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cc S Hogg

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Treasury Chambers, Parliament Street, SWIP 3AG
071-270 3000

23 January 1991

~~Prime~~ Minister

Since Ministers have not yet discussed or endorsed the Chancellor's proposals for amending our approach on EMU, this is standard stuff & really just repeats our earlier ~~pap~~ line. It's a bit long & repetitive.

CDP 23/1

Sir Charles Powell KCMG
Private Secretary to
the Prime Minister
10 Downing Street
LONDON
SW1

Dear Charles,

EMU DEBATE, 24 JANUARY

I attach the latest draft of the Chancellor's speech opening the EMU debate tomorrow.

Yours,

Sheila

S M A JAMES

DRAFT: 23.01.91 at 6.00 pm

CHANCELLOR'S SPEECH FOR THE EMU DEBATE, 24 JANUARY

No more important question faces Europe today than EMU. It is a matter of profound economic, political and constitutional importance to Britain.

2. The Government acknowledges that Parliament has a deep and legitimate interest in the issues raised by EMU.

3. That is why we have told our European partners that we cannot accept any changes to the Treaty of Rome which would bind us to move to a single currency or a single monetary policy without a separate decision at the appropriate time by the UK Government and Parliament. That will be a question only <u>future</u> Parliaments can decide.

4. I intend to set out to the House this afternoon the background to EMU and then the Government's position: our proposals for a common currency; our reasons for taking a cautious approach towards EMU and why our proposals are gaining ground in Europe. Finally I shall explain to the House our objections to the Delors prescription for EMU which have been expressed on many occasions in the past by my RHF the Member for Finchley the former Prime Minister [and by my RHF the Prime Minister]: these objections remain unchanged.

[5. The impetus for EMU dates back to the 1960s. The Werner report of 1970 set out a three stage process for greater economic and monetary integration. This ran into the sands ostensibly because of the unfavourable economic environment of the 1970s, but in reality it foundered because the economies of member states were not remotely ready for it. By the 1980s governments had come to agree on the importance of fighting inflation through the tools of monetary policy, and the European Monetary System.]

6. It was the Delors Committee's report two years ago that brought EMU to the forefront of the European debate. The report defined EMU as the irrevocable locking of exchange rate parities leading to the adoption of a single currency, with a single monetary policy and a single European bank. And it set out a three stage process to get there, laying down strict conditions which would first need to be met.

7. We welcome the steps which the report defined as constituting Stage 1 of EMU. Indeed we have led the way in the Community as far as many of them are concerned. They include the completion of the single market and a single financial area; free movement of capital throughout the Community; a strengthened Community competition policy; and ERM membership. They continue the process of economic integration by which the Community in general, and the UK economy in particular, have benefited greatly over the past two decades.

8. But we part company with the Delors Report over its centralising, prescriptive approach to developments beyond Stage 1, especially the proposal that twelve member states, in their current state of economic development, should commit themselves now to move to a single European currency.

9. The Government believes it would be wrong to make such a commitment. The Community is a very long way from being ready for a single currency as I shall explain in due course. It would therefore be foolish to bind ourselves now to a rigid, inflexible structure for monetary union when there are huge uncertainties about what lies ahead of us.

10. We believe the right way forward is to build on our experience of economic and monetary integration to date, and to take the practical steps we can all agree on towards closer integration. As we go further down this road our understanding of the process of EMU will increase and we shall be better able to take decisions about the future. But we should not try to prejudge questions to which we cannot possible know the answers today.

11. Our proposals envisage the creation of a common currency, the hard ecu, rather than moving to a single currency, which we would oppose. A common currency would exist alongside national currencies rather than replace them. And to manage the hard ecu we would set up a new monetary institution, the European Monetary Fund. Both the hard ecu

and the EMF would come into being at the start of Stage 2 of EMU.

12. Initially the Delors proposals for a single currency were the only model for EMU under consideration in the Community. Our proposals have stimulated debate about a common currency. They have attracted a good deal of interest in Europe. Our partners know that our approach to European negotiations is hard-headed and practical, and they recognise we have strong arguments to back up our proposals. So those who do not agree with everything we say are prepared to give our proposals a fair hearing. For instance, M Beregovoy, the French Finance Minister, said:

> "It would be better to increase progressively the credibility of the ecu rather than to bring it in by decree on the first day of Stage 3. I approve entirely of the idea of an ecu whose definition will be strengthened and whose use on the markets will be developed."

The Southern Europeans have also expressed interest in our proposals, with Spain incorporating them in their own plans for Stage 2.

13. The introduction of the hard ecu and the EMF would, in our view, represent the best way to make progress towards EMU. Our objectives would be to provide economic convergence across the Community; to reinforce pressures for price

stability and to allow member states to build up their experience of working together.

14. But we certainly do not exclude the possibility that EMU might develop further. Over time, the hard ecu would promote anti-inflationary convergence among Community countries. The EMF would gain experience in the techniques of monetary management. And as the hard ecu became more widely used, businesses and individuals across Europe would become accustomed to its attractions as a low inflation currency.

15. As a result, and if peoples and governments so chose, the hard ecu could evolve towards a single currency. But that, as we have always said, is a decision not for now but for the future. And a decision which would be debated fully in this House.

16. Some people have criticised our proposals for being sufficiently anti-inflationary. This is nonsense. The EMF was specifically designed to strengthen anti-inflationary pressures. At realignments, the hard ecu would never be devalued against any other currency. The EMF would maintain interest rates at the level that would secure this. It would issue hard ecus only in exchange for Community national currencies, so that anything it added to the Community's total money supply would be exactly matched by what it took out.

17. Our proposals ensure that no national monetary authority could run a lax monetary policy on the assumption that the EMF would always hold any of its currency that no one else wanted. Instead, national monetary authorities would have to repurchase their currencies from the EMF if the Fund's stocks exceeded certain limits. And they would have to use hard ecu or some other hard currency to make that repurchase.

18. The EMF could not itself add to the Community's money supply. It is perfectly true that commercial banks could create hard ECU bank deposits, just as they can create bank deposits in other currencies; but the EMF would be able to use interest rates to exercise exactly the same sort of influence that other monetary authorities do at present over the actions of commercial banks.

19. There are no grounds for claiming that our proposals would blur responsibilities for monetary policy by dividing them between the EMF and national governments. The distinction would be quite clear. Responsibility for the hard ECU would lie solely with the EMF, which would manage it in the light of its legal obligation never to devalue the hard ECU against any other EC currency. Responsibility for decisions about national monetary policy would quite properly continue to be taken at national level. It would be entirely for national monetary authorities to ensure that they ran sufficiently tight policies; and the behaviour of their currencies against the hard ECU would be one additional indicator of whether their policies were tight enough.

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20. Since the UK's proposals for a common currency run by an EMF would strengthen anti-inflationary forces, inflation would tend to converge on the <u>lowest</u> rate in the Community. By contrast, the proposals for a single currency might well lead to convergence not on the lowest on the Community <u>average</u>.

21. Our proposals would work with the market allowing individuals and firms to use a common currency, in the form of the hard ecu, wherever they wished to do so. It would not be forced upon them. Nonetheless experience with the basket ecu suggests that a common European currency could have considerable attractions. The Institute of Directors have said that they believe the introduction of the hard ecu as a common currency

> "would be of immediate benefit to business and individual travellers"

22. As for fiscal policy, the Delors Report envisages binding rules on the budget deficits run by member states. This would mean that the House of Commons would no longer be sovereign on matters of taxation, or public expenditure or both, a position we could not accept. That objection aside, such binding rules are neither necessary nor practical: while excessive budget deficits should certainly be avoided, how that is done and what constitutes an excessive deficit can only be judged case by case. Rules to forbid monetary

financing and bail-outs are needed, and have been agreed. On this key issue, an increasing number of countries agree with us that binding budget rules are not needed. The Danes in particular are clear that it would be unacceptable if decisions by their national Parliament were to be overruled by the Council.

23. I have outlined our proposals and why we believe they represent the best way forward. Now the business of negotiation with our partners in the Community is underway, and I should like to explain to the House how the IGC will be organised and set out the approach we intend to take in discussions and our objectives over the months ahead.

24. The conference has been called to amend the Treaty of Rome in order to allow the later stages of EMU. The agenda is decided by the IGC itself. Ministerial meetings - at which I, or the Financial Secretary in my absence, will represent the UK - will take place monthly, with officials meeting once a fortnight. I attended the opening session of the IGC last month. The next Ministerial meeting will take place in four days' time.

25. The conference will be chaired by the Presidency - which is held by the Luxemburgers in the first half of 1991 and the Dutch in the second half - and the Secretary-General to the Council has been charged with organising the secretariat. During the Conference, there will be meetings with the European Parliament, and regular contacts between the

Chairman, the President of the Commission and the President of the European Parliament. No date has been set for the conclusion of the Conference, but at the European Council in Dublin last April it was agreed that member states should ratify Treaty amendments by the end of 1992. We shall keep the House in touch with the discussion as the conference progresses.

26. The opening session last month was encouraging. Every member state - the UK included - expressed its wish for the IGC to reach an agreement acceptable to all twelve.

27. We were all agreed that the primary objective of EMU should be price stability, in the context of an open market system. There is a significant degree of accord on other issues, such as the need to avoid excessive budget deficits.

28. Of course there remain several issues on which the positions of member states differ substantially. That is not surprising when one considers the complexity of the subject under discussion and our uncertainty about the consequences of EMU. But the gap between us is not unbridgeable. As Finance Ministers get down to the detailed, practical negotiations that are required to make progress, the problems will, I hope, be resolved constructively. Our minds are focused on the practicalities: that is the way we in the UK like to do business. And it is the right way to tackle the important issues ahead of us.

29. Far too much of the debate in the Community so far has focused on the abstractions of a single currency. Peering into a far distant and highly uncertain future is rarely a profitable pursuit. We need to learn from the experience of the next few years before taking final decisions.

30. I am glad to say that the debate in Europe is now shifting towards the immediate practical issues of what we do next and that the UK has been instrumental in influencing that change of direction. The questions we need to ask are: what kind of instruments? What kind of institution? What will promote convergence on the best? To date the UK's are still the only substantive proposals on the table which address these immediate issues.

31. Earlier this month I laid before the House texts for Treaty amendments which showed how our proposals could be framed in Treaty language, and how the EMF would operate. These have been tabled for discussion at the IGC.

32. If we compare our texts with the Commission's, there are clearly some differences and some similarities between the aims and operations of the EMF and the proposed European Central Bank. We differ on the imposition of a single monetary policy and a single currency which the Government cannot accept and have not provided for in our texts. But we agree, for example, on the need for a two-tier structure of Governing and Executive Boards, so we have incorporated

provisions into the EMF which resemble those proposed for the ECB. This makes for more constructive negotiation.

33. Now we are sitting at the negotiating table, we shall be arguing in favour of our proposals but also seeking the views of other member states on specific questions arising from our Treaty texts where we have not yet taken a firm view. For instance, how the EMF might best be made accountable - to Finance Ministers, national parliaments, and perhaps the European Parliament. This is a subject on which other member states have strong, and not immediately compatible, views. The same may be true of HMs on both sides of this House. The EMF would be a new institution, and it is by no means obvious how its accountability could be best ensured, and, if necessary, developed. We shall listen with care to the ideas our partners put to us.

34. But let me make this plain: a willingness to discuss and adapt our proposals does <u>not</u> mean that we have abandoned our concerns about a single currency. We are not about to withdraw the objections we have expressed all along to the Delors proposals.

35. Our overall objective at the IGC is twofold: to reach an agreement with our partners but one that meets our own concerns by fully respecting the sovereign rights of this Parliament. And that means keeping open the options not just for this Parliament but for future Parliaments as well.

36. We shall be looking for a Treaty which does not impose a single currency on the UK; for developments beyond Stage 1 which incorporate our ideas for a common European currency, and for a European Monetary fund; and for continued national responsibility for the main elements of budgetary policy.

37. What approach we might ask, would the Opposition take to EMU and to negotiations with our partners? HMs on this side of the House will not be alone if they are confused about Labour's policy. Their confusion is shared by the Party Opposite. Not least, as usual, by the leader of the Opposition himself. The truth is Labour have no policy on EMU. They simply hop on board the latest bandwagon - particularly if it bears the stamp 'made in Europe' - and worry later about what it means.

38. It is an old story. First it was credit controls which they tried to dress up as Germany's reserve asset ratios. Then it was the ERM. And now it is EMU.

39. So what is the Opposition's attitude towards a single currency? On 2 November last year, the leader of the Opposition explained to the listeners of the Today programme what accepting a single currency meant to him:

"You don't have to have the abolition of the pound"

he said

> "you have a pound with its ecu value and everybody can go on using whatever currency they want so long as its in stipulated ecu value".

When asked whether it matters whether we have a common or single currency "so long as the Queen's head is on it", the RHM for Islwyn beamed:

> "That's the whole point Leon Brittan and Jacques Delors and everybody else has made and they're right".

The bandwagon was rolling and the leader of the Opposition could not wait to hitch a lift; although if you ask him where he is heading or for a little help with the map reading, he might for once be lost for words.

40. As usual it was the RHG for Monklands East who set about the damage-limitation exercise, as he so often has to. He told the Daily Telegraph (7 November 1990) that

> "what Neil was trying to make clear was that it was rather a foolish view to say the only issue was whether the Queen's head appeared on the currency or not."

A heroic albeit unsuccessful attempt to save the day.

41. In November Labour's National Executive Committee published a paper 'The Intergovernmental Conference on Economic and Monetary Union'. This states that since our

Community partners have made clear that 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."

42. In December, in another interview on Today, Mr Kinnock said that

> "[the] eleven other countries are unanimous [about their desire for greater economic and monetary integration]. Now the choices therefore available are to go and turn our backs on that, which would be foolish, or to be involved in it ..."

43. So Labour's front bench would sign up to a single currency and a single European Bank if that is what the other eleven states want.

44. The Government is cautious about the uncertainties that lie ahead; the Government reserves decisions on a single currency for this House. The Opposition it appears are prepared to rush headlong into agreements in Europe without having the faintest notion of what these will mean for Britain and without the slightest regard for the sovereignty of Parliament.

45. I should now like to explain why the Government, unlike the Opposition, has always objected to the Delors prescription for EMU and the imposition of a single currency and why we will continue to oppose it.

46. First, consider what the Delors vision would mean. From Colonsay in the North, to Crete in the South, and from Cadiz in the West to Copenhagen in the East, 340 million people would overnight adopt a single currency. A Community in which income per head varies from £9,400 in Germany to £4,500 in Greece.

47. And income is only one measure of Europe's diversity. Consider, for example, the differences even between these member states whose countries are within the narrow bands of the ERM:

- inflation ranges from 2 per cent to 6½ per cent;

- short-term interest rates are 9½ per cent at the bottom end and 13 per cent at the top;

- unemployment, one important indicator of labour market flexibility, ranges from 1 per cent in Luxembourg to 15 per cent of the workforce in Ireland;

- and budget balances range from a surplus of 3 per cent to a deficit of 10 per cent of GDP.

When we take account of other member states, especially those who are not members of the ERM at all, the differences are far greater. So long as such wide divergences exist, a move to a single currency for all member states would represent a massive leap in the dark.

48. The desirability of convergence we can agree on. I have no quarrel with the Delors Report on that score. Convergence is vital if economic and monetary integration in the Community is to be sustainable in the context of greater stability in the financial markets. Inflation rates need to come down to the level of the best performer; interest rates will then follow. Labour markets everywhere need to be more flexible. The process of economic and monetary integration brings many benefits: more stable financial markets; enlarged markets for our trade and fewer barriers to our goods. But to achieve these gains we first need further convergence.

49. By trying to move prematurely to monetary union before we achieve greater convergence we run serious risks. The dangers of forcing the pace have been amply demonstrated in Germany. Unification means the rapid merger of two very different economies. Karl Otto Poehl has described Germany's experience as a "drastic object lesson" of the need for prior convergence before establishing a currency union. The short-term economic consequences are clear: a huge rise in the German budget deficit and rising unemployment in Eastern Germany. In the very special case of Germany there

can be no doubt that the right decisions were taken and that the German people have the will and determination to make a success of unification. But for the rest of the Community their experience of monetary union is salutary. It shows the strains and tensions set up by moving to a currency union before convergence. In the case of Germany, one strong currency and economy effectively took over a weaker neighbour. How much greater would be the stresses of 12 different stages adopting a single currency?

50. Pressing ahead now with a single currency and monetary union in Europe, before achieving adequate convergence, could well have serious consequences.

51. It is possible, for example, that to ease the pain of currency union, there would be calls for large sums to be spent in the poorer regions. A programme of transfers - potentially huge - would be very difficult for the more prosperous states to stomach. Even on present policies, by 1993, we will be funding a structural policy costing £11-12 billion each year. And, incidentally, such a programme would result in more power and decision-making being taken away from member states and given to the Commission.

52. A more fundamental problem is the fact that even assuming such transfers took place, all experience shows that they are not an effective way of abolishing regional differences. They do not remove the need for a painful

process of adjustment. That requires working with markets rather than obstructing them, and increasing flexibility not stifling it, as subsidies tend to do.

53. In the US, a large currency union, flexibility stems in part from the movement of people between states in search of employment and a better standard of living. In the Community, cultural and language barriers would make this degree of flexibility less likely and less desirable.

54. A second possible outcome is that without proper safeguards the European Central Bank would prove unable to live up to the high standards of the Bundesbank in reducing inflation. Instead of promoting convergence and improving economic performance, monetary union would have led to just the opposite: higher inflation and a worse economic performance.

55. The truth is that the full economic consequences of the Delors prescription are highly uncertain. They would take a long time to emerge and would be extremely difficult to forecast. The currency union envisaged in the Delors Report would have no precedent. Fixed exchange rate systems like the Gold Standard, Bretton Woods and indeed the EMS are not true precursors of EMU. They enabled individuals and companies to invest and trade against a stable background; and when Britain was on the Gold Standard before 1914 and a member of the Bretton Woods system after 1945, there was rapid growth of international trade and specialisation.

Equally, in the past, countries (such as Ireland) have tied their currencies to those of larger neighbours. But a common feature of all these arrangements was that there was <u>no</u> centralised monetary policy and <u>no</u> single central bank covering all the participants.

56. Moreover, these risks and uncertainties aside, the potential benefits of a single currency may well be much fewer than its supporters allege. In November the Commission published their report "One Market, One Money" on the costs and benefits of EMU. There would be savings from the reduction in transaction costs that would flow from a single currency - but perhaps not as great as the report suggests. For it overlooks the cheap mechanisms for transferring money between member states which are already in existence and it underplays the benefits resulting from financial liberalisation and technological change. Both are likely to reduce transaction costs significantly in the years ahead.

57. Even with a single currency banks would still incur costs in transferring money from one country to another, just as in the US clearing cheques between different states is expensive.

58. It is these concerns which prompted us to put forward our own proposals. Proposals which recognise the huge uncertainties ahead of us. We are willing to listen to our partners at the IGC and to try to find ways of meeting their concerns as well as our own. And we hope and expect that the

IGC will recommend a set of Treaty amendments acceptable to all member states that we can bring to this House for approval.

59. But at the same time we cannot accept a Treaty which would bind us to move to a single currency or a single monetary policy without a separate decision at the appropriate time by the UK Government and Parliament. That will be a question for <u>future</u> Parliaments to decide.

60. Some people see EMU as a big step towards political union, and look forward to the creation of a United States of Europe. That is not the Government's vision: we see a Community whose economics continue to benefit from closer integration but where the great bulk of economic policy decisions remain in national hands, because that is where they belong.

61. Mr Speaker, this debate will, I believe, show that economic and monetary union in Europe raises issues of the greatest economic and constitutional importance for this country. There are those in the Community who seem ready to bind themselves to make the move to the final stage of economic and monetary union with a single monetary policy and even a single currency. Our position is more cautious. As we have made clear, while we are ready to respond to the aspirations of the other member states in the Community, we believe it both unnecessary and premature to ask this House

to take binding decisions to move to the final stage of economic and monetary union.

62. We have said that our approach, or some development of it, could lead to a single currency. So while we do not rule out a single currency for ever, if that is what peoples and governments so wished, we cannot accept a commitment to move to a single currency or a single monetary policy without a separate decision at the appropriate time by this House.

63. It is on this basis that we will carry forward out negotiations in the Inter-Governmental Conference.

64. In the light of these assurances, I ask the House to commend the Government's approach to these complex issues, and in particular our emphasis on practical steps that will promote economic convergence; and I ask the House to endorse the Government's handling of the inter-governmental conference that lies ahead.

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