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MDHIAN 5917

CONFIDENTIAL
FM BONN
TO IMMEDIATE FCO
TELNO 153
OF 081203Z FEBRUARY 90
INFO PRIORITY EC POSTS, MOSCOW, EAST BERLIN, WASHINGTON, TOKYO
INFO PRIORITY UKDEL OECD, BMG BERLIN
INFO SAVING CGS IN FRG

FRAME ECONOMIC

MY TELNO 149: FRG/GDR MONETARY UNION

SUMMARY
1. FEDERAL FINANCE MINISTRY CONFIRM THAT DECISION TO OFFER MONETARY UNION TAKEN AT SHORT NOTICE UNDER PRESSURE OF IMMINENT ECONOMIC COLLAPSE IN THE GDR. CONSIDERABLE UNCERTAINTY ABOUT DETAILS AND ABOUT ECONOMIC CONSEQUENCES.

DETAIL
2. THE FEDERAL FINANCE MINISTRY HAVE CONFIRMED THAT UNTIL EARLIER THIS WEEK THE FEDERAL GOVERNMENT HAD BEEN THINKING IN TERMS OF A PHASED PLAN IN WHICH MONETARY UNION WOULD COME AT THE END OF A PROGRAMME OF REFORM AND IN WHICH THE EAST MARK WOULD HAVE BEEN MADE PARTLY CONVERTIBLE FOR A TRANSITIONAL PERIOD. HOWEVER EVEN MODROW'S TEAM NOW ADMITTED THAT THE GDR ECONOMY WAS ON THE POINT OF COLLAPSE. THE GOVERNMENT HAD FEARED THAT THIS COULD RESULT IN A WAVE OF RESETTLEMENT OF EPIC PROPORTIONS. A POLITICAL SIGNAL HAD BEEN NEEDED TO FORESTALL THIS.

3. OUR INTERLOUCTORS IN THE FINANCE MINISTRY SAY THEY RECOGNISE THAT THE SHORT TERM CONSEQUENCES OF SUDDEN MONETARY UNION COULD BE VERY DIFFICULT IN THE GDR. THERE WOULD BE CONSIDERABLE ROUGH JUSTICE. GDR FIRMS WHICH DID NOT HAVE SUBSTANTIAL BALANCES AVAILABLE TO CONVERT INTO WEST-MARKS OR COULD NOT ''EXPORT'' TO THE FRG WOULD GO TO THE WALL. THERE WOULD BE SIZEABLE UNEMPLOYMENT AND THE FRG WOULD HAVE TO PAY THE UNEMPLOYMENT BENEFIT. IT WOULD ALSO HAVE TO FINANCE THE RATIONALISATION OF REMAINING INDUSTRY THROUGH DIRECT TRANSFERS. NO-ONE YET KNEW WHAT THIS WOULD COST BUT ESTIMATES WERE IN THE REGION OF DM 6-12 BILLION THIS YEAR AND PERHAPS DM 20 BILLION NEXT YEAR.

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4. MUCH DEPENDED ON HOW MUCH TAX COULD BE COLLECTED IN THE GDR AND THIS IN TURN DEPENDED ON A COMPLETE OVERHAUL OF THE TAX LAW

INCLUDING THE INTRODUCTION OF VALUE ADDED TAX. PRICES (OTHER THAN RENTS) WOULD BE ALLOWED TO RISE TO MARKET LEVELS AND WAGES WERE EXPECTED TO RISE SIMILARLY.

5. THE FINANCE MINISTRY DID NOT RECOGNISE GATTERMANN'S OVERALL FIGURE FOR THE NUMBER OF EAST-MARKS IN CIRCULATION (MY TUR). THEY THOUGHT THAT THERE WERE 16 BILLION EAST-MARKS IN CASH AND 150 BILLION IN SAVINGS ACCOUNTS. BUT THEY DID NOT KNOW YET HOW MUCH WAS IN BANK DEPOSITS, PENSION FUNDS, ETC. UNTIL THIS QUESTION WAS CLARIFIED, THEY COULD NOT SET THE RATE FOR THE CONVERSION OF EAST-MARKS TO WEST. THEY ARE CONSIDERING WHETHER IT MIGHT BE NECESSARY TO FREEZE SOME BALANCES AND TO EXCHANGE THEM OVER A LONGER PERIOD.

6. ON EMU WITHIN THE EC, THE FINANCE MINISTRY HAVE AGREED WITH THE AUSWAERTIGES AMT THAT INSTRUCTIONS SHOULD BE SENT TO GERMAN EMBASSIES IN COMMUNITY CAPITALS TO MAKE CLEAR THAT INNER GERMAN MONETARY UNION WILL NOT CHANGE THE FRG'S VIEWS ON THE DIRECTION OF EUROPEAN MONETARY POLICY, THE PLANS FOR AN IGC THIS DECEMBER OR THE EMS. NO-ONE IN THE FINANCE MINISTRY WAS PREPARED TO SPECULATE AT THIS STAGE HOWEVER ABOUT THE EFFECT WHICH MONETARY UNION WITH THE GDR WOULD HAVE ON THE DM EXCHANGE RATE.

7. COMMENT FOLLOWS. PLEASE PROTECT THE SENSITIVE INFORMATION/VIEWS IN PARAGRAPHS 3-5.

MALLABY

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ADDITIONAL 1

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