

THE WHITE HOUSE

WASHINGTON

April 8, 1978

~~CONFIDENTIAL GDS~~

ACTION

MEMORANDUM FOR: THE PRESIDENT

FROM: HENRY OWEN *HO*

SUBJECT: Chancellor Schmidt's Messages to You
About the Summit

25.

1. When I saw him last week, the Chancellor told me that he accepts the notion of a package approach suggested in your recent letter to him. This report summarizes his comments on the package's three main elements -- US action on inflation and energy, German and Japanese growth, and UK and French acceptance of more liberal trade policies -- and submits for your approval a draft letter to Schmidt.

2. US Action

a. Inflation. The Chancellor stressed the need for effective US anti-inflationary action to strengthen the dollar; he said that he realized from his own experience both how painful such measures were bound to be politically in the US, and how necessary it was to stick with them, year in and year out, if inflation was to be brought under control.

b. Energy. The Chancellor asked about energy prospects. He made clear that nothing would do so much to enhance European confidence in US leadership as effective action to limit oil imports, and asked when you would act, if the Congress did not.

The Chancellor said that we were on the right track in thus addressing the causes, rather than the symptoms, of the dollar's decline. Neither he nor any of his subordinates showed any desire to see us intervene more actively in exchange markets.

3. German and Japanese Action

a. Japan. I told the Chancellor that my Japanese Summit colleagues in the Summit Preparatory Group felt that there was a good chance of Fukuda submitting an expansionist budget to the Diet in September, intended to raise Japanese 1978 growth from 5-6% to something over 6%. Schmidt was skeptical the Japanese would reach such a high figure.

b. Germany. He said the German government would introduce a stimulus package if the FRG could not achieve its 3.5% 1978 growth target. He warned that he would not say so publicly, until

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and unless the time came to act. He was unclear about timing; at one point he indicated that he would only make his decision in August, i.e., after the Summit. His subordinates, by contrast, favored announcing the proposal for a tax cut before or at the Summit. I stressed to them the difficult situation in which you would find yourself attending a Summit, if German growth was low and the German government gave no sign of wanting to do something about it.

The Chancellor wanted you to know how hard he had worked to achieve a tax cut last year when he realized that German growth was falling below target; he asked me to tell you that he was confident that he could get parliamentary approval this time if it proved necessary. He implied that German stimulus measures would hinge on a favorable international environment -- i.e., the US vigorously attacking its inflation and energy problems.

4. UK and France. One German official said: "The politically tough decisions in this package have to be made by the US and Germany; there's nothing we want from the UK and France except better trade policies." He is right. A successful MTN and avoidance of specific forms of protectionism should be the UK's and France's contribution to an economic package, since they are the worst offenders on trade policy. The Chancellor asked about creeping US protectionism; I said there was nothing wrong with US trade policy that a successful MTN wouldn't cure.

5. Conclusion. My hour and a half meeting with the Chancellor was specific and business-like. He asked me to tell you that Germany would loyally support US policy, and that he wanted to cooperate closely with you. The discussion covered much the same ground that you did with Callaghan and gave us most of what we wanted: German agreement to a package approach, and a commitment to stimulus measures, if needed. It did not settle the important problem of stimulus timing. I suspect, as you indicated at the Callaghan lunch, that the Chancellor will eventually agree to action at the Summit, since he wants a successful Summit. But he will have to decide this before the Summit, since several weeks of advance consultation with party leaders will be required.

6. Action. I attach a letter to Schmidt, cleared with State, Treasury, and Jim Fallows, thanking him for the messages he sent you, nailing down his commitments, and nudging him politely on timing. (Tab A)