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RECORD OF A CONVERSATION BETWEEN THE PRIME MINISTER AND THE
PRESIDENT OF THE FRENCH REPUBLIC IN THE ELYSÉE PALACE, PARIS
AT 10.00 A.M. ON THURSDAY 20 MAY 1971

Present

The Prime Minister

President Pompidou

Mr. A.M. Palliser

Prince Andronikof

INTRODUCTION

President Pompidou expressed his pleasure at welcoming the Prime Minister. It was no exaggeration to describe their meeting as of great importance for their two countries and for Europe. He himself greatly hoped that they would reach a satisfactory conclusion and that, as a result, they could subsequently work closely together. The President saw this not as a question of creating a new entente cordiale. That had been directed against someone. Clearly France and Britain must have a cordial understanding but their purpose now was to co-operate with others in a common task. If the two of them could reach a genuine and sincere understanding all hopes would be permissible. Speaking frankly, and without wishing to appear to place the onus on the Prime Minister, the President felt he could honestly say that what was involved was a historic change in the attitude of Britain from the outset. If Britain was really decided to make this change France, in his person, would greatly welcome it.

The Prime Minister thanked President Pompidou for his own welcome and for the warmth of his reception the previous evening by the French Prime Minister at Orly.

Their meeting resulted from President Pompidou's own initiative at The Hague Conference in December 1969, which had opened the way to the enlargement of the Community. When they had last met in November 1970, they had undertaken to have a

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subsequent discussion in order to examine in depth the whole position concerning enlargement. For the Prime Minister this was an occasion not only of historical importance but of particular personal importance. Throughout the 20 years of his political life, following on his war time period in Europe, he had worked for the concept of a wider Europe as President Pompidou had proposed at The Hague. It was therefore of great personal satisfaction for him to be meeting the President on this occasion.

The Prime Minister said that he wished to comment on one point. It was true that Britain's desire to become a permanent member of an enlarged European Community was a decision of major importance. But throughout his own student days and during the 30's the British had always regarded themselves as European. Of course, they had had Imperial connections as indeed had France. He recalled visiting the great Colonial Exhibition in Paris before the war at which the might and power of France had been so singularly displayed. Historically, Britain had always been part of Europe. It was only during the past 25 years that it had come to seem as if our natural connection might be with the United States. But we were in fact still part of Europe; and his Government were giving evidence of this in the extent to which they were orientating their policies so as to bring them into line with the European Community.

ANNOTATED AGENDA

President Pompidou proposed that they should turn to the ... Agenda in the Paper (copy attached) that had been prepared previously by Officials. He invited the Prime Minister to open on the "first and widest ranging" point, since this had been included at British suggestion.

The Prime Minister said that the countries of Europe represented the most important civilization in the world and the one with the most world influence. Until thirty years

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previously only Europe had counted. Now they were living in a world of two great Super Powers, the United States of America and the Soviet Union; and before the end of the century China would probably have become the third. Within this world, individual European countries could not hope to exert influence. But through an enlarged Community, which would enable the countries of Europe to work constructively together, this influence could be achieved. This required a strong economic base of comparable size to that of the two great Super Powers. But this could only be achieved within an enlarged European Community and through a wider unity within Europe.

It was sometimes said that Britain only sought partnership with the United States. His frank reply to this was that there could be no satisfactory partnership, even if Britain wanted it, between two powers one of which was barely a quarter the size of the other. In Europe, on the other hand, such a partnership was possible with countries of the same size and within a European Community applying the same rules and working to the same principles. His purpose was to see a strong Europe, which could speak with a single voice after a full discussion in common of the world problems affecting it, and could then exert effective influence in different parts of the world. He regarded this of particular importance in the political field. He did not regard it as healthy that world affairs should be settled between themselves by the two Super Powers. They might consult individually with European countries, but in practice they then settled things as they themselves wished.

The Prime Minister said that he also attached much importance to this policy from the view point of the German commitment to Europe. As Chancellor Brandt had said to him in Bonn, Germany needed to be firmly based in Western Europe if she was to carry out her Ostpolitik.

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In the trade field too, there was a need for a strong European organisation to negotiate the important agreements in respect of international trade that would be required in the coming years.

The Prime Minister said that in time to come it would also be of great importance that Europe should be able to exert more effective influence in the field of defence and to contribute more actively to its own security. The President and he both recognised the importance of the American "nuclear umbrella". But they also realised the weight of the constant pressures that were brought to bear, in the field of European policy, upon successive United States Presidents. These were particularly evident at the present time. President Pompidou had described membership of the Community as similar to marriage; this implied that he regarded it as permanent. This fully accorded with the British Government's view, which was to think in terms of the development of Europe for the long-term future.

The Prime Minister said that Britain had a major part to play in this process. In Monsieur Pompidou's recent interview with the BBC Panorama programme (on 17 May), which had been watched with interest by millions of people in Britain, he had referred kindly to certain British qualities. These were not to be found simply in the fields of industry and technology. Perhaps even more important was the social stability, the parliamentary and diplomatic experience of Britain and the general British outlook towards the world. His hope was that an enlarged European Community could play its part in world affairs generally - relations with the Soviet Union, the Middle East, Asia and Africa. There was no question of enlargement taking place in an atmosphere of hostility to anyone - neither to the United States, nor indeed to the Soviet Union. Their purpose was to stand up for European qualities and traditions.

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The Prime Minister saw the development of the European Community as of great importance also for the developing countries. At the conference on trade and development in Geneva in 1964, the co-operation between the Minister then representing the French Government and himself had exerted great influence on the outcome of the conference. Between the two of them, they had had connections with more of the developing countries than all the other Ministers present. He had often felt that Europe bore the responsibility for the 19th Century divisions within Africa and Asia. Now, in creating an enlarged Community and a wider Europe, they had the opportunity of healing some of those divisions. As these countries came to be associated with the European Community, in accordance with Part Four of the Treaty of Rome, the divisions between them should gradually disappear. He had been struck by the desire of those who lived in former British territories to learn French and to establish closer relations with their French-speaking neighbours; and equally, in talks in both London and New York, he had noticed a comparable feeling amongst the leaders of French-speaking developing countries. The enlarged Community thus provided the natural way for carrying out these responsibilities. He regarded this as of great political importance for the world as a whole.

President Pompidou said that his own thoughts on Europe reflected the same concern as those of the Prime Minister. There was a sense of nostalgia for the role that our countries had played in the past and a conviction that they could not find a worthy place for themselves in Europe except through unity. When they looked at the map and saw Western Europe as a tiny peninsula at the end of the huge land mass that ran from the Oder-Neisse frontier to Vladivostok, they became aware of new divisions and of old ones that had been healed. For example, the Urals no longer represented such a division; the Soviet Union had now

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expanded over two continents. There were North-South divisions, with China in the South, India and the Middle East; and the contemplation of this situation obliged one to conclude that, when such a populous, dynamic and civilised group of people as existed in Western Europe were so tightly confined by geography, their response must be to combine all their efforts. This idea had been at the root of the establishment of the Community and it applied, of course, with equal force to Britain, to Ireland and to others - and, speaking frankly, he would include Spain.

The question then arose how could this be done and what part could Europe play. There was the economic aspect - a European ensemble would be an economic power roughly equivalent to either of the Super Powers; probably weaker than the United States but stronger than the Soviet Union. This ensemble would need to have economic unity and common rules both inside and in its relations with the world outside. There must, for example, be the Common External Tariff. This should not be set too high; but it must exist in order to differentiate between the world outside and the world inside: it was the frontier. The Prime Minister had said that political and economic Europe should not be directed against anyone. This was obviously right. They were allies of the United States and would probably continue to need that alliance for a long time. The French Government and, he believed, the British Government were also convinced of the need for tranquil and assured relations with the Eastern European countries. They realised that the Soviet Union was expansionist in its attitude: if no barriers were set in its path, it would advance like a river in flood. But they also believed that the Soviet Union was concerned with the maintenance of peace and had many internal and external preoccupations, and that, by multiplying contacts and exchanges of all kinds, economic, commercial, cultural and human, real security could be created - if indeed this were ever possible in the world.

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Defence

President Pompidou said that for the moment it was difficult to discuss this. Britain and France had a common defence within the Alliance. But France had adopted a special position, which Mr. Heath would well understand. This resulted from her desire to build a nuclear force solely by her own efforts. Britain had preferred to do with United States help and had no doubt derived substantial advantages from this. But the consequence of this difference in approach was that France, being both one of the three nuclear powers of the Alliance and also the only European country to have created such a force alone, naturally felt free to take a more independent attitude and was able to dispose freely of her own nuclear force, however modest it might be. Thus, speculation about some kind of Anglo-French nuclear entente was not for the present. He agreed that the United States would probably withdraw gradually from Europe. There was much that could be said about this. Naturally it would be ludicrous that the military strength of Europe should be diminished through the departure of the United States forces without some countervailing withdrawals by the Soviet Union. Nevertheless, he believed that if the Soviet Union ever wished to attack Western Europe they could not be held back even by the present forces there. They could only be restrained by the American nuclear umbrella (i.e. massive nuclear intervention by the United States.), the role of which was indeed precisely such deterrence. He did not therefore feel that it mattered greatly whether there were 300,000 or 200,000 U.S. troops in Europe. What mattered was whether the United States felt that their very existence would be threatened by Soviet domination of Europe; he believed they did.

Relations with the United States

Nevertheless, in the process of "making Europe" they were bound to create difficulties with the United States. He believed that he had already told the Prime Minister of a conversation he

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had had with General de Gaulle in 1958, when the latter had said that the difficulty about the Common Market was that it would lead to a quarrel between France and Britain. He would not use such a strong expression about relations between the Community and the United States, but enlargement was bound to create difficulties. One felt this already. The Americans were concerned about the economic strength of Europe and their own balance of payments, even if they preferred not to admit this, and although they would continue to profess support for European unity it must be expected that they would "make a little war" against the Community itself. It was beginning to irritate them as they sensed a potential threat to some of their interests. This must be taken into account.

As regards the Soviet Union, the President believed that, although she did not like the prospect of enlargement she would accept it. Moreover, it was not directed against the Soviet Union and this must be made manifest.

The President had little to add to what the Prime Minister had said about the developing countries, with which he fully agreed. Britain and France had indeed a large part to play in eliminating the divisions of the colonial period and in bringing Africa closer to Europe. They should work together to achieve this - and, in the process, they should try to eliminate the traditions of their two Colonial Offices!

The European Community had a moral role to play in the world and could exercise considerable political weight. Britain - and he said this with no desire to flatter - had much to offer. With France, she was the only European country with a "world vocation". France and Britain were the two oldest nations, with great qualities and certain failings. They were very different because of their past, but there was also a difference between them and all the other European countries which itself resulted from their past history, their wars, their manifold contacts and the interpenetration of their civilisation and culture. If the political and intellectual

prestige and authority of Britain were added to those of Europe, this would greatly enrich the Community.

The President apologised for speaking at some length, but he wished to speak also with absolute frankness. Although Britain, as the Prime Minister had said, had always been in Europe there was a feeling on the continent that her purpose had always been to divide Europe. This was understandable. Britain had tried to prevent any one power from uniting the continent to Britain's own disadvantage. They had done this against France at the time of Napoleon and with her against Charles V and Hitler. Now the task was not to divide but to unite. He approached this task with confident hope.

The Prime Minister welcomed the extent to which he and the President found themselves in such broad agreement in their general approach. He was content to accept the President's view that they should not at this stage have a detailed discussion of defence. But he hoped that, once the Community was enlarged and with the development of a broader political entity in Europe, this subject would be taken further. This process would develop naturally. As the President and he realised, it was essential, especially in the nuclear field, to plan a long way ahead. But he agreed that, for the time being, this was all that could be said.

He wished to comment briefly on the President's last point. He realised that the notion of a British desire to divide Europe had been in the mind of many people in Europe over the past 20 years. He himself had been greatly impressed by the ability of General de Gaulle and Dr. Adenauer to come together and forge a firm friendship between two countries that had been enemies for a century. This had so far formed the basis of the Community; and if this had been possible between France and Germany it must certainly be possible between France and Britain and indeed between Britain and Germany, so as to constitute an enlarged Community. They must recognise that the situation had changed. There was now no threat arising within Western Europe; in the past 25 years the threat

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had come from the East. Thus the historic situation was now different. Britain recognised that the only way to create a united Europe and one with effective influence in the world was by all the member countries working together. He could assure the President that he need have no anxiety about the part that Britain would play within the Community.

Institutions

President Pompidou said that he had expressed certain ideas about the evolution of the Community Institutions. Indeed, their partners sometimes regarded them as "obsessed" with the subject. This was because they believed profoundly in the light of their past history and that of their partners, that there could be no normal progress in Europe without respect for national feelings and vital national interests. This might be more applicable to France than to certain other members of the Community. But Germany had recently regained much of her strength and was coming to adopt a similar attitude. The French were convinced that, if vital interests were at stake, whatever theoretical dispositions might be taken, there must be unanimous agreement on the conclusions reached, i.e. the country concerned must give its assent. This had produced a crisis in the Community, in what had been known as the policy of the "empty chair" and the meeting in Luxembourg. France had made clear the very firm interpretation she placed on the text agreed in Luxembourg and had had it incorporated in the Annotated Agenda in the hope of obtaining the Prime Minister's complete agreement to it. This was not a matter of such legal importance as was sometimes thought. Clearly - and here he could speak only for France - if some unacceptable decision affecting vital French interests were taken, France would not allow it to be imposed upon her. But there was

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no point in deliberately organising a state of permanent crisis within the Community. It was preferable that everyone should know that, if vital interests concerning Britain, Germany or Italy (just as much as France) were at stake, then any decision in the matter must be unanimous. The President realised that this was, in any case, the way things had worked so far; but there were constant efforts by certain countries, especially by some of the smaller ones, to bypass the Luxembourg understanding. France was resolutely determined to stick to that understanding and hoped that Britain would be prepared to do likewise. It seemed to him to conform to the British "genius" and to the Prime Minister's own thinking.

The Prime Minister expressed his complete agreement with the President. During a number of conversations in Paris in September 1960, he had told M. Jean Monnet that people in Britain were concerned at the majority voting provisions in the Treaty of Rome. M. Monnet had replied that, in a Community of old established States such as those in Europe, it would always be impossible for the other member states to overrule any single member which felt its vital national interests to be involved. For this reason M. Monnet considered that, if such an attempt were made, the Community would break up: but since all members were concerned to preserve the Community they would be obliged to recognise that they could not overrule the vital interests of a member. The Prime Minister had always recalled this conversation and had followed the discussions leading up to the Luxembourg understanding with close attention. HMG had expressed their acceptance of the Treaty of Rome, of its regulations, its Institutions and its voting arrangements: but they had always recognised that the protection of vital national interests was part of the facts of life. He felt confident that he and the President could agree on this.

The Prime Minister said that greater practical difficulties could arise in this context with the gradual developing of monetary

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co-ordination within the Community. Time was needed to examine the problems that arose and to work for agreement on them between the member countries. But monetary crises nowadays developed so rapidly that there was no time to examine them properly and to work out a common policy towards them. The recent Deutschmark crisis was an example of this. In that situation, individual countries tended to adopt the solutions that appeared to suit them best and agreement on a Community basis became very difficult. Should they not try to take steps to reach agreement at the right moment to co-ordinate their monetary policies?

Sterling

The Prime Minister said that this brought them to the second main item on their Agenda.

President Pompidou, responding to the Prime Minister's previous comment, said that, in parallel with the Community, various groups of experts and the Council of the Governors of central banks met regularly - indeed, they could perhaps meet more frequently - and, as part of the initial stages of progress towards monetary union, they were supposed to prepare plans for dealing with these contingencies. He felt free to say, since he had said this the previous day to the German Ambassador, that the recent Deutschmark crisis had been artificial. There had, of course, been a basic reason for it, in that tens of billions of dollars were roaming around the world in search of favourable interest rates and at the whim of speculative pressures. But there had been no reason for such an abrupt crisis. In his view, the German Economics and Finance Minister had been essentially preoccupied with the internal economic situation and resolved to take measures against inflation. Although Dr. Schiller was a Socialist, his approach to economic matters was "ultra-liberal" and he accordingly sought to restrain domestic inflation by monetary means. He had, therefore, "organised" the crisis. A series of leaks and rumours had encouraged speculators to expect a Deutschmark revaluation and the consequent

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flood of dollars into Germany had produced the crisis.

This had lessons for them all. First, they must seek to shelter their different currencies from crises of external origin. This meant having a policy and a body of measures to protect all the countries concerned against these sudden inflows of floating capital and the crises they created. They must, therefore, try to conceive a policy of short and medium term support between the European countries, to defend them against their own internal weaknesses and the consequences thereof which had, for example, been so conspicuous in France during the past twenty years. In addition, although this could not be done at once, they must try to discuss this in a crisis-free atmosphere with the United States Government and to take another look at the Bretton Woods Agreements. These no longer had anything but a theoretical value and were being permanently violated. There was no hope of engaging in this dialogue before the Presidential Election in the United States. Nevertheless, he noted that the latest Deutschmark crisis had aroused concern in the United States and given them cause for reflection. He had no solution to the problem: he knew how delighted the Prime Minister would have been if he had. It was not sufficient just to think in terms of a return to the Gold Standard, or of Special Drawing Rights, or of controls over the Euro-dollar market. But Europe and the United States must try to harmonise their policies and Europe must seek - as the French were doing - to persuade the Americans that this was a matter that concerned them just as much as other countries. It was not good enough for them to take the attitude of lofty calm that they had adopted to the recent crisis. Admittedly to wield power on a scale such as that of the United States enabled one to take a calmer view than was possible for weaker countries.

Germany was becoming increasingly conscious of her financial and economic strength and she too would wish to seek a solution. Although he himself had none, he feared that Professor Schiller believed himself to have one and Germany's partners would need to

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be circumspect. France and Britain had a common interest. One could not protect oneself artificially from crises affecting the currencies of one's neighbours. It was in this spirit that he had expressed the wish to speak to the Prime Minister about sterling.

The Prime Minister said that he wholly agreed on the need to discuss the situation with the Americans. There were at present very sudden movements around the world of large masses of liquidity. These had no direct relationship to the internal economic situation of a country or to its internal price levels. Moreover the great international companies were also able to move around large liquid resources. The substantial expansion of world trade could, because of leads and lags, have a considerable impact on a single country with significant effects on the currency in question. He too had no solution to offer.

Monsieur Pompidou said that one should think in terms of solutions, rather than of a single solution. Possible measures to be taken included policies on interest rates, or differing policies for non-resident deposits; and through a broad and cumulative succession of technical procedures it might be possible to produce some form of minimum protection against a crisis. The purpose should be to achieve a situation where exchange rates corresponded to reality and where liquidity could be controlled and made to correspond to the needs of world trade and not simply be responsive to the economic requirements of any particular country.

President Pompidou suggested passing to the problem of the pound as a reserve currency, in the perspective of British membership of the Community. A basic principle of the Community, especially with the prospect of economic and monetary union however distant this might be, was the equality of status of the currencies of the member states. No currency should have advantages, whether technical or juridical, over the others.

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This was not a problem specific to sterling. It would be just as inequitable and as incompatible with monetary union for the Deutschemark to be a reserve currency. On one point at least he agreed with Professor Schiller, namely that no healthy monetary policy could be based on an artificial situation. The present world monetary instability was largely because of the artificial value of the dollar. This reflected the political power of the United States, which was so great that, whatever the pressures of inflation or the deficit in the US balance of payments or other major factors of this kind, the Americans could take the serene view that the dollar must remain untouchable and that everyone else must simply adapt to it. This situation was too artificial to last. It was necessary to discuss it with the Americans. But it was not in the interests of Europe to attack the dollar. A dollar crisis would affect everyone. However, the problem must somehow be resolved before a further major crisis arose which would do great damage to them all.

The pound was in a somewhat similar situation. This resulted from history and they realised its origins. But it had become artificial because it was based on artificial machinery. The sterling balances represented a British indebtedness and thus constituted a permanent pressure on the value of the pound: moreover this situation was kept in existence by agreements which were all related to the dollar. He was referring to the Basle Agreements with a dollar guarantee up to a certain figure, or provision whereby depositors of sterling in London obtained a dollar exchange guarantee in respect of a certain percentage of their holdings.

These pre-occupations were not simply nationalistic French ones. He was making his point in a Community not a bilateral spirit. This was why they firmly desired that Britain should give undertakings, first, to stabilize the official sterling

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balances (i.e. central bank holdings) at their present level (they could not of course expect control to be exercised over private holdings); and then progressively and gradually to run down these balances. Clearly in the common interest, the quicker this could be done the better; but without creating excessive difficulties for Britain. This was no part of their purpose.

The Prime Minister said that, in a speech in Britain in 1967 surveying the development of the Community and the part that Britain might play in it, he had said that before negotiations began for British entry there should be private discussions with the Community, first, on the problem of the British indebtedness that had resulted from the period of Labour Party Government; and, secondly, on sterling. He was accordingly glad to discuss this subject with the President and to do so in private, since these were very delicate matters which could have undesirable repercussions in the exchange markets. The British Government did not regard sterling as an instrument of prestige nor did they feel sentimental about it; nor did they believe that the future of the City of London as a financial centre depended on the sterling area. This was a practical question. The President had been right to refer to the historic origins. Before the Second World War, the sterling balances stood at £500 million and assets at £500 million. After the War, the balances had swollen to nearly £4 billion because the British Government had insisted on paying countries such as Egypt and India for the privilege of defending them. When Egypt and India became independent they had run down their balances. But other more prosperous members of the sterling area, such as Malaysia and Nigeria, had built up theirs. Today the official balances stood at around £2,200 million. The importance of the sterling area had progressively declined. It had represented 28% of world reserves after the War, but only 8% today. This represented a radical change. A further radical change during

the past 5 years had been the decline from 63% in 1967 to 44% today of the proportion of their reserves which sterling area countries held in London.

The Prime Minister said that there were two aspects to the question: indebtedness, and the sterling area. The Government had concentrated since coming into office on repaying the debts incurred after 1964. This had now all been repaid to countries outside the IMF and there was a phased programme for the gradual reduction of indebtedness to the IMF.

As regards the sterling area there had never been any agreement on sterling, nor had anyone sought such an agreement prior to the 1967 devaluation. Then the Government had negotiated the Basle Agreement in order to stabilise the sterling system. He had criticised this decision at the time but recognised that it had probably been necessary. At the beginning of 1971 the Government had begun to renegotiate the Basle Agreement; the outcome of the negotiations for membership of the EEC was then uncertain. If they failed, such renegotiation would be necessary to ensure continued stability; while, if they succeeded, it would provide support for the Community against any rapid movements in the official holdings of sterling balances. When Mr. Wilson had discussed these matters with the Community he had undertaken that any sterling movements unconnected with the balance of payments would be dealt with not under Article 108 of the Rome Treaty, but separately. The Prime Minister had criticised this approach because of the implication that we wished somehow to deal with our problems in separation from the Community.

The British Government would like to discuss with the Community - they had already begun some discussions with officials - the whole question of the future of the remaining sterling balances and the way in which the Community thought they should best be handled. For example, if existing holders of the £2,200m. were

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not to hold sterling, the question was into which alternative currency the Community would prefer the money to be transferred. To transfer it into dollars would tend to precipitate certain problems. Some members of the sterling area were already diversifying their holdings by transfers into Deutschmark. Would this be welcome to the Community; or might a suitable alternative consist in some arrangement with the IMF? For example, there could perhaps be a system of Special Drawing Rights. The UK would service the interest but the units would be held with the IMF. They would wish to discuss these ideas with the Community and to act on a Community basis. It would be necessary to devise a scheme acceptable to official holders of sterling. It must also not impose an intolerable strain on Britain, as a result of a transfer in the obligations from sterling to something else, particularly since this would coincide with the burden resulting from our contributions to the Community Budget.

Summing up, the Prime Minister said that if there were to be an arrangement of this kind, it would require a funding operation. The issue of Special Drawing Rights with the IMF would not represent an increase in liquidity since the sterling liquidity element would be replaced by IMF liquidity, on which the countries concerned could draw. The official sterling balances were not held on a Government-to-Government basis. The balances held by Governments were usually invested in British stocks or other interest-bearing securities. It was difficult for HMG to control the way in which other Governments invested their money. Exchange control had been in operation since 1931 but we could not control such overseas holdings of securities. He welcomed the move resulting from The Hague Conference towards greater co-ordination of currencies and towards a common economic and monetary policy; and he accepted the principle that sterling should come to have a status broadly similar to

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that of the other Community currencies. But this would be a complex and difficult process. Would it not be possible to discuss these problems fully with the Community? The British purpose was to free themselves but not to place burdens on the Community.

President Pompidou said that he recognised that there had been a reduction in the scale of the sterling area and a diminution in sterling area reserves. But since the Basle Agreements, which had been designed to defend the pound, and had in effect given it a dollar guarantee, there had been a fresh increase in the sterling balances of about £800m. i.e. 50% more than before the Basle Agreements. The Prime Minister had said that he did not wish to provoke a monetary crisis or a sterling crisis. But the figures spoke for themselves. The Prime Minister had suggested what would amount to a global settlement, involving the transfer of the sterling balances into an issue of Special Drawing Rights by the IMF. But, even if they thought in terms of such a global solution, there was no need to exaggerate the extent of the problem. At £2,200m. the official holdings of sterling balances represented about \$5 billion. This was roughly the equivalent of the American balance of payments deficit for the first quarter of 1971. Thus, even on a world scale, the figures involved would not be disproportionate to the present difficulties. This would not create a situation of great difficulty for Britain and the Community. What was now required - and the experts of the Six were now proposing this - was that the balances should be stabilised. The Prime Minister had said that foreign Governments could do what they wished. The President did not accept this. Britain had agreements with those Governments which gave them a dollar guarantee. This was valuable to them, but in return, they were obliged to deposit part of their reserves in London. Would it not be possible to substitute for that specified proportion a figure that represented a stabilisation of the balances at their present level? There would no doubt be

other ways of achieving the same object. But the fact of stabilisation need not cause serious trouble to anyone.

As regards the amount of the balances, the Prime Minister had asked where the Community would wish money transferred out of sterling to go. The amounts involved were, as he had said, not particularly alarming since they barely represented the equivalent of one quarter's American balance of payments deficit. A modest reduction of this kind surely presented little problem. A reduction in 1973 of £100m. (or about \$250m.), i.e. about 5% of the total, would really be of no great significance. For each of the last two or three years, since the restoration of the British balance of payments, Britain had invested four or five times more than this abroad. Accordingly, M. Pompidou believed that what the French Government desired - and the Community experts had recommended - would not entail a substantial effort by Britain. But it would amount to a decision in principle to stabilise and gradually to run down the balances. This would not only represent an economic attitude, but it would also demonstrate British determination to change the nature of sterling, on entry into the Community, so that it could progressively acquire the character of a Community currency rather than what it had been previously. For the French this was a very important matter.

The Prime Minister said that, before devaluation, the sterling balances had run down to an exceptionally low level. In the month prior to devaluation they had dropped by £400m. Subsequently they had returned to the level obtaining before devaluation; and they were now slightly higher because certain sterling area countries had achieved good balance of payments surpluses themselves. It would be difficult to negotiate an absolute figure with members of the sterling area because they feared the possibility of a bad balance of payments, in which event the sterling proportion of their reserves would rise too high. This was why the Basle Agreements had made provision for the sterling element to be on

a proportional basis. But the British Government would be willing, if this would help the Community, unilaterally to reduce the minimum sterling proportion. They could not, of course, guarantee that other countries would necessarily come down to that minimum figure. Nevertheless, a measure of this kind would undoubtedly help to stabilise the balances.

The Prime Minister said that he wished to refer very frankly to another aspect of this matter, namely the potential burden on the British balance of payments. He was obliged to consider the total demand on our balance of payments surplus, resulting both from repayment of existing debt and from other requirements, including those that would arise as a result of our membership of the European Community, especially during the transitional period. He was thinking in particular of Community finance and our contribution thereunder to the Community budget. He had to take into account the effect of all this on the balance of payments. If the official holdings of sterling balances were reduced, this too would be a charge on the balance of payments. He was obliged to look at these problems as a whole. He had no desire to see Britain in a position where, even perhaps during the transitional period, she was obliged to seek help from her Community partners because of undue pressure on her balance of payments. There was thus a question of establishing priorities; which was the most important issue having regard to the balance of payments problem?

As regards investment, the Prime Minister said that a considerable part of the amount shown publicly as investment abroad was in fact the reinvestment locally of profits by British firms operating overseas; a further element represented borrowing by British firms in other currencies. Thus only a small part affected the current balance of payments, though in 1969 and 1970 and again in 1971 these amounts would be shown in the balance of payments statistics.

The Government had been obliged to take drastic action at home in order to preserve a balance of payments surplus. He must re-emphasise the importance of taking all these factors into account and their relationship to this surplus. He had felt obliged to draw the President's attention to this aspect of the problem.

President Pompidou said that they would wish to resume their discussion of these matters at a later point. He would like to summarize the position the Prime Minister had described to him in order to ensure that he had correctly understood it. The Prime Minister was not disturbed at the principle of stabilising the sterling balances; and thought that this stabilisation could be arranged by a unilateral British decision to modify the proportion of the balances held in sterling. The Prime Minister's concern derived from the need to take a global view of his balance of payments problem. A reduction of the sterling balances, the repayment of British indebtedness and the payments required under the Community Finance Regulation would all have an impact on the balance of payments. In the last analysis, therefore, the Prime Minister's attitude towards each of these individual points was conditioned by the need to achieve a comprehensive solution. This was the impression he had gained. Was this correct?

The Prime Minister confirmed that it was.

President Pompidou said that the Prime Minister had spoken of the Basle Agreements as now being virtually re-negotiated. But he had expressed British willingness, on joining the Community, to review them in the light of the general situation prevailing at the time. He wished to say that, if the Prime Minister and he could satisfy each other on the sterling problem, France would be ready to take part in the renewed Basle Agreements.

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The Prime Minister thanked President Pompidou for this suggestion. He asked when this French participation could be expected. President Pompidou said that it would be at the moment when the Agreements next fell to be renewed. The Prime Minister repeated his thanks for this constructive offer.

The Prime Minister and the President agreed that nothing would be said to the Press about their discussions before these had been concluded.

The meeting ended at 12.55 p.m.

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