

PRIME MINISTER'S BREAKFAST WITH CHANCELLOR SCHMIDT AND PRESIDENT GISCARD

1. Further reflection about what the Chancellor and the President said suggests that in spite of some apparent inconsistencies it is basically a proposal for an extended European Snake, with two features not present in the existing Snake.

They are:

i some pooled reserves, part dollars and part European currencies (it sounds as if the dollar element could be something like \$10 billion)

ii settlements between central banks, made necessary by the use of these reserves for intervention, in European Units of Account. These EUA's might also be held as reserve assets, rather like SDR's which also represent a basket of currencies.

2. It follows that the earlier briefing about entry to a European Snake and pooled reserves applies. ii above makes no major difference to the nature of the proposal.

3. The Prime Minister will wish to go on saying that he recognises that this is an imaginative plan but of course he needs to understand it a lot better and would like to see a full written account of it. When such an account is available it might be desirable to have a small group of experts of the three countries meet to examine it, so that each could report back to his Head of Government. But this should strictly be without publicity. There are risks about publicity, e.g. if there were any thought that the UK were joining a form of Snake some would assume that we would have to devalue on entry. That could cause pressure on sterling.

4. The Prime Minister might ask some of the following questions:-

i is this basically a proposal for a new form of European Snake but with some pooled reserves for currency support?

ii is the suggestion for the European Unit of Account that it should be used for central bank settlements arising out of intervention? or is there any suggestion that it should actually become a new currency?

- iii is any restriction suggested on the use of existing national currencies e.g. in trading with non-European currencies?

- iv what would be the effect on the dollar and is it really practicable just to ignore the dollar? If it were known that 15 per cent or 20 per cent of West European reserves were to be used for intervention to keep the franc and sterling higher in relation to the deutschemark, would not that depress the dollar further? Would Germany continue its present policy of intervening to support the dollar, or to keep the mark down in relation to the dollar? Doesn't the problem of the mark going up against the dollar remain, affecting all Germany's non EEC trade?

- v Would the whole scheme look like Europe turning its back on America? Wouldn't that strain our defence relationship with them and increase the risk of US protectionism?

- vi Would it really be practicable to bring the lira into such a scheme? And if not, would not we be giving notice now that Italy and the new entrants would be second class members of the EEC?

- vii Does the scheme really do anything for the problem of unemployment or the real currency instabilities in the world which are those between the dollar on the one hand and the yen, the mark and the Swiss franc on the other? Doesn't it take our eye off the ball?

5. The most important questions are i, iv, v and vii.

/ 6. Handling

6. Handling. The Prime Minister may think it wise to say that while he appreciates the imaginative character of the proposal and hopes to see it reduced to writing and examined speedily, he trusts that it will not be publicized in a way which suggests we favour it. Both because of the possible effects on our currency markets and for political reasons he would be obliged to adopt a reserved attitude to the scheme in public if there were such publicity. Nor could he let it be thought he was turning away from the United States within a fortnight of his discussions with President Carter.

K. Couzens.

7 April 1978