CONCLUSIONS of a Meeting of the Cabinet held at 10 Downing Street, S.W.1, on Monday, 16 August, 1971, at 6 p.m.

Present:

The Right Hon. EDWARD HEATH, M.P., Prime Minister
The Right Hon. SIR ALEC DOUGLAS-HOME, M.P., Secretary of State for Foreign and Commonwealth Affairs
The Right Hon. WILLIAM WHITELAW, M.P., Lord President of the Council
The Right Hon. SIR KEITH JOSEPH, M.P., Secretary of State for Social Services
The Right Hon. ROBERT CARR, M.P., Secretary of State for Employment
The Right Hon. GORDON CAMPBELL, M.P., Secretary of State for Scotland
The Right Hon. PETER THOMAS, Q.C., M.P., Secretary of State for Wales
The Right Hon. JOHN DAVIES, M.P., Secretary of State for Trade and Industry and President of the Board of Trade

The Right Hon. ANTHONY BARBER, M.P., Chancellor of the Exchequer
The Right Hon. LORD CARRINGTON, Secretary of State for Defence
The Right Hon. GEOFFREY RIPPON, Q.C., M.P., Chancellor of the Duchy of Lancaster
The Right Hon. MARGARET THATCHER, M.P., Secretary of State for Education and Science
The Right Hon. PETER WALKER, M.P., Secretary of State for the Environment
The Right Hon. JAMES PRIOR, M.P., Minister of Agriculture, Fisheries and Food

Secretariat:
SIR BURKE TREND
Mr. N. F. CAIRNCROSS
Mr. T. D. O'LEARY
Mr. J. ANSON
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International Monetary Situation

*1. The Prime Minister said that the President of the United States had announced on the previous evening a wide range of new economic measures. In the field of prices and incomes policy, the President had said that he was ordering a freeze on all prices and wages for a period of 90 days. He did not however have power to enforce this measure and had indicated that he was relying on voluntary co-operation to make it work. Second, he was proposing to stimulate the expansion of the economy by substantial tax reductions. These, however, were to be offset by economies in Government expenditure, including a considerable reduction in foreign economic aid. Third, he was imposing a surcharge of 10 per cent on goods imported into the United States, in spite of the fact that the United States Government themselves had still not taken all the action to which they were committed under the Kennedy Round to reduce discrimination against foreign imports under the American Selling Price policy and the Buy American Act. Fourth, he had suspended the convertibility of the dollar into gold and had called for a reform of the international monetary system. If the London exchange market had been allowed to remain open after this announcement, there would have been a large inflow of unwanted dollars. Instructions had therefore been given to close the market; and, in view of the continuing uncertainty, it would remain closed on 17 August. The immediate need was to obtain some further clarification of the intentions of the United States Government, in order that we could decide our broad objectives and the manner in which they could best be achieved. It was unlikely, however, that the London exchange market could remain closed for more than three days or so. This allowed very little time which to examine the complex issues involved; and we should have to consider what course to adopt if a settlement had not been reached before the market needed to be reopened.

The Chancellor of the Exchequer said that Mr. Volcker, the Under-Secretary of the United States Treasury for Monetary Affairs, had arrived in London for a meeting with British, French, German and Italian officials. In a discussion between himself and Mr. Volcker before the Cabinet's meeting, Mr. Volcker had said that President Nixon was not prepared to recommend to Congress an increase in the official dollar price of gold. Mr. Volcker had given the impression that this was a firm position. He had also indicated that, before the import surcharge was removed, the United States Government would want not only to see the establishment of a satisfactory pattern of exchange parities but also to have assurances about the removal of unfair trading practices. He had confirmed, however, that the United States had no complaint against the United Kingdom on this score. In reply to a suggestion that, once the exchange parity problem had been settled, it would be unfair to maintain the surcharge against countries whose trade practices were not disputed he had said that it was theoretically possible that the

* Previously circulated as a Confidential Annex.
surcharge might be lifted against some countries and not others but that no decision had yet been taken on the way in which it would be removed.

In the middle of the holiday season it had been extremely difficult to ascertain the reactions of other European countries. If possible, however, it was hoped to arrange a meeting between ourselves and the French, German and Italian officials after the meeting with Mr. Volcker. At that stage, however, it was unlikely that these officials would be able to express firm views on behalf of their Governments. Meanwhile Mr. Schweitzer, the Managing Director of the International Monetary Fund (IMF), had arranged an immediate meeting of the IMF Executive Board; and it was understood that he would propose that there should be meetings of the IMF Board and of the Ministers of the Group of Ten in Washington in the course of the next few days. From our point of view there would be advantage in a meeting of the Ministers of the Group of Ten; and it would also be desirable first to have discussions at Ministerial level between ourselves and the member countries of the European Economic Communities (EEC). It was in the general interest of the United Kingdom that the benefit which we had gained from the recent changes in other exchange rates should not be removed by a revaluation of sterling in relation to the dollar. Although our present current balance of payments was satisfactory, it was at present benefiting from the fact that the United Kingdom economy was working below capacity. Having regard to the burden which would be placed on our balance of payments in due course by the cost of entry into the EEC, it was not in our interest to adopt any course which would impair the existing surplus; and it was to be hoped that European countries would recognise this.

In discussion it was pointed out that the United States Government appeared to be seeking the necessary adjustment of the dollar exchange parity by means of changes in the parities of other currencies. But, since the German, Dutch and Swiss currencies had recently been adjusted, the United States action seemed to be directed mainly at Japan; and it was unreasonable that a surcharge should be placed on imports from all her trading partners in order to achieve this objective, particularly when, as in our own case, there was no cause for complaint on the score of our trading practices. The United States Government might, however, have other objectives as well, such as an improvement in the terms of their offset agreement with the Federal Republic of Germany. Since it was probably unrealistic to expect agreed parity changes to be effected very quickly, there was a risk of growing confrontation between Europe and the United States; and the scope of the discussion could become extended beyond the international monetary system to other issues, such as the sharing of the European defence burden. In the meantime the trade surcharge would have a serious effect on our exports to the United States, probably reducing them by $400 million or more. This could have undesirable effects on employment in our exporting industries; in particular, the surcharge might call in question once again the continuance of the Rolls-Royce RB 211 engine project.
Even if a satisfactory pattern of exchange parities could be determined fairly soon, Mr. Volcker had indicated that the United States Government would also require assurances on the removal of unfair trade practices; and in any case they would be tempted to maintain the surcharge until after the Presidential Election in 1972. Our action when exchange markets reopened would have to take account of the views of other European countries, which were not yet sufficiently known. It seemed impracticable to enforce a complete embargo on the inflow of dollars without detriment to ordinary commercial transactions. The alternative would be to allow the sterling exchange rate to rise above its present limits, either by widening the existing margins or by allowing the rate to float. There were drawbacks, however, in allowing the rate to rise. The Federal Republic had found already that their export industries were being adversely affected by the appreciation in the value of the Deutschemark. In our case, if the effect of an appreciated exchange rate were added to that of the trade surcharge, the effect on our exports could be very damaging.

In further discussion it was suggested that in the long run the difficulties confronting the United States might only be solved by an increase in the official dollar price of gold. There were several reasons, however, why the United States Government were unwilling to seek Congressional approval of this course. The argument that it would tend to benefit the Soviet Union and South Africa would probably not be conclusive in itself. In addition, however, the United States Government maintained that, if a change were once made in the official price, it would increase the expectation of further changes and thus impair the stability of the international monetary system. The most compelling reason was probably that it would be a serious blow to the political prestige of the United States Government; and, now that President Nixon had stated categorically that he was not prepared to take this step, it was unlikely that it could be brought about, at least in the short term.

The Prime Minister, summing up the discussion, said that the Cabinet agreed that the United Kingdom should support the demand which was expected to come from the Managing Director of the IMF for a meeting of Ministers of the Group of Ten and that we should also seek to have discussions beforehand at Ministerial level with our future partners in the European Communities. He would consider further with the Chancellor of the Exchequer, in the light of Mr. Schweitzer's message when it was received, how best these aims could be secured. On the substantive issues the Chancellor of the Exchequer should be guided by the views which had been expressed in discussion. In particular, he should seek to avoid a change in the parity of sterling with the dollar, on the grounds that any impartial assessment of the relative price levels involved, of the prospects for our balance of payments and of our trading practices in general provided no justification for the setback to our exports which the United States action would otherwise involve. The position to be adopted by the United Kingdom in the further international discussions could only be finally determined, however, in
the light of the outcome of the discussions with other European countries.

The Cabinet—

Took note, with approval, of the summing up of their discussion by the Prime Minister and invited the Chancellor of the Exchequer to be guided accordingly.

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SECRET

Northern Ireland
Previous Reference: CM (71) 43rd
Conclusions, Minute 3

2. The Cabinet considered current developments in Northern Ireland; the conclusions reached were separately recorded and circulated only to The Queen, the Prime Minister and those Ministers who had to take action.

The conclusions are recorded separately in the standard file held by the Secretary of the Cabinet.

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SECRET

Malta
Previous Reference: CM (71) 43rd
Conclusions, Minute 6

3. The Cabinet discussed current developments in relation to Malta.

The Prime Minister reviewed the course of recent exchanges with the Prime Minister of Malta, Mr. Mintoff, and the discussions which had taken place within NATO on the response to be made to his demands. On 13 August the Government of Malta had demanded acceptance by us of their proposals as the basis for detailed negotiations, coupled with an advance unconditional payment of £2 million, both to be conceded by the night of Wednesday, 18 August; if we were to decline, they would regard both the British and NATO arrangements as terminated. Over the weekend we had tried to concert with our allies in NATO a message from the Prime Minister designed to leave open the possibility of further negotiations (for which the Secretary of State for Defence was ready to go to Malta) without conceding the demand for an unconditional cash advance. Although it had been our hope to secure NATO agreement on such a reply before the Maltese Parliament met at midday on 16 August, divergences of opinion within NATO about an unconditional advance of funds had delayed the settlement of an agreed text reflecting the substance of our own views; and agreement had only just been reached.

In discussion Ministers agreed that it was impossible to judge the extent to which the reply might prompt new demands from the Government of Malta. If it were delivered forthwith it might provoke a further message from Mr. Mintoff designed to exploit the divergences of opinion within NATO, particularly as regards the unconditional advance payment, of which he was already aware.

It was agreed that it would be most advantageous if the High Commissioner were not instructed to deliver the agreed reply to
Mr. Mintoff until midday on 17 August. In the meantime it was believed possible that certain other members of the NATO Alliance (the United States and Germany) might take the initiative in providing the Maltese Government with an unconditional advance of funds. Such an initiative need not necessarily affect our own position. For our part, however, we should stand firmly upon our own basic proposal, which had been endorsed by NATO as a whole.

The Cabinet—

(1) Invited the Foreign and Commonwealth Secretary to arrange for instructions to be sent to our High Commissioner in Valletta after midday on 17 August to deliver to Mr. Mintoff the agreed text of the Prime Minister's message.

(2) Invited the Secretary of State for Defence to hold himself in readiness to visit Malta, if Mr. Mintoff responded to the offer for immediate further discussion contained in the Prime Minister's message.

Cabinet Office,
17 August, 1971.