Let the Ch. X. see this please
I'd welcome a commentary on it
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**Confidential** **National Executive Committee** **GS:6/11/90.**

**Economic and Monetary Union**

The attached position paper on 'The Intergovernmental Conference on Economic and Monetary Union', has been agreed by the Economic Committee of the Shadow Cabinet and the Economic Policy Sub Committee of the Policy Review Groups.

It is recommended that the National Executive Committee notes the content of this position paper, and that it forms the basis of our contribution to the discussions and amendments for the draft text for the forthcoming Conference of Leaders of the Confederation of Socialist Parties of the European Community, to be held in Madrid on 10 December.

Prime Minister [2]

Labour's policy document on EMU, in case you did not see it at the Treasury. It gets interesting from the middle of page 3 onwards. As a policy it is of the "and-with-one-bound-he-was-free" variety.

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**Labour's approach to the Intergovernmental Conference on Economic and Monetary Union and subsequent developments in the European Community.**

Looking to the Future, endorsed by this year's conference, stated:

"Given the effect of the Single Market, and Britain's likely participation in the ERM, closer cooperation on monetary policy between the EC countries is both inevitable and desirable."

Against that background and on the basis of the policy positions adopted by the Party on European Community issues :

1. Labour is committed to ensuring that Britain is actively involved in the process of closer economic and monetary cooperation within the EC. We argued for the entry of the Pound into the ERM. We support the process of the Single Market, and strongly endorse the Community's adoption of the Social Charter. We would therefore negotiate positively with EC partners to achieve further economic and monetary integration in a manner which best serves the long-term interests of Britain and the Community. Labour's policies to strengthen the supply side of British industry are a fundamental and necessary part of making that process a success for Britain.

2. The medium term monetary interests of the Community would be best served by a steady hardening of the ERM, reinforcing the credibility of the mechanism. This would necessarily be accompanied by ever closer monetary coordination. Effective and accountable means must be established for this coordination to be satisfactorily achieved.

It would be quite wrong to abdicate European monetary policy to the Bundesbank whose responsibility is purely national, even though its importance is clearly Community-wide.

The present proposal by the Commission is that responsibility for monetary coordination should be increasingly vested in a System of European Central Banks. However, within the ERM, prior to the establishment of any monetary union, strategic coordination would be far more

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effective if it were the responsibility of the Council of Economic and Finance Ministers (ECOFIN) - a body whose members are directly accountable to national parliaments. ECOFIN should be strengthened and given the task of providing strategic guidance to the process of monetary coordination.

ECOFIN's role in providing such strategic guidance is already growing. It now reports regularly on economic conditions within the Community and monitors economic policy and performance concerning growth, inflation, employment, and regional development. In order to strengthen ECOFIN's capacity, its authority must be further enhanced, it's consultation procedures extended, its secretariat strengthened, and its deliberations must be made more explicit and open to public scrutiny.

3. The process of increased monetary integration does not automatically require the creation of a single currency. However, EC partners have made clear that, beyond the operation of a narrow band ERM, their desire is to move toward full monetary union and the establishment of a single currency. Labour believes that it would not be in the national interest if Britain allowed itself to be excluded from such developments. In a period of critically important negotiations all options for the UK must remain open. There can be no question of accepting "Division Two" status for our country in the Community of the future.

4. Whilst the desirability of progress towards monetary union clearly relates to the intentions of the other members of the EC, it also depends upon an assessment of the costs and benefits such a move may entail. Monetary union could not, of course be imposed upon any of the democracies which make up the European Community. The possibility of monetary union depends upon the judgements made about its acceptability amongst member countries and their legislatures.

Potential benefits of monetary union include the following features :

* Monetary stability would be established definitively on an EC scale, with consequent advantages for investment and improvements on the supply side.

* Currency speculation within the EC would be eliminated. It is difficult to overestimate this benefit. Free movement of capital within the EC (established under the Single Market programme) will place considerable strain on

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the ERM, and could destabilise the weaker currencies. Monetary union would remove this threat and the persistent need for governments to massage "market sensibilities" in the search for monetary stability.

* Member states would collectively acquire a more powerful role in the international economy.

Potential costs of monetary union include:

* The possibility of realignment would be removed by monetary union, reinforcing the need for supply-side success. Without a strong commitment to the supply side regional imbalances would be exacerbated. The disparities in levels of economic development, income, and the severe inhibitions to labour mobility, suggest that there might be greater pressures than those experienced in other existing single currency areas.

* In addition to these major structural differences, the macro-economic performance of member states of the EC remains sharply divergent. In the absence of further progress in economic convergence, too rapid progression toward economic and monetary union would run the risk of failure, with adverse consequences for the Community as a whole.

* Monetary union would mean the transfer to EC monetary authorities most of what monetary powers (including exchange rate management) still remain with national central banks and national monetary authorities. It is clear that democratic accountability would then have to be exercised through EC institutions, notably ECOFIN.

An important question to be faced is - how significant are the powers of the Bank of England and the Treasury at the moment? Even before ERM entry it was clear that monetary "sovereignty" was closely constrained by the relationship between the pound and the Dmark. Now, the only real freedom the UK monetary authorities have to manipulate monetary policy independently of the Bundesbank is defined by the width of the ERM bands and 'market expectations' (which can give freedom to move and take it away).

5. The movement toward monetary union will only be in the interests of the EC if there is a substantial degree of convergence in the economies of the member states at improved levels of performance. For the Right, especially British Conservatives, "convergence" is predominantly (in some cases, solely) a reference to relative inflation rates. Important though inflation rates obviou[illegible] "convergence" must be a much wider concept. indicator of the form of convergence that is nec

in the balanced growth of consumption and production as well as in the control of inflation - is the ability of all member states to sustain adequate rates of growth and employment without incurring unsustainable current account deficits. Such a balance within the Community must be achieved by the application of industrial and regional measures on an EC scale, not by the imposition of deflation on weaker regions. Monetary union in the absence of this degree of convergence would create unbearable strains within the Community, resulting in fragmentation rather than close integration.

It would thus be an error to attempt to establish a rigid timetable for monetary union that takes insufficient account of the realities of divergence in real perfomance. In the interests of the Community and of the individual member countries it is far better to work on the process of convergence with the objective of attaining the conditions of balanced growth appropriate for monetary union. Achieving levels of industrial competitiveness comparable with those of our major EC partners, is of course, the essential and long-established objective of Labour's economic policies. The process of integration and the proposals for monetary union in the EC further strengthen the case for those policies.

6. We do not believe that parallel currency schemes are an acceptable route to monetary union. Schemes such as the "hard-ecu" will create costly complexity, and may have an excessively deflationary bias. Creation of a parallel currency would also negate one of the major potential advantages of monetary union - the elimination of speculative currency markets within the EC.

7. Monetary union would require the establishment of a European Central Bank (ECB) to manage EC monetary policy. Given the predominant role of London as a monetary centre, particularly for dealings outside the EC, the ECB should be located in London.

8. It is obvious that in the case of monetary union the day-to-day management of monetary policy would be the responsibility of the ECB.

It would, however, be quite wrong for the medium term monetary policy of the EC to be established by the ECB. Monetary policy strongly influences all aspects of economic life and therefore cannot and must not be completely detached from democratic decision making. Whilst the objectives of medium term policy should be defined in the statutes of the Bank, the Bank should be

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statutorily accountable to ECOFIN for the attainment of these objectives and for the formulation of medium-term strategy.

If ECOFIN were given the role suggested above in the operation of the narrow-band ERM, it will have acquired strategic experience and institutional substance in the years before the advent of monetary union.

The European Council could, of course, from time to time amend the statues of the Bank, if necessary.

9. The exchange rate strategy of the Community should be the responsibility of ECOFIN. The day-to-day management of the exchange rate with non-EC currencies could be the responsibility of a Central Bank. The EC, operating as a unit, could play a more effective role in attaining and operating exchange rate agreements with the US (together with Canada) and Japan - giving some substance to what was attempted in the Louvre agreement.

10. Monetary policy within a monetary union would naturally require a strong and unified system of financial regulation, to ensure both legal propriety and also consistency of practice between the financial systems of all EC countries.

11. The establishment of a monetary union would not require a uniform economic policy throughout the whole Community. Key economic policy decisions, such as fiscal and budgetary policies, could and must remain the responsibility of member states. The Commission has already conceded there should be no binding rules dictating the fiscal position of member states.

We recognise, of course, that no one country's fiscal stance is completely independent of the fiscal stance of its closest trading partners, and it is all too easy for fiscal interdependence to result in competitive deflation.

Monetary union will therefore require close fiscal cooperation between the member states to safeguard against the deflationary bias of a system in which any member can deflate independently but virtually no country can operate expansionary policies without regard to conditions in the rest of the Community. In the best interests of all member states, effective means would have to be developed for the coordination of fiscal strategies for sustainable expansion throughout the Community.

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12. Even if a substantial degree of economic convergence was attained within the EC, there would still be a danger that the establishment of a single currency would place greater deflationary pressure on the weaker regions - deflationary pressures which would be damaging to the performance of the Community as a whole. It will therefore be essential to establish an enhanced system of regional and structural funds supplementing project transfers with budgetary transfers. It will not be enough simply to increase the size of the regional and structural funds. Regional policy must be used as an effective means of assisting convergence. New principles therefore need to be considered which emulate, at least in part, those which determine the scale and pattern of transfers made in existing national "monetary unions". Labour will be bringing forward specific proposals for the changes needed.

The full assessment of the regional and structural funds planned by the Commission for the end of 1991 will provide an important opportunity to review the instruments and resources available to the Community to promote social cohesion and economic balance of the Single Market as a whole.

13. Closer integration within the Community and progress towards monetary union must not be allowed to prevent "widening" of the Community, whether by the relatively rapid accession of former EFTA countries, or by the later association and accession of the countries of central and eastern Europe.

14. In all circumstances - in the years before formation of any monetary union and within monetary union - strong supply-side policies are absolutely essential. Consistent investment in supply-side strength - in capacity, in infrastructure, in ideas, and, most important of all, in the skills of the people, is a necessary condition for economic success both within Britain and throughout the Community Only Labour has the consistent and practical commitment to employing those policies in Britain.