

SECRET

Teletyped to 9
Chequers 11/2

NOTE FOR THE RECORD

As arranged in Paris on Friday evening, the Chancellor spoke to Herr Schmidt, the West German Minister of Finance, by telephone this morning; after an earlier attempt this took place at 10.30 a.m. The Chancellor said that he had already spoken to M. Giscard d'Estaing, to give our reaction before his talk with Mr. Volcker. The Chancellor had seen Mr. Volcker for one and a half hours last night, and had then discussed the whole matter with the Prime Minister. They believed that the right action for this country was to accept the U.S. proposal to take action while other countries stayed put; the reasons for this were:-

- (i) It was the right way to deal with the real problem which mainly concerned two countries, the United States and Japan; he had understood privately from Mr. Volcker that there was reason to believe that the Japanese would take action following moves by others.
- (ii) It would also be in line with our general approach to monetary reform, i.e. - moves to correct imbalances should be symmetrical, so that when the dollar was in difficulties it was for the United States rather than other countries to take action.

/(iii)

SECRET

S E C R E T

- (iii) It would avoid the need for a deutesmark float, on which the Chancellor fully recognised the embarrassment for the West German Government.

The Governor had returned from Basle last night, and had been at the Chancellor's talk with the Prime Minister; after talking with Dr. Emminger, the Governor had concluded that it would not be practicable in a few days to settle all the details of a common EEC float. Herr Schmidt and Herr Brandt had very generously talked in terms of unlimited support for other EEC ^{countries} ~~guarantors~~, without strings. But it was right to say that we had a very large problem of the sterling balances, and any mutual support in reserves would have to cover the financing of liabilities. In a common float now we could not be sure of holding these balances, and many of the large holders would be glad of an opportunity of diversifying into deutesmarks and other European currencies. We also assumed that there would need to be a pooling by all the European partners of all types of reserve assets, including gold.

The Chancellor went on to say that he recognised the great political advantages of Herr Schmidt's proposal, but if the conclusion was reached that it was not practicable in the timescale, he hoped very much that the Community

/would

S E C R E T

S E C R E T

would agree to examine in detail how a joint float with pooling of reserves might be made to work. He was also very impressed by M. Giscard d'Estaing's point that above all they should avoid calling a European conference unless it was almost certain to succeed. If in the next few days they were to attempt to work out a system for joint floating, it would be extremely serious if in the event sterling could not be kept within the limits, following last year's experience, and in our view there was a very real chance that this might happen again.

Herr Schmidt said that he fully understood our position on this. Mr. Volcker's proposal was acceptable to his Government. They had been hesitant earlier to take this line because they were uncertain of the reaction of the French, especially as Mr. Volcker had asked them two or three times to put pressure on the French to accept his solution - he and Herr Brandt had decided that they should not seek to exercise any influence in this direction, but M. Giscard d'Estaing had spoken to him after that morning's word with the Chancellor by telephone, and he now had the feeling that the French might accept the American proposal. This would be a good solution for the world monetary system, though less good from a European point of view. There were two unanswered questions:-

/1. How

S E C R E T

S E C R E T

1. How far the Japanese would float.
2. Whether the Americans would be prepared to devalue by a big enough step to stop the flow of dollars into Germany.

Because of this second uncertainty his Government could not agree to lift all exchange controls until they saw the extent of the U.S. measures and their effect. He and the Chancellor agreed that Mr. Volcker would surely accept this. On the question whether the French would accept the U.S. proposal, Herr Schmidt said that the French had shown themselves more flexible than a few weeks ago in accepting his scheme for a joint EEC float, so that he thought there was a reasonable chance that they would agree.

They agreed that when Mr. Volcker talked of action this weekend, he had it in mind that the US exchange market would be closed tomorrow, Monday, on holiday, so that it would presumably be necessary to close European markets. It was agreed that they could take stock when M. Giscard d'Estaing had had his talk with Mr. Volcker and perhaps consulted President Pompidou. But they agreed that it might be useful to meet in Paris for dinner (as on Friday night) at 8 p.m. this evening. It would be useful to arrange for Mr. Volcker to be available to try to reach a firm agreement, and Herr Schmidt would ask M. Giscard d'Estaing to arrange for this.

/The Chancellor

S E C R E T

S E C R E T

The Chancellor posed the question whether Governors should attend, and Herr Schmidt said that he thought M. Giscard d'Estaing would be inclined against this.

Herr Schmidt said that he would keep in touch with the Italians by assuring Signor Malagodi again that there would be no decision taken without the Italians present.

A.M.B.

11th February 1973

S E C R E T