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NOTE FOR THE RECORD

PROPOSALS FOR A EUROPEAN CURRENCY RESERVE

The following is a summary, as reported by the Prime Minister, of the discussion which took place at the European Council in Copenhagen on Friday 7 April, at the Heads of Government Meeting, when Chancellor Schmidt launched his ideas for a new initiative to stabilise European currencies. Mr Jenkins added to the Prime Minister's report and his comments are incorporated.

The discussion opened with a defence by Chancellor Schmidt of German economic policy. The German PSBR was 4½% of GNP compared with 1% in the USA and less than 4% in the UK. They had very low interest rates and M2 in Germany had risen 15% in the last 4 months, only a quarter of which was attributable to intervention in the currency markets. In 30 months German GNP had risen 10%, but German imports from the EEC by 27%. UK exports to Germany were 33% of imports from Germany in 1974, 67% in 1977. He saw no potential for more growth in the German economy because the unemployed did not really constitute a potential for growth. Meanwhile the dollar would go on down and down, unless the US took drastic action on energy. President Giscard commented that it would certainly decline against the deutschemark and Swiss franc.

Chancellor Schmidt also referred to the problem brought about for all the European economies by the transfer of technology to developing countries, which was killing our own industries. This raised acute problems because we could not stand the structural strains, but equally we could not cut off the ldc's from this development. He foresaw, gloomily, no ship-building industry in Germany in thirty years' time. The Prime Minister responded that he was not prepared to see British ship-building disappear. President Giscard adopted a similar stance and said that we should rely less on foreign trade, e.g. we should not concern ourselves with trade with India. We must get together in Europe and support each other. The Prime Minister

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questioned what the impact of this would be (a) on defence, for the United States could not be expected to adhere to defence commitments if economically the relationship was being sundered; and (b) on our own regions.

President Giscard said that we had to recognise there were now six groups of economies in the world:

- ldc's with oil;
- ldc's without oil;
- ldc's which were industrialised (e.g. Brazil);
- three types of Western economy graded in terms of size

President Giscard pointed out that, in 1977, the EEC as a whole had achieved only 1.9 per cent growth against Japan's 5 per cent. His diagnosis was that our own internal monetary confusion was in part responsible for this. He commented that the Community had \$150 billion worth of trade taken together, and if we could bring our international currency activities together we should all be stronger. The French view was that if we could not make progress on this by July, then they would move independently to rejoin the Snake.

Chancellor Schmidt then outlined his ideas. One aspect of them was to achieve a much greater role for the European Unit of Account (EUA) in a European bloc. The European currencies would be stabilised in relation to one another and there would be considerable support funds. He envisaged a contribution to a pooled reserve of 15% or 20% of FRG dollar reserves, with comparable contributions from other countries. Each country would also make available indefinite amounts of their own currencies. Credit in the intervention scheme would be for one month or if need be longer term for up to 6 to 8 years. EUA's could be used in settlements between central banks under the intervention scheme. The EIB could raise loans in EUA's and might be linked to the management of the central support fund. EUA's would also be available as reserve investments for third countries and might emerge as a reserve asset for OPEC in the 1980's. He



appeared to envisage that ultimately the Community countries would be related to the European Unit Account and would not be directly quoted against the dollar; it would be the EUA which would be quoted against the dollar. In response to a question from the Prime Minister, the Chancellor said that this was a scheme not to replace the present snake but to swallow it.

President Giscard had responded positively to this proposal and said that the Community was now at a cross-roads - either they took joint action along these lines, or France would act independently and join the Snake. If they acted together, then it could create a European Bretton Woods with a European exchange rate against the dollar, based on the EUA. It was important to get an answer to these proposals in the coming months. He would much prefer a nine-country basis.

In further discussion, Chancellor Schmidt commented that there were not only the possibilities of either pursuing this idea or remaining in what was effectively a "two-speed Community" - there was also the possibility of the European Community breaking up as a result of the stresses brought about by the present situation. (At this point the Prime Minister noted that the Chancellor had said that he would, if necessary, stimulate the German economy in August, not because he was intellectually convinced of the case for it, but because he accepted it to be a commitment required of him by the Bonn Summit).

The Prime Minister commented that, so far as he could gather from the discussion, the amount contributed by each country to the reserve pool would be 10 or 15 or 20 per cent of its own reserves. The dollar reserves might ultimately be used to finance stocks of raw materials, and this process might start as early as 1981/82. It was envisaged that the management of the Fund would be in skilled hands, either Central Bank Governors or Finance Ministers. The IMF would not be put out of business by this proposal since, e.g., it would retain its role as lender of the last resort for ldc's. The proposal would not guarantee

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growth, but it would at least remove the present confusion which was an obstacle.

The Prime Minister's comment on the proposal was that at first blush it was very interesting and constructive, but it plainly needed a lot of working out and needed to be worked out without publicity. Mr. Jenkins commented that Chancellor Schmidt had evidently completely sold this proposal to President Giscard.

K.R.S.

11. April 78

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## 10 DOWNING STREET

*From the Principal Private Secretary*

11 April 1978

I enclose a copy of the note I have dictated based on my notes of the 1 a.m. debriefing which the Prime Minister gave us in Copenhagen on Saturday morning. On reflection I see no way in which we can usefully turn this into a shortened note. It had better stand as the inchoate thing it is. If there are any additions or amendments which you can suggest, which might have the effect of making it marginally more useful, please feel free to do so.

LW

K.E. Couzens, Esq., C.B.,  
H.M. Treasury.

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