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NOTE OF A MEETING HELD AT 10 DOWNING STREET ON FRIDAY 2 MARCH 1973
AT 10.30 pm

Present:

Prime Minister
Chancellor of the Exchequer
Governor of the Bank of England
Sir Douglas Allen
Mr. D.J. Mitchell
Mr. C.W. McMahon
Sir Burke Trend
Mr. J.J.B. Hunt
Mr. R.T. Armstrong

The Currency Crisis

The Prime Minister began by recounting what had passed at his meeting with the Federal Chancellor in Bonn at 4.00 p.m. that afternoon. He had run through the possible courses available following the large movements of dollars on 1 March and the decision to close markets on Friday 2 March. The course of re-opening and **trying** to stand it out had effectively been precluded by the decision to close the markets. A German national float would present internal political difficulties in Germany, and would be a severe set-back to Franco/German and wider European cooperation. A joint float by part of the Community, leaving others (possibly Britain, France and Italy, to come in later) was unlikely to be acceptable, and ran the risk of being very disruptive. There remained the course of using this crisis as the basis for a major step forward, a joint Community float, with unconditional reserve pooling.

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It had become clear that the Germans wanted a Community solution, and must in any case have a European cover for whatever they decided to do, even if it was a decision that everybody should float separately. Mr. Mitchell had pointed out some of the practical difficulties of a joint Community float, but the Germans had argued that these difficulties could be overcome: the existing intervention arrangements worked very efficiently, though they would not exclude the creation of a European Central Bank. It was also argued that it was difficult to set this all up in the limited time available. The German argument was that, where there was a political will, the way could be found. The Prime Minister had urged that it had to be a genuine reserve pooling; he must not be open to the charge of moving into debt to the Europeans, in order to support a fixed parity. Poehl had argued that a joint Community position would give sterling and the other Community countries strength to beat off speculative movements.

Summing up the political position, the Prime Minister pointed out that the Germans were in a position to bring strong pressure to bear upon the French: if the French were not prepared to cooperate in a joint Community solution, the Germans could float; they would be followed by the Dutch; and that would leave the French alone. As the Germans wanted a Community solution very badly, we were in a position to make them pay the price if we thought the result would be advantageous to us. The Germans had made it clear that they were prepared to pay a very high price for a Community solution for political reasons.

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The Chancellor of the Exchequer said that Herr Schmidt had said, at their previous meetings, that we could count on as much support as we liked, for as long as we liked, without interest. On this basis he thought that we could join a Community float. The markets could stay closed on the existing basis (which was different from that adopted before) for as long as was necessary to agree an arrangement. The Commission's proposals were, however, completely half-baked and unacceptable, including as they did a proposal for blocking all foreign accounts when funds seemed likely to move. If the meeting of Finance Ministers on 4 March started from the Commission's proposals, it would never get anywhere. His view therefore was that he should start by making a very full statement, to the effect that Britain was ready to join a Community float, on the basis of certain conditions. These conditions should at this stage be stated at their maximum. The ball would then be in the court of the rest of the Community. If they were prepared to make a considerable move, we could go in.

The Governor said that a decision to pool reserves and liabilities would be a very big decision. What was proposed would mean a considerable acceleration of other developments in European economic cooperation, which had hitherto been foreseen as being spread over a longer period. As he saw it, if it was simply a question of whether we should join a Community float, the arguments against would, on balance, prevail; but it might be worth making a move, if it could be part of a bigger operation which could deal with

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a lot of other problems, such as the sterling balances, in a European context.

In discussion it was suggested that it would be difficult to achieve the optimum rate profile for us under a joint Community float. Ideally we should be keeping a relatively high rate now, but, in view of the balance of payments forecast, be in a position to come down after some time. There was thus a conflict between the promise of support and the need for flexibility. It might none the less be advantageous to move into a joint Community float at this stage, if the conditions were right and if the Community was prepared to make a public statement accepting responsibility for the sterling balances.

The Prime Minister, summing up the discussion, said that the question for decision was whether the joint Community float was in our interest, and what we wanted to have. If we decided that, given the right conditions, it was in our interest, then we should be in a position to chart the way to drive ahead. One advantage of making the move at this stage would be that the Germans were prepared to pay a price a great deal higher than they might be prepared to pay at some later stage, if other members of the Community had advanced and it was a question of our coming in on our own. The provisional judgment of the meeting was (as Sir Douglas Allen had put it) that the proposals envisaged by the Chancellor would be sufficiently attractive to make it worth our while to join a Community float,

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so long as we were left free to adjust our exchange rate at some future date if we needed to do so. As the Governor had said, the necessary conditions for us would amount to a substantial amount of reserve pooling, plus an acknowledged recognition that the sterling balances were covered. It would be important that whatever support arrangements were made they could be such as to be justifiably described as reserve pooling.

The Prime Minister invited the Chancellor of the Exchequer to work out the draft of his proposed statement for the meeting of Finance Ministers, in the light of the discussion at this meeting. He would arrange for a further meeting, to take a final decision, before the Chancellor left for Brussels.

REA

3 March 1973

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