Couzens has furnished two further documents, i.e. some draft guidance to relevant posts in Europe about the UK attitude towards monetary reform, and a draft letter to President Giscard setting out for his guidance the kind of considerations which you have already put to Chancellor Schmidt. These are annexed to his letter within together with the other immediately relevant documents (*some of which are already in your folder - but these will now be going to other participants for the first time*).

Apart from any general discussion you wish to have about the proposals (including such amplification of the French and German attitudes which John Hunt may be able to provide after his Bonn Summit meeting) the papers call for conclusions on four points:-

1. Are the terms of the UK "counter-draft" acceptable and should this be sent to Schulman/Clappier?
2. Is it desirable for you to write to President Giscard on the lines of the proposed draft?
3. Is it sensible to instruct our Ambassadors in relevant European posts to give guidance of the UK's attitude to this matter, as on the line suggested in the draft telegram?

4. Finally, in the light of the foregoing, do you wish to attend the proposed private meeting with President Giscard and Chancellor Schmidt in Bremen at 1200 on Thursday 6 July.

On this last point, there is a substantial head of steam in Whitehall in favour of your attending this meeting but opinions are by no means unanimous about the merits of what is now being put forward by Schulman/Clappier, nor on the tactics which President Giscard and Chancellor Schmidt are adopting. Ken Couzens is fully aware of the considerations which led you to take a very cautious and sceptical view about all this; and he tells me that fortunately Tony Solomon is now beginning to take a much more critical interest from the United States Government point of view in, e.g., the significance for the dollar of the proposed single basis of intervention for all European currencies against the dollar. You will want to judge in the light of discussion whether it is in the UK interest to put our own cautionary views forward in the preliminary private meeting with Schmidt and Giscard or whether it will be more effective to do so when the subject comes up in the full Council.

KRS.

30 June 1978



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

30 June 1978

Dear Ken,

EUROPEAN MONETARY REFORM

I attach a group of papers for the Prime Minister's meeting on this subject, which is to be at 9.30 a.m. on Monday 3 July. They are:-

- Annex A: a possible UK 'counter-draft' to the Franco-German paper by Schulman and Clappier on a European monetary system. ✓
- Annex B: the Schulman/Clappier paper as given to ^{Couzens} ~~Congress~~ in Bonn on 28 June. ✓
- Annex C: a note of the "preconditions for UK entry" described by the Chancellor of the Exchequer at the Finance Council in Luxembourg on 19 June. ✓
- Annex D: report from the Finance Council to the Bremen Council. ✓
- Annex E: draft letter from the Prime Minister to Chancellor Schmidt and President Giscard. ✓
- Annex F: draft telegram to Ambassadors in certain Community capitals. ✓

You already have the two papers called: Assessment of the UK's interests; and Handling, Timing and Tactics; which were attached to the Chancellor's minute of 22 June. ✓

Copies of this letter and enclosure go to the private secretaries
K Stowe Esq



POSSIBLE IN CONCERT DRAFT

to the Foreign Secretary and the Chancellor of the Duchy of Lancaster, the Governor of the Bank of England, Sir John Hunt, Sir Michael Palliser, Sir Douglas Wass, Sir Kenneth Berrill and Mr. McMahon.

Yours etc.

A.M.W. Battishill

(A.M.W. BATTISHILL)

2. They have therefore asked Finance Ministers to consider for European monetary cooperation with certain defined characteristics. They believe that a plan of the right kind, set in the right framework of cooperation, could contribute both to the reductions of the general level of inflation in the Community and to a higher rate of economic growth.

3. First, Heads of Government agree that the system must be constructed so as to be durable. They agree further that it will succeed and will have a truly cooperative character only if all member countries, including the stronger as well as the weaker economies, make continuous efforts to ensure convergent economic performance.

4. Secondly, consideration should be given to defining exchange parities by reference to a basket of currencies, such as the European Unit of Account, with appropriate margins of fluctuation.

5. Thirdly, in consultation on reference rates, it would be understood that changes in the rates should be made where adjustment was required by underlying economic conditions.

6. Fourthly, there should be arrangements for the coordination of exchange rate policy towards other currencies in general use in international trade or finance.

7. Fifthly, the smooth functioning of the system would require adequate financial support mechanisms, in the fields of both short-term and medium term credit. The scale of support would have to correspond to the very large sums which now need to be employed for exchange rate intervention and to the linking in certain systems of currencies in close use in trade and finance.

POSSIBLE UK COUNTER DRAFT

1. Heads of Government wish to see developed for their further consideration a plan for European monetary cooperation with certain defined characteristics. They believe that a plan of the right kind, set in the right framework of cooperation, could contribute both to the reductions of the general level of inflation in the Community and to a higher rate of economic growth.
2. They have therefore asked Finance Ministers to prepare a proposal for such a system, in consultation with Central Bank Governors and other appropriate authorities, which would take account of the following orientations.
3. First, Heads of Government agree that the system must be constructed so as to be durable. They agree further that it will succeed and will have a truly cooperative character only if all member countries, including the stronger as well as the weaker economies, make continuous efforts to ensure convergent economic performance.
4. Secondly, consideration should be given to defining exchange parties by reference to a basket of currencies, such as the European Unit of Account, with appropriate margins of fluctuation. *not straight on long term permanent capital flow*
5. Thirdly, in consultation on reference rates, it would be understood that changes in the rates should be made where adjustment was required by underlying economic conditions.
6. Fourthly, there should be arrangements for the coordination of exchange rate policy towards other currencies in general use in international trade or finance.
7. Fifthly, the smooth functioning of the system would require adequate financial support mechanisms, in the fields of both short-term and medium term credit. The scale of support would have to correspond to the very large sums which now need to be employed for exchange rate intervention and to the linking in this system of currencies in wide use in trade and finance.

8. Sixthly, the European Monetary Cooperation Fund might be developed into a European Monetary Fund which would have a central role in the system as the source of credit and of certain reserve assets, and as one of the means of securing greater convergence within the Community.

9. Seventh, the European Monetary Fund might create European Units of Account against deposit of member currencies or of other reserve assets. The European Unit of Account could serve as an instrument of settlement between EEC monetary authorities.

propose to establish in the EEC a system of closer monetary cooperation (European Monetary System-EMS) leading to a zone of monetary stability in Europe.

1. In terms of exchange rate management this system will be at least as strict as the so-called snake. In the initial stages of its operation and for a limited period of time member countries currently not participating in the snake may opt for somewhat wider margins around central rates. In principle, interventions will be in the currencies of participating countries. Changes in central rates will be subject to mutual consent. Non-member countries with particularly strong economic and financial ties with the Community may become associate members of the system. The European Currency Unit (ECU) ¹⁾ will be at the centre of the system; in particular, it will be used as a means of settlement between EEC monetary authorities.

2. An initial supply of ECU's (for use among Community central banks) will be created against deposit of US dollars and gold on the one hand (e.g. 20 per cent of the stock currently held by member central banks) and member currencies on the other hand in an amount of a comparable order of magnitude.

The use of ECU's created against member currencies will be subject to conditions varying with the amount and the maturity; due account will be given to the need for substantial short-term facilities (up to 1 year).

¹⁾ The ECU has the same definition as the European Unit of Account.

3. Participating countries will coordinate their exchange rate policies vis-à-vis third countries. To this end they will intensify the consultations in the appropriate bodies and between central banks participating in the scheme. Ways to coordinate dollar interventions should be sought which avoid simultaneous reverse interventions. Central banks buying dollars will deposit a fraction (say 20 per cent) and receive ECU's in return; likewise, central banks selling dollars will receive a fraction (say 20 per cent) against ECU's.

4. No later than two years after the start of the scheme, the existing arrangements and institutions will be consolidated in a European Monetary System. *fund*

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How do you deal with Smith's Comtas

5. A system of closer monetary cooperation will only be successful if participating countries pursue policies conducive to greater stability at home and abroad; this applies to deficit and surplus countries alike.

6. The competent Community bodies are requested to elaborate the provisions necessary for the functioning of the scheme and to conclude their work not later than 31 October 1978.

ANNEX C

UK pre-conditions

At the Finance Council in Luxembourg on 19 June the Chancellor of the Exchequer made clear the UK pre-conditions for a new European currency scheme in the EEC Finance Council on 19 June:

- i. nothing the Community did must weaken the dollar or the yen;
- ii. the Community must not commit itself to a strategy it could not sustain. The scheme must be of a durable character;
- iii. the scheme must assist growth by reducing excessive currency fluctuations without attempting to prevent market pressure from making adjustments made necessary by underlying economic relationships;
- iv. the scheme must make available the necessary resources of credit to sustain the agreed level of intervention;
- v. there must be improved convergence of policies, but the convergence must be by the stronger as well as the weaker countries. There must be symmetrical obligations as well as rights as between surplus and deficit countries;
- vi. in a scheme progressing towards currency union, there must be proper arrangements for the right transfer of resources to the weaker units in the medium term. Too often at present transfers (eg the CAP) were from the weak to the strong.

EUROPEAN COMMUNITIES

Secretariat of the
Monetary Committee

Brussels, 27 June 1978

11/438/78-EN

Conclusions of the Council's debate of 19 June, on possibilities
of bringing about greater exchange rate stability in the Community

1. The Council wishes to see progress towards exchange rate stability even before Member States have entirely solved the problem of differences in inflation rates and balance of payments. Such progress on exchange rates could contribute to improving the convergence of economic trends and policies of the Member States along the lines of more adequate economic growth and lower inflation in the Community.
2. However, greater stability in exchange rate relations in the Community can only be expected on a durable basis if substantial continued progress towards convergence of economic performance is achieved.
3. As regards the exchange rate mechanism to be developed to this end, there was broad agreement in the Council that it should be based on the following principles :
 - (a) The system should include all snake and all other E.E.C. currencies (possibly with a transition period) and could be open to other European currencies.
 - (b) It should achieve an equitable symmetry between the responsibilities of member countries whose performance diverges from objectives, including the balance of payments.
 - (c) It should not be damaging to third currencies.
 - (d) It should permit the continuance of the snake for its Members.
 - (e) The system should involve intervention obligations and firm economic policy commitments.

(f) While the system itself should help reduce divergences of economic performance, it should not prevent remaining real disparities in economic performance from being reflected in exchange rates.

(g) An exchange rate mechanism involving obligations to intervene would necessitate an adequate adjustment in the Community's very short-term financing as well as short-term monetary support.

4. The Council agreed that, if balance of payments difficulties which have led to the use of short-term credits were to persist, because better convergence could not be achieved during the life of the credit, provision should exist for this debt to be consolidated, in whole or in part, by medium-term Community financing, in order to bridge the period necessary to achieve sufficient economic convergence. To this end, the Community's medium-term facilities should be reexamined.
5. The Council expressed interest in conferring a more active role on the European Monetary Cooperation Fund in the context of progress towards EMU. Support was expressed for the suggestion that the fund could issue European units of account which would serve as a means of settlement between monetary authorities. Claims and liabilities resulting from operations in the EMCF might be denominated in EUA.
6. The Council is of the opinion that Community exchange rate stability would be facilitated if a better stability in relation to the principal third currencies were achieved.

DRAFT LETTER FROM THE PRIME MINISTER TO

1. CHANCELLOR SCHMIDT
2. PRESIDENT GISCARD

I am sorry that a group of urgent ^{Party} political and Parliamentary issues make it essential for me to conduct a meeting of the Cabinet on the morning of 6 July; and that as a result I cannot get to Bremen in time for the private meeting on European monetary matters which you proposed for that morning. In the circumstances it may be helpful if I write to you to explain that I believe we ought now to make progress on European monetary reform.

I understand that you and President Giscard/Chancellor Schmidt reached some conclusions when you met in Hamburg which your representatives are explaining in other Community capitals. I have also seen an outline of a scheme for a new European monetary system which M. Clappier and Herr Schulman gave to Couzens. To make clear how I think we could best handle matters in Bremen I attach a note drafted in the form of a conclusion of Heads of State and Government. It would give guidance to Finance Ministers and other competent authorities on the preparation of proposals for a European Monetary system.

This note covers much the same ground as I believe you and President Giscard/Chancellor Schmidt have had in mind but it does not attempt to do more at this stage than to give orientations to those who must develop any scheme, and it makes it rather clear that no Government is committed until a scheme has been worked out and it has been able to exercise a judgement on the result.

I am sure this is realistic. No real commitment is possible until

the details of a system are known, figures have been put on it and, in our case, until we can see whether the conditions mentioned by Denis Healey at the Finance Council meeting in Luxembourg on 19 June are met. [With us there is the additional complication of the possibility of a relatively early election, and the obvious objections to any commitment in advance of it.] On the technical side, I do not think it is sensible to tie too tightly the hands of those who have to address themselves to constructing a viable system, though I am sure it is right to give some general orientations.

However, there is already before the Bremen Council a report from the 19 June Finance Council meeting which takes account of views of all Community members. I would not wish in any sense to supersede or set aside that report, and would regard it as a perfectly suitable basis for our discussion there.

I am sending this note to you and to President Giscard/Chancellor Schmidt so as to let you know my position and so that it will be available to all of us if needed.

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DRAFT TELEGRAM

To Brussels, The Hague, Luxembourg, Copenhagen, Rome, Dublin.

Copied to Paris, Bonn, UKREP Brussels.

EUROPEAN MONETARY COOPERATION

1. You should now speak to senior officials in the Finance Ministry and among those preparing the Bremen European Council on the lines of paragraph 2 below. The background in paragraphs 4 - 5 may be helpful to you if questions are asked about the state of play and our part in it.
2. Line to take. You should say that we understand that emissaries from Chancellor Schmidt and President Giscard have been explaining to other Community Governments the attitude of the French and German Governments towards further progress on European monetary cooperation and exchange rate stability. You should make it clear that, although we have been in close touch with the French and the Germans on this matter, their present initiative results from bilateral discussion between Chancellor Schmidt and President Giscard, and they did not seek to agree it with us. The one agreed document on this topic available to the Bremen meeting is the report from the Finance Council meeting of 19 June in Luxembourg, which was agreed with all 9 capitals (my ift) and in our view it provides an excellent basis for discussion at the European Council. The Prime Minister hopes that on this basis it will be possible for the European Council to give useful guidelines to Finance Ministers which will enable them to develop for the further consideration of the European Council at its next meeting a plan for European monetary cooperation. We believe that the details of such a system will be extremely important if it is to be durable and to include all snake and other EEC currencies. Our own decision as to whether to join

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such a system will depend on our being satisfied that the scheme has the right characteristics and in particular that it meets the requirements described by our Chancellor of the Exchequer in Luxembourg, some of which are reflected in the Finance Council Report. It does not seem to us, however, that Heads of Government and Foreign Ministers (in the absence in particular of Finance Ministers and Central Bank Governors) would be able at Bremen to settle the details of any scheme. The most they could do would be to give very broad guidelines, which would have to be without commitment, to Finance Ministers for future work.

3. In speaking on these lines your aim should be to gain support for the idea that:

- (a) it would be inappropriate for the European Council to get down to discussing the details of a new scheme; and
- (b) it would be good and sufficient progress if the European Council were to reach agreement on the sort of work which they would now like Finance Ministers to undertake in preparation for the European Council's next meeting;
- (c) the best basis for directions to Finance Ministers is the report of the Finance Council in which all members of the Community participated.

At the same time it would be helpful if you could discover as much as possible about reactions in your capital to the French and German approaches and about the line which will be taken by your Prime Minister at Bremen.

4. Background. There have been contacts at senior official level between the FRG, France and the UK on this subject following the last European Council in Copenhagen. These discussions have been explanatory however. Naturally we did not envisage them superseding the official work in the Community involving all members which has been proceeding in parallel in the Monetary Committee and which resulted in the report of the Monetary Committee to the Finance Council (our telegrams Nos. to).

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5. Our understanding of what the Germans and French may be proposing is that it involves a greater degree of commitment both to the scheme as a whole and to some of the details of it than is practicable or sensible at Bremen. Moreover we are not confident that it meets the requirements about a balance of obligations on stronger and weaker parties in economic management about which Mr Healey spoke at Luxembourg. The details of a scheme would be technical but have important implications. They will require further serious work by representatives of Finance Ministries and Central Banks before they can be put into shape. Decisions will be required about a number of difficult questions such as a degree of reserve pooling, the creation of currency units against national currencies, the role of the EMCF, conditionality of drawing rights and so on. It is very difficult to see how Heads of Government could tackle these questions at Bremen.

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