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From the Private Secretary

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ECONOMIC AND MONETARY UNION (EMU)

The Prime Minister had a talk this evening with the Chancellor of the Exchequer about his minute of 24 May and accompanying paper on EMU. Sir Peter Middleton and Mr. Nigel Wicks were also present.

The Chancellor said that his starting-point was a determination not to commit the United Kingdom to a single currency or a European System of Central Banks. His preferred course would be to de-rail the Delors concept for Stage 3 of EMU completely. But after many months of discussion in the Community, he had concluded that this would only lead the other Eleven member states to go ahead and sign a separate Treaty without us. That would be damaging to Britain's interests and deprive us of any significant influence over future developments in the economic and monetary field in Europe. It would leave the field free for the Germans to dominate. Against that background, our tactics should be to win time for wider changes in Europe to affect views on EMU. The fact was that other member states were not looking to achieve full EMU now, but wanted to draw up a Treaty which would allow them to do so at some point in the future. In practice, it could only happen once there had been a much greater degree of economic convergence in the EC than existed at present and that would take a considerable time. Further enlargement of the Community was likely in that period, which would increase the practical difficulties of implementing full EMU.

The Chancellor continued that other European governments had worked themselves into a position where the outcome of the Intergovernmental Conference, starting in December, would almost certainly be Treaty amendment to establish the objective of full EMU with a single currency and a European Central Bank. That risked the isolation of the United Kingdom, which would not be welcome, particularly with the approach of the general election. To avoid such an outcome, we should not object to Treaty amendment establishing the aim of full EMU, but should insist on a provision which left to individual member states the decision whether and when to join. That would accommodate our refusal to

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be committed to moving to full EMU, which he entirely supported. At the same time, we should put forward proposals for a substantial Stage 2 of EMU, which would have the effect of delaying the implementation of Stage 3. He was convinced that our chances of derailing full EMU on the Delors model were better over a period of time than in the short term.

The Prime Minister said that she did not accept the inevitability of a move by other member states to full EMU. It was psychologically wrong to put ourselves in a frame of mind where we accepted that, rather than continuing to attack the whole concept. We frequently started in a minority of one in the Community, but by steady persistence ended by getting our own way (or much of it). The fact was that permanently locked currencies would not work. That had been amply demonstrated by the collapse of the Bretton Woods system. We should take every opportunity to point out the inherent weaknesses and contradictions of Stage 3 of Delors. With the Germans we could argue that it would involve dilution of the fundamental commitment to pursue anti-inflationary policies. We should bring home to the poorer countries that there would be no bailing out: and that without massive transfers of resources, EMU could be unsustainable for their economies. In short, we should do everything to get others round to our point of view, playing also on their fears of German domination. There were signs that some others were becoming more aware of the difficulties.

The Prime Minister continued that there were other reasons why we should not accept the objective of full EMU. It would involve a massive accretion of bureaucracy, at a time when other countries in Europe were moving away from central control. And for some in the European Community, it was a way of getting to a federal Europe by a back door. The Government could not put forward the proposals in the Chancellor's paper without further debate in Parliament, and she did not believe that the House would be ready to agree the objective of Stage 3 of Delors, because of the loss of sovereignty this would incur. She did not regard the opting-in mechanism proposed in the Chancellor's paper as an adequate defence against being drawn into full EMU. The same reasoning which led the Treasury to argue now that we had no alternative but to accept the objective of full EMU, would be employed when the time came to argue that we could not afford to be left out. Accepting the opting-in mechanism now would be tantamount to a commitment to join eventually and she was not prepared to make that commitment.

The Prime Minister continued that we should use the time between now and the IGC in December both to undermine the commitment of other member states to Stage 3 of Delors and to develop a wider vision of the way ahead. We should point out the dangers of establishing tight blocs of countries, which would inevitably become protectionist. We should build on the American proposals for strengthening the political aspects of NATO by suggesting a trade dimension to the Atlantic Community, bringing together the European members of NATO with the free trade area established between the United States and Canada. We should work up alternatives to the Delors proposals, for instance linking currencies to some objective reference standard such as a

commodity index which would operate automatically. We might propose extending such a system also to the dollar and the yen. In short, we should be more crusading in trying to knock out Stage 3 of Delors, and at the same time hold out a wider vision. There were plenty of opportunities for this, at the NATO Summit, at the Economic Summit and at the various European Councils between now and the end of the year. We could demonstrate that our ideas, going beyond a narrow Europe, were much more in tune with wider political developments.

In discussion, it was suggested that tabling new proposals at this stage of discussion would be seen by others as a wrecking tactic. It was unlikely to prevent them from going ahead with plans for EMU. We would do better to concentrate on putting forward ideas for a substantial Stage 2, either the Treasury proposals or the 'Butler' proposals or a combination of them. Even these had little chance of securing support unless we were prepared to accept Treaty amendment setting the ultimate goal of a single currency and a European Central Bank. But there was certainly merit in the idea of establishing an objective reference standard for European currencies. This could be presented as a non-discretionary monetary policy which would be more effective against inflation than a Central Bank which would have political discretion. It would not involve surrendering sovereignty to an institution, but committing ourselves to a mechanism which would function automatically.

The Prime Minister concluded that we should mount a substantial campaign over the next few months to instil doubts in the minds of other European Governments about the implications of full EMU. In parallel, we should argue the case for a much broader approach to economic and monetary cooperation, going beyond Europe, and proposals for this should be worked up in time for the NATO Summit and the Economic Summit. We should also refine proposals for a objective reference standard for European currencies. The Chancellor's proposal for an opting-in mechanism should not be put forward in this period, in which our efforts should concentrate on undermining the Delors concept. But he had discretion to table proposals for a substantial Stage 2 of EMU based on those described in the paper at Annex B to his minute.

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