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NOTE OF A MEETING HELD IN THE CABINET ROOM ON THURSDAY 20 APRIL

Present

The Prime Minister
The Chancellor of the Exchequer
The Chancellor of the Duchy of Lancaster
The Governor of the Bank of England
Sir John Hunt
Mr. Ken Couzens
Mr. N. L. Wicks

The Prime Minister said that he had expected that by now President Giscard and Chancellor Schmidt would have provided the papers on their European monetary ideas which they promised at Copenhagen. He himself had said that he would not prepare a paper but he would wish to ask sceptical questions about their papers.

Mr. Couzens, reporting on his discussion that morning with Herr Schulmann, said that Herr Schulmann had not brought with him a [redacted] paper. Schulmann had said that Chancellor Schmidt was still working on his [redacted] paper. The Chancellor apparently did not wish to discuss his ideas in detail at Chequers, though from what Herr Schulmann had said, the discussion on Sunday evening would be crucial for the future of Europe! Everything was still at a high level of generality and enthusiasm, and it was extremely difficult to appreciate what motives were moving the Germans. One was probably their disillusion with United States policy. The Prime Minister interjected that that was at the bottom of their ideas. Continuing, Mr. Couzens said that the Germans also believed that exchange rate movements were purely monetary phenomena, though they denied that they were thinking of the re-introduction of a fixed exchange rate regime. The Governor commented at this point that this was not his understanding.

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The Prime Minister then recalled the history of his discussions with Chancellor Schmidt. The Chancellor had first raised these matters with him on the day of the first French election. He stressed that he had told no-one else, and the Prime Minister had said that he would keep his ideas very close. Nevertheless, the Chancellor had apparently spoken widely. President Giscard had then telephoned to arrange the Copenhagen breakfast. But the Chancellor then talked in some detail about his plans on the Friday night of the Copenhagen Council, so that there was very little else to talk about at the next morning's breakfast. It was clear that President Giscard wanted to return to the Snake some time during the summer and there was no doubt a bit of blackmail afoot to get the United Kingdom to join in as well.

The Prime Minister said that he had told the Chancellor and the President that he was concerned that the Chancellor's ideas would adversely affect our regions and did not chime in with the philosophy of the five-point plan and the need to involve the United States. He was prepared, however, to enter into technical discussions, though he would express public scepticism. Chancellor Schmidt's ideas could no doubt be considered further if the Bonn Summit failed. It was clear that the ideas were founded in the distrust of the United States and his conviction that American growth would soon slow down.

Sir John Hunt then commented that Chancellor Schmidt's ideas had given impetus to the Commission's ideas for monetary integration in Europe. Mr. Couzens said that Chancellor Schmidt and President Giscard probably kept their ideas to a close circle, but they leaked out after the discussion on the Friday night in Copenhagen at which the Commission had been present. The leaks were coming from Brussels. German Ministers were apparently not in the picture.

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The Chancellor of the Exchequer said that the Prime Minister should tell Chancellor Schmidt that he was destabilising opinion by his vague hints. He should give details. Herr Matthofer apparently did not know what was afoot. The Governor said that Herr Emminger knew something.

The Prime Minister said that he would not tackle Chancellor Schmidt in quite the terms suggested by the Chancellor. President Giscard's views were important. He believed that Europe had to organise itself for its own protection. The Chancellor of the Duchy said that the Prime Minister should try to divert Chancellor Schmidt's ideas into constructive channels for our own purposes. The Prime Minister commented that the defence aspect must not be forgotten. Chancellor Schmidt appeared to do this, though President Giscard did not.

The Governor then said that the dollar was much stronger now than it had been for months, partly as a result of a technical device taken by the United States authorities and partly because of their announcement of gold sales. It was possible that there had been a sea change in the market. The Prime Minister said that Chancellor Schmidt would say that there could be no change while the United States were running a substantial trading deficit.

The Chancellor of the Exchequer said that Chancellor Schmidt had mentioned to him on several occasions the possibilities of using the substantial German reserves for some good political purpose, though the German Chancellor had no idea what that was. The Governor said that Chancellor Schmidt appeared to be suggesting that a new Snake should swallow the Snake; there should be greater use of the European Unit of Account and the E.M.C.F. should be used as some form of bank and perhaps intervention instrument. These ideas were not altogether stupid. Mr. Couzens suggested that we could offer to study the wider use of the E.U.A. since this was the ^elast harmful element in the package for our interest. The Prime Minister commented that he would not want to launch such a tiddler with such a fanfare.

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The Chancellor of the Duchy then referred to the Hever Bank concept which might incorporate some of Chancellor Schmidt's ideas. It would be unwise to throw away the willingness of the Europeans to provide the basis for some helpful international financial agency. The Chancellor of the Exchequer said that it was important first to establish proper global arrangements before considering the details of regional mechanisms.

The Chancellor then said that the Prime Minister should, on the Sunday evening, ask Chancellor Schmidt in the politest possible way to be more precise about his ideas; about their function and about the specific mechanism in contributing reserves, their use and so on. If answers were obtained, we should undertake to consider them. He personally could see a situation when it would be in our interest to rejoin the Snake and he would therefore give the Chancellor's ideas sympathetic study. The Prime Minister said that he would start off on this basis.

The Prime Minister then asked about the effect on the British economy of a French re-entry into the Snake. After the Chancellor of the Exchequer had said that he did not expect that they would remain for long in the Snake, Mr. Couzens said that this should not hurt us. The Governor said that it would in part depend on the level of the French franc on re-entry.

The Prime Minister then said that there would be great difficulty to do anything on the lines Chancellor Schmidt had in mind before the General Election unless it was patently in our interest. The Governor then asked whether, if we were persuaded that the Chancellor's ideas had no dangers for the dollar, we would be willing to consider them in the interests of greater monetary stability. The Chancellor of the Exchequer said that this would depend on other factors; for example, German reactions to increase their growth rate.

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The Prime Minister said that he feared that the British economy could be harmed by a too dominant Deutschmark zone. The Governor then asked whether, given the prospects for our exchange rate, we would prefer a floating rate system or a fixed, but adjustable, system. The Chancellor of the Exchequer said that it depended on the rate at which we would enter such a fixed but adjustable system and the rules for adjustment. Under such a system, there were political penalties to pay on a devaluation. The present floating system had permitted a substantial depreciation in the last month without any political disadvantages. The Chancellor of the Duchy said that the terms of the support mechanism were also important. The Chancellor of the Exchequer, agreeing, said that if anything was to come of Chancellor Schmidt's ideas, he hoped that the United Kingdom would be associated with them, because he believed that the skill of our people would get something for the United Kingdom from them. The Prime Minister agreed.

N.L.W.

20 April 1978

c. Master Ser.
Econ. PR. (Seelig/Dollar) Mar 20.
Germany (Schmidt/Winter) Mar 16.

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