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RECORD OF A CONVERSATION BETWEEN THE PRIME MINISTER AND
THE CHANCELLOR OF THE FEDERAL GERMAN REPUBLIC AT THE FEDERAL
CHANCELLERY IN BONN ON FRIDAY 2 MARCH, 1973, AT 4.00 P.M.

Present:

The Prime Minister	Herr Willy Brandt
Mr. R. T. Armstrong	Herr Heinz Weber
	Herr Schilling

Foreign Exchange Situation

The Prime Minister said that at their discussion in the morning the Chancellor and he had not reverted to the present currency problems. He was glad of the opportunity of this additional and unprogrammed meeting in order to do so. He understood that, though most other European markets had been closed, the French exchange market had opened this morning, but that, having taken in about \$400m. in a short period, the authorities had decided that they could not resist the pressures and had closed the market. He understood that a meeting of the Monetary Committee had been called for the following afternoon and a meeting of the Community Finance Ministers in Brussels for 4.00 p.m. on Sunday 4 March.

In this situation he had decided, with regret, that it would be better not to carry out his visit to Bavaria. He would visit the Abbey of Maria-Laach that evening and then fly home to London after dinner.

The Prime Minister then rehearsed the possible courses of action that he had discussed with the Chancellor at their earlier meeting.

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The first possibility was for the Germans to defend their existing dollar parity. Presumably the decision to close the exchanges meant that a decision had been taken against that course.

The second possibility was for the Germans to float the DM. That would present difficulties from the domestic political point of view; it would also present difficulties from the point of view of progress to European monetary union. The Chancellor interjected that, if one could push aside the European considerations, a national float would be technically satisfactory and not unacceptable in domestic terms. But it would undoubtedly be a great setback to European monetary co-operation. The Prime Minister agreed: presumably the Dutch would follow the Germans in floating, and that would leave only the French: this morning's experience suggested that the French would not now be likely to try holding out on their own.

The Chancellor said that it was still questionable whether the French would feel able to come into a general European solution in the middle of an election. The decision of M. Giscard d'Estaing to go to Brussels on Sunday afternoon suggested, however, that they might be willing to do so, and Herr Poehl thought that it was probable that they would be prepared to move if an acceptable formula could be found.

The Prime Minister said that the third possibility was for other members of the Community to go into a joint float without Britain and Italy, on the basis that Britain and Italy would come in when they could. The Chancellor said that he would not exclude this solution, but Herr Poehl doubted whether the French would be prepared to accept it. The Prime Minister asked the Chancellor whether he thought

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that the French would object to a joint Community solution which excluded Britain, Italy and France. The Chancellor thought that they probably would.

The Prime Minister said that the last alternative was to take a major step forward: for the Community to take advantage of the crisis to operate together on a solution based on a joint floating. Such a solution would have to include reserve pooling and other things which went with it.

The Chancellor said that he did not know what the decision of the Italian Government was. He understood that Signor Ossola, speaking personally, had said that the Italian decision would depend on the British decision. They might find it difficult to join in a Community float, but would want to come as close as possible.

The Prime Minister said that a joint float would present the British with considerable problems. We should have to fix a new parity with other European currencies. There might be some argument about what the rate would need to be, if there was to be a reasonable prospect of avoiding speculative movements against sterling. The joint float would have to be backed by reserve pooling: reserves would have to be available for use for the support of any currency without payment of interest and without fixed repayment arrangements. It would be important from a political point of view to take this step to reserve pooling: otherwise those who received support would be open to the charges of incurring new debts and, for his part, he would not wish to be in that position.

The Prime Minister asked whether what he had described represented the lines on which the Chancellor was thinking.

The Chancellor said that it did; but that, if they were

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were joined by experts.

At this point Mr. D.J. Mitchell and Herr Karl-Otto Poehl were called into the meeting.

Herr Poehl said that there had now been further discussions of possible support arrangements in the joint float. They would certainly go very much further than the credit facilities available in the Community's existing arrangements. In a joint float every member would have to support the other. A danger of speculative movements against European currencies was, however, less serious now than it would have been three weeks ago, because in the meantime the dollar had been devalued. The Germans would be prepared to do anything they could do in a European monetary union to support a joint float situation.

Herr Poehl said that the Chancellor of the Exchequer had argued at an earlier meeting that there were enough credit facilities already and that what was needed was not to lose reserves. He thought it hard to judge whether Britain would lose more reserves by continuing to float alone or by joining in a Community float. He thought that the psychological aspect was important: the strength which would come from the degree of unity involved in a joint float would be important in helping to avoid loss of reserves. It was hard to say precisely what the terms of support should be. What Herr Schmidt had said in Paris was that the Germans would be prepared to go further than the present position. Clearly the terms would need to be negotiated.

Mr. Mitchell said that, when the Chancellor referred to the adequacy of the existing credit facilities, he had in mind the whole swap network and the I.M.F. drawing rights,

which together produced a considerable volume of credit. That credit, however, was subject to certain terms as to interest and timing of repayment. The contrast between that and what was now in his mind was the unconditionality that might be available for support in an E.E.C. jointfloat. This had never been clearly defined, but at one point Herr Schmidt had referred to a total lack of conditions. This of course put the whole matter in a completely different light.

Herr Poehl confirmed Mr. Mitchell's account. He said that Herr Schmidt had clearly contemplated large amounts of credit on easy terms. He himself believed it could be done on the basis of a nil interest rate and repayment over several years - he suggested seven or even ten years. Herr Schmidt had to all intents and purposes been making an offer, and Herr Poehl confirmed, with the Chancellor's agreement, that the offer still held good. Terms of interest and payment had not been discussed in Paris or since, and the Germans would prefer not to make any offer; they would prefer the British to say what they thought would be reasonable.

The Prime Minister said that he had been going over the possible alternatives with the Federal Chancellor, and he briefly recapitulated the four alternatives discussed, ending with the final suggestion that the crisis should be used as an opportunity to make a major step forward, with a joint float and moving towards strong central institutions and reserve pooling, so that the Community together could stand up against any pressure coming from outside.

Herr Poehl said that the Monetary Committee would be considering the proposals from the Commission at its meeting tomorrow. He repeated that it was not a problem for the

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German Government, and it was not for the Germans to make an offer; they would now await the meetings of the Monetary Committee and Finance Ministers. He was sure that the Commission's proposals would include various conditions and prices to pay, but he reaffirmed that the Germans were ready to pay a very high price for a European solution.

The Prime Minister said that in his Press Conference he had taken the line that he could not comment on the matter, because it was now for the Commission to make proposals.

Herr Poehl asked what we thought would be necessary to make a European solution credible as far as ^{we} were concerned.

Mr. Mitchell said that one could say what the elements would be, but it was difficult to quantify them. One of the most difficult questions was the choice of a parity. Given the probable course of our balance of payments over the next year or two, there was a danger that, if we came in on too high a parity now, the cost of holding that parity could prove to be very great.

Herr Poehl said that a joint European position which included an efficient intervention system and adequate reserves would provide an element of stability: it would mean that the next crisis for sterling would be put very much further into the future. So much of all this was a matter of psychology. Mr. Mitchell said that, though the techniques were basically simple, he would not himself have great confidence in the Brussels machinery to run such a system. Herr Poehl said that it would not be run from Brussels; it would be run under the aegis of the European Monetary Co-Operation Fund, which would mean that it would be run by the central bankers, operating

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through the existing concertation arrangements and the Bank for International Settlements.

Mr. Mitchell reminded the meeting that it had taken a long time to agree upon the details of the present mutual support and intervention arrangements. It might take an equally long time to agree upon the details of operation through the European Monetary Co-operation Fund. Herr Poehl thought that this need not be so. If the political will was there and the political decisions were taken, technical working out could follow reasonably quickly. If the Council of Finance Ministers, meeting on Sunday afternoon, came to the conclusion that a joint European float, plus certain regulations favoured by the French and Belgians, should be adopted and that that should be combined with an adequate support and intervention system, it would be a matter of only days or at most a few weeks to work it out. Mr. Mitchell said that if it could be worked out in two days that would be fine, but that things would not be so easy if it took weeks.

Herr Poehl said that his own personal view was that, when markets opened again next week, the dollar would be very strong, if the Community had decided upon a joint float. The dollar was not overvalued now and in the circumstances he envisaged that a great many people who had taken decisions earlier this week would be forced to close those positions when the markets re-opened. If we fixed a new sterling parity on Wednesday 7 March, and there was some loss of reserves, and we were supported by Bundesbank intervention on the lines discussed, he thought that the system would soon settle down to greater stability.

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Mr. Mitchell asked Herr Poehl what he thought the Italians would do. Herr Poehl said that the Italians were in principle in favour of a joint float. He thought that it might be said that Signor Carli had provoked the crisis by writing an article recommending a joint float. If other members of the Community agreed, the Italians could not be outside.

The Prime Minister asked what would be the solution to the problem of the Eurodollar market. He recalled that Herr Poehl had said at one stage that a strong European central bank was the way to control the Eurodollar market. Herr Poehl said that a joint Community float would be a very elegant answer to the Eurodollar problem. If Europe did not do something like this, there would in his view be grave danger of damaging the convertibility of currencies and the liberalisation of trade and services. In a recent paper on monetary union the Community had committed itself to freedom of capital movements, but the policies at present followed were quite opposite. He recalled that every step forward in the Community had arisen out of a crisis and had involved taking risks. Whatever system was worked out would not, perhaps could not, be perfect from the outset. If in a few weeks we encountered problems and troubles, we could improve the system. He accepted that a move to a joint Community float would be a course of no return; but if we did not adopt that course, there would be a severe setback to progress towards European economic and monetary union. Mr. Mitchell remarked again that a great deal of the burden would fall on central bankers, and that working out a new system in the short time available would be a serious problem. By the

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end of the meeting of Ministers on Sunday they would need to be sufficiently satisfied that the system could work and to make arrangements for negotiating new parities within the Community. That might not be easy.

Herr Poehl said that, so far as the Federal Republic was concerned, there was no problem. They were not interested in whether the sterling parity was high or low. Even if the Italian Government sought to devalue the lira, the Germans would accept that, even though they could see no balance of payments justification for it; he did not think that they would devalue by very much. He was sure that the French would not wish to change their parity. He realised that the main risk for us was fixing the right parity. The system would of course include scope for changing the parity, but it would be important not to make too much of that, because if a change in parity came to be expected, there could be a threat to sterling. The parity adopted must therefore be credible. We should have to refix our parity some time. We could not float for ever, unless indeed the international system for the future was going to be based on floating rates.

Mr. Mitchell said that the problem was to fix a new parity while the degree of success which would be achieved by the counter inflation programme was still in the balance. Herr Poehl argued that it would be preferable for us to fix within a European system which provided us with massive support than to fix alone. Mr. Mitchell said that the Germans had been very generous in their approach to the possible conditions of such support. But there had also been a certain amount of talk of the need to scrutinize

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the domestic policies of countries who required the support. Herr Poehl agreed that what they needed was a measure of reserve pooling; but it might not be necessary to pool all reserves. Mr. Mitchell said that it might be possible to develop a system on the lines of the I.M.F. quotas, with reserves available for support divided into tranches, the first tranche being large in amount and unconditional in terms of availability. He was not advocating such a system, but he thought that it was possible that the Community might find itself discussing something on these lines.

Herr Poehl said that, if we believed that the European Monetary Co-Operation Fund should be the nucleus of a European central bank, then it did not make much sense to put conditions on the support which that Fund gave. If one had a united currency, in fact even if not in name, then there were no problems of balance of payments disequilibria within the area covered by this currency. He recognised that this implied a system of total reserve pooling and drew attention to a paper by Prof. Triffon which moved in this direction.

Finally, Mr. Mitchell said that a move to a joint Community float would have two requirements: that there should be a political will and an institutional framework. Even if the will was there, the framework barely existed. Herr Poehl reminded Mr. Mitchell that the system of central bank intervention at present in operation worked extremely well and could readily be adapted for this purpose.

The meeting concluded shortly after 5.00 p.m.

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