

SECRET

DESKBY 030900Z

FM ROME 021930Z NOV 78

TO IMMEDIATE FCO

TELEGRAM NUMBER 504 OF 2 NOVEMBER

INFO PRIORITY BONN (PERSONAL FOR HM AMBASSADOR), PARIS (PERSONAL FOR HM AMBASSADOR), AND UKREP BRUSSLES (PERSONAL FOR AMBASSADOR.

PERSONAL FOR BUTLER (DUS) AND FOR JORDAN-MOSS (TREASURY)

MY TELS NO 501 AND 502 : GERMAN/ITALIAN TALKS IN SIENA ON 1/2 NOVEMBER, EMS

1. ON 2 NOVEMBER HEAD OF CHANCERY SAW RUGGIERO (UNDER SECRETARY FOR COMMUNITY AFFAIRS AT THE MFA) WHO WAS PRESENT AT THE SIENA TALKS.
2. RUGGIERO STRESSED THE NECESSITY OF TREATING THE FOLLOWING ACCOUNT IN COMPLETE CONFIDENCE AND NOT PLAYING ANY OF IT BACK TO NON-BRITISH (INCLUDING ITALIAN) OFFICIALS. OTHER WISE HIS OWN POSITION WOULD BE DAMAGED GRAVELY. CHANCELLOR SCHMIDT AND SIGNOR ANDREOTTI HAD PROMISED TO KEEP EVERYTHING NOT MENTIONED IN THE PRESS CONFERENCE TO THEMSELVES. ACCORDING TO RUGGIERO, CHANCELLOR SCHMIDT PLAYED HIS HAND VERY CLEVERLY, CONCENTRATING HIS POLITICAL ONSLAUGHT ON SIGNOR ANDREOTTI (WITH WHOM HE GETS ON EXTREMELY WELL), WHILE BRUSHING ASIDE ALMOST CONTEMPTUOUSLY, THE TECHNICAL ARGUMENTS OF MINISTER PANDOLFI AND GOVERNOR BAFFI.
3. IN HIS POLITICAL OBSERVATIONS, CHANCELLOR SCHMIDT SPOKE OF HIS PERSONAL COMMITMENT TO THE ESTABLISHMENT OF THE EMS DESPITE CRITICISM FROM THE GERMAN PARLIAMENTARY OPPOSITION, FROM THE BANKERS AND EVEN MEMBERS OF HIS OWN GOVERNMENT. IF MONETARY STABILITY WERE NOT NOW ESTABLISHED IN THE COMMUNITY, IT WOULD BREAK UP BEFORE 1985 WITH VERY SERIOUS INTERNAL AND EXTERNAL CONSEQUENCES FOR ALL MEMBERS. HE DID NOT HAVE GERMAN INTERESTS ONLY IN MIND. MONETARY STABILITY WOULD FACILITATE INVESTMENT AND TRADE THROUGHOUT THE COMMUNITY. NO ONE HAD PROPOSED AN ALTERNATIVE STRATEGY FOR THE CONSTRUCTION OF EUROPE. IN A REFERENCE TO PANDOLFI'S AND BAFFI'S MORE CAUTIOUS IDEAS ON MODALITIES, THE CHANCELLOR SAID THESE MIGHT HAVE SOME JUSTIFICATION BUT THEY IMPLIED LESS GROWTH FOR THE COMMUNITY.

cc Italy Sept 76
 (André Vian)

(PM has seen) 3 1/2

Mr. [unclear]
 Mr. [unclear]

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4. IN HIS COMMENTS ON OTHER COUNTRIES THE CHANCELLOR RESERVED HIS HEAVIEST CRITICISMS FOR THE AMERICANS FOR THEIR MONETARY INDISCIPLINE. PERHAPS, HOWEVER, EUROPE COULD SET THEM AN EXAMPLE. IN THE PRESS CONFERENCE HE HAD AGREED WITH SIGNOR ANDREOTTI TO WELCOME PRESIDENT CARTER'S ECONOMIC MEASURES, BUT HAD COMMENTED PRIVATELY TO THE ITALIANS THAT THESE HAD COME A YEAR TOO LATE. TURNING TO CHANCELLOR SCHMIDT'S REMARKS ABOUT HIS COMMUNITY PARTNERS, RUGGIERO SAID THERE WAS NO TRACE OF ANTI BRITISH SENTIMENT. BUT THE CHANCELLOR CLAIMED THAT BRITISH OBJECTIONS TO THE EMS WERE ONLY POLITICAL, NOT ECONOMIC AND THEREFORE WERE NOT RELEVANT. AS FOR THE ITALIANS, THEY WERE TOO PRUDENT AND SCEPTICAL. THOSE WHO REJECTED THE EMS WOULD SINK TO A SECOND RANK WITHIN THE COMMUNITY. IF ITALY REJECTED IT, SHE WOULD BECOME LIKE GREECE OR TURKEY.

5. SIGNOR ANDEOTTI HAD ALSO STRESSED POLITICAL CONCERNS. AS A FOUNDER MEMBER OF THE COMMUNITY ITALY GAVE THE CONSTRUCTION OF EUROPE TOP PRIORITY, BUT WANTED AN EMS THAT STRENGTHENED AND DID NOT SPLIT THE COMMUNITY.

6. MINISTER PANDOLFI AND GOVERNOR BAFFI CONCENTRATED ON ECONOMIC ARGUMENTS. THEY EXPLAINED THAT THE ITALIAN ECONOMIC SYSTEM WAS EXTREMELY RIGID THROUGH ITS PUBLIC DEFICIT AND ITS INDEX LINKED WAGE SYSTEM. THE ONLY FLEXIBLE ELEMENT WAS THEIR CURRENCY AND IF THIS WERE ALSO MADE RIGID THE CONSEQUENCES COULD BE VERY NEGATIVE. THEY WERE NOT CONVINCED THAT A RIGID EMS WOULD BE A VALID DISCIPLINE FOR ITALIAN TRADES UNIONS. THEY WANTED A WIDER BAND OF FLUCTUATION, AS AN INTEGRAL PART OF THE SYSTEM. THEY EXPLAINED THEIR IDEAS ABOUT THE TWO INTERCOMMUNICATING ZONES (PARA 7(D) OF MY TELNO 501), AND CLAIMED THIS WOULD DECREASE THE NEED FOR FREQUENT CHANGES OF PARITY AND FOR UNDUE CENTRAL BANK INTERVENTION. A TRANSFER OF RESOURCES FROM THE WEALTHY CENTRAL COUNTRIES TO THE NEEDY PERIPHERAL ONES WAS ALSO VITAL. THE ITALIAN MINISTERS HAD OF COURSE ALSO STRESSED THE NEED FOR A SYSTEM WHICH PLACED POSITIVE OBLIGATIONS ON DEVIANT CURRENCIES. THE ITALIANS HAD THROUGHOUT UNDERLINED THEIR INTEREST IN INCLUDING BRITAIN IN THE EMS ON ECONOMIC AND TECHNICAL MONETARY GROUNDS AS WELL AS POLITICAL ONES.

7. IN REPLIES TO CERTAIN OF THE ECONOMIC POINTS CHANCELLOR SCHMIDT SAID THE FOLLOWING. HE COULD ACCEPT THE CONCEPT OF THE OUTER BAND BUT NOT THE IDEA THAT COUNTRIES IN THE INNER SHAKE

BAND SHOULD PASS TO THE WIDER BAND. (COMMENT: IT IS NOT CLEAR WHETHER HE LIMITED THE WIDER BAND CONCEPT TO ITALY ONLY). HE AGREED IN THEORY THAT A TRANSFER OF RESOURCES AND A DEVELOPMENT OF COMMUNITY POLICIES WELL BEYOND THAT OF THE COMMON AGRICULTURAL POLICY WOULD BE NECESSARY, EVEN IF THERE WERE NO EMS. BUT IN PRACTICAL TERMS HE ADVANCED ONLY THE PROPOSAL FOR A REBATE OF INTEREST FOR EIB LOANS WHICH SHOULD BE RESERVED FOR COUNTRIES PARTICIPATING IN THE EMS ONLY. AS FOR THE 'ALARM BELL CONCEPT' HE DESCRIBED THIS AS STUPID AND INCOMPREHENSIBLE. HE COULD NOT UNDERSTAND GISCARD'S IDEA OF PLACING THE ECU AT THE CENTRE OF THE SYSTEM BUT HAD HAD TO INCLUDE A REFERENCE IN THE BREMEN COMMUNIQUE TO PLEASE THE FRENCH. IN REPLY TO AN OBJECTION BY THE ITALIANS THAT THEY WERE UNDER PRESSURE FROM THE COMMUNISTS AND SOCIALISTS TO OBTAIN CERTAIN OBJECTIVES, THE CHANCELLOR EXCLAIMED "WHAT DO THEY UNDERSTAND ABOUT MONEY?". ON THE TIMETABLE, THE CHANCELLOR WAS MUCH LESS FLEXIBLE ABOUT A GRADUAL IMPLEMENTATION OF THE SYSTEM AFTER A SYMBOLIC BEGINNING ON 1 JANUARY THAN PRESIDENT GISCARD HAD BEEN.

8. THE ITALIANS AND GERMANS HAD AGREED TO CONTINUE TECHNICAL TALKS IN PREPARATION FOR THE EUROPEAN COUNCIL MEETING ON 4/5 DECEMBER.

9. IN CONCLUSION, RUGGIERO STRESSED THAT DESPITE WHAT HE HAD SAID ABOUT SIGNOR ANDREOTTI, THE LATTER HAD BEEN EXTREMELY PRUDENT AND HAD RESISTED ATTEMPTS BY SCHMIDT TO MAKE HIM FORCE THE PACE. HE HIMSELF BELIEVED THAT EVERYTHING WOULD REMAIN OPEN ON THE ITALIAN SIDE UNTIL THE EUROPEAN COUNCIL AND STRESSED, IN THIS CONTEXT, THE VITAL IMPORTANCE OF SIGNOR ANDREOTTI'S VISIT TO LONDON ON 22 NOVEMBER. HE VENTURED TO ADVISE, ON A STRICTLY PERSONAL BASIS, THAT THE ESTABLISHMENT OF A PERSONAL RAPPORT BETWEEN THE PRIME MINISTER AND SIGNOR ANDREOTTI ON THAT OCCASION

WOULD BE VERY IMPORTANT. ONE ELEMENT MIGHT BE A PRIVATE SESSION BETWEEN THE TWO. SIGNOR ADNREOTTI WAS VERY RESPONSIVE TO A POLITICAL COLLEAGUE WHO HE FELT UNDERSTOOD HIS PROBLEMS. HE FELT THIS ABOUT SCHMIDT BUT NOT ABOUT GISCARD.

CAMPBELL

7 NOV 1978

11/14/78

FILES
 HD/EID (I)
 HD/EID (E)
 HD/FRD
 HD/ECON D
 HD/TRED
 HD/WED
 PS
 PS/MR JUDD
 PS/PUS
 SIR A DUFF
 MR BUTLER
 MR HIBBERT
 MR THOMAS
 MR FRETWELL
 MR HAYES
 MR FERGUSSON

COPIES TO:

PS/CHANCELLOR OF THE EXCHEQUER
 PS/CHANCELLOR OF DUCHY OF LANCASTER
 MR JORDAN MOSS)
 MR COUZENS) TREASURY
 MR MACMAHON)
 MR M BALFOUR) BANK OF ENGLAND
 MR STOWE NO 10 DOWNING ST
 SIR J HUNT)
 MR FRANKLIN) CABINET OFFICE