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FM BONN 281420Z FEB 80

TO PRIORITY FCO

TELEGRAM NUMBER 201 OF 28 FEBRUARY

INFO EC POSTS, WASHINGTON

Read in full

MT

EMS: FRG VIEWS ON BRITISH ENTRY

1. YOU WERE NO DOUBT STRUCK, AS I WAS, BY THE FACT THAT, IN THEIR CONVERSATIONS WITH YOU HERE ON 26 FEBRUARY ABOUT CURRENT PROBLEMS OF THE EUROPEAN COMMUNITY, INCLUDING THE UK BUDGET PROBLEM, GENSCHER AND THE FEDERAL CHANCELLOR SEPARATELY ADVOCATED UK MEMBERSHIP OF THE EMS AS DESIRABLE, BOTH IN ITSELF AND TO IMPROVE THE ATMOSPHERE FOR THE RESOLUTION OF OUR BUDGET PROBLEM. IN SO DOING, THEY BOTH INVALIDATED THE SIGNALS WE HAVE BEEN RECEIVING FROM GERMAN OFFICIALS.
2. GENSCHER MADE THE CASE FOR UK MEMBERSHIP AS A SYMBOL OF POLITICAL SOLIDARITY: HE SUGGESTED THAT WHILE A DECISION TO JOIN IMMEDIATELY WAS NOT PERHAPS NECESSARY, HMG SHOULD GIVE THEIR COMMUNITY PARTNERS THE PERSPECTIVE OF A FIRM INTENTION TO JOIN WITHIN, SAY, 12 - 18 MONTHS. SCHMIDT WAS MORE DIRECT: HE REPEATED THE VIEW HE HAS TAKEN FROM THE BEGINNING: THAT THE EMS IS NECESSARY FOR DEVELOPING THE COMMUNITY AND FOR ESTABLISHING A DISTINCT EUROPEAN IDENTITY IN THE FINANCIAL FIELD. HE Poured SCORN ON THE QUOTE EXPERTS UNQUOTE ON BOTH SIDES. EXPERTS EXISTED, HE SAID, TO ADVISE MINISTERS ON HOW BEST TO DO WHAT MINISTERS HAD DECIDED TO DO, NOT TO TELL THEM THEY COULDN'T DO IT.
3. SCHMIDT WENT ON TO ARGUE THAT IN PRESENT CIRCUMSTANCES THERE WERE STRONG ECONOMIC AND MONETARY ARGUMENTS FOR EMS MEMBERSHIP FROM THE UK POINT OF VIEW. IF WE WERE WORRIED ABOUT THE UPWARD FLOAT OF THE POUND, MEMBERSHIP OF THE EMS WOULD HELP TO KEEP THE POUND DOWN. IF WE WERE WORRIED THAT THE VALUE OF THE POUND AS A PETRO-CURRENCY WAS OUT OF LINE WITH THE REAL ECONOMIC PERFORMANCE OF THE ECONOMY, MEMBERSHIP OF THE EMS WOULD CUSHION ANY CHANGING VIEW THE MARKET MIGHT TAKE: THERE WERE MOREOVER ARRANGEMENTS WITHIN THE EMS TO ALTER THE PARITY WITHOUT DIFFICULTY. IF HMG'S POLICY REMAINED FIRM TO ESTABLISH MONETARY DISCIPLINE AND CONTROL INFLATION, THEN MEMBERSHIP OF THE EMS WOULD HELP NOT HINDER THESE OBJECTIVES. HE DISCUSSED THE VALUE THE BELGIANS ATTACHED TO THE EMS IN REINFORCING MONETARY DISCIPLINE. MEMBERSHIP WOULD REDUCE SPECULATIVE FLOWS INTO AND OUT OF STERLING: GENERALLY, IT WOULD PROMOTE THE STABILITY OF THE POUND AND CONFIDENCE IN IT. HE REJECTED ANY SUGGESTION THAT THERE WERE VALID FINANCIAL ARGUMENTS FOR OUR REMAINING OUTSIDE THE SYSTEM. OUR OPPOSITION WAS POLITICAL: OUR FINANCIAL EXPERTS WERE SIMPLY NOT READY TO ACCEPT ANY DIMINUATION IN THEIR ABSOLUTE CONTROL OVER THE POUND STERLING. HIS MANNER INDICATED THAT HE HAD NO REGARD FOR THIS ARGUMENT AND THAT OUR REFUSAL TO JOIN IN MAKING A SUCCESS OF HIS OWN BRAINCHILD MADE HIM DOUBTFUL OF OUR EUROPEAN CREDENTIALS AND KEPT US ON THE SIDELINES OF EVENTS.

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4. SCHMIDT'S REMARKS INDICATE THAT HE HAS CHANGED IN NO WAY HIS APPROACH TO THE EMS AS DESCRIBED IN MY TELEGRAM NO 566 OF 8 OCTOBER, NOR HIS VIEW OF OUR ATTITUDE AS DESCRIBED IN MY LETTER TO YOU OF 20 SEPTEMBER. HE STILL SEES IT PRIMARILY AS A POLITICAL ACT OF EUROPEAN SOLIDARITY THOUGH ONE WITH BENEFICIAL ECONOMIC CONSEQUENCES. HE IS ALSO INCLINED TO SEE BRITAIN'S CONTINUING ABSENCE FROM MEMBERSHIP OF THE EXCHANGE-RATE MECHANISM AS A POLITICAL ACT, EXPLAINED BUT NOT JUSTIFIED BY THE TECHNICAL ARGUMENTS ADDUCED IN SUPPORT OF IT, A POLITICAL ACT MOREOVER WHICH IS UNHELPFUL TO THE EUROPEAN UNITY HE IS TRYING TO BUILD. HE IS NOT PLEADING WITH US TO JOIN THE EMS: THAT IS NOT HIS STYLE: WE CAN TAKE IT OR LEAVE IT. IT IS FOR HMG TO MAKE THEIR OWN DECISION. BUT HE IS POINTING OUT THAT THE DECISION IS AN IMPORTANT INDICATION FOR HIM OF BRITISH INTENTIONS, NOT ONLY TOWARDS HIS AND GISCARD'S FAVOURITE CHILD BUT ALSO TOWARDS THE CONCEPT OF EUROPE WHICH LIES BEHIND IT. IN THIS SENSE HE IS CLEARLY INDICATING A LINK BETWEEN UK SUPPORT FOR HIS MONETARY INITIATIVE TO PROMOTE EUROPEAN SOLIDARITY AND OUR OWN APPEAL TO THAT SOLIDARITY FOR SOLUTION OF OUR SPECIAL BUDGETARY PROBLEM.

5. THE UK ATTITUDE TO EMS MEMBERSHIP IS ALSO VERY IMPORTANT TO SCHMIDT IN RELATION TO THE FRENCH. GISCARD, AS WELL AS SCHMIDT, HAS INVESTED MUCH POLITICAL CAPITAL IN EMS, CLAIMING IT INDEED AS HIS OWN INITIATIVE. SO LONG AS BRITAIN DECLINES TO BECOME A FULL MEMBER, GISCARD AND THE WHOLE FRENCH FINANCIAL ESTABLISHMENT CAN AND WILL ARGUE THAT THIS SHOWS BRITISH LACK OF INTEREST IN THE FRANCO-GERMAN CONCEPT OF EUROPEAN SOLIDARITY AND IS AN ADDITIONAL REASON FOR NOT BENDING OVER BACKWARDS TO SOLVE THE UK BUDGETARY PROBLEM. IF, HOWEVER, THE UK WERE TO DECIDE TO JOIN THE EMS EXCHANGE MECHANISM, THESE ARGUMENTS WOULD APPLY IN REVERSE. SCHMIDT WOULD THEN HAVE A STRONG ARGUMENT IN HIS HAND, FOR DEMOLISHING THE FRENCH ANTI-BRITISH CASE AND PRESSING UPON GISCARD THE GERMAN DESIRE FOR A FAIR SETTLEMENT OF OUR BUDGETARY PROBLEM IN THE LONGER TERM INTERESTS OF THE COMMUNITY ITSELF. SCHMIDT WILL NOT MENTION THIS ASPECT TO YOU: HE CONSIDERS HIS PERSONAL RELATIONS WITH GISCARD AS VERY MUCH A PRIVATE AFFAIR. BUT I HAVE NO DOUBT AT ALL THAT, ON THIS AS ON OTHER MAJOR COMMUNITY ISSUES ON WHICH THE FRENCH ARE BEING DIFFICULT, SCHMIDT IS LOOKING FOR SOLID FACTS AND ARGUMENTS TO DEMONSTRATE THAT FRENCH INTRANSIGENCE IS UNREASONABLE, AND TO MOVE THE FRENCH TO A MORE COOPERATIVE POSITION.

6. I THEREFORE MAINTAIN AND INDEED UNDERLINE IN THE LIGHT OF THIS CONFIRMATION OF GERMAN MINISTERIAL THINKING THE RECOMMENDATION IN MY TELEGRAM NO 566 OF 1979.

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