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Mr Petrie

cc: Mr Fretwell
Mr Jenkins
Miss Bailes

MONETARY ZONE IN EUROPE : TRANSCRIPT OF MR COUZENS' PRESS BRIEFING

1. You may be interested in the attached transcript of Mr Couzens' briefing of the British press on the Franco/German monetary proposals which I have obtained via Mr Gooch in OID.

[Signature]
Thomas
European Integration Dept
(Internal)

13 July 1978

KEN COUZINS PRESS CONFERENCE:

(P ~~CONFIDENTIAL~~)

COUZINS: What I wanted to do primarily, was not to go into the kind of background that the Prime Minister has given already but rather to offer an opportunity to explain some of the technicalities in particular, to give you some help, in case it was any use to you on the so called Franco/German scheme or outline or whatever you like to call it, this single sheet, and briefly to compare it with some of the sort of conditions for endurable that Dennis Healey explained in Luxembourg on 19 June and which were largely reflected in the Finance Council Report of which you've got copies. That's the centre of what I wanted to do, I'm not on aspects of the backstage work of this thing at all, I just wanted to try and give you some guidance through the rather complicated stuff. It seemed to us wrong that nearly all the briefing on this, apart from the enquiries that have been reaching us, should come from German or Community sources. So we ought to let you know what these bits of phrases and paragraphs appear to mean to us, and how far they satisfy UK requirements and how far they don't. As Ministers have already made clear, this little outline, these 5 paragraphs, has got both good and not so good in it. It's got some things which we would entirely agree with, though they may still need working out, other things which are entirely deficient, there are some very real gaps so it's a starting point, as I think the Prime Minister has said, and it's no more at present and I wanted to try and make clear to you in what respects it looks as if it's a useful start and where not. I hope that acceptable helpful. Well, on the assumption that it is helpful there are

number of sentences in this thing which it is difficult to attach any close meaning to. And the first one, in a sense, is one of nerves; when it says in terms of exchange rate management will be at least as strict as the Snake well that sounds like a Snake operation with margins at least as narrow as the Snake or even narrower. But in fact and using some composite currency unit, a European currency unit, like the European unit of account, as a reference point for these currencies that would be quite substantially different and you can see what is meant if that happens by "at least as strict as" because it would be relating currencies to a basket of currencies much as no you see the £ quoted everyday in terms of our effective rate which is a basket of currencies weighted before we do our trade. This might be a different basket but there's a concept of relating currency to a basket hidden somewhere in this - at least as a strong possibility. And so the opening words are a bit, in that respect, mysterious and so one doesn't have to attach too much weight to it. Then the next sentence says that newcomers, as distinct from the present Snake

countries, marked for somewhat wider margins around central rates for a transitional period, at least for a transitional period. So there is contemplated there, at least for a time, and temporary can sometimes last for a long time,

a two tier system. It's not always been clear that everybody was keen on a two tier system. I think we're a bit neutral, we must see what the terms are, but the French at times have seemed very unhappy about the two tier system. So one

one doesn't quite know what their attitude might be to that, but they appeared, since they joined in this document, to have accepted the idea, at least temporarily, of a two tier system with a wider margin for some countries. It doesn't follow we would say a wider margin is always better to live with, it's not as simple as that. You can make judgements about whether it makes any difference, some bankers would say you are no more no less vulnerable, perhaps a bit less, with a narrow margin than a wide one to the kind of speculative attacks that one might fear. So there is a technical question behind that sentence, it's not open and shut. The next one is very important. In principle, interventions will be in the currencies of participating countries. What Europe's used to and what we're used to is that when there is intervention in support of a currency, or any sort of central bank exchange market activity, is intervening normally in dollars, not always, it sometimes happens in other currencies, but that's the common thing because most people's reserves are in dollars and dollars is the world wide resilient currency, and it's the currency of a large part of trade. So people are used to dollars as a means of intervention but the idea here is that interventions ought to be in community currencies. Now this is quite important, the Chancellor said in Luxembourg, the Prime Minister has said, if there is a scheme of this sort it shouldn't be damaging to the dollar or the Yen and, in a sense, that sentence is a recognition of that point. If you're going to be doing more intervention and doing it in dollars you're obviously going to be selling more dollars, which in principle doesn't do the dollar any good. The Americans themselves have on occasions wondered whether Snake interventions oughtn't to be, not in dollars, but in European currency and often they have been, but sometimes they haven't. So the idea that interventions might be in some other currency, including

the Deutchemark, could mean that it's got all sorts of implications about some shift in the composition of reserve currency and that's echoed further down in this note. I'll come to it. The next one explains itself, the non-member countries and so on, the Swedes who are in the Snake formally, the Austrians who are close in, they could come in as the thought, I think, behind that. The European Currency Unit will be at the centre of the system, the same definition as the European Unit of Account, ^{GISCARD} Ecole, calling it an ECU is a nice one for J'Esquard because it sounds like the ancient French and all that jazz, it doesn't matter what you call this. But "will be at the centre of the system", well that's another of these rather high flown sentences which can mean either anything or nothing but until one sort of gets behind it one doesn't know exactly what it means. But the next bit is concrete "used as a means of settlement between EEC monetary authorities." That is, the central banks owing one another money, for example, as a result of intervention activity, they could play in this composite unit. I mean the SDR is a composite unit but this one would be a unit in which obviously, the Deutchemark, would be the heaviest single bit..... so the obvious thing is that you would start to create a new reserve unit but the thought here appears to be that it's confined to central bank transactions, which is the position of the SDR, is not on sale to King Faoud, if it were it would worry the Americans. There's an important point there to be watched in relation to whether the thing is going to do harm to the dollar or not. If it's just a European transactions unit there's no risk of that kind as far as I can see, if, on the other hand, it became a general reserve asset and it was scrambled for in displacement for the dollar then it's not so good from the point of view of possible damage to the existing reserve currency. Well then the next one is

this next paragraph 2. Is the bit on which somebody has built the idea that there's a \$50b fund but first part of it consists really in hanging a new label over existing reserve assets. All the members deposit 20% of their US dollars and 20% by value of the gold - question - what value?, but it doesn't say and Schmidt was questioned on that point in the press conference and did a bit of clever bosint, but I've no doubt at all that the French and Italians, for whom gold is a significant part of their reserves, would like it valued at market value, ~~XX~~ there was a nice one to argue about there. But, at all events, 20% of this lot by value is supposed to be deposited it doesn't actually say where at this point, and in exchange the central banks get composite units called ECU. So the first operation changes the composition of reserves, instead of a lot of dollars you've got the baskets of European currency, one third of which are Deutchemarks and some other proportion is Francs and some of it is sterling and so on. So you've changed the composition of your reserves and that has implications for the exchange risk that you're running on your reserves obviously but it hasn't done anything else, I mean it hasn't created some marvellous new fund or anything of that sort. Up to that point its just hung a new label over something that's there already. We've all got that 25b, it is about 25b, perhaps a shade more according to how you value the dollar, So that's one laugh but the second laugh is dolloars and gold on the one hand and member currencies on the other hand in an amount of a comparable order of magnitude. Now there are worlds of subtlety I think behind these phrases. What this all means is that by saying e g 20% and then saying "we now announce that the comparable order of magnitude for the own currency creation" you give a shrewd hint of quantity and in particular you give a hint of a quantity say the Germans, are prepared to see created against member currencies

, which is really where the sort of bounce

starts to come in as distinct from merely relabelling what you've got already. . Now that's a step in the magnitude of nearly 25 to XXX \$30b, that's where they get their \$50b from, the adding up of those two elements. But, remember the first half of this fund is a relabelling the second half is subject to the next clause which says, "the use of ECU's created against member countries will be subject to conditions varying with the amount and the maturity".

Now that's just IMF stuff, this is where the European IMF concepts start to come in. You don't put down your Sterling or your Francs and get nice ECU's no questions asked.

There is, on the face of these words, so; measure of conditionality. It may be progressive like the IMF, easy first draw, not so easy, hard, that kind of progression, it may be easier if you borrow for 2 years than if you borrow for 5, or something, that's what's implied with amount and maturity. But it's not, it in principle and it's drafted here, it's conditional. So when anybody shouts \$50b one naturally wants to turn them over and look underneath and x there are real possibilities here of extra resources available for intervention on a large scale but it's not sort of sticking out a mile, one has to go and look and see what the conditions are going to be and how onerous that could be. What is also not said here at any point is whether the central fund, or whatever you call it, would itself intervene in the markets or not but it doesn't say so. In fact, one is left to start by xxx assuming that it wouldn't, the general trend of this is that there would be co-ordination, that people would intervene in accordance with an agreed plan or something or against agreed reference points but not that the central 'thing' would do the intervention. So the idea of a of a \$50b again isn't very clear.. What would happen is if you hand over your dollars to the central fund and you take away your ECU's,

which you are going to use as you need them, converting them in francs etc, the dollars you've given up we assume, though they don't actually say, it's one of the many things xxx on which there's only the merest outline, we assume they'd be invested in New York like our reserves, on short term so as to get them quick, so as to earn a bit of interest, that would be the obvious thing. We find it hard to believe that the proposals under the first leg going to use both, that would be just creating \$25b ECU's complete new money. I don't think that's the implication and I understand is that that would not be the intention of the central fund is sterilizing these dollars in New York, locking them away, not having them available for intervention, as a small income, but that's all. And the same, I mean if one is thinking on IMF lines, if you draw ..

.....
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Again all that is the merest outline and raises about twice as many questions as it answers.

QUESTION:

COUZINS: Well I'd suspect, but again one doesn't know - it doesn't say, that a possible basis for a quota, s quotas there are, would be the composition of the ECU. You know a key like that , there are other keys, you know if it's 33% d, 15% f, 15% st, whatever it is those would be your quotas.

QUESTION:

COUZINS: Well that would govern the amount you could brought against national currency. You see we don't know, this is the merest outline and in some areas prompts more questions than it answers..

There's another good sentence after that, "Due account will be given to the need for substantial short term facilities up to one year". That really is a reference to the kind of thing that has hitherto been covered by central bank swaps and there's a hint there that instead of the usual central bank gain of 3 months money which is turned over once or twice you can hold this for a whole year, a slight extension of credit and there is a reference to substantial short term facilities. So that paragraph, with all its mysteries and allusions and twists and everything else, is all we've got to go on at the moment about what, say the Germans who are bound to bear a large part of of the burden of this sort, that is all we've got really at the moment about the credit which might be available under a scheme of this sort. There are good points in relation to our requirements in which an effort obviously has been made to steer away ~~far~~ from damaging the dollar, in one sense to help it by taking some of the reserve currency burden off it, in the second there is recognition that quite a lot of credit will be needed of one kind or or another but it all needs looking at very closely. Then the third one, well the first three sentences all sort of go together and speak for themselves; ordained exchange rate intervention policy, ~~vix~~

I suppose possibly the Swiss franc in some circumstances ~~byxxx~~ but finally it's the dollar.

QUESTION:

COUZENS: That's right,, I mean that's a situation in which, shall we say, the Bundesbank is buying dollars and the Bank of France is selling

QUESTION:

COUZENS: No that sentence I'm sure is only this rather narrow technical point, how dare we be giving two directions among ourselves at the same time, that sort of thing it's good central bank stuff but of no great force of significance. The next one is of some interest, . What that says is that if the Bundesbank, in pursuit of of a co-ordinated intervention policy against the dollar, is buying a lot of dollars then it's entitled to unload a fifth, or say a fifth, onto the the central institution and get back these parcels of European currencies in return. One obvious effect of that is that instead of the Bundesbank buying dollars to and bearing the exchange risk on the loos, it gets , ~~ixx~~ as to one fix, something else including a parcel of its own currency back so that first it ~~xxxxxx~~ spreads the exchange risk round and secondly, there is an argument , I think the Germans are probably conscious of it, that by unloading that in that way they'll reduce the pressure on on their domestic money supply and pass a fifth of it on to somebody else's because somebody else's currency accepts the extent of the EEC What basically happens is that you have to print Deutchesmarks to buy the dollars, up goes the German money supply and to the extent that you unload , somebody else is buying the dollars so they take it on their money supply, that I think is a possible point, I don't know I'm only rather guessing that. What is certainly true is it will reduce, I think that it well be reducing, the exchange rate risk if your view is that the dollar is going on down and European currencies on the average were going down less or going up. So that's presumably what's behind all that.

QUESTION:

COUZENS: Well then, 4 is the 'let's create a European Monetary Fund' paragraph. It's quite an interesting one xxx and it's an idea for which, in this kind of scheme, we would have a certain amount of sympathy. The leading question I have is that it's the French who are interested in casting this thing more in form of a European Monetary fund but having had two goes and failed at the Snake they would quite like, and you've heard J'Essquard say this We're not opposed to that approach, we quite like the mechanism of a European Monetary Fund as distinct from with present credit mechanisms. So one may say that would take the place of the EMCF which is no more than a brass plate Well then there is a statement which I think really has been thrown in to suit us but we'd never word it like that, it recognizes deficit and surplus countries alike have got to be ready to change their policies. At least I hope it recognizes, it just says pursue. There is a thought that there are obligations in respect of policy on both deficit and surplus countries but it could be read, since it's entirely in terms of greater commitment, as meaning we will go on as at present and you can be more We would word it quite differently, we would say that there must, and it was worded correctly, let me read it for what was said in June 19 statement "... the exchange regulations in the Community can only be expected a substantial continued progress towards conferred convergence of economic performance is achieved. Improving the convergence of economic policies along the lines of more adequate economic growth and low inflation" I mean the thought is already differentiated, those who've already got very low inflation and a large

surplus there it's ... because the Germans live with it but an equitable symmetry between the responsibilities of member countries whose performance diverges with objectives, including the balance of payments. Everything possible has been done to reduce that to gobbledy gook with ~~xxxx~~ considerable success but before that was done what it said was what we wanted it to say, which is that you must have convergence from both directions so as to avoid a deflationary bias in the whole thing. I'm not clear whyfore they say 2 years, I don't for the moment see why it has to take that long if you're going to do it. There are 3 sorts of credit in existence, there's the very short term credit that exists in the Snake by which there is a settlement day..... that's all we had back in 1972, last time we were engaged on this. But then in addition in the Community, not in the Snake, there is short term credit but it's limited to and there's medium term credit which is what the Italians have had lots of in recently. And the thought here is you build all this together into a European monetary fund which would both do medium term lending, that's what ECU's means for open currencies with quotas, and would also do very short term loans which is more like central bank swops, which the IMF of course doesn't do. So it's a sort of IMF plus in that respect that seems to underline this. Coming back to that 5, it's got a flavour of our thinking but rather badly spiced. If you glance at the list of June 19 as a check, which reflect a lot of the Chancellor's condition experiments, this document is all machinery.

But this is just the monetary machinery. So if you look at 3, "the systems between all Snake and all other EEC countries etc..... open to other European countries", something very close to that is in this obviously, it's open to other Europeans, it's a transition period and the idea is opposed to making money. The equitable symmetry, well we've just commented on that, C it should not be damaging to third countries", well the key point on that is intervention in European currencies not the dollar, that is a definite effort to avoid anything damaging to the dollar and the Americans are I think, would recognise it as such, very interested,.....

QUESTION:

COUZENS: Well yes, I'm talking strictly in the context of the world as it is and I've no doubt at all there may come a time when the dollar may look stronger. But talking just rather blinkeredly in terms in which the US still has a rather large deficit and Germany in particular still has a surplus and has a strong currency, that's the immediate background and probably the background for at least a year. It could happen the other way round that's true. But at the moment now, in the fourth quarter of this year when one is discussing this scheme and when our Ministers have said we mustn't damage the dollar - one has to look at it against the dollar as it is. I agree with you in theory that could be the case, it could turn round the other way.

QUESTION:

COUZENS: If all other things are equal and the general effect is to hold the average European currencies higher than would otherwise have been the case without this scheme, well put it another way, if the Deutchemark remains more or less unaffected and the other currencies are pulled up a bit towards it, however little of it, then apart from the confidence factor created by the whole scheme, if there is one, that postulates more intervention.

QUESTION:

COUZENS: Yes if it pulled the Deutchemark down as much as it pulled the other s up, yes that is true. And then of course we get back to this matter of whether the whole scheme is deflationary and the Americans will be interested in that, partly for the very reason you've just rehearsed.

QUESTION:

COUZENS: Well it depends on the balance doesn't it.

QUESTION:

COUZENS: I literally did not hear at Bremen during the whole 25 hours I was there any particular figures mentioned except the one I've read in the paper which were the ones you quoted.

HEDLEY-MILLER: But anyone who's pontificated on margins has done more work than I think they have done because another thing you want to think about is you're a rate system or on a unit.....
.... and this is ... intolerably complicated and we certainly haven't come to any conclusions on what margin

QUESTION:

COUZENS: I can't vouch entirely for what's gone on between the French and the Germans obviously but certainly we are not aware of of this stuff having been pushed very significantly further than this document reveals. I mean here and there the document suggests

a bit of pulling back. For example, it isn't specific about relating the currencies to the European unit of account. There is a wool phrase, "will be at the centre of the system", what the hell does that mean? If it implies that, but somebody may be having second thoughts for all I know or that they can't agree on how they define it or something of that sort, that's what it would suggest to a suspicious and elderly Treasury mind.

QUESTION:

COUZENS: I don't think any real progress has been made on any of that.....
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XX

I mean there'd be no need to conceal on a great deal of these technical questions if there wasn't a great deal of dubiety and there is. I mean operating a currency by means of the european unit of account would

Frankly, on their merits, we would quite like to see a basket of currency as a system but it's got to be worked out, in a sense the Government have had some sort of driving light since last July, an effective rate, which is a basket concept. This particular thing in the way in which Mary had described it is different, the weights vary with the values of the currencies so you get yourself into a pretty good mess as we've certainly got.....
So the answer doesn't mean that we reject the concept, it means a lot more work has got to be done, you may have to create some other unit in which the weight stays the same, it's not a big point. There's nothing political about it, there's no need to hide it. It remains to be worked out and will have to be worked out during the autumn.

QUESTION:

COUZENS: If you must offer the choice between those two it's nearer the second than the first. It says in terms you see "immediate settlement between the EEC monetary authorities the ECU, it is in that respect it sounds much more like the SDR which isn't a thing which King is going to buy I think Schmidt has talked about a reserve asset of wider availability as a kind of long term thing and one sees why, made available as a wider asset it could be ⁺contrary to our view that this thing shouldn't damage the dollar and anyway that wouldn't do the Germans any good would it because that's the last thing, they want to put the mark up because that's what damaging the dollar means. So the proposal as far as I can see is a limited one, that this is a thing held by central banks and used in transactions between - period - nothing else.

QUESTION:

COUZENS: No, this is a Franco German proposal as suddenly layed on the table in Bremen.

QUESTION:

COUZENS: It's the view of the Government that it could be inflationary. If it were seen simply as a scheme for imposing greater discipline on deficit countries or weaker countries with no change of policy by circumstances, then the implication is that the overall effect would be deflationary. In a sense you're a bit near creating a voluntary Deutchemark zone, if on the other hand the idea is essential a 'communo-terre' argument in which we're all going to acquire more influence on each other's economic policy then that needn't happen at all. There is no doubt that anybody who is going to be a debtor is going to have plenty of influence applied to his policy, you don't need to provide extensive rules to achieve that result, we've had plenty experience of that situation.....

The thing is whether there's going to be any balance the other way. In a sense I think the word symmetry is a bit imperfect for describing what one hopes for and expects there because you don't necessarily expect 100% balance in these things, it can't be but what you are after is some acknowledgement, and I think there is some from the German side, that they've got to move in your direction as well as you in theirs.... it could apply to other countries as well as us, speaking in general terms, and let's hope it won't but at any rate it's the idea of a balance This is an attempt to achieve something in which there is a balance, it's not just a Deutchemark zone.

QUESTION:

COUZENS: then people talked about those mechanisms, we've talked about them in the past, and one of the questions is is it possible to devise any of those which can be proved acceptable and invention could be one for all I know.

QUESTION:

COUZENS: If I could take the question in two parts. The first object would be stop them bouncing up and down but if it were possible so to construct it that it helped to achieve the coverage of people on their ^{economic} performance then it would have the kind of term and effect you describe. Even preventing the bounce has a value, there is no doubt that the bounces we've gone through since March 76 , 202, October 150, then up again one point or something and all that, has cost us in terms of growthIt has been one of the things which has forced us to do a lot of changes in policy. So if you were able to reduce that there would be a gain for everybody, the Government thinks that.

But there's a second stage of course, if this did prove to be an instrument of of policy the gaps would marry. The problem with the world is precisely that all the gaps are too wide, gaps in performance, etc, etc, so if this thing did help in a small way, one thing I think we're clear upon is that this is not the greatest thing since sliced bread. and you can have disciplines inside a thing like this or outside, you don't have to have this but you may get extra value out of this if it can be constructed right. That's the best point I'd have thought.

QUESTION:

COUZENS: There are some good points in it like; the recognition that it mustn't damage the dollar, like a clear ~~ex~~ recognition that there needs to be a lot of credit though not, the idea of a European monetary fund, that corresponds with our point of view, it's not a bad idea, we don't mind this idea of a sort of composite currency unit as an instrument between central banks, we don't mind the thought of taking some of the weight off the dollar as a reserve asset - not because we want to manage the dollar but for exactly the opposite reason, and there's some recognition that both sides have got to move closer together even if the ~~ex~~ words are all wrong, so there are a number of good things; there are a few which look a bit shifty and there are some large gaps so all we can do is work at it. There are 4 or 5 points which are in there and some which aren't and others which are all a muddle

I think in France as in the UK there are differences of opinion with J'Esquard and some others. You will have to ask them I think on this, I'm no no profound interpreter on the French point of view. But I think one of their main things is plenty of credit.

Don't think that we were alone in Bremen, please don't misinterpret the German information service. You must start with the proposition that the German government has important national interests in securing this thing, they would not have proposed it otherwise. Nobody is more concerned about the competitiveness of the mark than the Germans and everything they've said and done in the last year reveals that. They've been petrified about it. So they have an interest in this thing and this interest has been fairly steadily pursued. A point for example is that they were trying to suggest that there were differences in views between British Ministers and even between British civil servants and ministers. It's not true, you're in the business of looking behind the, you want to look behind theirs. Much they say is absolutely right but remember they are pursuing, as one expects any country to do, their national interest. That's one of the reasons why we owed it to you to explain the British point of view on this thing.

We have to be realistic and realise that one German motivation is this mark business and we are only saying it won't do if that is the basis on which the thing is constructed.. It's got to be a balance. XX Now we are prepared to work very hard to find ways of achieving that balance and we don't rule out that one can achieve some of that. There are various routes by which some greater guarantee of convergence can be achieved. The Government's opinion is that there is a chance of something useful for the UK national interest in it and we shall pursue it on that basis. We are not alone, the Irish, Italians and a lot of French feel the same, and in the long run it's in the Germans own interest.