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From the Private Secretary

20 December 1979

Dear Tony.

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The Prime Minister held a meeting this evening to discuss possible measures which we might take to assist the USA over Iran. The following were present: Chancellor of the Exchequer, Foreign and Commonwealth Secretary, Secretaries of State for Energy and Trade, the Attorney General, the Governor and Deputy Governor of the Bank of England, and Mr. Wade-Gery. The meeting had before it your letter of 19 December and the documents which you enclosed with it.

The Prime Minister said that the Government must do something to help the Americans, and certainly no less than their other allies in Europe. It was necessary to look for measures which would be presentationally useful but which would not do us substantial damage. It appeared that the Germans and the French were willing to go along with most of the Administration's latest proposals provided that action was taken on a concerted basis. But she did not wish the UK to be seen to be simply following the lead taken by others. It was important that we should take the lead ourselves. On the face of it, three of the four American proposals relating to the banking system could be implemented without having much of an adverse effect on our interests; and it looked as if we could also go along with the two proposals relating to oil purchases - provided all these measures were agreed with our partners. The Foreign and Commonwealth Secretary added that it seemed unlikely that the Americans would obtain a Chapter 7 determination. In that case, and if they did not obtain the kind of support which they were now asking us for, they might well be forced into actions which would be far more damaging to our interests than anything which might result from our going along with their proposals. Agreement to their proposals ought therefore to be seen as an alternative to something far worse.

The Chancellor and the Secretary of State for Trade argued that, even if we rejected proposal B in the American document and accepted proposals A, C and D, this could be very damaging to our financial interests. They might not look far-reaching, but they would give the impression that we were prepared to take more drastic action - such as introducing legislation to freeze overseas assets. The Iranians would regard these measures as an hostile act,

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and were likely to react against us. Moreover, it was unlikely that they would have any practical effect in terms of bringing about the freeing of the hostages.

The Governor said that the American information contained in Annex D on what other countries would be prepared to do was misleading. He had spoken to most of the European central bankers over the last few days, and based on these conversations, it seemed that the American information over-stated other countries' readiness to act. In addition he had heard that the Saudis were very worried at the US freezing of the Iranian assets: it raised with them the question of whether they would not be better off keeping their oil in the ground. Any action by the UK on the lines proposed by the Americans would aggravate the fears of the Saudis and other OPEC countries. The Chancellor added that he too was anxious that other Governments would do less than they had apparently told the Americans they would do. Moreover, even if they did move in concert with us, their exposure to retaliation was considerably less than ours.

The Prime Minister commented that according to our latest information from Bonn (Telegram No. 799) the Germans were prepared to go along with the American proposals; and they were certainly assuming that we would do so. In any case, the UK ought to take positive steps to persuade other Governments to assist the Americans. It also seemed from the note by Treasury officials that the three banking proposals as set out in the draft reply to the Americans would be unlikely to arouse serious opposition from the banks. If there were overriding objections to the proposals, then something must be found to take their place.

There was then some discussion of the three proposals as set out in the "draft document to be agreed between the central banks". It was pointed out that proposal (i) was a watered-down version of the American proposal A in that the banks would not be asked to stop short-term credit normally associated with commercial transactions. As for proposal (ii) (which corresponded with the American proposal C), the Governor commented that - if the objective was to prevent massive switching out of dollars into other currencies - it would be better for central banks to organise a re-cycling facility. As regards proposal (iii) (which corresponded to the American proposal D) the Governor said that this might be more acceptable if there could be a let out clause - which would allow banks to accept increases in non-dollar deposits by the Iranian Government where their claims on Iran exceeded their existing deposits.

The Secretary of State for Trade said that ECGD had stopped offering credit to Iran, but it had not publicised this. To announce a stoppage would invite retaliation, and this risk could not be dismissed since ECGD's exposure in Iran exceeded £600 m. On the other hand, there remained one or two steps which ECGD could still take against Iran; and these might help our position with the Americans. But again, we would have to tell them privately.

Turning to the two oil proposals, the Secretary of State for Energy said that neither of these should cause difficulty. The British oil companies were already paying for Iranian oil in US dollars and he had already asked the companies to avoid buying oil from Iran at prices sharply in excess of those charged by other OPEC countries. It would of course be in our interests to obtain international endorsement of this latter proposal - though in the light of the latest OPEC meeting, it would be less meaningful because of the wider variation in OPEC prices which now seemed likely.

Summing up the discussion, the Prime Minister said that she was determined that the UK should respond positively to the latest American proposals. Ministers were agreed that whatever action we took, it should be done in concert with our European partners. But it had not been possible to agree on what the measures should be. The meeting should reconvene the following afternoon at 1600 hours. In the meantime, the Treasury and the Bank should reconsider the "draft document to be agreed between the central banks" and the draft letter to the US and produce new drafts which the Chancellor and the Governor would find acceptable. In particular, they should draft an alternative to proposal C to cover the Governor's suggestion on re-cycling. They should also "neutralise" the central banks' document so that it would not appear as a text emanating from the UK. The Secretary of State for Energy should consider the paragraph of the draft letter on "advice to oil companies" and - if necessary - offer any amendments. The Secretary of State for Trade should consider the possibility of taking further measures in respect of ECGD: these could be explained in a separate letter to the Americans if he thought that was desirable. Finally, the FCO should consider how best we might concert with European Governments and with the Japanese.

I am sending copies of this letter to George Walden (Foreign and Commonwealth Office), Bill Burroughs (Department of Energy), Stuart Hampson (Department of Trade), Bill Beckett (Law Officers' Department), John Beverly (Bank of England), and to Martin Vile (Cabinet Office).

Tom

Tim Lehurst

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