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NOTE FOR THE RECORD: PRIME MINISTER'S MEETING WITH CHANCELLOR SCHMIDT AT THE BUNDESKANZLEI, BONN, ON SUNDAY, 12 MARCH 1978

The Prime Minister met Chancellor Schmidt at the Bundeskanzlei from 6.30 p.m. on 12 March until 01.00 on 13 March, alone. The Prime Minister gave the following account of their conversation.

Economic Matters

The Chancellor gave the Prime Minister an account of the new U.S./F.R.G. SWAP arrangement. He suggested that the Prime Minister should telephone President Carter on Monday afternoon and that the United Kingdom should participate in the SWAP too.

On economic matters generally, the Chancellor was pessimistic. He did not propose to reflate the German economy, nor to print money, and he did not believe in the so-called "convoy" approach. It was up to the U.S. to promote growth. He expected that he might be forced in the end to take some measures, but was very dismal about the prospect; and said that he might even resign rather than do so. He had no hope of seeing economic growth generated in the world economy, and did not believe that the United States would keep even its own rate of growth up to present levels.

Herr Schmidt described to the Prime Minister the tough line he was taking on the F.R.G. steel industry, whose leaders had approached him for Government help. He had told them there was no more money available and that their capacity of 42(?) million tonnes a year would have to be halved: they would have to go on getting smaller. The same was true of other industries. He did not see how in this context to reduce unemployment; especially when pensioners were already saving 8 per cent of their incomes, and the population generally was saving 14-15 per cent. There was no use pumping more money in in that situation.

/ The Prime Minister

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The Prime Minister said that he talked over with the Chancellor the elements of the UK package and he covered the ground of the various elements seriatim without ever proposing a package as such to the Chancellor. The Chancellor said again that he thought that the United States rate of growth would not be sustained, but the Prime Minister said he did not think it would be cut back. The Prime Minister said that protectionism would inevitably come into being if nothing was done - there was increasing pressure for it. Herr Schmidt reiterated that he did not believe in printing money. There was no continuing growth and he saw no solutions to the problems of German industries.

The Prime Minister gave the Chancellor an account of the U.K. budget strategy, with its reliefs mainly in the form of tax reductions. The Chancellor said that it was not much of a stimulus.

Herr Schmidt expressed his exasperation with the United States Government. President Carter should not surround himself by a group of people who saw economic policy only through United States domestic eyes. The Prime Minister should talk to him about this and encourage him to take a broader view.

The Prime Minister then told the Chancellor of his own view in favour of expanding public expenditure to cover the problems of inner city centres. He would like to see the United Kingdom expanding expenditure on these areas, for it would give work to skilled people without involving imports. He would concentrate it on such city centres as Glasgow and Merseyside. He asked the Chancellor what he thought about this. The Chancellor said that he thought it was absolutely right to do it. The Prime Minister said he could relate it to the benefits of North Sea oil but would this frighten the money markets? The Chancellor said that he would go ahead and do it and explain it to the money markets: these were not transfers or subsidies.

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Anglo-German Summit

The Chancellor said that he would like to come over to dinner on Sunday, 23 April at Chequers and would like the Prime Minister to give a dinner party there. He would like to bring with him Herr Maihofer and Dr. Emminger, together with a reputable financial journalist and a banker. He would like the Prime Minister to invite, e.g., the Governor of the Bank of England and a reputable financial journalist (The Chancellor was much taken by the Financial Times, which he follows closely). The Prime Minister commented that the thought of inviting Gordon Richardson to talk freely in the presence of a journalist struck him as novel! The Prime Minister agreed to give a small informal dinner party somewhat along these lines.

European Community Matters

The Chancellor said that he had wanted the European Council meeting to be of Heads of Government without Foreign Ministers. He had compromised, however, to meet other views; and hoped now that the full meeting would end early, so that they could send the Foreign Ministers off and the Heads of Government meet on their own, as they had done before. He was replying to Anker Joergensen in that sense.

While watching the T.V. news, the Chancellor commented that the reporter was saying that they were discussing fish. The Prime Minister commented that that was splendid, and they had now discussed fish.

Miscellaneous

The Chancellor said that he thought the United States had given too much away to the Russians in SALT 2. He would not follow up SALT 2 with SALT 3. He proposed to speak at the Special Session on Disarmament, before the Prime Minister, probably on the Friday

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before Whitsun. He would then go on to Jamaica for a private visit for one day to see Mr. Manley. He was worried over defence and all aspects of United States policy on defence. The F.R.G. had to speak softly to the Russians because of Berlin. He commented that East Germany and Poland were as bad off economically as the rest of us.

On E.R.W.s, he said that the F.R.G. would not and could not help the United States. They could not bargain over this. His own view was that President Carter would announce the intention to go ahead with E.R.W.s, but that in practice they would not be built. They were as much offensive as defensive weapons in his view, because by destroying enemy tanks they made a path through for one's own tanks.

On Africa, Chancellor Schmidt said that he hoped the United States would be firm with the Ethiopians; he believed they would be, and that they would not allow them to cross the Somalia border.

On the Middle East; Chancellor Schmidt said that he was sorry for President Sadat, and thought that Prime Minister Begin was losing the chance of a lifetime.

On Panama, the Chancellor said he would be sending a message to General Torrijos, because he thought this would help President Carter.

On Luneburg, the Chancellor asked whether the Prime Minister could find something helpful to do.

On URENCO, the Chancellor commented that we might have to break it up. The Prime Minister asked why. The Chancellor said he thought that it was not viable if it failed the first test that it made.

K.K.S

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The Prime Minister told me, when alone, that Chancellor Schmidt had explained to him "an exotic idea" that he was pursuing. The Chancellor had discussed this so far only with Dr. Emminger and Herr Schulmann. The idea was to create another European snake, but of a different kind. He would not be going as far as Roy Jenkins wished to go in terms of E.M.U., but what he would propose was that the F.R.G. and certain other members of the Community should each put half their reserves into a new currency pool, the currencies of which would be fixed against a European Unit of Account. This Unit of Account would be the currency which operated vis-a-vis the dollar, and would be the sole unit of intervention. The pool would be managed by Finance Ministers. Countries in difficulties could borrow from this pool, and repay in one of three periods: over eight weeks; over six to 12 months; or over two years. He would not want this pool to be tied to the dollar because the U.S. economy was too large and uncontrollable: the captain was not in charge, even though he was well meaning.

On this basis, the F.R.G. will put in \$20 billion and the United Kingdom \$10 billion, with the French making a comparable contribution.

If President Giscard won the next round of his elections, he would propose to put this suggestion to him. He had not told Herr Mahofer and he particularly asked that the Prime Minister should not tell the Chancellor of the Exchequer.

The Prime Minister commented that he had no technical understanding on which to form a judgement of this proposal. Chancellor Schmidt said that he could tell the Prime Minister that one effect would certainly be to weaken the German mark. The Prime Minister's final comment to the Chancellor on this was that he would not tell Denis

/ Healey

Healey about it, as the Chancellor had asked him not to, but he would have to get the proposal examined.

The Prime Minister discussed with me the question of technical advice. He decided that he could not properly ask Mr. Lever. He might ask Mr. Couzens of the Treasury to advise him.

KRS.

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