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Second Permanent Secretary
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6 April 1978

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Dear Nigel

CHANCELLOR SCHMIDT, THE SNAKE AND POOLING RESERVES

I attach a copy of a paper and enclosures by way of briefing for the Prime Minister. In the time available it has been possible to agree it only in general terms with the Bank.

I am copying this letter and enclosures to the Governor, to Sir John Hunt and to Kit McMahon.

Yours ever

Ke.

K E Couzens

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CHANCELLOR SCHMIDT'S PROPOSAL : RESERVE POOLING
AND THE SNAKE

1. As the Prime Minister knows this note and its enclosures have been prepared in some haste in the Treasury and the Bank with the most limited consultation. We hope however that it will be sufficient for the Prime Minister's discussion with Chancellor Schmidt and President Giscard. The Prime Minister may think that the main objective of the discussion should be to get Chancellor Schmidt to explain in more detail what he has in mind; and to say why he is making the proposal and what he sees as the implications of it. If the matter is to be pursued we assume that it would have to be referred to some small group for examination and that Finance Ministers would have to be brought into it. But any such examination would have to be strictly confidential if it were not to affect currency markets.

The Proposal

2. We know that Chancellor Schmidt has suggested a pooling of part of each country's reserves. As far as we can see, that could only make sense if linked with an agreement to use the pooled reserves for market intervention to influence currency relationships. It may be that Chancellor Schmidt despairs of the dollar and wishes to try for greater stability within Europe, regardless of what happens outside. This might have certain attractions for the French if the terms seemed right to them. We would think however that there was not much future in any arrangement which treated the dollar as a lost cause.

3. Chancellor Schmidt's proposal therefore suggests to us that what he wants is some development of the European "snake" or of a "near snake" alongside it. The snake is after all an existing arrangement for a more stable relationship between European currencies than free floating might produce and in particular it relates certain currencies to the Deutschemark. The Bonn correspondent of the "Times" reported on 4 April:

"It has been suggested in Bonn that Herr Schmidt may have suggested a strengthening of the European joint currency float as one method of protecting Europe from the effects of the dollar's decline on foreign exchange markets."

4. Sir Oliver Wright's telegram 238 of 4 April also suggested that the Germans were preoccupied with the possibility of re-vitalising the snake. But he also reported that the Chancellor's Office "discouraged any idea that a reinforced snake was more than brain storming at this stage" and said "they do not change their view that economic and monetary cooperation should proceed hand in hand". A copy of that telegram is attached.

5. The essence of the idea would then seem to be that the Mark, the Franc and sterling should be kept in some predetermined relationship with one another, no doubt within a band or "tunnel". They might fluctuate as a group in relation to the dollar or the yen but their fluctuation in relation to one another would be limited. The pooled reserves would be an instrument to this end.

Nature and History of the Snake

6. A note by the Bank about the history and operation of the snake with a brief comment on the implications of UK linkage with it is attached.

A Variant

7. Also attached is a short note by the Bank about a different scheme which would not involve pooling of foreign currency reserves but would consist of an understanding to use domestic currencies (Marks, Francs, Sterling) up to certain limits for intervention policies. The objective of keeping three currencies in a certain relationship to one another would be the same but this variant would not involve sales of dollars. It would however add to the money supply of the countries concerned when their currency was used for intervention.

