

NOTE FOR THE RECORD

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(Sterling Dollar)

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Prime Visit to Washington

MEETING WITH THE PRESIDENT OF THE UNITED STATES IN THE CABINET ROOM  
AT THE WHITE HOUSE ON THURSDAY 23 MARCH AT 1100 HOURS

Present:	President Carter	The Prime Minister
	Vice-President Mondale	Sir John Hunt
	Secretary of State Cyrus Vance	Mr. K.E. Couzens
	Secretary of State Blumenthal	Mr. W.S. Rylie
	Dr. Kingman Brewster	Mr. T.D. McCaffrey
	Ambassador Henry Owen	Mr. T. McNally
	Dr. Brzezinski	Mr. K.R. Stowe
	Mr. Hunter	

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The President began by saying that he had had a private talk with the Prime Minister. He was grateful to him for setting out his ideas. He agreed with the Prime Minister that the international economic situation constituted a serious problem and he also agreed that leading industrial nations should let the world know that they were willing to act in concert collectively in the fields of economic growth, movements of capital, energy, trade and protectionism. He said that the Prime Minister had given the United States Government, in his paper, a very good presentation of the case. He reported that the Prime Minister had said that it would not be possible to persuade the Federal Republic of Germany to go further immediately in stimulating economic growth. Certainly the United States had tried and had not succeeded. They had to recognise that in different countries different considerations applied in these matters.

The President, continuing, said that the Prime Minister in their talk had emphasised the extreme sensitivity of world economies to the dollar and <sup>that</sup> when the dollar fell, countries reacted with consternation. He had told the President that the United States must not regard the problem of the dollar as a <sup>matter simply for a</sup> domestic

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crusade. The Prime Minister emphasised the importance of using the period from March to July to prepare carefully for an economic summit and had stressed that it was important when each major country took significant economic action <sup>during that period, that</sup> it should do so in a collective framework. The President said that he agreed with this approach and that we should inform each other of actions that we were taking, and consult about them. If the United States were taking action on energy and inflation, these would be matters on which such consultation would be appropriate. He agreed with the Prime Minister that there was need for something to be done and he was glad to have this opportunity of speaking frankly about what it should be.

The Prime Minister said that the paper he had sent the President had gone through many drafts, but it was still not a plan. Something certainly needed to be done. Speaking as an old hand, he saw that there were now fewer signposts by which to steer the major economies. Many had been swept away in circumstances which he need not describe. New criteria would be needed against which the industrial nations could judge how to manage their economies. In the longer term new criteria could be evolved but in the short term he saw profound difficulties. That was why he had come to see the President, as the leader of the nation which, by its political power, led the Western world. But economic leadership went along with political leadership and, if, the economic position was strong, then political advance was possible. Since it was clear from the President's response that both the United Kingdom and the United States Governments had the same perception of the problems, he thought the next step was to ask our officials to get to work on solutions within the proposed framework. He was quite clear that there would be no possibility of getting a stimulus for economic growth <sup>simply by asking for it</sup> from the FRG. Herr Schmidt would never do it by intellectual conviction, but he might be persuaded to do it if he saw other countries working together <sup>and</sup> taking action as part of a collective programme. The President and other leaders would be entitled to ask what was the United Kingdom Government proposing to do in that case? He would answer first that we could do more on energy conservation; secondly, that we could help with regard to attitude on protectionism, in particular the CAP and in the MTNs; thirdly, we could help in relation to SDRs; and, finally, we could help to promote growth. We would want to coordinate our measures under

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these heads within a general programme and do it fairly soon. The United Kingdom budget would be presented in ten days' time and he would go back to the Chancellor and ask him to let his United States colleagues know of his proposals in order to see how they fitted in to the general perception and whether they saw any objection. Similarly, he would suggest that the United States Government might show us their energy proposals. It was important that we should all present what we did between now and July as part of a concerted programme, and that each of us should be prepared to do, by way of a contribution to a collective programme, that which we might not otherwise want to do at all. Japan, for example, could do more to redress its balance of payments surplus. The United States would know more about that than the United Kingdom would, but he would have thought that they could do more on aid. He was quite clear that the world wanted action not promises or targets of the kind put forward at the Downing Street Summit which, from that point of view, had been a failure. Inflation still remained the outstanding problem but so too did the total of 16 or 17 million people out of work. It was essential that we reacted to these grave problems by producing a group of proposals for collective action.

Mr. Blumenthal said that he agreed with the Prime Minister that the guidelines had gone. They certainly had in trade. The monetary system had largely gone too: we did not know how to deal with the surpluses that have built up since the oil price rise. The short-term situation was very difficult but the psychology was the important and key factor in the situation - and if it could be shown that we were all acting in concert, this would provide the psychological boost that was needed. Certain fundamentals were clear:-

- (a) the energy situation, on which the United States President was now working very hard and on which he hoped shortly to show the world some progress;
- (b) internal inflation - this was difficult because they were committed to growth and, even though the growth rate had been poor in the first quarter of 1978, the outlook for the rest of the year was good and, over the year as a whole, they would probably achieve

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their growth targets; the problem was how to deal with inflation while maintaining growth; and

- (c) lack of growth in Germany and Japan - Germany could not do more for they were now committed to  $3\frac{1}{2}\%$  growth this year from a position of zero growth the previous year, so a significant improvement was in progress. Even if they took the decision today to achieve more, they would not in fact do it before the Summit. The Japanese were a different case. They had had \$13 billion surplus last year and had committed themselves to a 7% expansion in order to redress this. But it was clear that 7% was not attainable - it might be 5% or at the most 6% and the surplus in 1978 was likely still to be significantly more than the target of \$6 billion, perhaps \$9 billion or \$10 billion.

Mr. Blumenthal continued by saying that the United States Government would make its contribution to a collective programme. They would certainly do their best to limit "disorderly conditions" in the money markets. There had already been massive intervention since October to support the dollar - Japan \$11 billion, Germany \$5 billion and the United States itself \$2 billion since the beginning of the year. The United States Government could not hope to get approval for more and he did not think that persistent intervention was the answer. The Prime Minister commented that intervention was of no use if it did not turn the situation round in the short term. He did not think that Germany would be able to help <sup>the dollar</sup> much more and it was important that we all move together on growth, aid and trade. He asked Mr. Blumenthal what further action they could take to stabilise the dollar and was it not important, from the point of view of e.g. the Saudis, that they should achieve stability soon? Mr. Blumenthal replied that the Saudis were pretty strongly committed to the dollar because they saw the U.S. economy as having underlying strength.

The President said that, at his Press Conference last week, he had said that key factors in the U.S. economy were good. Interest rates had remained stable. The variations in economic growth were being overcome: last year there had been growth of 3% more.

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/This year

This year the gap would be less. He did not expect an increase in the volume of oil imports in 1978. The Prime Minister had put his finger on the key point, which was that a psychological movement was required to generate confidence and we must create a comprehensive programme within which, for example, the United States Government could present their own measures on oil imports and inflation. If such action were taken after consultation and it was known that such consultation had taken place, this would add to the benefits.

The Prime Minister said that we would need to work at this for the Summit. He then reflected that he saw similarities between the position of the dollar now and the pound in the 1960s. He thought that the President and his own colleagues, and perhaps the US Treasury also, would be very angry with him for saying this, but he recalled how Henry Fowler, when Secretary to the Treasury, had helped the United Kingdom Government in its efforts to maintain sterling as a reserve currency because he did not want it to go leaving the dollar alone as the reserve. He thought that in the longer term the United States Government would find that the burden of the dollar as a reserve currency would be too great and it would fail. If it did fail, then the United States Government would be pressed again to undertake massive intervention. He thought they had been wise in this context to reactivate SDRs as a means of payment for the marks used for intervention. These had been stuffed away in a cupboard and were now being brought back. He thought that was right. He recalled that it was Dr. Emminger and he himself who had worked together to create them and he hoped they would now be built up alongside the dollar as a reserve currency. They could not get this accepted at the time they were introduced because it was thought that they would simply create excessive liquidity. If, however, we could each put some of our dollar reserves in SDRs and freeze them, we could develop a new reserve currency without adding to liquidity. If the purpose of a reserve currency was, as it should be, to provide a constant store of value, then its stability was essential and, if that was not forthcoming, it would lose its role.

The President suggested to the Prime Minister that they should pursue the discussion of these difficult monetary questions over lunch.

The discussion continued over lunch in the President's Dining Room. The President invited Mr. Blumenthal to pick up the points which the Prime Minister had made about the problems of stabilising the dollar.

Mr. Blumenthal said that the United States Treasury might take up the theological positions on monetary and reserve currency issues to which the Prime Minister had referred but he wanted to make it clear that he and Tony Solomon did not. They were open-minded on these matters. He saw two distinct aspects: the justification for the existing floating rate system and the possibility of some fixed system to serve as the basis for the future of the dollar as a reserve. He certainly agreed with the Prime Minister that there were great burdens in having a currency which served as a reserve currency and these burdens had come as a rude awakening, especially in relation to an economy like that of the United States of which foreign trade accounted for only a small proportion. On the fixed rate versus the floating rate issue, he would argue that the old fixed rate did not and could not work. The floating rate had been necessary to adapt to changes and this flexibility was still necessary because the changes were still going on. He recognised that the floating rate did not work well enough and in this connection drew attention to the imminent amendment to the IMF Articles which could lead to improved surveillance. As regards invoking the SDR as a new reserve currency, he would think it sensible while the roof was leaking to avoid leading markets to believe that we were going to tinker with the whole structure as well. This would involve too much uncertainty and would add to the difficulties. It was possible that over the long run some move of this kind might be possible but he would want to be very careful about it and think many times over. It was important not to give the impression that one was tinkering with the system while it was under stress.

/The Prime Minister

The Prime Minister said he agreed with what Mr. Blumenthal had said - this was a long-term issue. His own approach had always been that money, like a woman's virtue, was much better when not talked about. He agreed that the issue was one largely of psychology. And he certainly would not think it right to make any early move towards fixed rates: there was not sufficient convergence among the economies of the world and in any case more drastic changes were coming. But he maintained that the problem of dollar instability was still there and that it was in the interests of the United States to solve it.

Mr. Couzens said that the United Kingdom and the United States authorities were in agreement on fundamentals; they had argued on the same lines in several different fora and the UK had used the same arguments in their document in support of the approach which the Prime Minister had outlined. The development of SDRs was one of the elements they could put into their bilateral discussions, as proposed by Mr. Blumenthal, and he thought it was sensible to let these ideas develop in that way. Mr Ryrie commented that Dr. Witteveen would be putting forward proposals about the development of the SDR and Mr. Blumenthal said that these proposals would come up for consideration at the Interim Committee next month.

The Prime Minister said he hoped that the United Kingdom and the United States would continue to work together in this field.

Mr. Blumenthal said that the problem in the lead-up to the Summit was how to get more commitment on growth. It was not so much the particular figures cited as targets which were important as the degree of commitment to them by the other major countries. Dr. Owen said that he agreed that a package approach embodying commitments of that nature was right and thought that it would be possible to get that degree of commitment at Bonn. Sir John Hunt said that there was a link between what was being said about Special Drawing Rights and about commitments to growth: he was sure that we would not get any response from the FRG on growth without something to complement it on monetary

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stability. Dr. Owen commented that the monetary instability was essentially a symptom of underlying fundamental problems relating to energy and inflation and it was necessary to keep the right balance between treating the symptoms and treating the fundamentals.

Mr. Blumenthal then referred to the idea of a multilateral swap which had been raised by the Prime Minister in his letter to the President. There was a real difficulty about this because, first of all, they would not have the backing of Congress for such a development and, secondly, because what the market was interested in was the relationship between the dollar and the deutschemark, not the relationship between the dollar and other currencies. And it was then necessary to consider, as the President would certainly expect him to consider, what were the costs that would be incurred by a commitment to a multilateral SDR swap system.

Mr. Vance asked why the yen did not appear to be significant in Mr. Blumenthal's argument. Mr. Blumenthal replied that the yen was in fact a distinct currency functioning separately, whereas the deutschemark was a key currency in Europe and largely determined the European relationships.

The Prime Minister said that he had only raised the question of a multilateral swap because, during his discussions in Germany, Helmut Schmidt had suggested that this would be desirable and because he thought it right that in making proposals for a programme of collective action, the United Kingdom should indicate that it was willing to put its money where its mouth was. Mr. Couzens commented that we could not press this if the Americans did not want it.

The Prime Minister then asked how the United States proposed to finance its deficit, and he repeated that he would not want the United States Government to attempt to deal with the deficit by deflation. Mr. Blumenthal said that the United States Government was prepared to go further in selling SDRs and in

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using the IMF facility. These were but different ways of borrowing however. They would also probably be taking action on energy and inflation because they thought this would affect the market's perception of the problem. He went on to say that the Saudis would have a very strong interest in what the United States Government did in this matter and if they saw the United States Government itself diversifying out of the dollar then they, too, would leave the dollar very rapidly. Mr. Blumenthal added that there was an important technical aspect to this idea of borrowing in foreign currency to obtain reserves in other denominations for they had found it expensive and unprofitable in the past, e.g. with their experience of Roosa-bonds.

The Prime Minister said that Mr. Blumenthal seemed to be describing all the things he could not do! He agreed that in these matters the focus would have to be on long-term action but the market was essentially a short-term market and the United States Government would have to deal with it. Mr. Blumenthal said that he would put the question back to the Prime Minister. Supposing the United States were acting on energy and inflation and there was an agreement by the seven Summit powers on a commitment to growth, coupled with the new swap loan, the sale of SDRs and perhaps some sale of gold and an IMF drawing, would that stabilise the situation? The Prime Minister said that he thought that would be a formidable combination of measures which should buy security for two or three years. The President said that none of these measures involved difficulty for the United States.

The Prime Minister said that good as Mr. Blumenthal's propositions were they were all if, if, if, and dependent on getting the Germans on board. Sir John Hunt commented that it was important, if a collective programme were to succeed, that from now on all relevant action taken by the Summit powers should be "scored" as fulfilling the programme. And that no action on, for example, energy or inflation should be undertaken in isolation. Mr. Couzens said the same argument applied in relation to the monetary system.

/The danger was

The danger was living hand-to-mouth by dribbling out ad hoc measures. It would certainly help if they could score all relevant actions against an agreed general plan. He fully understood the difficulties for the United States Government of the multilateral swap part of the approach to currency stability, although there were two separate aspects to this: the currency or currencies of contribution and the question whether the swap was financed bilaterally or multilaterally.

The Prime Minister asked how we should now proceed? Dr. Owen said that the Personal Representatives Group meeting in Bonn on 31 March could table the five areas proposed for discussion and work through them. On some of them, e.g. on energy and non-inflationary aspects of growth, we should seek expert help, convene a meeting of Ministers and feed the results into a further meeting. If the other participants supported an approach along these lines, then he thought we should be able to work towards a succession of measures and proposals which, taken together, could be ratified at the Summit. Since the key to all this was the German attitude, he thought the President should write to Helmut Schmidt fairly soon. Sir John Hunt said that he agreed with this approach but it was important to remember that the FRG would go on saying 'no' until the very last minute when Helmut Schmidt could well make a concession because he wanted a successful Summit. It was also important that the strategic objectives should be set out and discussed at the meeting of the European Council in Copenhagen on 7 and 8 April when the Prime Minister would seek, and he believed get, top political encouragement.

The Prime Minister said that Helmut Schmidt, when he had discussed all this with him, had agreed with the analysis but disagreed absolutely with the solutions. His worry was that the FRG would make a small gesture in May which would be no more than a gesture and then say at the Summit that he had done his bit. Mr. Blumenthal said that he thought that paragraphs 4 and 5 of the statement of 13 March issued by himself and Herr Matthoefer was reassuring on this: it had been drafted with these considerations in mind.

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The President summed up the discussion by saying that he had welcomed the meeting because it had clarified so much thinking. The items which Mr. Blumenthal had referred to would all be announced or implemented before the Summit. The United States would itself want to identify these measures as part of a programme of collective action into which each country would contribute and which would, as a whole, support economic recovery. The Prime Minister said that Copenhagen should help to keep things moving. He would himself want to tell Helmut Schmidt how impressed he had been by the United States understanding of the problem. The President said that he would himself write to Helmut Schmidt and would set out the measures which Mr. Blumenthal had described and emphasise their place in a cooperative venture. The Prime Minister said that he would write in a similar vein to Prime Minister Fukuda of Japan.

K.R.S.

23 March 1978