

PO/CH/NL/727

Part. B

PO/CH/NL/727

Part. B

ECONOMIC AND MONETARY UNION
(EMU)

Begins 15/06/1989

Ends 20/07/1989



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

CH/EXCHEQUER	
REC.	16 JUN 1989 ✓ 16
ACTION	Mr N P Williams
COPIES TO	PJ/ST, PJ/AMG Sir P M DOOLEY MR WICKS MR R GATTEN MR Odling-Smee MR PEREZ MR M BROWN

15 June 1989 Miss O'Mara
Mr Nelson

Dear Alex,

DELORS REPORT

Sir Michael Butler came in to see the Prime Minister this evening on behalf of the European Committee of the British Invisible Exports Committee to discuss the Government's approach to the Delors Report and handling of it at the Madrid European Council.

Sir Michael said that there were concerns in the City over the possibility that, if the United Kingdom remained adamant in its objections to the Delors Report, other EC governments might decide to move ahead towards EMU without us. This could endanger the City's leading position and cause loss of business to other financial centres such as Paris and Frankfurt. His Committee emphatically did not believe that the government should endorse Stages 2 and 3 of the Delors report or the linkage established in paragraph 39. Overall they disliked the highly centralised approach which it represented. Their recommendation was that the government should agree to work on Stage 1, with implementation beginning on 1 July 1990 and thereafter proceeding in parallel with completion of the Single Market by end 1992 - which would incidentally be after the next elections in the United Kingdom. Later Stages would be left for study after 1992. Sir Michael noted that the Delors Report did not make membership of the ERM an absolute condition of Stage 1.

The Prime Minister said that her main concern was to see the other European governments fulfil their obligations to complete the Single Market by 1992. There was still a long way to go. The Germans for instance continued to impose a mass of restrictions on insurance, investment and public purchasing. The aim must be to get genuine fair competition in Europe. Her readiness to proceed with Stage 1 would be closely linked to the commitment of others to make progress in these areas. The two must proceed in parallel. Our position on membership of the ERM remained as expressed in the Conservative Election Manifesto: we would join when the time was right.

Sir Michael was optimistic about progress on the Single Market and the extent to which Europe was becoming a genuinely capitalist free market. The Prime Minister thought him rather optimistic.

I am copying this letter to Stephen Wall (Foreign and Commonwealth Office), Neil Thornton (Department of Trade and Industry), and to Roger Lavelle (Cabinet Office).

Yours sincerely,
Chris Zeman

(C. D. POWELL)

Alex Allan, Esq.,
HM Treasury.

CONFIDENTIAL

FROM: N L WICKS
DATE: 21 June 1989
EXT : 4369

CHANCELLOR OF THE EXCHEQUER

cc Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr H P Evans
Mr Peretz
Miss O'Mara (MG1)
Mrs Chaplin (CX)
Mr Tyrie (FST)

Ms Wheldon (T.Sol)

*Thanks.
This is an attempt at construction wh. we are considering in the light of the above appointment.*

EMS: A COUNCIL (OR BOARD) FOR EUROPEAN ECONOMIC AND MONETARY CO-ORDINATION

I have deliberately delayed putting forward further elaboration of the idea, sketched out in my minute of 27 April, for a Council or Board with the remit to supervise the operations of the EMS. But I now do so in the note attached the this minute, which reflects discussion in the Treasury and with Juliet Wheldon in Treasury Solicitor's Department. The purpose of such a Board/Council, which would not be institutionalised through Treaty amendment, would be to help us to argue that the EMS and the development of economic policy co-operation in the Community was under greater political supervision by Member States.

2. Clearly, the proposal is not something to run for the time being. But despite its formidable difficulties, it has some attraction. Certainly, if the Community is to develop its monetary and economic co-operation, it would be much better to do so through the device described in the note than through standard Community (Commission dominated) machinery.

3. Putting forward the proposal - and the inevitable connection with membership of the ERM (see Section X of the note) - might create expectations about the precise timing of our membership.

CONFIDENTIAL

Wicks
TO
CHEO
21/6

CONFIDENTIAL

If so, that would have market consequences. But this raises wider issues, which can be examined as and when.

N.L.W.

N L WICKS

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EMS: A COUNCIL (OR BOARD) FOR EUROPEAN
ECONOMIC AND MONETARY CO-OPERATION

(I) The Objective

To provide for greater political oversight over the EMS, and so help to justify UK membership of the ERM; and to lay the basis for the future development of economic and monetary co-operation in Europe in a way which emphasises the predominant role of nation states.

(II) Present arrangements

(i) The EMS was established on a hybrid basis, with only certain of its operations, eg involving the ECU and the EMCF (and the operating rules of the realignment meeting), grounded in Community legislation.

(ii) The operation of the EMS does not reflect normal Community decision making procedures, ie the Commission proposes and the Council disposes. It is operated by central banks with overall supervision by Member States.

(III) The Proposal

To establish a Council (or Board) for European Economic and Monetary Co-operation with the following functions:

(i) to exercise general oversight over the EMS including the provision of a forum for realignment conferences; and

(ii) to provide a forum for the mutual surveillance of member states' economies, and co-ordination of economic policies as appropriate.

Comment

a. The operation of the Council would need to be reconciled with the powers of the EMCF and the Committee of Central Bank Governors in relation to the EMS. Bundesbank sensitivities about political interference would need careful handling.

b. Realignments are now carried out at a meeting, not a formal Council, of Ministers and Central Bank Governors. They could be carried out in this new body.

c. The Council's relationship with ECOFIN would need careful definition. To ease the acceptance of the new body, ECOFIN should continue as far as possible much as now, but the twice yearly informal ECOFINs might be turned into meetings of the new body, concentrating on discussion of the macro-economic situation in the world and member states' economies.

d. There is already a body of Community legislation on the subject of economic and monetary co-operation and it would be desirable to amend certain subordinate legislation in this area, such as the 1974 Convergence Decision and Directive (which would need amendment in any event if "stage 1 of EMU" was agreed).

(IV) Constitution: By resolution or declaration of the European Council.

Comment

a. The new body would be constituted by agreement between the participants and would not have an EC Treaty base.

b. If some way could be found of associating the central bank governors with the resolution, this would help in distancing the resolution from the Treaty.

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c. Annex A, which is based on material provided by Ms Wheldon describes some of the legal considerations.

(V) Name: The Council (or Board) for European, Economic and Monetary co-operation.

Comment

a. The name "Council" or "Board" is designed to make the body sound substantial. But such a name would emphasise its institutional character and exacerbate the problem with Article 102a referred to in paragraph 5 of Annex A (the risk that the UK would appear to undermine the provision in Article 102a - which provides a safeguard against institutional development without Treaty change - on which we have hitherto placed some reliance).

(VI) Representation

Finance Ministers and Central Bank Governors and the Commission.

Comment

a. The considerations at (III)(a) above suggest that the Central Bank Governors should attend the meeting, probably as full members, though just possibly only in attendance. The Commission could hardly be excluded in view of the overlap between the macro-economic discussions and Community affairs generally. But they should not have undue influence or the right to propose.

(VII) Meetings: Twice yearly to review macro-economic developments and more often if necessary.

(VIII) Secretariat: Independent of the Commission and the Council.

(IX) Support: Monetary Committee members (from Finance Ministries and Central Banks) could be designated Alternates.

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(X) Presentation

There are many possibilities, for example:

(i) we could continue to maintain "when the time is right" formula, but to make clear that arrangements on the lines above would facilitate our joining the ERM. Directly satisfactory arrangements on the lines above had been established there would be an announcement that the UK would join the ERM within a defined (limited) period of time. At the time of joining HMG would claim that the new Council pointed the way ahead: economic and monetary co-operation between member states. Such a statement could be coupled with a declaration that HMG regarded membership of the ERM as justified in terms of national economic policy, and not as a move towards EMU on the lines described in the Delors Report.

(ii) It is possible, however, that other member states would not be willing even to discuss the proposal seriously without a quid pro quo of a firm agreement to join the ERM by a definite date.

(XI) Other Member States' Reactions: Possibly generally favourable if they believed that the new Council would lead to the UK's entry into the ERM in the fairly near future. Some may welcome the proposal as a means of improving economic discussion in the Community, for example the French who have recently floated an idea for joint discussion in ECOFIN between Ministers and Central Bank Governors. But the Bundesbank, and its allies in central banks, could well be hostile if they feared that the new Council would lead to political control of interest rates. Some member states, too, would object to what they would see as increased political control over central banks. Others might envisage the Council being put onto a statutory (Treaty) basis in due course; and indeed might press for this ab initio.

*Depends critically
on what is
happening re Delors
& EMU.*

SOME LEGAL CONSIDERATIONS

THE LEGAL BASIS

There are various points which arise from an examination of the suggested arrangements.

1. There already exists a significant measure of Community competence in the economic and monetary area. True, the relevant provisions of the Treaty are few in number, and are rarely resorted to in practice, but there is quite a body of subordinate legislation largely based on those provisions whose legal effect is to curtail Member States' competence (and hence their sovereignty) in relation to the matters covered by the legislation. In practice of course Member States have enjoyed considerable freedom to follow their own policies and the Commission have not enforced the legislation to the letter.

2. Nor is there any shortage of existing Community institutions with functions in the economic and monetary area. In addition to the Council (Article 145) and Commission (which has a general policing function under Article 155), we already have an Economic Policy Committee (Council Directive 74/122/EEC) to promote co-ordination of Member States' short and medium term economic policies, a Monetary Committee (Article 105) to promote co-ordination by keeping under review the monetary and financial situation of the Member States and the Community, the high level Co-ordinating Group and, last but by no means least, the Committee of the Governors of the Central Banks (Council Decision 64/300/EEC).

3. Given the existing provisions and institutions, those politically opposed to the proposals in the note could argue that there is no need for another institution or quasi-institution in this area and that a new Council would indeed cut across existing legislation. How seriously those political points were taken would depend on the legal climate.

4. Alternatively, if the need for a Council is accepted, others in the Community might argue that the new institution or quasi-institution should be set up under the powers conferred by the Treaty, if need be either under Article 236 or Article 235, the general enabling power which forms the legal base for a number of the instruments in this area, eg Regulation 907/73/EEC establishing the EMCF. The answer to this point would have to be that the existing constitution of the EMS is such as to lead naturally to the use of an instrument which falls outside the Community legal order.

5. The reference to article 236 raises a slightly awkward point. The single European Act inserted the following provision as 102a(2) of the EC Treaty:

"Insofar as further development in the field of economic and monetary policy necessitates institutional changes, the provisions of Article 236 shall be applicable."

The provision was intended by those Member States wary of economic and monetary convergence to operate as a brake on monetary union. Full-blown treaty amendment under Article 236 is of course infinitely more complicated than legislation under Article 235 and the provision could therefore be regarded as quite a serious check on future developments. The Presidency and Commission signalled their concern about this in a joint declaration annexed to the Single European Act to the effect that the new provisions were "without prejudice to the possibility of further development within the framework of existing powers" ie Article 235 in particular. If the ideas in the note were put forward, there would be a real risk that the UK would put appear to undermine the provision in Article 102a on which it has hitherto taken as a safeguard.

THE POSITION OF THE COMMISSION

6. It would not be the intention to establish the new Council totally outside the Community order and the note itself makes it clear that the Commission would have some role. But it would be important to prevent the Commission dominating the new body, by for example setting its agenda and providing the secretariat. There appears to be nothing in EC Treaty law which prevents our achieving this objective, assuming that it has political support. The new body would not be taking legally binding decisions and its activities should not cut across the Commission's Treaty right of initiation. Even certain bodies set up strictly within the treaty framework operate at arm's length from the Commission: the Monetary Committee and the Committee of Central Bank Governors for example have their own rules of procedure and provide their own secretarial services. There could however well be difficulty about an attempt to prevent the Commission raising any issues at all. This might provoke the argument mentioned in paragraph 3 above that the new body was inconsistent with existing Community law. An acceptable compromise might be to allow the Commission to raise issues before the new Council but to prevent it having any exclusive right to determine the agenda or the ability to regulate discussions.

PA FCU/EMU

5A



WVF 100/22

- 1. cc Mr Wicks: MNT. BRITISH CONSULATE GENERAL
Mr Havelle: Cabinet Office FRANKFURT-AM-MAIN
Mr Powell: No 10.

M. T. Jones
M. J. [Signature]
29/6

- 2. cc PS me
- 3. Mr Arthur [Signature] 29/6

Sir Christopher Mallaby KCMG
HM Ambassador
Bonn

22 June 1989

cc Mr Baker 100
Mr [Signature]
Mr [Signature]

Dear Christopher,

HERR PÖHL AND EMU

*Please copy this further
sign of security tonight by
Pohl to Mr Kerr - for
him to copy further as
necessary of the Madrid [Signature] 2/6*

1. I attended last night a big dinner given by the ICI Board attended by a good sprinkling of luminaries from the business world and public life (including Paul Volcker and Rüdiger von Wechmar) at which Karl Otto Pöhl gave an unscripted after-dinner speech. Much of it was devoted to the subject of European Monetary Union and the British attitude to the subject. Although many of the points he made are familiar ones which he has made in public, I think it is worth singling out one or two of the more important ones.

2. Pöhl said that he had no idea what would emerge at the European Council meeting in Madrid next week. But although he expected few concrete decisions it would undoubtedly mark the beginning of the integration process. Member governments would be pressed hard to start formulating their ideas for treaty changes, despite the opposition expected to come from Mrs Thatcher. He suspected that the British would not be as isolated as they appeared at present since other governments also had doubts about yielding up such fundamental powers as the Delors proposals implied.

3. Turning to the concept of a European Central Bank, he said that he shared Mr Lawson's views. You could not have a central bank without a countervailing political authority such as the European Parliament. At present this simply did not exist. Nor therefore did the conditions for creating such an institution. There were other difficulties. How could any sort of independence in decision-making by the bank be guaranteed so long as it came under the instruction of national governments? What sort of voting powers would the directors have: would they be equally weighted or graduated? Where would it be sited? He had to admit that at present the obvious site would seem to be London. But this clearly could not take place so long as sterling remained outside the Exchange Rate Mechanism. It was perhaps conceivable that the Board of Governors could be seated elsewhere.

2/6



4. Pöhl said that his position on EMU was not negative. But we thought that one should be very careful. If negotiations began too soon there was a great risk of failure. Careful preparation was necessary and the ERM had to be improved first. He welcomed therefore the Spanish decision to join. But the Spanish could well find that it entailed more problems than those involved in a possible UK accession. He recognised though that in the UK case the decision was essentially a political one. If however the UK maintained their present position and remained outside, they would lose substantial influence. //

5. A second area for progress, Pöhl thought, was convergence. Here there were big problems such as trade imbalances and exchange rates. The French deficit was growing almost commensurately with the German surplus. No-one wanted to change exchange rates. It would not be easy to move forward. In the long run however sovereignty was a chimera. All member countries had to accept constraints. //

6. I managed to have a private word with Pöhl after his speech. He said he had spoken frankly because he thought the British attitude would play a key role as the debate over Delors got under way. He had been encouraged by recent statements by Mr Lawson to think that our position on the ERM might be changing. But the German position on EMU was not secure. He was not confident that Kohl and particularly Genscher would stand up to the French. He was particularly worried at the recent get-together between Genscher and Dumas (a reference I assume to the joint Franco-German communiqué after their meeting in Paris at the beginning of this week). There would be difficult times ahead during the French presidency.

7. I am aware how sensitive this subject is from earlier exchanges with Pauline Neville-Jones. I am not therefore copying this letter anywhere else but may I leave it to you to arrange for it to be distributed as you think fit.

Yours etc.
Julian

J D N Hartland-Swann

TRANSLATION

Extracts from a speech held by the President of the Bundesbank Karl-Otto Pöhl in Munich on 22 June 1989.

Instead, the Werner plan has been revived and with it the idea that one should arrive at economic and monetary union via parallelism with economic developments. An economic and monetary union as described in the Werner Report is no longer a utopian vision today. We find ourselves in the midst of a dynamic process of converging markets with the corresponding political consequences. Important decisions will be taken within days, weeks or months. It is no longer a question of "whether" but "how" and "when" a monetary union is established. With the exception of one or two, it is clear that virtually all the governments in Europe are of the opinion that economic and monetary union should be realised in Europe. This corresponds to the development of the Single Market in which there are no longer any restrictions on goods, services, capital and persons. The Single Market requires a minimum of centrally taken decisions on economic and financial policy. There are three elements to monetary union which were already defined to a large degree in the Werner Report.

1. The irrevocable fixing of exchange rates, perhaps over a longer transitional period with the possibility of exchange rate adjustments which would, however, be subject to more difficult conditions such as in the old Bretton Woods system.
2. The complete liberalisation of money and capital transactions.
3. Institutional changes including the creation of a central bank or a central bank system, as we set out in the Delors Report, and ultimately, a common currency as well.

In the light of its high inflation rate, Spain's decision to join the exchange rate system of the European Monetary System must be considered brave. This will put Spain in the position of having to defend a fixed exchange rate. England still remains outside and seems likely to stay there for the time being. I regret this, for a country which is the home of the most important financial centre in Europe really ought to belong to the EMS. Otherwise, the EMS will remain a torso. Great Britain could also make useful contributions with regard to the "philosophy" of an economic and monetary union such as a liberal "bias" to counteract the administrative, dirigiste "bias" brought to bear by some of the other states. British support would be very useful in dealing with the divergencies which exist here. Its membership of the EMS as well as in the exchange rate mechanism would doubtless be an important contribution. But this is a decision which the British Government must take and any advice would be misplaced.

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By far the most difficult stage which lies ahead of us is the question of institutional changes. The Delors Report made some proposals in this direction, but I would like once again to point out the nature of the report. The Group was expressly called upon by the European Council to make such proposals. By way of this mandate the European Council reminded member states that in acceptance of the SEA they had endorsed the gradual realisation of Economic and Monetary Union. This was unanimously accepted by all EC heads of government. One cannot subsequently hold us responsible for having proposed EMU and a far-reaching renunciation of national sovereignty if one wants to realise such a union. With one exception, the creation of a reserve fund, the report was passed unanimously.

Despite this unanimity not everybody can support every word of the report. The report naturally has a certain compromise character, but I believe that from the German point of view it contains very many positive elements. I admit that it is correct to point out the weaknesses contained in the report within the description of the second phase. This is indeed the weakest part of the report, but we were all fully aware of this. Basically, all controversial questions about the transitional phase were put to one side. We were fully aware of the problems and there existed very different ideas about this second phase. In order to avoid complete disagreement we had to put this to one side along with many other questions which have to be discussed in more detail in the future. Nothing has been tied down. Furthermore no-one, including the Central Bank Council, is committed by this report. What needs to be decided in Madrid and probably in Paris in December? First, the question whether one should affirm that if one enters the first stage, one is also striving for the last stage. I believe that this is a little like the argument about the Kaiser's beard. In the first place, this had already been stated in the mandate from Hanover. There is little point in starting a journey if the destination is unknown. It would be meaningful to affirm that we want an economic and monetary union. When and how can be left open, but the final goal should be established. We will see whether all heads of government are ready for such a commitment. You

are aware that the British Prime Minister has already firmly rejected this.

Second, the beginning of the first stage is to be decided. It is an open question whether this can only be decided according to our proposals, when a commitment to the final stage of monetary union exists. We said that the first stage should come into effect in mid-1990 with the liberalisation of capital movements. The first stage incorporates measures which can all be taken on the basis of existing law or which have been agreed but which still need to be implemented. In the first instance, of course, the full realisation of the internal market, harmonisation of indirect taxation, etc. Then a stricter application of the Directive agreed in 1974 concerning cooperation in economic and fiscal policy.

All this already exists but little use has been made of it. What is of prime interest and concern to the Bundesbank, and what still needs to be discussed carefully within the Central Bank Council, is the proposal to strengthen the role of the Committee of Central Bank Governors in Basle. This means giving the Committee a higher profile to enable it, for example, to express opinions and, not least, to exert a stronger influence on exchange rate policy within the EMS. Through this Committee closer cooperation in the preparation of monetary policy decisions is to be achieved. It is stated expressly that this preparation is not binding just as the opinions of the Committee cannot be binding, but there is no doubt that they would carry a certain weight.



FROM: A C S ALLAN
DATE: 23 JUNE 1989

BF 29/6
5/7
For Thursday
EMS
meeting

MR WICKS

- cc PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Sir T Burns
- Mr Lankester
- Mr Scholar
- Mr R I G Allen
- Mr H P Evans
- Mr Peretz
- Miss O'Mara
- Mrs Chaplin
- Mr Tyrie

Mr Wheldon - TSol

EMS: A COUNCIL (OR BOARD) FOR EUROPEAN ECONOMIC AND MONETARY CO-ORDINATION

The Chancellor was grateful for your note of 21 June. He thinks the idea of a council (or board) for European economic and monetary co-ordination is an interesting and constructive suggestion, which we should consider further in the light of the outcome of Madrid.

ACSA

A C S ALLAN

ACSA
TO
WICKS
23/6

Handwritten red scribbles

UNCLASSIFIED

Handwritten signature

FROM: J GIEVE (IDT)
DATE: 27 June 1989
x 4420

CHANCELLOR

cc Ministers
Advisers
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Evans
Mr Peretz

MADRID COUNCIL

At her press conference following the Council at lunchtime today, the Prime Minister made a few opening remarks on the following lines:

- We have reaffirmed the priority of completing the single market, especially on financial services, public purchasing, transport.
- Accepted that there should be no withholding tax.
- Accepted widely the need to keep frontier controls for terrorism, drugs and crime.
- On EMU, the practical decision was to go ahead with the early implementation of stage 1, which involved the completion of the single market and the creation of a European financial area, strengthening competition policy; it also involved all countries joining the ERM on which her statement had been received positively; further work would now be done on what might follow stage 1 with the Delors report forming "a" rather than "the only" basis for discussion; there was no automatic movement beyond stage 1 and substantial differences remained on the right way forward;

- Accepted a social dimension, but without agreement on the social charter.

2. In answer to questions she said:

- She had not conceded anything on an IGC because this could be convened by majority vote and she was sure it would be convened with our voting against in due course; however there had been agreement on the need for full and adequate preparation; she did not consider it would be right to leave "an empty chair" at any IGC.
- She had not changed her view that stages 2 and 3 of Delors, could only make sense with political union and would be unacceptable to the British people.
- She was asked whether it was possible that we would join the ERM before 1992 and said she could not give a date, it depended on how quickly the Community pressed ahead with the abolition of exchange controls and other financial liberalisation so that we could join on "a fair basis".
- She was asked whether she had any other models of EMU which were not set out in the Delors report; she replied that - as the Economist had pointed out - alternatives had not been properly considered and she was sure that papers would be put in to the further discussions; she certainly favoured a minimalist interpretation of EMU without fiscal controls etc and the commitment was to "a progressive realisation of EMU" ie a gradual stage by stage process; she saw the way forward as a gradual convergence of policies and saw no need for a common currency.
- On the social dimension she had received great support for her view that differences needed to be taken into account and the ^v subsidiarity should be the guiding principle.

a. Raen

PP JOHN GIEVE
signed on his behalf

UNCLASSIFIED - PART ONE OF TWO
FM MADRID
TO IMMEDIATE FCO
TELNO 655
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INFO PRIORITY EC POSTS

(COLLAR)

FOLLOWING FROM HANNAY:
MIPT EUROPEAN: COUNCIL: MADRID 26/27 JUNE

FOLLOWING IS TEXT OF CONCLUSIONS:

1. THE EUROPEAN COUNCIL, MEETING IN MADRID, REVIEWED THE SITUATION AND THE PROSPECTS FOR PROGRESS TOWARDS EUROPEAN UNION.

2. THE EUROPEAN COUNCIL WELCOMED THE VIGOROUS TURN TAKEN BY EUROPEAN CO-OPERATION, WHICH HAD BEEN GIVEN A FRESH BOOST BY THE SINGLE ACT, AS DEMONSTRATED BY THE COMMUNITY'S GREATER ROLE IN INTERNATIONAL AFFAIRS.

THE COMPLETION OF THE INTERNAL MARKET AND THE STRENGTHENING OF ECONOMIC AND SOCIAL COHESION WERE THE PRIORITY OBJECTIVES OF THIS NEW CHAPTER IN THE HISTORY OF THE COMMUNITY.

IT ALSO NOTED THE PROGRESS MADE BY THE TWELVE AS A RESULT OF INCREASING INVOLVEMENT IN WORLD AFFAIRS AND GREATER CONSISTENCY BETWEEN COMMUNITY OBJECTIVES AS SUCH AND POLITICAL CO-OPERATION.

3. THE THIRD ELECTIONS TO THE EUROPEAN PARLIAMENT BY DIRECT UNIVERSAL SUFFRAGE, WHICH TOOK PLACE BETWEEN 15 AND 18 JUNE, LIKEWISE BORE WITNESS TO THE CONSOLIDATION OF EUROPEAN INTEGRATION.

THE EUROPEAN COUNCIL CONSIDERED THAT THE IMPLEMENTATION OF THE PROVISIONS OF THE SINGLE ACT HAD LED TO A REAL AND APPRECIABLE INCREASE IN THE PARLIAMENT'S CONTRIBUTION TO THE COMMUNITY LEGISLATIVE PROCESS. THIS CONTRIBUTION WAS NOW EMBODIED IN EFFECTIVE CO-OPERATION BETWEEN PARLIAMENT, COMMISSION AND COUNCIL, DEVELOPING IN A CLIMATE OF MUTUAL TRUST.

IN THIS CONNECTION THE EUROPEAN COUNCIL HEARD A REPORT BY THE OUTGOING PRESIDENT, LORD PLUMB, TO WHOM IT PAID SPECIAL TRIBUTE.

THE EUROPEAN COUNCIL NOTED THE BROADLY POSITIVE CONCLUSION ARRIVED AT BY THE PRESIDENT OF THE EUROPEAN PARLIAMENT REGARDING THE STATE OF INTER-INSTITUTIONAL CO-OPERATION AND THE MEANS OF IMPROVING IT. IN THIS CONTEXT, IT WOULD BE DESIRABLE FOR THE VARIOUS COMMUNITY INSTITUTIONS TO ANALYSE THEIR RESPECTIVE POST-1992 ROLES.

4. THE COMMUNITY AND EUROPEAN POLITICAL CO-OPERATION WERE CURRENTLY ENGAGED IN AN AMBITIOUS WORK PROGRAMME INVOLVING THE COMPLETE AND BALANCED IMPLEMENTATION OF THE SINGLE ACT.

I. EUROPEAN COMMUNITIES

A. IMPLEMENTATION OF THE SINGLE ACT

I. INTERNAL MARKET

COMPLETION OF THE INTERNAL MARKET

THE EUROPEAN COUNCIL NOTED THAT THE FORWARD THRUST IN ACHIEVEMENT OF THE INTERNAL MARKET WAS MASKING AN EVER-INCREASING CONTRIBUTION TO EXPANSION AND IMPROVEMENT IN THE EMPLOYMENT SITUATION. THIS THRUST HAD HITHERTO RESULTED MAINLY FROM THE DECISIONS TAKEN TO REMOVE TECHNICAL BARRIERS TO TRADE. IT WAS NOW NECESSARY TO MAKE SIMILAR PROGRESS TOWARDS THE ELIMINATION OF PHYSICAL AND FISCAL OBSTACLES WITH A VIEW TO ACHIEVING AN AREA WITHOUT INTERNAL FRONTIERS BY 31 DECEMBER 1992 IN ACCORDANCE WITH THE PROVISIONS OF ARTICLE 8A OF THE SINGLE ACT.

THE GROWING RATE AT WHICH DECISIONS WERE BEING TAKEN MEANT THAT WELL OVER HALF THE MEASURES LISTED IN THE WHITE PAPER HAD BEEN ADOPTED. THE COUNCIL RECALLED CERTAIN PRIORITY FIELDS IDENTIFIED AT ITS MEETINGS IN HANOVER AND RHODES, AND WELCOMED THE FACT THAT IMPORTANT DECISIONS HAD BEEN TAKEN IN THE AREAS OF PUBLIC CONTRACTS, BANKING AND FINANCIAL SERVICES, THE APPROXIMATION OF TECHNICAL STANDARDS AND TRANSPORT. HOWEVER, IT NOTED THAT THERE WERE STILL DECISIONS TO BE TAKEN IN THESE PRIORITY FIELDS, INCLUDING TRANSPORT, IN PARTICULAR CABOTAGE, AND ASKED THE COUNCIL TO INTENSIFY ITS WORK IN THESE SECTORS.

THE EUROPEAN COUNCIL INVITED THE COMMISSION TO SUBMIT TO THE COUNCIL THE REMAINING PROPOSALS PROVIDED FOR IN THE WHITE PAPER AT THE EARLIEST OPPORTUNITY, AND EXPECTED THE COUNCIL TO FINALISE ADOPTION, AS QUICKLY AS POSSIBLE, OF THE INSTRUMENTS THAT WOULD PERMIT THE COMPLETION OF THE INTERNAL MARKET.

FRAUD

THE EUROPEAN COUNCIL EMPHASISES THE NEED FOR FIRM ACTION TO TACKLE THE PROBLEM OF FRAUD TO THE DETRIMENT OF THE COMMUNITY BUDGET.

IT WELCOMED THE VERY SUBSTANTIAL PROGRESS ALREADY ACHIEVED IN COMBATING FRAUD BY MEMBER STATES TAKING PART IN THE COMMISSION ACTION PLAN APPROVED BY THE ECOFIN COUNCIL ON 19 JUNE 1989.

IT INVITED THE COUNCIL OF MINISTERS TO DECIDE AS SOON AS POSSIBLE ON THE VARIOUS PROPOSALS FOR REGULATIONS TO COMBAT FRAUD WHICH HAD BEEN SUBMITTED TO IT BY THE COMMISSION.

TAXATION

THE EUROPEAN COUNCIL WAS CONCERNED AT THE DELAY IN FINDING A SOLUTION FOR THE PROBLEM OF THE TAXATION OF SAVINGS AND STRESSED THE NEED TO ENSURE THAT THE LIBERALISATION OF CAPITAL MOVEMENTS DID NOT FACILITATE TAX FRAUD. THE EUROPEAN COUNCIL ASKED THE COUNCIL TO INCREASE ITS EFFORTS TO FIND A SATISFACTORY SOLUTION TO THE PROBLEMS OF TAXATION OF SAVINGS IN ORDER TO REACH AN AGREEMENT BEFORE 1 JULY 1990.

THE EUROPEAN COUNCIL WELCOMED THE FACT THAT DETAILED DISCUSSIONS HAD NOW BEGUN IN THE FIELD OF THE APPROXIMATION OF INDIRECT TAXATION ON THE BASIS OF THE NEW APPROACHES PROPOSED BY THE COMMISSION AND TAKING ACCOUNT OF THE MEMBER STATES' SUGGESTIONS, AND THAT A PROCEDURE FOR THE CONTINUATION OF THOSE DISCUSSIONS HAD BEEN LAID DOWN. THE EUROPEAN COUNCIL EMPHASISED THE NEED TO REACH AGREEMENT ON THE BROAD LINES OF A SOLUTION IN THIS AREA BEFORE THE END OF THE YEAR, HAVING REGARD TO ALL THE PROBLEMS INVOLVED, IN ORDER TO ENSURE THAT THE INTERNAL MARKET CAME INTO OPERATION ON SCHEDULE.

AUDIOVISUAL PRODUCTION

THE EUROPEAN COUNCIL CONSIDERED IT VITAL THAT FURTHER EFFORTS BE MADE TO STRENGTHEN ALL AREAS OF EUROPE'S AUDIOVISUAL PRODUCTION CAPACITY, AS IT HAD REQUESTED AT ITS MEETING IN RHODES. THAT IMPLIED THE COMMUNITY'S TECHNOLOGICAL PRESENCE, THE FREE MOVEMENT OF PROGRAMMES WITH DUE REGARD TO CULTURAL DIVERSITY AND THE PROMOTION OF EUROPEAN PRODUCTION.

THE EUROPEAN COUNCIL NOTED THE SUBSTANTIAL PROGRESS MADE IN THIS

FIELD WITH THE ADOPTION OF A DECISION ON HIGH-DEFINITION TELEVISION. IN VIEW OF THE ABOVE IT INVITED THE COUNCIL TO CONTINUE WORK ON THE DIRECTIVE ON THE FREE MOVEMENT OF TELEVISION SIGNALS, WITH A VIEW TO ADOPTING IT WITHIN THE TIME-LIMIT LAID DOWN IN THE PROCEDURE FOR COOPERATION WITH THE PARLIAMENT.

THE EUROPEAN COUNCIL HOPED THAT THE FORTHCOMING AUDIOVISUAL CONCLAVE WOULD BE SUCCESSFUL.

FREE MOVEMENT OF PERSONS

IN ACCORDANCE WITH THE RHODES EUROPEAN COUNCIL'S DECISION, THE COORDINATORS' GROUP DREW UP A REPORT (THE 'PALMAS DOCUMENT') ON THE MEASURES NEEDED IN DIFFERENT FIELDS IN ORDER TO ACHIEVE PROGRESS TOWARDS THE EFFECTIVE FREEDOM OF MOVEMENT OF PERSONS WITHIN THE COMMUNITY.

THE EUROPEAN COUNCIL, FEELING THAT FREE MOVEMENT OF PERSONS WAS A PRIORITY FOR 1992, ENDORSED THAT DOCUMENT'S CONCLUSIONS, WHICH WERE LARGELY BASED ON THE APPROACH AND METHODS EMPLOYED IN THE WHITE PAPER ON THE COMPLETION OF THE INTERNAL MARKET, OF PROVEN EFFECTIVENESS IN THIS CONTEXT. IT INSTRUCTED THE COORDINATORS' GROUP, AT THE INSTIGATION OF THE GENERAL AFFAIRS COUNCIL, TO SPARE NO EFFORT TO ENSURE THAT THE PROGRAMME OF WORK PROPOSED IN THE PALMA DOCUMENT WAS COMPLETED AS PLANNED.

2. SOCIAL DIMENSION

THE EUROPEAN COUNCIL CONSIDERED THAT IN THE COURSE OF THE CONSTRUCTION OF THE SINGLE EUROPEAN MARKET SOCIAL ASPECTS SHOULD BE GIVEN THE SAME IMPORTANCE AS ECONOMIC ASPECTS AND SHOULD ACCORDINGLY BE DEVELOPED IN A BALANCED FASHION.

THE EUROPEAN COUNCIL REAFFIRMED ITS HANOVER AND RHODES CONCLUSIONS ON THE ACHIEVEMENT OF THE INTERNAL MARKET AS THE MOST EFFICIENT METHOD OF CREATING JOBS AND ENSURING MAXIMUM WELL-BEING FOR ALL COMMUNITY CITIZENS. JOB DEVELOPMENT AND CREATION MUST BE GIVEN TOP PRIORITY IN THE ACHIEVEMENT OF THE INTERNAL MARKET. IN THIS WAY THE COMMUNITY SHOULD CREATE 5 MILLION JOBS BETWEEN 1988 AND 1990.

THE EUROPEAN COUNCIL NOTED WITH SATISFACTION THAT THE AIMS OF ARTICLE 118A WERE BEING FULFILLED BY THE ADOPTION OF IMPORTANT DIRECTIVES ON THE SAFETY AND HEALTH OF WORKERS, LEADING TO AN IMPROVEMENT IN THE QUALITY OF THE WORKING ENVIRONMENT.

THE EUROPEAN COUNCIL STRESSED THAT MAKING THE MOST OF HUMAN RESOURCES THROUGH TRAINING WAS A FUNDAMENTAL ASPECT OF ECONOMIC AND SOCIAL DEVELOPMENT: IT NOTED THE AGREEMENT REACHED ON CONTINUING VOCATIONAL TRAINING. THE EUROPERAN COUNCIL CALLED UPON THE COMMISSION, THE COUNCIL AND BOTH SIDES OF INDUSTRY TO EXPEDITE THEIR ON-GOING WORK WITH A VIEW TO OBTAINING AS SOON AS POSSIBLE THE MUTUAL RECOGNITION OF QUALIFICATIONS, FULL OCCUPATIONAL MOBILITY AND THE IMPLEMENTATION OF BOTH PRIORITY OBJECTIVES DECIDED UPON BY THE EUROPEAN COUNCIL IN BRUSSELS IN FEBRUARY 1988, NAMELY THE INTEGRATION OF YOUNG PEOPLE INTO WORKINGH LIFE AND COMBATOMG LONG-TERM UNEMPLOYMENT.

THE EUROPEAN COUNCIL NOTED WITH INTEREST THE PROGRESS MADE IN THE SOCIAL DIALOGUE AT COMMUNITY LEVEL PURSUANT TO ARTICLE 118B OF THE TREATY. THE INTERNAL MARKET MUST BE ACHIEVED IN A CLIMATE OF CLOSE COOPERATION BETWEEN EMPLOYERS AND WORKERS SO THAT ECONOMIC AND TECHNICAL CHANGES TAKE PLACE IN A SOCIALLY ACCEPTABLE MANNER. TO THIS END SOCIAL ACHIEVEMENTS MUST BE PRESERVED AND ECONOMIC AND SOCIAL COHESION STRENGTHENED.

THE EUROPEAN COUNCIL ALSO TOOK NOTE OF THE COMPARATIVE STUDY ON NATIONAL SOCIAL LEGISLATION WHICH IT HAD REQUESTED FROM THE COMMISSION IN HANOVER. IT CONSIDERED THAT AN ANALYSIS OF THE SIMILARITIES AND DIFFERENCES CONTAINED IN THE SUTDY WOULD GREATLY ASSIST THE CURRENT DISCUSSIONS.

THE EUROPEAN COUNCIL MEETING ON SOCIAL AFFAIRS ON 12 JUNE THE COMMISSION HAD SUBMITTED A PRELIMINARY DRAFT COMMUNITY CHARTER ON FUNDAMENTAL SOCIAL RIGHTS ON WHICH AN INITIAL DEBATE HAD BEEN HELD, LEADING TO THE DRAFT CONCLUSIONS SET OUT IN ANNEX 1 AND ACCEPTED BY ELEVEN DELEGATIONS.

THE COUNCIL WILL CONTINUE ITS DISCUSSIONS WITH A VIEW TO ADOPTING THE MEASURES NECESSARY TO ACHIEVE THE SOCIAL DIMENSION OF THE SINGLE MARKET, TAKING ACCOUNT OF FUNDAMENTAL SOCIAL RIGHTS. FOR THIS PURPOSE THE ROLE TO BE PLAYED BY COMMUNITY STANDARDS, NATIONAL LEGISLATION AND CONTRACTUAL RELATIONS MUST BE CLEARLY ESTABLISHED.

THE COUNCIL, AFTER CONSULTING BOTH SIDES OF INDUSTRY, SHOULD STATE ITS POSITION ON THIS WORK PROGRAMME PRIOR TO THE NEXT MEETING OF THE EUROPEAN COUNCIL.

3. ENVIRONMENT

THE EUROPEAN COUNCIL WELCOMED THE STEPPING UP OF THE COUNCIL'S ACTIVITY DURING THE PAST SIX MONTHS AND EMPHASISED IN PARTICULAR THE IMPORTANCE OF THE MEASURES THAT HAD BEEN ADOPTED IN THE AREAS OF OZONE LAYER PROTECTION, THE GREENHOUSE EFFECT, POLLUTANT EMISSIONS FROM SMALL CARS AND FORESTRY POLICY.

CONSCIOUS OF ITS RESPONSIBILITIES IN THE FACE OF THREATS ON A GLOBAL SCALE (CLIMATIC CHANGES, DEFORESTATION, DESERTIFICATION, ETC), THE EUROPEAN COUNCIL CONSIDERED THAT THE COMMUNITY HAD AN ESSENTIAL ROLE TO PLAY IN THE PROTECTION OF THE ENVIRONMENT, BOTH BY MEANS OF INTERNAL LEGISLATION AND BY ITS ACTIVE CONTRIBUTION TO ALL THE INITIATIVES TAKEN AT INTERNATIONAL LEVEL.

AS PART OF A GLOBAL ENVIRONMENTAL POLICY INCLUDING THE FIGHT AGAINST DESERTIFICATION, EROSION AND DEFORESTATION, THE EUROPEAN COUNCIL CALLED UPON THE COMMISSION TO SUBMIT A PROGRAMME FOR THE PROTECTION OF THE ENVIRONMENT AND THE REGIONS OF THE COMMUNITY AFFECTED BY THESE PROBLEMS.

AT THE REQUEST OF THE CHANCELLOR OF THE FEDERAL REPUBLIC OF GERMANY, THE EUROPEAN COUNCIL DISCUSSED THE VITAL CONTRIBUTION OF TROPICAL FORESTS TO THE STABILITY OF THE WORLD'S CLIMATE AND TO THE PRESERVATION OF THE EARTH'S GENETIC RESOURCES. AWARE OF THE SPECIAL RESPONSIBILITY OF THE INDUSTRIALISED COUNTRIES FOR MAINTAINING THE BALANCE OF NATURE WORLD-WIDE, THE EUROPEAN COUNCIL EXPRESSED THE WISH THAT THESE QUESTIONS BE DEALT WITH IN CLOSE COLLABORATION WITH THE COUNTRIES CONCERNED.

THE EUROPEAN COUNCIL TOOK NOTE OF THE RECENT COMMISSION PROPOSAL FOR THE CREATION OF A EUROPEAN ENVIRONMENT AGENCY OPEN TO EUROPEAN COUNTRIES WITH THE OBJECT OF PROVIDING THE BASES OF THEIR SCIENTIFIC EVALUATION OF ECOLOGICAL PROBLEMS. IT CALLED UPON THE COUNCIL TO EXAMINE THIS PROPOSAL AT THE EARLIEST OPPORTUNITY.

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FOLLOWING FROM HANNAY

EUROPEAN COUNCIL: MADRID 26/27 JUNE

EUROPEAN POLITICAL COOPERATION: CHINA

1. DISCUSSION IN THE POLITICAL COMMITTEE FOCUSSED ON DEFINING A LIST OF MEASURES TO WHICH MEMBER STATES COULD SIGN UP IMMEDIATELY. THERE WAS LITTLE DIFFICULTY OVER SUSPENSION OF POLITICAL AND MILITARY CONTACTS AND OF NEW AID PROJECTS AND EXTENSION OF VISAS FOR CHINESE STUDENTS. (THE PORTUGUESE MADE IT CLEAR THAT THEIR NECESSARY CONTACTS WITH THE CHINESE OVER MACAO WOULD HAVE TO CONTINUE.) BUT THERE WAS HESITATION ABOUT A BAN ON CULTURAL, SCIENTIFIC AND TECHNICAL EXCHANGES: THE FORMULA EVENTUALLY AGREED LEAVES FLEXIBILITY TO MEMBER STATES IN DECIDING WHAT ACTIVITY IS JUSTIFIED.

2. DOUBTS WERE ALSO EXPRESSED ABOUT THE PROPRIETY OF TAKING ACTION IN TECHNICAL ECONOMIC FORA (WORLD BANK, GATT) FOR POLITICAL REASONS, AND GATT WAS EVENTUALLY EXCLUDED FROM THE PACKAGE. IT WAS AGREED THAT THERE SHOULD BE A RIDER TO THE EFFECT THAT THE MEASURES WERE OCCASIONED BY THE ECONOMIC UNCERTAINTY CREATED BY THE CURRENT SITUATION. ANDREOTTI ARGUED THAT THE MEASURES SHOULD NOT BE REGARDED AS INDEFINITE AND SHOULD BE REVIEWED BY MINISTERS IN THE AUTUMN. THE FRENCH NOTED THAT CONTACT WITH THE CHINESE FOREIGN MINISTER MIGHT BE NECESSARY AT THE PARIS CAMBODIA CONFERENCE, AND RESERVED A DECISION ON WHETHER THE PLANNED TROIKA MEETING AT THE UN SHOULD TAKE PLACE.

3. DISCUSSION OF THE REST OF THE TEXT WAS RELATIVELY STRAIGHTFORWARD, THE PRESIDENCY HAVING PREPARED A GOOD FIRST DRAFT. FRETWELL (UK) SAID THAT AN ACKNOWLEDGEMENT AT THE EUROPEAN COUNCIL LEVEL OF THE DISQUIET EVENTS HAD CAUSED IN HONG KONG WOULD BE AN ENCOURAGEMENT TO THE POPULATIONS THERE. MACEDO (PORTUGAL) WAS HESITANT: HE DID NOT WANT MACAO MENTIONED, FEARING THIS MIGHT GIVE THE CHINESE A PRETEXT FOR ACCUSATIONS OF LACK OF FAITH IN THE JOINT DECLARATION, AND THERE WAS THEREFORE WORRIED ABOUT ANY MENTION OF

HONG KONG. DEUS PINHEIRO SUBSEQUENTLY ACCEPTED A REFERENCE TO HONG KONG.

4. TEXT OF DECLARATION IN MIFT.

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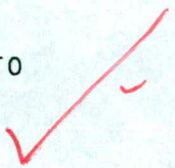
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FOLLOWING FROM HANNAY

EUROPEAN COUNCIL: MADRID: 26/27 JUNE
EUROPEAN POLITICAL COOPERATION: MIDDLE EAST

1. IN DISCUSSION IN THE POLITICAL COMMITTEE A DIVISION QUICKLY BECAME APPARENT BETWEEN THOSE (PRESIDENCY, GREECE, FRANCE, ITALY) WHO WANTED A TEXT WHICH WOULD GIVE NO (NO) COMFORT TO ISRAEL AND THOSE (UK, DENMARK, FRG, NETHERLANDS) WHO WANTED SOME BALANCING ELEMENTS INCLUDED.
2. THE PRESIDENCY FLATLY REFUSED TO CONTEMPLATE INTRODUCTION OF ANY REFERENCE TO AS GENERAL CALL FOR RESTRAINT IN THE OCCUPIED TERRITORIES, STICKING TO TOUGH LANGUAGE ON THE NEED FOR ISRAELI RESTRAINT. ONLY UNDER MUCH PRESSURE, SUSTAINED AT THE FOREIGN MINISTER'S DINNER, WERE THEY BROUGHT TO ACCEPT AN EXPRESSION OF WELCOME FOR SHAMIR'S PROPOSALS.
3. INITIAL GERMAN AND DUTCH RESEVATIONS ABOUT 'PARTICIPATION' BY THE PLO IN AN NTERNATIONAL PEACE CONFERENCE WERE DROPPED AT FOREIGN MINISTER LEVEL.
4. TEXT DECLARTION IN MIFT.

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10. HAUGHEY (IRELAND) SAID A MEANINGFUL DECISION MUST TAKE ACCOUNT OF THE PROBLEMS OF THE POORER REGIONS OF THE COMMUNITY AND MUST TRY TO DIMINISH REGIONAL DIVERGENCIES. SANTER (LUXEMBOURG) EMPHASISED THE CONTRIBUTION OF THE WERNER REPORT ON THE MONETARY SIDE. THE BUDGETARY SIDE WOULD NEED TO CATCH UP. THE EUROPEAN COUNCIL SHOULD AGREE ON STAGE 1 BUT SHOULD NOT CONVENE AN IGC UNTIL THERE WAS AN AGREED BASIS FOR DOING SO. STAGES 2 AND 3 AND OTHER ALTERNATIVES NEEDED STUDY.

11. MITTERRAND (FRANCE) CONGRATULATED THE SPANISH PRESIDENCY ON THEIR ACHIEVEMENT. IT WAS IMPORTANT TO KEEP UP THE MOMENTUM. HE WELCOMED THE DELORS APPROACH. ALL WERE AGREED ON SETTING A DEADLINE FOR STARTING STAGE 1 BUT WHAT WAS THE POINT OF STAGE 1 IF THERE WERE NO FURTHER STAGES? FURTHER DEADLINES SHOULD BE SET NOW AS THEY HAD AT THE MILAN EUROPEAN COUNCIL WHICH HAD BEEN A SUCCESS.

12. AT A RESUMED SESSION, FOLLOWING LUNCH, GONZALEZ PROPOSED A FOUR POINT CONCLUSION: A) THE EUROPEAN COUNCIL SHOULD CONFIRM ITS SUPPORT OF EMU, AS ALREADY DECIDED IN THE SINGLE EUROPEAN ACT AND THE HANOVER CONCLUSIONS:
B) THE DELORS REPORT SHOULD BE ACCEPTED AS THE (A?) BASIS FOR AN OVERALL STAGED PROCESS TOWARDS EMU, WITH PARALLEL PROGRESS TO BE MADE ON THE ECONOMIC AND MONETARY SIDE.
C) THE FIRST STAGE SHOULD START ON 1 JULY 1990 AND BE PREPARED BY THE ECOFIN COUNCIL.
D) SOME DELEGATIONS THOUGHT AN IGC SHOULD BE CALLED TO PREPARE THE SECOND AND THIRD STAGES WHILE OTHERS PREFERRED TO GIVE A MANDATE TO THE COMPETENT ORGANS OF THE COMMUNITY TO UNDERTAKE STUDIES IN PREPARATION FOR AN IGC.

13. KOHL AGREED WITH THE FIRST THREE POINTS BUT REDEFINED POINT (D). THE COMPETENT AUTHORITIES (ECOFIN, FOREIGN AFFAIRS COUNCIL, THE COMMITTEE OF CENTRAL BANKS, MONETARY COMMITTEE, THE ECONOMIC POLICY COMMITTEE AND THE COMMISSION) WOULD TAKE DECISIONS ON STAGE 1 AND SHOULD MAKE CONCRETE PROPOSALS FOR STAGES 2 AND 3. AN IGC SHOULD BE SET UP AFTER THE START OF STAGE 1 AND AFTER SUFFICIENT WORK HAD

BEEN DONE ON STAGES 2 AND 3 TO GIVE THE IGC A GOOD PROSPECT OF SUCCESS. GONZALEZ SAID KOHL HAD CORRECTLY INTERPRETED ONE OF HIS OPTIONS BUT RECALLED THAT MITTERRAND PREFERRED THE OPTION OF CALLING AN IGC NOW. THE PRIME MINISTER SAID THAT THE REFERENCE TO A STEP BY STEP PROCESS LEADING TO EMU COULD BE SEEN AS INVOLVING THE TRANSFER OF FUNDAMENTAL ISSUES OF SOVEREIGNTY. WHE AND OTHERS COULD NOT ACCEPT THIS. SHE WOULD PREFER TO SEE THE REPORT AS 'A TOOL FOR FURTHER WORK'. WORK WAS NEEDED ON OTHER WAYS OF ACHIEVING EMU. HOW COULD WE GO AHEAD WITH AN IGC UNTIL FURTHER WORK HAD BEEN DONE?

14. LUBBERS WELCOMED THE PRESIDENCY'S FOUR POINTS BUT THOUGHT THAT (D) SHOULD BE QUALIFIED BY A REFERENCE TO THE PRINCIPLE OF SUBSIDIARITY AND THE NEED FOR A LARGER MARGIN OF AUTONOMY FOR MEMBER STATES THAN PROVIDED FOR IN THE DELORS REPORT. DELORS SAID HE COULD ACCEPT THIS. HIS REPORT WAS NOT A BIBLE AND THERE WAS NO NEED TO FOLLOW IT EXACTLY AS LONG AS THE PROCESS WAS CONSIDERED AS A WHOLE.

15. SCHLUTER SAID HE TOO HAD DOUBTS ABOUT STAGES 2 AND 3 AND THERE MUST BE NO PROVISION FOR PASSING AUTOMATICALLY FROM ONE STAGE TO ANOTHER. CAVACO SAID THE DELORS REPORT SHOULD ONLY BE DESCRIBED AS (A NOT THE) BASE FOR FURTHER WORK AND THE DECISION TO CALL AN IGC SHOULD BE TAKEN AFTER PREPARATORY STUDIES ON STAGES 2 AND 3 IN THE APPROPRIATE FORA. DE MITA COULD AGREE THE PRESIDENCY'S CONCLUSIONS IF ALL COULD DO SO BUT WOULD HAVE PREFERRED A DECISION TO CALL AN IGC IMMEDIATELY. MARTENS COULD AGREE THE PRESIDENCY'S CONCLUSION BUT EMPHASISED THAT A DECISION TO EMBARK ON STAGE 1 SHOULD BE ACCOMPANIED BY A COMMITMENT TO THE OTHER STAGES. OTHERWISE WE WOULD NEVER GET BEYOND STAGE 1.

16. MITTERRAND SAID ALL MUST AGREE TO REAFFIRM THE COMMITMENT MADE AT HANOVER. STAGE 1 WAS NOT AN END IN ITSELF. WE COULD NOT IDENTIFY THE CONTENTS OF STGES 2 AND 3 NOW BUT WE SHOULD AGREE THAT THERE WOULD BE SUCH STAGES. WE MUST AGREE ON THE PRINCIPLE OF HOLDING AN IGC. HE ACCEPTED THE IDEA OF SUBSIDIARITY THAT AS MUCH AS POSSIBLE SHOULD BE LEFT TO GOVERNMENTS. GONZALEZ CONCLUDED THAT A REVISED TEXT OF HIS FOUR POINTS TAKING ACCOUNT OF THE POINTS MADE BY KOHL, LUBBERS AND SARTZETAKIS WOULD BE CIRCULATED THE NEXT DAY.

INTERNAL MARKET SOCIAL DIMENSION ETC

17. DELORS SAID GOOD PROGRSS WAS BEING MADE ON THE INTERNAL MARKET WITH 32 DECISIONS ADOPTED UNDER THE SPANISH PRESIDENCY AND HALF OF THE DECISIONS NOW TAKEN. PROGRESS HAD BEEN MADE ON FINANCIAL SERVICES BUT AN EFFORT WAS STILL NEEDED ON INSURANCE. THERE WAS ALSO

WORK TO DO ON TAX, AUDIO-VISUAL, PHYSICAL FRONTIERS AND ENVIRONMENT. ON THE LATTER SOME IMPORTANT DECISIONS HAD BEEN TAKEN E.G. ON SMALL CARS AND THE LONDON AND HAGUE CONFERENCES BUT HE HOPED AGREEMENT WOULD BE REACHED ON A EUROPEAN ENVIRONMENTAL AGENCY WHICH WOULD BE LIMITED TO COLLECTING DATA AND OPEN TO EFTA COUNTRIES. THE SOCIAL DIMENSION WAS NOT NEW AND ITS IMPLEMENTATION SHOULD RESPECT SUBSIDIARITY AND THE DIVERSITY OF PRACTICES IN MEMBER STATES. UNDER HIS PRESIDENCY NO PROPOSAL HAD BEEN PRESENTED WHICH INTERFERED WITH SOVEREIGNTY. THE SOCIAL CHARTER WOULD HAVE POLITICAL AND SYMBOLIC VALUE IN REAFFIRMING THE COMMUNITY'S VALUES. BUT HE HAD NO INTENTION OF INTERFERING IN THE BALANCE OF POWERS BETWEEN MEMBER STATES AND THE COMMUNITY. ANDRIESEN (VICE-PRESIDENT OF THE COMMISSION FOR EXTERNAL RELATIONS) REFERRED BRIEFLY TO THE INTEREST OF THIRD COUNTRIES IN THE COMMUNITY'S ACHIEVEMENTS ON THE SINGLE MARKET AND TO RECENT SUCCESSES IN THE URUGUAY ROUND, IN RELATIONS WITH THE US, IN DEALING WITH EFTA (WHERE THE COMMUNITY WOULD HAVE TO CONSIDER WHETHER IT WAS READY TO COOPERATE AT AN INSTITUTIONAL LEVEL) AND IN ITS COOPERATION AGREEMENTS WITH EASTERN COUNTRIES.

18. LUBBERS CALLED FOR MORE ACTION IN THE FIELD OF ROAD TRANSPORT, ESPECIALLY CABOTAGE AND THE EXCISE TAX ON DIESEL OIL. THE SOCIAL CHARTER SHOULD BE A MINIMUM AND THE QUESTION OF IMMIGRANTS FROM THIRD COUNTRIES SHOULD NOT BE FORGOTTEN.

19. THE PRIME MINISTER EMPHASISED THE NEED FOR PROGRESS ON AIR AND ROAD TRANSPORT. ALSO MORE WORK WAS NEEDED ON INVESTMENT SERVICES AND INSURANCE AS WELL AS IN THE FIELDS OF STANDARDS AND PUBLIC PROCUREMENT. SHE WAS ALSO CONCERNED ABOUT THE IMPLEMENTATION OF THE DIRECTIVES ALREADY AGREED. THERE WAS A RISK THAT SOME MEMBER STATES WOULD FALL SERIOUSLY BEHIND. WE SHOULD INTENSIFY THE FIGHT AGAINST STATE AIDS AND THE GROWING DELAYS IN LIBERALISING CAPITAL MOVEMENTS. ON THE SOCIAL DIMENSION, EACH MEMBER STATE HAD ITS OWN POLICIES EVEN IF THERE WERE SOME COMMON ELEMENTS. HER FEAR WAS THAT THE ADOPTION OF A SOCIAL CHARTER WOULD BE USED AS A PRETEXT FOR PUTTING FORWARD DIRECTIVES. THE COUNCIL OF EUROPE CHARTER WAS A GOOD TEXT. IT WAS PREFERABLE FOR EACH MEMBER STATE TO DEAL WITH THE HANDICAPPED, RETIRED OR SICK IN ITS OWN WAY. SHE WAS OPPOSED TO A MINIMUM WAGE AND IT WAS BETTER TO HAVE A SYSTEM FOR TOPPING UP PAYMENTS TO THOSE WHO DID NOT EARN ENOUGH DEPENDING ON THEIR FAMILY SIZE. TO IMPOSE AN IDENTICAL SYSTEM ON ALL MEMBER STATES WOULD BE WHOLLY ARTIFICIAL. THE CHARTER SHOULD INCLUDE OBLIGATIONS AS WELL AS RIGHTS OR IT WOULD SEND THE WRONG MESSAGE.

20. CAVACO WELCOMED THE PROPOSED CHARTER. MIGRANT WORKERS WHO WERE

NATIONALS OF MEMBER STATES SHOULD NOT BE FORGOTTEN. MARTENS THOUGHT THE SOCIAL CHARTER HAD GREAT POLITICAL AND SYMBOLIC VALUE. SARTZETAKIS SAID THE SOCIAL CHARTER WAS THE GUARANTEE FOR ALL LEVELS OF SOCIETY THAT THEY WOULD BENEFIT FROM THE SAME MARKET. THE COMMISSION SHOULD PRESENT AN ACTION PROGRAMME - THIS WAS THE HUMAN FACE OF EUROPE. KOHL SAID THE PROPOSAL FOR QUOTAS ON BROADCASTING WAS UNREASONABLE AND WOULD CREATE CONFLICT WITH THE UNITED STATES, WHOSE SUPPORT WE NEEDED ON HDTV. ON THE SOCIAL CHARTER HE AGREED WITH THE PRIME MINISTER ON THE IMPORTANCE OF DIFFERENCE BETWEEN MEMBER STATES BUT SAW NO OBJECTIN TO A CATALOGUE OF RIGHTS.

21. SANTER WHO WAS IN FAVOUR OF BINDING MINIMUM STANDARDS WHILE AVOIDING OVER-REGULATION. HAUGHEY AGREED WITH THE PRIME MINISTER ON THE NEED FOR MORE WORK ON A LIBERALISATION OF AIR TRANSPORT. HE WAS IN FAVOUR OF PROGRESS ON THE SOCILA DIMENSION AND THE SOCIAL CHARTER WAS ACCEPTABLE BUT EACH MEMBER STATES'S DIFFERENT TRADITIONS HSOULD BE TAKEN INTO ACCOUNT. HE WAS ALSO IN FAVOUR OF THE PROPOSAL FOR A EUROPEAN ENVIRONMENTAL AGENCY.

22. GONZALEZ SAID THE INTERNAL MARKET HAD A SOCIAL IMPACT AND WE MUST SEE THAT IT LED TO JOB CREATION. THE EUROPEAN COUNCIL SHOULD SEND A CLEAR SIGNAL THAT IT WANTED PROGRESS ON THE PRELIMINARY DRAFT FOR THE SOCIAL CHARTER, WHILE RESPECTING THE COMMUNITY'S DIVERSITY. HE HOPED THE UK COULD SUPPORT THE CONCLUSIONS AGREED BY 11 SOCIAL AFFAIRS MINISTERS. THE MOMENTUM SHOULD BE KEPT UP ON THE BROADCASTING DIRECTIVE. WE SHOULD AGREE ON THE EUROPEAN ENVIRONMENTAL AGENCY. DRAFT CONCLUSIONS ON THE POINTS RAISED WOULD BE CIRCULATED ON THE FOLLOWING DAY.

SECOND DAY

23. IN DISCUSSION OF THE TEXTS CIRCULATED OVERNIGHT WE WERE ABLE TO SECURE SOME IMPROVEMENT OF THE LANGUAGE ON THE INTERNAL MARKET. WE ALSO GOT AGREEMENT TO THE INCLUSION OF A USEFUL PARAGRAPH ON FRAUD (WHICH HAD BEEN MISSED OUT OF THE CONCLUSIONS, ALTHOUGH AGREED IN AADVANCE BY THE SPANISH PRESIDENCY). IN THE AUDIO VISUAL SECTION A REFERENCE TO THE DESIRABILITY OF EARLY AGREEMENT ON THE BROADCASTING DIRECTIVE WAS AGREED. ON THE FREE MOVEMENT OF PERSONS A MANDATE WAS GIVEN TO THE COORDINATORS GROUP TO FOLLOW UP THE WORK PROGRAMME.

24. ON THE SOCIAL DIMENTION AGREEMTNE WAS REACHED WITHOUT DIFFICULTY ON A TEXT REFERRING TO THE ACCEPTANCE BY 11 DELEGATIONS OF THE CONCLUSIONS AGREED BY THE SOCIAL AFFAIRS COUNCIL ON 12 JUNE. IN DISCUSSION OF THE TEXT ON THE ENVIRONMENT A CALL FOR A PROGRAMME

FOR THE PROTECTION OF THE ENVIRONMENT IN THE MEDITERRANEAN REGIONS WAS AMENDED TO REPLACE THE MEDITERRANEAN REGIONS BY THE REGIONS OF THE COMMUNITY AFFECTED.

25. ON ECONOMIC AND MONETARY UNION, AGREEMENT WAS REACHED WITHOUT MUCH DIFFICULTY ON THE FIRST THREE PARAGRAPHS RESPECTIVELY REAFFIRMING THE OBJECTIVE OF ECONOMIC AND MONETARY UNION, WELCOMING THE DELORS REPORT AS A GOOD BASIS FOR FURTHER WORK (WITH A USEFUL REFERENCE TO SUBSIDIARITY) AND AGREEING THAT THE FIRST STAGE SHOULD BEGIN ON 1 APRIL 1990. THERE WAS ALSO AGREEMENT ON PARA 4 A ON THE LAUNCHING OF THE FIRST STAGE. THERE WAS A LENGTHY DISCUSSIN ABOUT PARAGRAPH 4 B. MITTERRAND PRESSED HARD FOR A DEADLINE, SUGGESTING AT ONE POINT THAT THE SECOND AND THIRD STAGES SHOULD BE COMPLETED BY 31 DECEMBER 1992. IT RAPIDLY BECAME CLEAR THAT HE WAS ISOLATED AND THAT 11 DELEGATIONS COULD ACCEPT THE ORIGINAL TEXT. AT THIS STAGE DE MITA PROPOSED A TEXT ON THE LINES OF THE FINAL CONCLUSION. THE PRIME MINISTER SAID SHE COULD ACCEPT THIS BUT WISHED TO MAKE A UNILATERAL DECLARATION AS FOLLOWS:

' ' THE UNITED KINGDOM NOTES THAT THERE IS NO AUTOMATICITY ABOUT THE MOVE TO NOR THE TIMING OR CONTENT OR STAGE 2. THE UK WILL TAKE ITS DECISIONS ON THESE MATTERS IN THE LIGHT OF THE PROGRESS WHICH HAS BY THEN BEEN MADE IN STAGE 1, IN PARTICULAR OVER THE COMPLETION OF ALL MEASURES AGREED AS BEING NECESSARY TO COMPLETE' '.

PRESIDENT MITTERRAND SAID HE ALSO WISHED TO MAKE A DECLARATION OF THE EFFECT THAT THE IGC SHOULD MEET AS SOON AS POSSIBLE AFTER 1 JULY 1990. GONZALEZ CALLED FOR BOTH DECLARATIONS TO BE WITHDRAWN, RECALLING THAT THE EUROPEAN COUNCIL DID NOT IN ANY CASE HAVE A RECORD IN WHICH MINUTES COULD BE INSCRIBED. THE PRIME MINISTER POINTED OUT THAT SHE HAD MADE HER DECLARATION AND MIGHT WISH TO REPEAT IT ELSEWHERE. 70

26. THE SECTION ON EXTERNAL RELATIONS WAS AGREED WITHOUT DIFFICULTY BUT WITH AN AMENDMENT OF THE PASSAGE ON DEBT TO REMOVE ANY SUGGESTION OF THE COMMUNITY HAVE COMPETENCE IN THIS FIELD. IT WAS ALSO AGREED THAT A REFERENCE TO RELATIONS WITH THE UNITED STATES SHOULD BE INCLUDED. THE PARAGRAPH ON THE SPANISH PROPOSAL FOR A EUROPEAN GUARANTEE FUND TO DEAL WITH DEBT PROBLEMS WAS SHORTENED. AFTER A BRIEF DISCUSSION OF THE POLITICAL COOPERATION TEXTS THE MEETING WAS CONCLUDED.

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INFO PRIORITY EC POSTS

FOLLOWING FROM HANNAY:

EUROPEAN COUNCIL: MADRID: 26/27 JUNE

SUMMARY

1. DISCUSSION ON THE FIRST DAY WAS LARGELY FOCUSED ON EMU WITH TWO COMPLETE TABLE ROUNDS LASTING UNTIL LATE AFTERNOON. THIS LEFT LESS THAN TWO HOURS FOR A FURTHER TABLE ROUND COVERING THE INTERNAL MARKET, THE SOCIAL DIMENSION AND EXTERNAL QUESTIONS. THE SECOND DAY WAS ENTIRELY DEVOTED TO DISCUSSION OF THE DRAFT CONCLUSIONS WHICH HAD BEEN PRODUCED OVERNIGHT. WE WERE ABLE TO SECURE SATISFACTORY AMENDMENTS, WHERE REQUIRED, ON ALL THE MAIN POINTS.

2. THIS TELEGRAM SUMMARISES THE COURSE OF DISCUSSION. MY MIFT COMMENTS ON THE OVERALL OUTCOME AND MY SECOND IFT CONTAINS THE AGREED CONCLUSIONS. THE EPC DISCUSSIONS, WHICH LED TO ADOPTION OF DECLARATIONS OF THE MIDDLE EAST AND CHINA AS WELL AS AN AGREEMENT ON A SET OF CONCLUSIONS DESCRIBED IN MY SIX FURTHER IFTS.

Not yet
am
received

DETAIL

3. THE MEETING OPENED WITH THE USUAL SPEECH BY THE PRESIDENT OF THE EUROPEAN PARLIAMENT. LORD PLUMB CONCENTRATED ON THE MAIN SUBJECTS ON THE AGENDA - EMU AND THE SOCIAL DIMENSION BUT REFERRED ALSO TO THE SUCCESS OF THE COOPERATION PROCEDURE AND TO THE PARLIAMENT'S INTENTION TO PREPARE PROPOSALS ON THIS FUTURE DEVELOPMENT OF THE COMMUNITY. GONZALEZ (PRESIDENCY) CONGRATULATED LORD PLUMB ON HIS LEADERSHIP OF THE PARLIAMENT AND INVITED THE MEETING TO DISCUSS ECONOMIC AND MONETARY UNION (EMU).

EMU

4. DELORS (COMMISSION) GAVE AN ACCOUNT OF HIS REPORT. HE EMPHASISED THE PRINCIPLE OF SUBSIDIARITY AND THE AIM OF KEEPING BINDING RULES ON MEMBER STATES TO A MINIMUM BUT THE NEED NEVERTHESS FOR A SYSTEM OF EUROPEAN CENTRAL BANKS WHICH SHOULD BE INDEPENDENT OF

NATIONAL AUTHORITIES. THE GOAL OF ECONOMIC AND MONETARY UNION WITH FIXED EXCHANGE RATES SHOULD BE ATTAINED BY A GRADUAL STAGE BY STAGE PROCESS AND THE SETTING OF PRECISE DEADLINES SHOULD BE AVOIDED. THE EUROPEAN COUNCIL SHOULD GIVE A POLITICAL COMMITTEMENT TO THE GOAL OF EMU, SHOULD AGREE ON THE HOLDING OF AN INTER-GOVERNMENTAL CONFERENCE (IGC) AND SHOULD AGREE THAT THE FIRST STAGE, AS RECOMMENDED BY THE REPORT, SHOULD START ON 1 JULY 1990 (THE DATE ON WHICH THE LIBERALISATION OF CAPTIAL MOVEMENT COMES INTO FORCE). GONZALEZ SUGGESTED THAT DISCUSSION SHOULD CONCENTRATE ON WHETHER THE DELORS REPORT COULD BE ACCEPTED AS A BASIS FOR WORK AND ON THE QUESTION OF A DECISION ON THE FIRST STAGE AND THE LINK WITH THE LATER STAGES.

5. LUBBERS (NETHERLANDS) THOUGHT THE REPORT PROVIDED A GOOD BASIS FOR DISCUSSION. HE EMPHASISED THE IMPORTANCE OF SUBSIDIARITY -POWERS SHOULD BE TRANSFERRED TO THE COMMUNITY ONLY WHERE A CLEAR NEED TO DO SO COULD BE PROVED. HE AGREED THAT MOVEMENT TO ECONOMIC UNION SHOULD GO IN PARALLEL TO MONETARY UNION BUT CONVERGENCE ON THE BUDGETARY SIDE SHOULD BE LIMITED TO WHAT WAS NECESSARY. KOHL (GERMANY) SAID THE DELORS REPORT WAS HIS STARTING POINT. THE EUROPEAN COUNCIL SHOULD AGREE TO AFFIRM THE OBJECTIVE OF EMU IN ACCORDANCE WITH THE SINGLE ACT. THE REPORT WHICH HAD BEEN APPROVED BY UNANIMITY IMPLIED A SINGLE PROCESS AND PARA 39 WAS IMPORTANT. THE FIRST STAGE SHOULD START ON 1 JULY 1990 AND ALL COMMUNTIY CURRENCIES SHOULD BE INCLUDED IN THE EXCHANGE RATE MECHANISM (ERM). A MANDATE SHOULD BE GIVEN TO ECOFIN AND THE ECONOMIC POLICY COMMITTEE TO SET IN HAND DECISIONS ON THE FIRST STAGE AND TO PREPARE CONCRETE PROPOSALS FOR THE SECOND STAGE. AND IDC SHOULD BE SET UP IN A FORESEEABLE TIME.

6. SARTZETAKIS (GREECE) SAID THE DELORS REPORT WAS BALANCED AND GREECE AGREED WITH THE STAGED APPROACH. A START DATE FOR STAGE 1 SHOULD BE AGREED. THE DECISIONS ON LATER STAGES SHOULD DEPEND ON DEVELOPMENTS. THERE SHOULD BE AN INCREASE IN THE STRUCTURAL FUNDS BEFORE THE BEGINNING OF THE SECOND STAGE. BETTER MECHANISMS WERE NEED TO TRANSFER FUNDS TO THE LESS DEVELOPED REGIONS AND TO GIVE HELP IN DEALING WITH BALANCE OF PAYMENTS PROBLEMS. FLEXIBILITY WOULD ALSO BE NEEDED OVER THE DRACHMA JOINING THE ERM. THE POWERS OF THE PROPOSED CENTRAL BANK WOULD NEED TO BE CAREFULLY STUDIED. THERE SHOULD BE A COMMUNITY RESERVE FUND WHICH COULD INTERVENE AT REQUEST OF A MEMBER STATE. TREATY REVISION WOULD BE NEEDED. SCHLUTER (DENMARK) SAID ALL WERE AGREED ON THE FINAL OBJECTIVE. HE COULD NOT AGREE TO PARARGRAPH 39 UNLESS STAGES 2 AND 3 HAD BEEN SPELT OUT AND NEGOTIATED IN ADVANCE. THE COMMITTEE OF CENTRAL BANK GOVERNORS AND THE ECOFIN CONCIL SHOULD BE GIVEN A MANDATE TO START WORK ON STAGE 1 AND TO CLARIFY STAGES 2 AND 3 IMMEDIATELY. THE DECISION ON THE IGC

COULD BE TAKEN LATER. MARTENS (BELGIUM) ALSO THOUGHT A MANDATE SHOULD BE AGREED TO START WORK ON STAGE 1 AND TO INVITE THE COMMISSION TO ESTABLISH AN INDICATIVE LIST OF DECISIONS WHICH WOULD HAVE TO BE TAKEN BY AN IGC. THERE SHOULD BE REPORT BACK OF THE DECEMBER EUROPEAN COUNCIL ON THESE TWO POINTS. IT SHOULD ALSO BE AGREED THAT STAGE 1 WOULD START ON 1 JULY 1990 AND THAT THERE WOULD BE AN IGC.

7. DE MITA (ITALY) SAID THE EUROPEAN COUNCIL SHOULD CONFIRM THE PRINCIPLE OF EMU AGREED IN HANOVER AND SHOULD AGREE ON PROCEDURE INCLUDING A START STAGE 1 AND THE PRINCIPLE OF SETTING UP AN IGC, WITHOUT SETTING A DATE. A MOVE TOWARDS EMU WOULD ACT AS AN ACCELERATOR TOWARDS POLITICAL UNION. CAVACO (PORTUGAL) SAID THAT BECAUSE OF THE POSSIBLE FINANCIAL AND SOCIAL CONSEQUENCES EMU SHOULD BE ACCOMPANIED BY CERTAIN GUARANTEES INCLUDING THE POSSIBILITY OF A TRANSFER OF RESOURCES TO POORER COUNTRIES. OTHERWISE THERE WAS A RISK OF A FLOW IN THE OPPOSITE DIRECTION. SOME LOSS OF NATIONAL AUTONOMY WAS INEVITABLE. BUT HE WONDERED WHETHER THE SMALL SIZE OF THE COMMUNITY BUDGET (2% OF PUBLIC EXPENDITURE IN THE COMMUNITY) WAS SUFFICIENT FOR A BALANCE TO BE MAINTAINED. WAYS MUST BE FOUND TO AVOID DESTABILISING CERTAIN MEMBER STATES.

8. THE PRIME MINISTER SAID THE DELORS REPORT WAS RIGHT TO GO FOR A STAGED APPROACH AND STAGE 1 SHOULD BE STARTED SOON. HAD STERLING BEEN IN THE EMS THIS WOULD HAVE BEEN DAMAGING BOTH TO US AND TO THE EMS, AS A RESULT OF STERLING'S STATUS AS A PETRO-CURRENCY. THE PRIME MINISTER DREW ATTENTION TO THE REFERENCE IN THE DELORS REPORT TO THE IMPORTANCE OF ALL COMMUNITY CURRENCIES JOINING THE EXCHANGE RATE MECHANISM OF THE EMS DURING STAGE 1. SHE MADE CLEAR THAT HER REACTION TO THIS WAS POSITIVE ALTHOUGH SHE COULD NOT SET A DATE FOR JOINING THE ERM. THE TIMING WOULD DEPEND ON PROGRESS IN THE UK AGAINST INFLATION AND PROGRESS IN THE COMMUNITY ON A SINGLE MARKET, AND PARTICULARLY ON THE ABOLITION OF EXCHANGE CONTROLS. THE TIMING OF THE DECISION WAS OF COURSE FOR HMG ALONE.

9. THE PRIME MINISTER SAID THAT STAGES 2 AND 3, HAD FAR REACHING ECONOMIC AND POLITICAL IMPLICATIONS WHICH WOULD NOT BE ACCEPTABLE TO THE BRITISH PARLIAMENT. SHE WAS SCEPTICAL OF THE IDEA OF MASSIVE SUBSIDISING ON THE COMMUNITY PERIPHERY. MORE WORK WAS NEEDED TO SEE WHETHER THERE WERE ANY OTHER POSSIBLE MODELS FOR REACHING EMU, AS AN ALTERNATIVE TO STAGES 2 AND 3. FINANCE MINISTERS WERE ALREADY PREPARING STAGE 1 AND THE EUROPEAN COUNCIL SHOULD ENDORSE THIS. MORE STUDY WAS NEEDED ON THE LATER STAGES.

GORDON LENNOX

YYYY

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Foreign and Commonwealth Office

London SW1A 2AH

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C D Powell Esq
No 10

28 June 1989

CH/EXCHEQUER	
REC.	29 JUN 1989 ✓ 29/6
ACTION	MR PERETZ
COPIES TO	EST, PMG SIR P. M. DOLETON SIR T. BURNS, MR WICKS MR SCHOLAR, MR LANKESTER, MISS O'MARA, MR R. G. ALLEN, MRS BROWN, MR MERCER MRS CHAPLIN MR TYRRE

Dear Charles

EUROPEAN COUNCIL STATEMENT: SUPPLEMENTARIES

1. I attach our suggested supplementaries for use after tomorrow's statement.
2. Copies of this letter and enclosures go to **Alex Allan** (HMT), Clive Norris (Dept of Employment), and Trevor Woolley and Roger Lavelle (Cabinet Office).

Yours ever

Charles Hamilton

C A Hamilton
Parliamentary Relations Unit

PRIME MINISTER'S STATEMENT: SUPPLEMENTARIES: EC
ISSUES

ECONOMIC AND MONETARY COOPERATION

UK genuinely committed to EMU?

- The Community's commitment to progressive realisation of Economic and Monetary Union pre-dates our accession. But it was repeatedly reaffirmed by Labour governments of the 1970s; and is repeated in the preamble to Single European Act, which this House approved.

- [IF PRESSED: Conclusions of the Hague European Council in November 1976 state: "The achievement of Economic and Monetary Union is basic to the consolidation of Community solidarity and the establishment of European Union". Similar references at European Councils in December 1974, July 1978 and December 1978. Hanover Conclusions (June 1988): "recalls that, in adopting the Single Act, member states confirmed the objective of progressive realisation of EMU".]

UK concession on Inter-Government Conference?

- Some member states wanted to set a firm date now. We did not agree, because we believe that adequate preparation is essential. An IGC could have been called at any time, for only a simple majority vote is required. But the outcome of Madrid ensures no IGC in near future. Conclusions state that IGC can begin only after implementation of first stage has begun in July 1990 - and when there has been full and adequate preparation.

[IF PRESSED ON WHETHER UK WOULD ATTEND AN IGC:
Yes. UK would certainly attend. To leave an empty chair would mean giving up all influence over what was discussed. Any serious discussion will show that Stages 2 and 3 on the Delors Report's prescription present grave difficulties for other member states as well.]

UK committed to Stages 2 and 3?

- Certainly not. There is no agreement on anything beyond Stage 1. Nor is there any automaticity about the move to, or the timing or content of, Stages 2 and 3. The UK and other member states will take decisions on these matters in the light of the circumstances at the time, the wider work which will now be done, and the progress which has by then been made on Stage 1 - in particular on completion of the Single Market.

IGC will agree comprehensive Treaty change to implement EMU?

- Madrid Council reaffirmed progressive nature of Economic and Monetary Union. But there is no agreement to the Delors Report's prescription other than for Stage 1. We shall ensure that alternative approaches are fully examined. The scale of the transfer of sovereignty required by the Delors Report model is neither necessary nor acceptable. And it would be doubly absurd to suggest that a single, comprehensive legal text could provide for a series of such fundamental changes which would stretch well into the next century.

What are key UK objections to Delors Stages 2 and 3?

- Fundamental doubts about, for example:-
 - (a) lack of democratic accountability. The arrangements the Report describes would mean a new Central Bank System less accountable than the most independent of the present Central Banks - the Bundesbank;
 - (b) treatment of fiscal policy. The Report asserts that binding rules for member states' budgetary policies would be essential in supporting monetary union. That goes far further than is normal even in federations;
 - (c) treatment of regional policy. The Report talks of massive subsidies to peripheral regions. But experience shows that differences in competitiveness are best dealt with by market forces.

- At Madrid, a number of others expressed similar doubts about the prescription for Stages 2 and 3.

Could UK accept any form of EMU?

- UK is committed to progressive realisation of Economic and Monetary Union. Exactly what forms this might take is to be the subject of further study by the Council, the Commission, the Committee of Central Bank Governors and the Monetary Committee.

UK behind on monetary cooperation?

- Far from it. On practical aspects of monetary cooperation, UK is among the leaders: led way in abolition of exchange controls. Issue of ecu-denominated UK Treasury bills, denominated and payable in ecu, demonstrates practical commitment. Pressing hard for liberalisation of financial services and welcome agreement - 19 June - on a good Banking Directive.

- [IF PRESSED: even steps we have warmly supported to date - eg full capital liberalisation - cause serious problems for some member states. Demonstrates how far member states are in practice from agreeing the much more fundamental changes EMU would involve.]

When will sterling join ERM?

- In judging the right timing for sterling to join the ERM we shall be looking primarily at progress against UK inflation; and on completion of the Community Single Market - particularly the abolition of exchange controls by our major Community partners. The timing is of course a matter for HMG alone. My statement at Madrid was received very positively.

[IF PRESSED ON EXCHANGE CONTROLS. UK, Germany, Netherlands and Denmark have abolished exchange controls: France, Italy, Belgium and Luxembourg have until mid-1990; the others until end 1992, though the possibility of some extension for Greece and Portugal is conceivable.]

Why could time not be found for a debate on the Delors Report before Madrid?

- This is a matter for my rt hon Friend the Leader of the House.

SOCIAL DIMENSION

- Welcome Madrid reaffirmation that creating the right conditions for employment growth has top priority. Liberalisation and deregulation only way to achieve this.

- UK domestic deregulation bears this out: 3 million jobs created since 1983, 600,000 last year alone. Imposing burdens on business does not produce jobs.
- Recognise social dimension to 1992. Made clear UK's excellent record.

Social Charter

- No need for an EC Charter. No one system is right for all member states. Each should deal with handicapped, retired or sick in their own way.
- Delors and others accepted need for diversity of practice on social issues and the role of national governments.
- Council of Europe Social Charter already exists: a good text.

11 to 1 split on Social

- Constructive discussion, many points of agreement. On the idea of a Social Charter, I confirmed that we cannot accept the ideas tabled at Social Affairs Council on 12 June.
- But discussions continue. UK record on social policy impressive. Will participate fully in future discussions.

SINGLE MARKET PROGRESS

- Excellent. Very successful Spanish Presidency (68 decisions) has taken us well past the half-way mark. Particularly welcome success in agreeing 2nd Banking Directive this month.

- Vital now to make sure these measures are implemented and enforced.

UK Priorities

- Fully reflected in Conclusions.
- Financial services: progress now needed on Investment Services, insurance.
- Standards: must keep up good work and move ahead on Testing and Certification.
- Transport: a lot of work to be done. Shipping cabotage; road haulage cabotage; more work on air services.
- Public purchasing: priority is further opening up of water, transport, energy and telecommunications.

FRONTIERS

- Sensible work underway to tackle cross-border drugs, terrorism and crime.
- Commonsense that, while working towards freer movement for EC citizens, essential checks must remain against illegal activities. Our legal position on our right to maintain controls against eg rabies remains unaffected.
- Good Madrid conclusions. UK will be active in encouraging greater cooperation among member states against common threats.

INDIRECT TAX

- Abolition of fiscal frontiers is an important element in completion of the Single Market. Decisions must be taken soon on the system to operate after 1992. Council conclusions recognised this and welcomed detailed discussions now taking place.

UK attitude to new Commission approach?

- We welcome the flexibility and realism in the Commission's new approach - in particular, the recognition that zero rates can be maintained. We shall stand by our pledges on zero-rating of food, domestic fuel and childrens' clothes and shoes.

FRAUD

- Council conclusions emphasise need for firm action to tackle the problem of fraud against the Community budget. Successful result of UK efforts to ensure Community devotes its full attention to this most serious issue.

ENVIRONMENT

- Environment policy must have firm scientific basis. Not convinced that new Agency, as proposed by Commission, best way to achieve this. Environment Council will consider proposal further.

- Agreed that countries concerned will be involved in work to conserve tropical forests. Essential for effective action.

RESEARCH AND DEVELOPMENT

- Community has important contribution to make to European competitiveness. Expect forthcoming review of R & D Framework Programme to undertake full evaluation of work so far.

EC EXTERNAL

EC/EFTA

- Reaffirmed importance of current discussions on even closer relations. In all our interests. Look forward to concrete results by next European Council.

Enlargement

- Not discussed. Common ground that Community must concentrate on consolidation not enlargement, at least until 1993.

GATT Uruguay Round

- Reiterated the importance of successful Round. Much work to be done in next 18 months. Progress on agriculture - including further CAP reform - vital.

EC/US

- Reaffirmed importance of transatlantic links, and welcomed cooperative relations with Bush Administration. But also warned against unilateral action in trade matters.

EC/Eastern Europe

- Confirmed appropriateness of EC's current positive but precedent policy. Common will to support economic reforms - in Poland and Hungary in particular.

POLITICAL COOPERATION SUBJECTS

China

- Chinese actions not compatible with normal governmental relations. But measures not intended to impede normal commercial business or contacts which benefit ordinary Chinese.
- Package not against Hong Kong's interests: sure HK people will welcome firm stance by UK and partners. Macao for Portuguese.
- (If asked). Twelve will approach the Chinese about access to trials and prisons.

Other Subjects

- Discussed by Foreign Ministers: see Conclusions.

Middle East

- Declaration valuable and balanced: reflects constructive influence of Twelve.
- Recognizes PLO moderation (calls for their participation in negotiations); welcomes Shamir's election proposal; calls on Arab states to recognize Israel.
- Iran: attitude not changed. Deal firmly with threats; call on them to respect international law.



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

28 June 1989

received in CX office on 29/6 at 9.25am

CH/EXCHEQUER	
REC.	29 JUN 1989
ACTION	Mr Nicks
COPIES TO	ES
	Sir P Middleton
	Sir T Burns
	Mr Scholof
	Mr R Allen
Mr Peritz	
Mr Colling Smee	

MADRID EUROPEAN COUNCIL: STATEMENT

I attach a slightly revised version of the Prime Minister's Statement on the Madrid European Council, taking account of most of the comments received. If there are any further points of fact on it I should be grateful to know by 1100 on 29 June.

I am copying this letter and enclosure to Alex Allan (H.M. Treasury), Clive Norris (Department of Employment) and Roger Lavelle (Cabinet Office).

2 on page 12, as I commented yesterday, "Secretary implementation" sounds far too binding a condition: "Secretary progress" would be better, but progress not negotiable with No. 10!

RWA
29/6 (CHARLES POWELL)

J.S. Wall, Esq.,
Foreign and Commonwealth Office.

Mr A CS Allan Passed to C Powell (1 not 2)

1. I really don't like his phrase to "be prepared" on p. 5, which strongly implies that we have signed up to all of Stage 1 of Delors. I would suggest deleting line 2 ("proposals ... for") and replacing with "measures necessary to achieve". This would, incidentally, be more consistent with the Communiqué (para 4(a)): "... to adopt the policies necessary for the launch of the first stage on 1 July 1990".



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CL
Not all amendments
taken on board but
probably OK?

(CHARLES POWELL)

J.S. Wall, Esq.,
Foreign and Commonwealth Office.

AA

Just
OK OK -

1

SP2AFQ

PRIME MINISTER'S STATEMENT

ON THE

EUROPEAN COUNCIL

IN

MADRID

With permission, Mr Speaker, I should like to make a Statement about the meeting of the European Council in Madrid on 26 and 27 June, which I attended with my Right Hon. and Learned Friend the Foreign and Commonwealth Secretary.

The full conclusions of the Council have been placed in the Library of the House.


Economic and Monetary

Economic and monetary matters were the main item on the Council's agenda.

Agreement was reached on four points:

- first, the objective of progressive realisation of Economic and Monetary Union was reaffirmed.

This objective was first set in 1972,
before Britain joined the Community, and
has subsequently been reaffirmed on
numerous occasions, including in the
Single European Act passed by this House.

 But no definition of it was agreed in
Madrid.

- second, the report of the Delors
Committee, which sets out an approach to

economic and monetary union by stages, was accepted as a basis for further work - but not the only basis.

It will be possible to bring in other ideas and other approaches.

- third, the Council agreed that the proposals set out in the Delors report for the first stage of progressive realisation of economic and monetary union will be

implemented from 1 July 1990.

These include:

- completion of the Single Market;
 - abolition of all foreign exchange controls;
 - a free market in financial services;
- and
- strengthening of the Community's competition policy by reducing

(no "in other countries")

No additions: I have
remonstrated with Charles but
he is v resistant, saying sentence
governed by "These include"

State aids.

They are all matters for which the United Kingdom has campaigned strongly and where we are well ahead of the great majority of our European partners.

No decisions were reached on what should follow this first stage, and stages 2 and 3 of the Delors Report were not endorsed.

Indeed, several delegations - not only the United Kingdom - made clear that they had substantial difficulties with them.

- fourth, it was agreed to carry out the preparatory work for the organisation of an eventual intergovernmental conference to lay down subsequent stages.

But such a conference would meet only after implementation of the first stage

has begun and when there has been full and adequate preparation.

Its decisions would have to be reached by unanimity and would require ratification by this House.

In short, Mr Speaker, we made as much progress as can be made at this stage, while leaving longer term issues for further discussion by Finance Ministers and

(FM & CBG
visited A
ELOFIN)

Central Bank Governors over the months and years ahead.

We have ensured that there is nothing automatic about the move to subsequent stages.

Very difficult issues remain to be resolved.

As my Right Hon Friend the Chancellor of the Exchequer has made clear, Stages 2 and 3 of the Delors Report would involve a

massive transfer of sovereignty, which I do not believe would be acceptable to this House.

They would also in practice mean the creation of a federal Europe.

The Government supports the objective of closer monetary co-operation, but will work for solutions which leave crucial economic decisions in our own hands.

Although Britain's membership of the Exchange

Rate Mechanism of the European Monetary

System was not an issue at this Council,

I reaffirmed our intention to join the

ERM.

(date gone! - not a point I made)

But we must first get our inflation down:

and we shall look for satisfactory

[still] implementation of other aspects of the

first phase of the Delors Report,

(but see next page)

(new) including free movement of capital and
abolition of foreign exchange control.

Social Matters

The Council also discussed what is called the
Social Dimension.

On this, the United Kingdom's record is,
of course, very good and I took with me to
Madrid our own document, setting out our

substantial achievements in this field.

We have also ratified the Council of Europe's
Social Charter, unlike some of our
Community colleagues.

The Council's conclusions on this subject
recognise that the highest priority is to
create the conditions for more jobs.

The Government does not believe that the

Community's proposed Social Charter would help achieve this aim.

Indeed, we believe that imposing extra burdens on industry would make the Community less competitive.

That is the main reason why my Right Hon Friend the Secretary of State for Employment was unable to accept the conclusions of the June Social Affairs

Council.

I confirmed that refusal in Madrid.

But the conclusions of the European Council did bring out a very important point, raised by many governments during the discussion: that national legislation and voluntary agreements have a legitimate role in achieving the Community's Social Dimension, and not everything has to be

the subject of directives from the EC.

We shall be putting this view very strongly in the further discussions which will take place.

Other Issues

Mr Speaker, I will summarise very briefly the outcome of the Council's discussions on the other main issues.

The Council reaffirmed the priority task of completing the Single Market with the emphasis on the areas of particular importance for the United Kingdom: financial services, technical standards, transport and public purchasing.

✓ The Council's discussions demonstrated that there will not be a withholding tax on

savings - a proposal which the United Kingdom has consistently opposed.

The Council welcomed the progress being made in the fight against fraud in relation to the Community budget.

The Council showed there is wide acceptance of our need to keep checks at frontiers against drugs, terrorism and criminals,

while making free movement of ordinary law-abiding citizens a greater reality.

In political co-operation, the Heads of State and Government expressed their utter condemnation of what has happened in China and agreed a series of measures, which match those which the United Kingdom is already taking.

The Council also expressed its

understanding for the anxiety which has been caused in Hong Kong by the atrocious happenings in China.

Conclusions

Mr Speaker, in conclusion I would like to congratulate the Spanish Government on their Presidency of the EC over the past six months, in particular for the progress

made on the Single Market, with over 60 directives agreed.

I also congratulate the Spanish Prime Minister, Sr Gonzalez, on bringing a difficult European Council to a successful conclusion.

I believe that the main outcome of the Council - agreement to implement a first phase of economic and monetary union - is very much

in the interests of British industry and the City of London, while fully protecting the powers of this House.

Far from being isolated, as some have claimed, the United Kingdom was able to play an important role in bringing the Council to these sensible and practical conclusions.

It is in the same spirit of determination to strengthen co-operation with other members of the European Community, while arguing always for cutting constraints on enterprise and free competition and leaving to member states those decisions which properly belong to them, that we shall approach the undoubtedly difficult discussions of the Community's future which lie ahead.



PWP

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

28 June 1989

Charles Powell Esq
10 Downing Street
LONDON
SW1

Dear Charles

EUROPEAN COUNCIL, MADRID: STATEMENT

... I attach Supplementaries for the Prime Minister's Statement tomorrow.

I am copying this letter to Stephen Wall (FCO) and to Trevor Woolley and Roger Lavelle (Cabinet Office).

Yours
Alex

A C S ALLAN
Principal Private Secretary

EMU

Government changed its position on sterling's participation in ERM?

We have always made it plain we will join when the time is right. In Madrid I explained that the decision when to join will have to be judged against progress in a number of areas, in particular:

- UK inflation significantly lower;
- Community-wide capital liberalisation;
- real progress towards the completion of the single market, freedom of financial services and strengthened competition policy.

Date for sterling's entry

We are not committed to any particular date.

Is UK committed to EMU

We are committed to the progressive realisation of economic and monetary union - as our adoption of the Single European Act makes clear. But we are not committed to the Delors Report's interpretation. Indeed, no definition agreed at Madrid.

Chancellor told TCSC that Government was not committed to EMU

The Chancellor made it clear that he was referring to the definition of monetary union in the Delors Report, rather than the concept of EMU.

What alternatives are there to Delors' definition of stages 2 and 3?

It was clear from the discussions in Madrid that we are by no means alone in doubting whether the proposals put forward in the Delors Report are either the best route towards economic and

monetary union or indeed necessary for it. We shall be discussing these issues in detail over the coming months.

UK took entirely negative attitude at Madrid

Far from it. We in the UK want to make progress on the steps listed under stage 1 as fast as we can and we have warmly endorsed the recommendation that stage 1 should begin on 1 July 1990. In several areas (eg. exchange control abolition) we are already ahead. And we want to see action during stage 1 on some points the Committee did not cover at all - active promotion of the private ecu, increased holding of private ecu in official reserves and their greater use in intervention. And we certainly support the objective of much closer economic and monetary cooperation.

Does progress on stage 1 imply progress on ERM entry

We clearly want to make rapid progress in all the areas I have listed, and it is against this background that entry into the ERM will be judged.

Why did UK agree to an inter-governmental conference

In practical terms, we could not stop it: it can be convened by simple majority.

[If pressed: The IGC would lay down subsequent steps to EMU. Since such steps, if endorsed, would be bound to involve institutional change - and hence Treaty amendment - an IGC would be necessary by definition. But it would not meet until after stage 1 had begun to be implemented and after full preparations had been made for it. A lot of work will be needed, and the UK will play a full part in this. Any IGC will have to reach unanimous decisions.]

Would UK refuse to attend an IGC

No. There is no question of an empty chair policy.

DEBT

Community role

As the Presidency conclusions recognise, it is for the member states of the Community, rather than the Community itself, to take an active role in the debt strategy within the framework of IMF and World Bank economic reform programmes.

Proposed Spanish "European Fund" to be remitted to ECOFIN

The Spanish and others want this to be considered by ECOFIN, but it has already been discussed there and received little support. The IMF and World Bank Boards have now decided the guidelines and resources available for debt reductions. A proposal for a European guarantee fund, by creating uncertainty, can only delay negotiations between the debtors and the bankers on debt reduction.

Eastern Europe

All Community countries are anxious to support the process of political and economic reform in Eastern Europe. At this stage they can best help - along with other western countries - in their capacities as members of the IMF and World Bank, and through rescheduling of debt.

Taxation of savings

We recognise that certain countries are concerned that removing exchange controls will provide increased opportunities for tax evasion. Our own experience suggests that these fears are largely groundless. But, as agreed in Madrid, we will continue to look at what can be done. The idea of a Community-wide withholding tax is effectively dead. In the UK's view, the best way forward lies in Commission proposals for greater exchange of information between tax authorities.

[If pressed:

We are prepared to consider further proposals for exchange of information which are cost-effective and carefully targetted against specific cases of fraud.]

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In the single market traders must be able to move goods freely, without cumbersome tax checks at frontiers. The UK has lead the way in the Community in suggesting new ways of collecting VAT on traded goods away from frontiers. Work needs to move ahead on that rapidly if systems are to be in place by 1993, and we agreed this in Madrid.

[If raised

We will be examining the Commission's ideas on other matters concerning indirect taxation. I am glad to say the Commission now recognise the importance of the UK's zero VAT rates. We have not accepted the need for a single, centrally-imposed, VAT rate on other goods].

FRAUD AGAINST THE EC BUDGET

Welcome progress is being made. The European Council agreed on the importance of dealing with the problem of fraud against the Community budget. This will require a sustained effort and I welcome the fact that the Commission has recently put forward a medium term, 45-point action programme. This needs to be translated speedily into measures to address specific problems, eg on export refunds and intervention storage. We shall continue to press the Commission and the Council to maintain progress on this front.



Chancellor.

Primed in to FCO.

JH

A good Dr. but one has to see the court for the money Prof
No FCO court for
No final structure and
what the committee
pushed - it is
unsubstantiated

PM's supplementaries on Madrid

N Wicks has suggested a further supplementary :

Q: Would you vote against an IGC?

A: Certainly, if the proposal is a treaty to implement the Delors Report. I see no need for early Treaty amendment. But we will play an active part in the preparatory work for the organisation of an IGC to lay down the subsequent stages, ^{which would meet} once the first stage had begun and which would be preceded by full and adequate preparation.

The point of this to nuance our position from the blanket "I'm vote against" expressed by the PM at her Press Conference.

Content ?

JH

28/6

FROM: MRS M E BROWN (EC1)
DATE: 28 JUNE 1989

x4709

- 1. MR WICKS
- 2. CHANCELLOR

not yet seen

- cc: Economic Secretary
- Sir P Middleton
- Mr R I G Allen
- Mr H Evans
- Mr Mountfield
- Mr Odling-Smee
- Mr Peretz
- Mr Ilett
- Ms O'Mara
- Mr Mercer
- Ms Symes
- Mr Tyrie

Mr P R H Allen-Customs

STATEMENT ON MADRID COUNCIL - SUPPLEMENTARIES

I attach Q and A's on Treasury aspects, contributed by relevant copy recipients. No10 have asked for them as soon as possible this afternoon.

Mary Brown

*Ch
OK?*

MRS M E BROWN

AA

OK on answer

EMU

Government changed its position on sterling's participation in ERM?

In Madrid I explained that the decision when to join

will
when the time is right.
~~No.~~ We have always made it plain we ~~shall~~ join. ~~Now simply spelling out that a decision~~ will have to be judged against progress in a number of areas, in particular:

- UK inflation significantly lower;
- Community-wide capital liberalisation;
- real progress towards the completion of the single market, freedom of financial services and strengthened competition policy.

Date for sterling's entry

We are not committed to any *particular* date.

particular
[If pressed: it would really be quite wrong to talk of one, for market reasons, even if we had a date in mind.]

Is UK committed to EMU

the
Yes, we are committed to progressive realisation of economic and monetary union - as our adoption of the Single European Act makes clear. But we are not committed to the Delors Report's interpretation. Indeed, no ~~agreed~~ definition agreed at Madrid.

Chancellor told TCSC that Government was not committed to EMU

The Chancellor made it clear
~~Hon member has clearly not read the Chancellor's evidence. The footnote to Q78 makes it clear beyond all doubt~~ that he was referring to the definition of monetary union in the Delors report, ~~not~~ the concept of EMU ~~in general~~.

rather than to

Chancellor suggested to TCSC Government's understanding of SEA commitment different from other countries. Do you know what you have signed up to now?

[Chancellor told TCSC "I suppose it was felt at the time that the terms of economic and monetary union were rather vague ... [and that] we went along [with reference to EMU in SEA] because it was felt that what was meant was closer cooperation on both the economic and monetary fronts and that is something which we are certainly in favour of" (Q81)].

We have always been clear that we regard a massive transfer of political sovereignty as unacceptable.

What alternatives are there to Delors' definition of stages 2 and 3?

[That is precisely what we need to study in detail over the coming months. But the Delors Committee, for instance, advocated the centralisation of budget policy. We do not accept that for one moment. Nor we do we accept the need for a massive increase in regional transfers under EMU. And the Community took far too little account of the need to provide for the democratic accountability of the new institutions it proposed.] The Council made it clear that the Delors Report was a basis for further work but not the only basis.]

UK took entirely negative attitude at Madrid

Far from it. We in the UK want to make progress on the steps listed under stage 1 as fast as we can and we have warmly endorsed the recommendation that stage 1 should begin on 1 July 1990. In several areas (eg. exchange control abolition) we are already ahead. And we want to see action during stage 1 on some points the Committee did not cover at all - active promotion of the private ecu, increased holding of private ecu in official reserves and their greater use in intervention. And we certainly support the objective of much closer economic and monetary cooperation.

It was clear from the discussion in Madrid that we are by no means alone in doubting whether the proposals put forward in the Delors Report are either the best route towards economic and monetary union or indeed necessary for it. We shall be discussing these issues in detail over the coming months.

Dangers to list since may imply accept the points - defn A monetary union - potentials.

Does progress on stage 1 imply progress on ERM entry

We clearly want to make rapid progress in all the areas I have listed, and it is against this background that entry into the ERM will be judged.

Why did UK agree to an inter-governmental conference

In practical terms, we could not stop it: it can be convened by simple majority.

[If pressed: The IGC would lay down subsequent steps to EMU. Since such steps, if endorsed, would be bound to involve institutional change - and hence Treaty amendment - an IGC would be necessary by definition. But it would not meet until after stage 1 had begun to be implemented and after full preparations had been made for it. A lot of work will be needed, and the UK will play a full part in this. Any IGC will have to reach unanimous decisions.]

Would UK refuse to attend an IGC

No. There is no question of an empty chair policy.

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DATE: 28 JUNE 1989

x4709

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ed1:BNK/MSB/20.0a

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Would UK refuse to attend an IGC

No. There is no question of an empty chair policy.

DEBT

Community role

As the Presidency conclusions recognise, it is for the member states of the Community, rather than the Community itself, to take an active role in the debt strategy within the framework of IMF and World Bank economic reform programmes.

Proposed Spanish "European Fund" to be remitted to ECOFIN

The Spanish and others want this to be considered by ECOFIN, but it has already been discussed there and received little support. The IMF and World Bank Boards have now decided the guidelines and resources available for debt reductions. A proposal for a European guarantee fund, by creating uncertainty, can only delay negotiations between the debtors and the bankers on debt reduction.

Eastern Europe

All Community countries are anxious to support the process of political and economic reform in Eastern Europe. At this stage they can best help - along with other western countries - in their capacities as members of the IMF and World Bank, and through rescheduling of debt.

ec: jh, brown/20.10.2

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We recognise that certain countries are concerned that removing exchange controls will provide increased opportunities for tax evasion. Our own experience suggests that these fears are largely groundless. But, as agreed in Madrid, we will continue to look at what can be done. The idea of a Community-wide withholding tax is effectively dead. In the UK's view, the best way forward lies in Commission proposals for greater exchange of information between tax authorities.

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We are prepared to consider further proposals for exchange of information which are cost-effective and carefully targetted against specific cases of fraud.]

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[If raised

We will be examining the Commission's ideas on other matters concerning indirect taxation. I am glad to say the Commission now recognise the importance of the UK's zero VAT rates. We have not accepted the need for a single, centrally-imposed, VAT rate on other goods].

SECRET/ATTN/PARA

FRAUD AGAINST THE EC BUDGET

Welcome progress is being made. The European Council agreed on the importance of dealing with the problem of fraud against the Community budget. This will require a sustained effort and I welcome the fact that the Commission has recently put forward a medium term, 45-point action programme. This needs to be translated speedily into measures to address specific problems, eg on export refunds and intervention storage. We shall continue to press the Commission and the Council to maintain progress on this front.



CH/EXCHEQUER	
REC.	28 JUN 1989
ACTION	MR WICHT <i>✓ 28/6</i>
COPIES TO	EST
	SIR P MEODLETON
	SIR T BURNS
	MR SCHOLAR
	MR RIG-ALLEN
	MR PERLETZ
	MR ODLING-SMEE

Foreign and Commonwealth Office

London SW1A 2AH

28 June 1989

See Charles,

European Council, Madrid: Statement

We have very few comments of substance on the draft enclosed with your letter today, but we suggest that:

- on page 11, the substantive sentence should read:
 "The Government supports the objective of closer monetary cooperation, but will work for solutions which leave key economic decisions in our own hands."
- on page 18, it would perhaps be over-egging it to suggest that the Council accepted the death of the Withholding Tax proposal. But it clearly is dead, and it would be reasonable to say that:
 "The Council discussions demonstrated that there will not be a Withholding Tax"
- also on page 18, we suggest that the last two lines read:
 "The Council showed wide acceptance of our need to keep checks at frontiers against ..."
- on page 23, line 4, the reference might be to reducing constraints "on enterprise and free competition..."

We hope to resolve the remaining points over the Conclusions today so we can place them in the Library tomorrow. Given the reference to it in the Statement, we think we should also put in the Library the document "Social Progress: United Kingdom's Record", describing it as a paper made available at the European Council.

Supplementaries for tomorrow will follow separately.

I am copying this letter to Alex Allan (HMT), Clive Norris (Dept of Employment) and Trevor Woolley and Roger Lavelle (Cabinet Office).

Jans,
Stephen Wall
 (J S Wall)
Private Secretary

C D Powell Esq
 10 Downing Street

PS/CHANCELLOR

FROM: R I G ALLEN (EC)
DATE: 28 JUNE 1989

cc: PS/Economic Secretary
Sir P Middleton
Mr Wicks
Sir T Burns
Mr Scholar
Mr Peretz
Mr Odling-Smee
Mrs Brown

WOW

EUROPEAN COUNCIL, MADRID: STATEMENT

in another box

I have a few comments on the draft Statement attached to Charles Powell's letter of 28 June: I shall be submitting supplementaries a little later in the afternoon.

2. On page 5, the third indent seems to imply that we have signed up to all the proposals in stage 1 of the Delors Report. It would be preferable to amend this slightly to read:

".....the Council agreed that, from 1 July 1990, measures necessary to launch the first stage of progressive realisation of economic and monetary union, as indicated in the Delors Report, should be implemented."

3. On page 7, after the first paragraph, it might be worth adding, as an additional paragraph:

"It will also be necessary to achieve greater cooperation between the Member States in economic and monetary policy".

This is probably the key element in stage 1 of Delors.

4. On page 12, sixth line, "implementation of" sounds far too binding: "progress on" would be preferable.

5. On page 18, I would like to see an additional sentence or two on fraud. Could I suggest the following:

"The Council welcomed the progress being made in the fight against fraud in relation to the Community budget. We shall continue to press strongly for further action in this area, which will require a sustained campaign over a period of years."

6. Also on page 18, I would be inclined to delete the sentence on the withholding tax on savings. It is not consistent with the Madrid Conclusions to say that "the Council accepted that there would not be a withholding tax". We are on slightly weak ground here, and I would suggest dealing with the subject in supplementaries. Similarly, I would not propose that the Council Conclusions on indirect taxation should be mentioned in the Statement.

MA

R I G ALLEN



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

28 June 1989

Dear Stephen,

EUROPEAN COUNCIL, MADRID: STATEMENT

I enclose a first draft Statement on the outcome of the European Council in Madrid. I should be grateful for comments in the course of the day - and if possible by 1430 - together with supplementaries.

I am copying this letter and enclosure to Alex Allan (HM Treasury), Clive Norris (Department of Employment), and Trevor Woolley and Roger Lavelle (Cabinet Office).

Yours sincerely,
C. D. Powell

C. D. POWELL

Stephen Wall, Esq.
Foreign and Commonwealth Office

Ch
Two suggestions for
amendments to P12
(which we may not get).
Otherwise seems OK,
except no mention of debt.

AA
[2 comments from DCLP]

✓ passed to CP and 28/6
1 first my marks
are clear
one (opinion) ✓
question ✓
push ✓
P4
P2
P9
P12
P14
P19.

CH/EXCHEQUER	
REC.	28 JUN 1989
ACTION	Mr. Wicks
COPIES TO	EST
	SIR P. Middleton
	SIR T. Burns
	MR WICKS
	MR Scholier
MR Peretz	MR R. G. Allen
MR Odling	Smee

SP2AFQ

PRIME MINISTER'S STATEMENT

ON THE

EUROPEAN COUNCIL

IN

MADRID

With permission, Mr Speaker, I should like to make a Statement about the meeting of the European Council in Madrid on 26 and 27 June, which I attended with my Right Hon. and Learned Friend the Foreign and Commonwealth Secretary.

The full conclusions of the Council have been placed in the Library of the House.

Economic and Monetary

Economic and monetary matters were the main item on the Council's agenda.

Agreement was reached on four main points:

- first, the objective of progressive realisation of Economic and Monetary Union was reaffirmed.

This objective was first set in 1972,
 before Britain joined the Community, and
 has subsequently been reaffirmed on
 numerous occasions, including in the
 Single European Act passed by this House.

But no agreed definition of it exists.

DCLP

There
 was agreed
 definitions in
 1970-72

was agreed in Madrid

- second, the report of the Delors

Committee, which sets out an approach to
 economic and monetary union by stages, was

accepted as a basis for further work - but not the only basis.

It will be possible to bring in other ideas and other approaches.

- third, the Council agreed that the proposals set out in the Delors report for the first stage of progressive realisation of economic and monetary union will be implemented from 1 July 1990.

These include:

- completion of the Single Market;
- abolition of all foreign exchange controls; ~~within the Community.~~
- a free market in financial services;
- ~~and~~
- strengthening of the Community's competition policy.

DCLP.
 (the 'single market' package has been accepted)

desirable, this will continue

- Entry of all member state currencies into the Exchange rate mechanism of the EMS
 and
 - ~~greater~~ improved co-operation between member states in economic and monetary policy

They are all matters for which the United Kingdom has campaigned strongly and where we are well ahead of the great majority of our European partners.

No decisions were reached on what should follow this first stage, and stages 2 and 3 of the Delors Report were not endorsed. Indeed, several delegations - not only the United Kingdom - made clear that they had

substantial difficulties with them.

- fourth, it was agreed to carry out the preparatory work for the organization of an intergovernmental conference to lay down subsequent stages.

But such a conference would meet only after implementation of the first stage has begun and when there has been full and adequate preparation.

Its decisions would have to be reached by
unanimity.

In short, Mr Speaker, we made as much progress
as can be made at this stage, while
leaving longer term issues for further
discussion by ^{the} ECOFIN ^{Council} over the months and
years ahead.

We have ensured that there is nothing
automatic about the move to subsequent

stages.

There are very difficult issues to be resolved.

As my Right Hon Friend the Chancellor of the Exchequer has made clear, Stages 2 and 3 as envisaged in the Delors Report, would involve a massive transfer of sovereignty, which I do not believe would be acceptable to this House.

They would also mean in effect the

creation of a federal Europe.

The Government supports the objective of much closer economic and monetary co-operation, but will work for solutions which leave crucial economic and monetary decisions in our own hands.

Although Britain's membership of the Exchange Rate Mechanism of the European Monetary

System was not an issue at this Council,

I reaffirmed our intention to join the ERM

But without setting a date.

We must first get our inflation down: and

we shall look for satisfactory progress on

~~implementation of~~ other aspects of the

first phase of the Delors Report.

My statement was received positively.

Social Matters

The Council also discussed what is called the

Social Dimension.

On this, the United Kingdom's record is,

of course, very good indeed and I took

with me to Madrid our own document,

setting out our substantial achievements

in this field.

The Council's conclusions on this subject contain very satisfactory recognition that the highest priority is to create the conditions for more jobs.

The Government does not believe that the Community's proposed Social Charter would help achieve this.

Indeed, we believe that imposing extra

burdens on industry would make the
Community less competitive.

That is the main reason why my Right Hon
Friend the Secretary of State for
Employment was unable to accept the
conclusions of the June Social Affairs
Council.

I confirmed that refusal in Madrid.

But the conclusions of the European Council did

bring out a very important point, namely that national legislation and voluntary agreements have a legitimate role in achieving the Community's Social Dimension, and not everything has to be the subject of directives from the EC. We shall be putting this view very strongly in the further discussions which will take place.

Other Issues

Mr Speaker, I will summarise very briefly the outcome of the Council's discussions on the other main issues.

The Council reaffirmed the priority importance of completing the Single Market with the emphasis on the areas of particular importance on the United Kingdom:

financial services, technical standards,
transport and public purchasing.

The Council accepted that there will not be a
withholding tax on savings - a proposal
which the United Kingdom has consistently
opposed.

Is
this
strike?
Tmls?

The Council signified a wide acceptance of the
need to keep checks at frontiers against

drugs, terrorism and criminals, while making free movement of ordinary law-abiding citizens a greater reality.

This is an area in which my Right Hon Friend the Home Secretary in particular has done a great deal of patient work.

X RIGA para in Jan

In political co-operation, the Heads of State and Government expressed their utter condemnation of what has happened in China

and agreed a series of measures, which match those which the United Kingdom is already taking.

The Council also expressed recognition and understanding for the anxiety which has been caused in Hong Kong.

Conclusions

Mr Speaker, in conclusion I would like to

congratulate the Spanish Government on their Presidency of the EC over the past six months, in particular for the progress made on the Single Market.

I would also congratulate the Spanish Prime Minister, Sr Gonzalez, on bringing a difficult European Council to a successful conclusion.

I believe that the main outcome of the Council

- agreement to implement a first phase of economic and monetary union - is very much in the interests of British industry and the City of London, while fully protecting the powers of this House.

Far from being isolated, as some have claimed, the United Kingdom was able to play an important role in bringing the Council to sensible and practical conclusions.

It is in the same spirit of determination to strengthen co-operation with other members of the European Community, while arguing always for reducing constraints and leaving to members states those decisions which properly belong to them, that we shall approach the undoubtedly difficult discussions of the Community's future which lie ahead.

PERSONAL AND CONFIDENTIAL

CHANCELLOR

*plse ask Mr J
if discuss this
with me*

FROM: A G TYRIE
DATE: 28 June 1989
cc: Mrs Chaplin

MADRID AND AFTER: A FEW THOUGHTS

The Government has avoided what could have been a colossal humiliation. As with the NATO Summit, so in Madrid, the Government came close to being trapped and isolated and has done something of a Houdini.

2. Fortunately the press have not written Madrid up as a bloody nose for the Prime Minister but they could easily have done so. She said she didn't want an IGC, and would vote against one, but it's clear we are going to have one. She said only recently that she didn't know whether the time would ever be right for Britain to join the ERM but she has now been forced to set out in much more detail her time scale and conditions for joining. She said that EMU could be achieved only when she was twanging her harp but she has now signed up to the principle of EMU, tacitly acknowledging that the preamble to the SEA and the conclusions of the Hanover Summit were more than mere lip-service.

3. Similar scrapes are bound to come. We have them because, both in style and substance, our Euro policy is in something of a mess. In particular:

- In style we have still not shaken off the confrontational politics of the early 1980s. Yet this is likely to yield much less than diplomacy and compromise over the next few years, not only with other countries but also in domestic political terms. The "Maggie does battle" line is simply not as effective or as popular as it used to be.

Politics has changed. The Reagan-style confrontation with "an evil empire" has, of necessity, been replaced by the subtleties required to handle Gorbachevian diplomacy. In the Community the brinkmanship of budget negotiations

TYRIE
TO
CX
27 JUN

in the early 1980s (give me my money back etc) has been replaced by the careful and tenacious negotiations required to secure the completion of the single market in a form which suits us. Similarly starting a diplomatic war on EMU will ultimately yield something more unpleasant for us than seeking to build a political consensus around a compromise we can wear.

- We seem to try and form the wrong alliances. We cuddle up to the French on how to handle the Germans when, if anything, our policy should be the reverse. The French seem to believe they could frustrate German nationalism by subsuming them in EMU and European unity. I do not think we should back that policy. My guess is that the Germans would do anything to get reunification when the chips were down, ultimately even reneging on EC agreements, if necessary. The Germans, of course, see the EC as a means by which a closer association between the two Germanies can be secured. In any case, German reunification is far more of a problem for the French than us.

Of course, we have tried to get close to the Germans before, for example over budgetary negotiations, where they always initially backed us and then let us down. But that was because the CDU always had to give way to CSU pressure to protect Bavarian farmers and because German net budgetary contributions are still seen by many Germans as a subscription to respectability.

EMU, and the threat it could pose to German anti-inflationary policy, is different. British and German interests are much closer on this. Indeed, the Madrid Summit is much more of a success for the Germans than anyone else. They didn't want to rush into anything. Progress towards the EMU has been slowed but any flack for obstructionism has come our way, not theirs - an ideal outcome from their point of view.

- We seem far too negative. Our European policy is increasingly defined in terms of what it shouldn't be rather than what we would like. That partly reflects fundamental disagreements within the Party about what we do want but, as I've said before, there are still things around which the Party can agree which we can press for.

Some specific objectives for UK policy

We should plan now for what we want out of a Treaty amendment, not only on EMU but in other areas as well.

✓ (i) Subsidiarity. We need something that embodies a devolutionist/decentralising tendency. For example the principle of subsidiarity should be written into Treaty law and weigh in Court judgements on Community competence.

(ii) Reining back the Commission. For what it's worth, I think we should go further than (i) and press for other amendments, although we would run the risk of appearing negative. Some ideas are:

- the Treaty could be amended to enable the Council to initiate legislation (at present this power rests with the Commission).
- the Commission's competence in monetary policy could be removed.
- most controversially of all, a list of areas in which the Community has no competence could be drawn up, thus circumscribing their powers, once and for all. This would undoubtedly be difficult to draft and even more difficult to rally support for. Such a list might also imply that anything not listed is fair game for the Commission. On the other hand, some general clauses in the Rome Treaty

*new for
due possibly*

and the Single European Act already seem to enable the Commission to meddle in almost anything.

[I would be happy to set these out in more detail if you are interested.]

- (iii) Monetary Union. After the signing of the Single European Act Britain was very close to if not in the Euro-driving seat for a while. At that time, we could have (and in my view should have) put forward some kind of monetary initiative ourselves. (Of course non-membership of the ERM would have made that extremely tricky.) We could have set the agenda, but that's history.

As we discussed in the meeting yesterday we now need to find rival descriptions of EMU. In doing so we should explain that many proposals would not really cost us much in terms of sovereignty and that some of the sovereignty people think we have lost in economic policy was surrendered long ago to the markets.

A range of options to look at would include: the evolution of the ERM towards fixed parities, with ever fewer realignments and with the DM as the de facto standard; a "gold standard" approach, possibly with a "commodity basket" as the standard, as the US recently floated in a G7 context; the "mutual recognition" or Hayekian approach; a parallel currency; (as a fall back) some kind of politically accountable central bank but without any concomitant agreement to an extension of regional policy or the need for fiscal co-ordination.

Of course, several of these can quickly be rejected but it is important that we marshal arguments now on why we have rejected them.

- (iv) Rhetoric. The PM's rhetoric has to change. We will only be able to secure reforms of this kind if we are not suspected of clandestine Euro-wrecking. After several

*Machiavelli
Opinion*

years of anti-European rhetoric it will not be easy for the PM to sing a sweeter song for European ears.

4. Proposals for the entrenchment of subsidiarity, some clipping of the Commission's tentacles, a rival and credible version of EMU, and a change in rhetoric and language, taken together, could perhaps restore a sense of purpose to the Government's Euro policy.

RJ.
A G TYRRE

FROM: N P WILLIAMS (MG1)
 DATE: 29 June 1989
 x5561

1. MISS O'MARA
 2. CHANCELLOR

mom
29/6

cc Economic Secretary
 Sir P Middleton
 Sir T Burns
 Mr Wicks
 Mr Scholar
 Mr R I G Allen
 Mr Peretz
 Mr Chaplin
 Mr Tyrie

Ch.
 Content for me to
 write is proposed?

OK - 29
 30/6

DELORS COMMITTEE REPORT

M Chaban-Delmas, President of the Comite d'Action Pour l'Europe, wrote to you on 14 June enclosing the conclusions of a working group chaired by H Herrhausen (President of Deutsche Bank) which adopted a position on 30 May to the effect that the Delors Committee Report formed a sufficient basis for political decisions to be taken at the Madrid Council. The group called on the Madrid Council to proceed without delay with the preparatory work for the negotiation of Treaty amendment and reiterated its views on monetary issues (see Annex). M Chaban-Delmas wrote in similar terms to the Prime Minister.

2. We think that a routine acknowledgement would be appropriate in the circumstances. A draft PS reply is attached. It would clearly be desirable for No.10 to reply in similar, though not identical, terms. We understand that the FCO are wondering whether a more fulsome response would be right in the light of the Madrid Council, and are waiting to know how you propose to reply.* We do not recommend such a course of action since the working group share the Delors Committee's vision of EMU.

* but will, I understand, reply in similar
 less fulsome terms if you agree that I
 should write as drafted.

NPW

N P WILLIAMS

UNCLASSIFIED

29
 30/6

Pse type final

(Pse also do a standard writing letter from Tony Dight to Neat Hammond)

DRAFT PS LETTER TO:

M. J Chaban-Delmas
President
Comite d'Action Pour l'Europe
Assemblée Nationale
233 bld Saint-Germain
75007 PARIS

The Chancellor has asked me to thank you for your letter of 14 June, which he read with interest. You will by now, of course, be aware of the outcome of the Madrid Council.

JMG T-
P-5-

COMITE D'ACTION POUR L'EUROPE

Jacques CHABAN-DELMAS
Président

Paris, le

14 JUIN 1959

24/23/6

23 JUN 1959 ✓ 23/6
Mr Peretz ✓
EST SR P MIDDLETON
SIR T BURNS
MR WOICES
MR SCHOLAR
MR LANKESTER
MISS O MARRA
MR R. G. ALLEN
MRS CHAPLIN
MR TYRRE

Monsieur Nigel LAWSON
Chancelier de l'Echiquier
Departmental Treasury
Parliament Street
LONDRES S.W.I. P3 A.G.

Monsieur le Chancelier,

Le Comité présidé par M. Jacques DELORS a maintenant remis son rapport sur l'Union économique et monétaire dans la Communauté Européenne.

Les principes et les orientations qu'il dégage sont conformes aux grandes lignes adoptées par le Comité d'Action pour l'Europe lors de sa réunion de La Haye en novembre dernier.

Nous avons alors demandé à M. HERRHAUSEN, président de la Deutsch Bank, d'animer un groupe de travail qui puisse permettre de prendre rapidement position, notamment avant le terme du prochain Conseil européen de Madrid.

Ce groupe de travail a adopté la résolution dont je vous prie de bien vouloir trouver ci-joint le texte et qui a été rendue publique à Francfort le 30 mai.

Les membres du Comité d'Action pour l'Europe ont ainsi, et sans attendre leur prochaine réunion plénière, voulu marquer leur adhésion aux conclusions du "Rapport Delors", et leur ferme désir de voir nos pays s'engager sans attendre et résolument sur la voie ainsi tracée.

~~Wyo Mars~~

Mr Willey
Could you pass this to Mrs. ...

Perhaps Mr Willey might suggest a PS reply.

23/6

Jacques CHABAN-DELMAS

RP 23/6

ACTION COMMITTEE FOR EUROPE

Jacques Chaban-Delmas
President

In June of last year, the European Council in Hanover recalled that in adopting the Single European Act, the Member States of the European Community confirmed the objective of the progressive realisation of economic and monetary union. It therefore decided to examine, at its meeting in Madrid in June 1989, the means of achieving this union. To this end, the European Council in Hanover entrusted to a Committee the task of studying and proposing concrete stages leading to economic and monetary union. The Committee was chaired by Jacques Delors and included among others the Central Bank Governors of all Member States.

At its meeting in the Hague on 17 and 18 November 1988, the Action Committee for Europe requested an internal working group chaired by Alfred Herrhausen to prepare a position on the establishment of economic and monetary union as soon as it had considered the report of the Committee created by the European Council in Hanover.

Having considered this report and following various meetings, the working group, headed by Alfred Herrhausen, met in Frankfurt on 30 May and adopted the following position:

The undersigned, members of the working group of the Action Committee for Europe, have taken account of the report presented to the Heads of State and Government by the Committee to study economic and monetary union, chaired by Jacques Delors. They consider it to be a sufficient technical basis for the political decisions which they now expect from the Governments of the Twelve.

At its meeting in The Hague, the Action Committee for Europe confirmed "its view that the realisation of monetary union in the near future is vital to the proper functioning of the internal market

which is an essential step towards European union". In seven points (1), the Committee reiterated its views on monetary issues. The undersigned note with satisfaction the concordance between these points and the report of the Delors Committee.

The realisation of economic and monetary union is all the more indispensable as the growing interdependence of economies reduces the room to manoeuvre for policies conducted at national level. Moreover, the liberalisation of capital movements and the creation of a common financial area in Europe require a strong improvement in cooperation in economic and monetary matters. It is only on these conditions that our countries will reap the benefits expected from the completion of the internal market.

We call on the Madrid European Council to seek further development towards economic and monetary union, basing itself on the report unanimously submitted by the Delors Committee, and to proceed without delay with the preparatory work for the negotiation of the necessary treaty amendments.

The evolution of East/West relations and the hopes which may emanate therefrom, make it even more necessary to achieve economic and monetary union, the basis for political union.

It is our intention, in the light of the Madrid European Council, to report once again to the Action Committee for Europe so that it can take a stand on this issue at its forthcoming meeting in Paris on the 21 and 22 November next.

(1) See Annex

Alfred Herrhausen, President (F.R.G.)
Giovanni Agnelli (Italy)
Jaime Carvajal Urquijo (Spain)
Jacques Chaban-Delmas (France)
David Howell (U.K.)
Max Kohnstamm (Honorary Secretary General)
Cees J.A. van Lede (The Netherlands)
Ernani Rodrigues Lopes (Portugal)
Peter Mitzscherling (F.R.G.)
Ioannis Pasmazoglou (Greece)
Poul Schade-Poulsen (Denmark)
Guy Spitaels (Belgium)
Patrick Sheehy (U.K.)
Peter Sutherland (Irelande)
Gaston Thorn (Luxembourg)

Extract from the Declaration of the Action Committee for Europe
adopted in The Hague on the 17/18 November 1988

1. Without a common currency, the proper functioning of the internal market demands in any case a high degree of stability of exchange rates and prices.
2. The free movement of capital must be assured by all our Governments as forming an integral part of the internal market.
3. Nevertheless, as can be seen on the world level, in the absence of a discipline managed by an international monetary authority, this free movement provokes important fluctuations in exchange rates and level of prices, hinders growth and feeds protectionist tendencies throughout the world.
4. If, within the Community, the free movement of capital were accompanied by an increased instability of exchange rates and rates of inflation, this free movement, and even the internal market itself, would be seriously threatened.
5. It is therefore essential to strengthen the European Monetary System by the establishment of a common monetary authority to ensure that the current degree of stability of exchange rates and prices is not weakened but, on the contrary, is gradually strengthened.
6. This objective also requires a strengthening of cooperation between Member States on their economic and fiscal policies.
7. The current monetary disorder in the world poses a threat to the functioning of a free world economy. The establishment of a monetary authority in the Community is therefore also necessary so that our nations can contribute effectively to reducing the disorder which the world has known since the demise of the Bretton Woods system.



FROM: A C S ALLAN

DATE: 29 June 1989

BE 3/7

*For Thursday
meeting Mike*

*(+ my note to
Doris on phone-call
from Gov)*

MR N L WICKS

FOLLOW-UP ON EMU

The Chancellor and Prime Minister had a discussion at their bilateral yesterday about the follow-up to the Madrid Council. The Chancellor said that the Treasury would be working up alternative models to Delors' (Hayek, gold standard etc.). The Prime Minister welcomed this but thought that it would also be helpful to stimulate work in France and Germany, since any UK studies would tend to carry less weight in the Community. The Chancellor commented that it might be worth his getting in touch with Balladur, who had set up a research institute. The Prime Minister suggested that Ewan Ferguson might have ideas, and the Chancellor thought Michael Jay would be useful. The Prime Minister also suggested that the German Bruege Group (Newman?) would be a good contact. She also is keen to stimulate some work by outside organisations in the UK, such as the IEA and CPS.

*ACSA
TO
Wicks
29/6*

A C S ALLAN



FROM: A C S ALLAN
DATE: 30 JUNE 1989

pay

MR WICKS

cc Sir P Middleton

FOLLOW UP ON EMU

The Governor rung the Chancellor this morning to ask about the follow-up on EMU reported in the Press. He was keen to ensure that the Bank was involved in this work. The Chancellor said that the precise arrangements had not been settled, but he was sure the Bank would be fully involved.

2. The Governor commented that the results of the Madrid Council seemed rather good. He wondered whether there was any chance of persuading the others to forget stages 2 and 3. The Chancellor said that the Madrid Council had been satisfactory as a holding operation. He would of course be delighted if we could get others to forget about stages 2 and 3, but thought that this was most implausible, especially given Delors' role.

ACSA
TO
WICKS
30/6

ACSA

A C S ALLAN

UNCLASSIFIED

WILLIAMS
→
CX
3/7

FROM: N P WILLIAMS (MG1)

DATE: 3 July 1989

EXT: 5561

Seen in draft. NPW 3/7

- 1. MISS O'MARA
- 2. CHANCELLOR

cc PS/Paymaster General*
 PS/Economic Secretary*
 Sir P Middleton*
 Mr Wicks
 Mr R I G Allen*
 Mr Odling-Smee*
 Mr Peretz*
 Mrs M E Brown*
 Ms Symes*
 Mr Nelson*

Ch... will recall

w/o attachments

MEETING WITH SIR MICHAEL BUTLER, SIR MICHAEL FRANKLIN AND SIR JEREMY MORSE: 7 JULY

As background for your meeting on 7 July, I attach:-

behind ("Odling-Smee" → PS/Ch 426/5)

(i) Sir Michael Butler's paper on the Delors Committee Report to the European Committee of the BIEC;

behind ("Powell" → Powell 14/6)

(ii) the PS letter to No 10 briefing the Prime Minister for her meeting with Sir Michael on 15 June; and

behind ("Powell - A Man 15/6")

(iii) Mr Powell's record of the meeting.

All were produced before Madrid, of course.

2. You will recall that Sir Michael was concerned about the consequences of a "two-tier" Europe for the City and wanted EMU discussions to move "in a constructive and acceptable direction". He should be reasonably encouraged by the Madrid outcome.

NPW

N P WILLIAMS

UNCLASSIFIED

11/7



FROM: A C S ALLAN

DATE: 3 July 1989

*Tulpe
Please fix
a convenient
SLA - Mrs*

MR TYRIE

cc Mrs Chaplin

MADRID AND AFTER: A FEW THOUGHTS

The Chancellor was grateful for your minute of 28 June. He would like to discuss this with you and we shall arrange a bilateral at a convenient opportunity.

A C S ALLAN



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

3 July 1989

M. J Chaban-Delmas
President
Comite d'Action Pour l'Europe
Assemblée Nationale
233 bld Saint-Germain
75007 PARIS

Dear M. Chaban-Delmas

The Chancellor has asked me to thank you for your letter of 14 June, which he read with interest. You will by now, of course, be aware of the outcome of the Madrid Council.

Yours sincerely

Jonathan Taylor

J M G TAYLOR
Private Secretary

*What ask
amount
win?*

FROM: SIR PETER MIDDLETON
DATE: 5 July 1989

CHANCELLOR OF THE EXCHEQUER

cc Sir T Burns
Mr Wicks

*Optimal
Currency
area*

? Stage 1

EMU: FOLLOW UP TO THE EUROPEAN COUNCIL

I have been giving some thought to how we should take forward the work on EMU following Madrid. We are meeting to discuss this at 5.15 pm on Thursday.

2. I see the work falling into two main parts;

(a) an examination of alternative models of economic and monetary union;

(b) consideration of a range of other issues arising from or related to EMU.

3. Under (a) we would need initially to take a quick look at the full range of possible EMU models; this would need to include the following:

(1) the Delors model;

is also fixed figure; & critique

(2) a modified version of Delors without a European central bank;

(3) a model involving fixed but adjustable exchange rates (a strengthened version of the ERM);

(4) a competitive currency model with or without competing central banks;

*Hayes &
M...
v...*

(5) a model under which central banks would be made fully independent but allowed to collude with one another if they so wished;

- (6) a gold standard model;
- (7) a sterling area model;
- (8) a Deutschemark based Bretton Woods model.

In each case it would be necessary to consider the implications, both nationally and on a Europe wide basis of the model for monetary policy; fiscal policy; exchange rate policy; and currency transactions.

4. I envisage that this work should be carried out under the auspices of a steering group which I would chair consisting of Sir T Burns, and Messrs Wicks, Scholar, Evans and Odling-Smee from the Treasury and Messrs George, Flemming and Crockett from the Bank. I believe it would also be appropriate to involve Alan Walters and perhaps Brian Griffiths. Much of the detailed work however would be carried out by a Treasury/Bank Group at Under Secretary level to be chaired by Mr Odling-Smee. Its first task would be to take a quick look at the various models outlined above - and any others that they were able to identify - with a view to identifying those which were worth further study; and eliminating those which were not.

5. The second part of the work programme would need to cover a variety of other EMU related issues of which the main ones would appear to be as follows:

- (1) alternative forms of Treaty;
- (2) the role of the various community institutions including the European Parliament and competent bodies under stages 2 and 3;
- (3) democratic accountability, not only of the proposed ESCB but of the other institutions which would have an enhanced role under EMU

(4) the role of regional (structural) policy and regional adjustment, both through national policies and the community budget;

(5) policies to encourage factor flexibility;

(6) the development of the single market;

(7) the pace of progress through stages 1-3;

V important
(8) the development of a strategy for forging alliances with like minded member states;

(9) ways of stimulating the debate within the community on alternative EMU models. *W. M. - (Swanwick) bottom*

6. I suggest that this work should be carried out through an interdepartmental group chaired by Mr Wicks in which Mr Evans would play a leading role. The group might include representatives of FCO, Cabinet Office, UKDEL and No. 10.

7. The two parts are interrelated and we shall need to move with considerable speed. There is a great deal of work here. This is bound to make substantial extra demands on a number of key areas of the department.

8. We might also have a word tomorrow about the discussions on EMU which are likely to take place over lunch at ECOFIN on 10 July; and more importantly at the informal ECOFIN in Antibes in September.



PETER MIDDLETON

pay



**NOTE OF A MEETING IN THE CHANCELLOR ROOM HM TREASURY
AT 5.45PM THURSDAY 6 JULY**

Those Present:

- Chancellor
- Sir P Middleton
- Sir T Burns
- Mr Wicks

.....

EMU: FOLLOW UP TO THE EUROPEAN COUNCIL

The meeting discussed Sir P Middleton's note of 5 July.

2. The Chancellor commented that, as well as studying the alternative models of monetary union on which proposed work programme concentrated, there might also be advantage in seeing whether there were alternative models of economic union. In discussion it was pointed out the softest form of economic union was the Single Market itself; the hardest would be one with harmonised tax rates and laws. Sir P Middleton said he thought it might be useful to study whether there was a stronger form of the Single Market we could go along with as a definition of economic union.

3. On alternative models of monetary union, the following points were made:

(i) A reasoned critique of the Delors model was needed; it was important to stimulate the debate in other countries.

(ii) There were various different ways in which the Delors proposals might be modified, for example by removing the fiscal or regional dimension. More work was needed on what, if any, rules would be needed on budget deficits or their financing. But it was not clear whether it would be worth looking at the Delors proposals without a central bank: we



did not want Delors either with or without a central bank; and for any proposals that involved a single currency, a single monetary policy and some sort of central decision-making were necessary.

(iii) On strengthened versions of the ERM, narrower bands were worth looking at; but less frequent realignments did not seem to offer much in practice. Another option was to have a single policy towards the dollar, and perhaps some sort of more formal machinery.

(iv) Competing currencies without central banks were intellectually attractive, but fanciful. It would be more sensible to look at models where central banks continued to issue currencies but all rules restricting the use of other countries' currencies were abolished. This was entirely consistent with our general approach towards the Single Market.

(v) A Deutschemark-based Bretton Woods model was virtually identical to a strengthened EMS, though there might be scope for allowing other currencies to join.

(vi) It was important to bring out the point that it was not possible to merge interceptably from EMS to EMU, since they were completely different animals. It was impossible to have separate but completely locked currencies. It would be worth investigating whether, if the Community had moved to a single currency, it would be possible for a country to withdraw and resume issuing its own currency.

4. The proposals for the steering group were agreed, subject to the following points:

(i) Sir A Walters should be a member, with Mr Griffiths as his alternate.



(ii) Mr Kerr (FCO) should be a member on a strictly personal basis.

5. On the second part of the work programme, the following points were made:

(i) It was very difficult to decide what form of treaty we might want until we knew what sort of stage 2 we wanted.

(ii) We should look at whether there were any additional proposals we should press to be included in stage 1.

(iii) It would be worth looking at what the work on optimal currency areas implied for EMU.

(iv) In looking at democratic accountability and the role of the various Community institutions, it was important to spell and analyse the necessary political and constitutional counterparts of the various models of EMU, but without appearing to advocate any of them. The work should seek to demonstrate that in order to get democratic accountability within the Delors proposals, there would need to be a European government.

(v) The forging of alliance with like-minded member states was most important.

(vi) We should aim to stimulate the debate within the Community on alternative models, both directly and via non-governmental organisations such as research institutes. Sir P Middleton's group would consider how this might best be done.

(vii) On regional policy, we needed to make the economic case: we could not rest solely on the line that UK tax-payers would not agree to channelling more funds to the



poorer regions. We should bring out that it was not in the poorer countries' interests to be permanent pensioners, since that gave them no incentive to introduce the flexibilities necessary for improving economic performance.

6. The work of this group should, as suggested be carried out through an interdepartmental group chaired by Mr Wicks; this should include representatives from the Cabinet Office, but there was no need to involve the No 10 Policy Unit.

A handwritten signature in black ink, appearing to read "ACSA" with a long horizontal stroke underneath.

A C S ALLAN

Distribution:

Those present

FROM: J GIEVE (IDT)
DATE: 6 July 1989
x4420

CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Wicks

ALTERNATIVES TO DELORS

The Financial Times are doing a series of articles on EMU including one by Simon Holberton on alternatives to Delors. He has asked for a briefing "off the record" with someone at the Treasury. I have also had a number of phone calls from other journalists on the same subject.

2. I take it that we are not in a position to say anything new about the UK's attitudes, but I see no disadvantage - and some potential advantages - in getting as wide as possible a list of alternatives into circulation. At present I am aware of the following:

- Delors.
- Delors less fiscal constraints on member states and/or enhanced regional policy.
- Delors with a greater degree of democratic accountability through either the Council or the Parliament.
- A common currency without a strong central bank - perhaps a small central secretariat with revolving chairmanship of a committee of national central bank governors.
- A parallel currency which becomes legal tender in all member states; this could be based on a basket of currencies like the ECU or could be based on a single strong currency.

- Competing national currencies ie all currencies to become legal tender in all countries.
- The gold standard.
- A DM standard perhaps with national currency boards.
- Progressive development of the ERM both to include all EC currencies and then to narrow the bands of variation towards zero.

3. Some of these overlap, of course. There are also some historical or contemporary examples of monetary union that can be examined eg the sterling area, the union in East Africa and the East Caribbean union.

4. In terms of briefing, it may be easier if I simply raise these as possibilities that have been canvassed in Parliament and the press rather than arrange a briefing with Mr Wicks.

5. Are you content with that?

J. Gieve

JOHN GIEVE

CONFIDENTIAL

FROM: R I G ALLEN (EC)
DATE: 6 JULY 1989

MR WICKS

cc: Miss O'Mara
Ms Symes
Mr Sharples

ECOFIN, 10 JULY: EMU

I attach the draft brief you requested: you may want to discuss it with the Chancellor this afternoon.

RIG

Chancellor, cc *to P. Rodrik*
to T. Burns, R I G ALLEN

*Are you content with this
as the line for ECOFIN?*

N.C.U

G.7

CONFIDENTIAL

ECOFIN 10 JULY 1989

BRIEF D

FOLLOW UP TO THE MADRID COUNCIL (EMU)

Relevant documents (attached)

- a. 1964 Council Decision defining the mandate of the Committee of Central Bank Governors;
- b. 1974 Council Decision on economic convergence;
- c. Delors Group Report (top copy only);
- d. UKREP telnos 157 and 158 reporting the informal ECOFIN in S'Agaro, 23 May 1989;
- e. Detailed commentary on Delors Report, HM Treasury, May 1989;
- f. Extract from Madrid European Council conclusions, 27 June 1989;
- g. Bostock to O'Mara on the likely EMU work programme, 4 July 1989.

UK Objectives

- i) To show a reasonable degree of enthusiasm for implementing as many as possible of the Stage 1 measures in good time for 1 July 1990 launch;
- ii) to ensure, as part of Stage 1, that continued progress is made towards completing the Single Market in financial services;
- iii) to ensure that work on Stages 2 and 3 will take place in slower time, and to register the main questions which the UK believes will require full consideration;
- iv) to resist any suggestions (eg by the French) of moving to an early vote on an IGC.

Be more active in setting agenda?

Points to make

On Stage 1:

- i) agree that priority should be given over the next few months for working up revised texts on the 1964 and 1974 Council Decisions;
- ii) important that these revised texts should (a) reflect up-to-date economic thinking (goodbye to fine tuning and all that), (b) include more emphasis on the medium-term and structural policies, (c) be procedurally flexible and not overload Brussels Committee structure (nor, indeed, Finance Ministers and Central Bank Governors);
- iii) Madrid agreement to proceed with Stage 1 requires completion of single market in financial services, and Community wide capital liberalisation:
 - reasonable progress being made in some areas: welcome agreement on 2nd Banking Directive. But need to move faster in others, notably life assurance and investment services;
 - also important to ensure that unnecessary restrictions on market access are lifted. May take form of excessive regulation of what financial services can be offered in particular markets and the way they are to be sold. Can amount to hidden barriers to trade;
 - full capital liberalisation due by 1 July 1990 for eight major EC countries. Essential for single market. Must include: removal of all remaining controls by Italy and France; rapid progress by remaining four member states (Ireland, Greece, Spain, Portugal) towards removal of controls; careful scrutiny of tax distortions on free movement of capital and unjustified regulatory obstacles (eg controls on overseas investment by savings institutions);

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- iv) there may be UK bids for additional measures to include in the Stage 1 shopping list, in particular to enhance the role of the ecu. (NB the question of increased holdings of the ecu and of Community currencies in member states' foreign exchange reserves is a sensitive one for FRG - tactically safer not to raise it at ECOFIN?)

On Stages 2 and 3:

- i) resist suggestions that there should be an early IGC (stress Madrid conclusions that such a conference "would be proceeded by full and adequate preparation");
- ii) such preparatory work needs to be comprehensive and thorough: the Delors Report left much important ground uncovered, and key questions unanswered. UK intends to play a full part in this work;
- iii) key questions which need to be addressed include the following (NB this is not a comprehensive list):
- are there any alternative models of EMU which should be considered, in particular: (a) other possible forms of monetary union (eg the parallel currency approach); (b) the type of Community Central Bank required eg full-blown ESCB or some reduced-form arrangement;
 - ✓ - how should we define economic union (the E in EMU) - not spelled out in the Report;
 - the role of fiscal policy in an EMU: how much or little fiscal coordination would be needed;
 - the implications of an EMU for other aspects of Community business, eg single market policy, regional policy, the flexibility of prices and wage rates within a competitive internal market;

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CONFIDENTIAL

- questions of democratic accountability, not only of the proposed ESCB but of the other EC institutions which would have an enhanced role under an EMU.
- iv) All these questions for discussion are without prejudice to the UK's stated position on the desirability of moving to Stages 2 and 3 in the foreseeable future, and on the timing of an IGC.

Background

1. The EMU discussion is billed as a follow-up to Madrid, but we do not expect any substantive discussion. The Presidency seem to expect the Commission to outline their timetable for bringing forward proposals, but there seems to be some confusion within the Commission about how rapidly these might appear, even on Stage 1 where early decisions on revised texts for the 1964 and 1974 Council Decisions are required to meet the 1 July 1990 deadline.
2. The Chancellor might like to use the occasion, however, to register the main lines of current UK thinking both on Stage 1 and on the preparatory work leading to an IGC.

CONFIDENTIAL



FROM: A C S ALLAN
 DATE: 7 JULY 1989

1 Joly
 2 pgs

MR R I G ALLEN (EC)

cc Sir P Middleton
 Sir T Burns
 Mr Wicks
 Miss O'Mara
 Ms Symes
 Mr Sharples

ECOFIN, 10 JULY: EMU

The Chancellor had a brief discussion with Mr Wicks about your minute of 6 July. They agreed the following amendments:

(i) The first of the UK objectives should refer simply to 'implementing the stage 1 measures', rather than expanding this to include the 1 July 1990 launch. Many of the measures are to be introduced during stage 1.

(ii) The third of the objectives needs to be made it clear that we are not just trying to register the main questions which we believe will require full consideration, but also to set the agenda as far as possible.

(iii) On the third point to make, we need to be very cautious over attacking other countries' prudential controls on overseas investment by savings institutions etc.

(iv) The question of increased holdings of ecu etc should not be raised at this Ecofin but held over to the next informal Ecofin in Antibes.

(v) There are a number of other important alternative models of emu, including for example competing currencies (as in Hayek), an extended EMS, and a new gold standard.

A handwritten signature in black ink, appearing to read 'ACSA'.

A C S ALLAN



FROM: A C S ALLAN
DATE: 7 JULY 1989

Handwritten initials

MR GIEVE (IDT)

cc Sir P Middleton
Sir T Burns
Mr Wicks

ALTERNATIVES TO DELORS

The Chancellor was grateful for your minute of 6 July. He does not feel that it would be appropriate to give any briefings to UK journalists now, not even as unattributable background. We have not yet thought through the implications of the various options and it seems to him most unwise to let it be known which alternatives we are studying (and by implication which ones we are not).

Handwritten signature: A C S ALLAN

A C S ALLAN



A handwritten signature in the top right corner of the page.

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

7 July 1989

Charles Powell Esq
PS/Prime Minister
10 Downing Street
LONDON
SW1

cc PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Wicks
Mr R I G Allen
Mr Odling-Smee
Mr Peretz
Miss O'Mara
Mrs M E Brown
Ms Symes
Mr N L Williams
Mr Nelson

Dear Charles

MEETING WITH SIR MICHAEL BUTLER AND SIR JEREMY MORSE

Sir Michael Butler, in his capacity as Chairman of the European Committee of the British Invisible Exports Committee, together with Sir Jeremy Morse, called on the Chancellor this morning to discuss the follow up to the Madrid Council's discussion of the Delors Report. Sir Terence Burns was also present.

Sir Michael said that the European Committee was concerned that the UK should place itself at the centre of follow up work to the Council. We should also seek to ensure that the Bank played a major role in any arrangements which might emerge from the process.

The Chancellor said we would be seeking to participate fully in the discussions. These should be thorough, and not rushed. We were developing a critique of Delors' Stages 2 and 3, and we hoped to put forward positive alternatives to Delors' proposals. There would be a preliminary discussion at next week's Ecofin, and a further discussion at the informal Ecofin in Antibes in September. We did not favour the creation of any central European banking institution and hence the question of where it might be located did not arise. Instead, we supported closer co-operation between existing central banks. Sir Jeremy Morse said that the Bank should seek to develop a role as a sort of 'Federal Reserve Bank of New York-plus' in the context of the various European Central Banks. The Chancellor confirmed that we would seek the strongest possible position for the Bank, and the City.

Sir Michael suggested that a flaw in Delors' proposals was that any European central bank would in fact conflict with the constitutions of the individual member states. The Chancellor said that any such bank would be founded on new Treaty provisions



and hence would presumably override national law. But it was certainly the case that other member states had not thought through the implications of the Delors proposals for their own constitutions.

Sir Michael suggested that, if the UK was to get anywhere with its arguments we would need to have a clear idea of what we meant by EMU. He did not think this could be less than a system of locked currencies with no margins. The Chancellor doubted that such an inflexible system was workable.

Sir Michael suggested that it would be worthwhile to set in hand an economic study of the damage to the growth prospects of eg Spain and Portugal if the 'social Europe' proposals were implemented. The Chancellor agreed.

I am copying this letter to Richard Gozney (PCO), Ben Slocock (DTI), Paul Tucker (Bank) and Trevor Woolley (Cabinet Office).

John Major
J M G Taylor
J M G TAYLOR
Private Secretary

FROM: N P WILLIAMS (MG1)
DATE: 10 July 1989
X 5561

- 1. MISS O'MARA
- 2. PS/CHANCELLOR

cc: PS/Economic Secretary
 Sir P Middleton
 Sir T Burns
 Mr Wicks
 Mr Scholar
 Mr H P Evans
 Mr R I G Allen
 Mr Peretz
 Mrs Chaplin
 Mr Tyrie

Semi draft N.P.W. 10/7
OK for me to write as proposed?
OK
11/7

LETTER FROM M. DE MAIGRET: ASSOCIATION FOR THE MONETARY UNION OF EUROPE

M. de Maigret wrote to the Chancellor on 6 July enclosing the Association's comments on the position taken on EMU by the Madrid Council. The Association welcomes the outcome of Madrid but wants further rapid progress towards Economic and Monetary Union. In line with its position hitherto, the Association wants stronger Government backing for the private ecu. It also hopes that an IGC will meet before the end of 1990.

2. M. de Maigret last wrote to the Chancellor on 19 May enclosing the Association's comments on the Delors Report. A draft PS reply is attached.

N.P.W.

N P WILLIAMS

DRAFT LETTER TO:

M. Bertrand de Maigret
Delegue General
Association Pour L'Union
Monetaire De L'Europe
26 Rue de la Pepiniere
75008 Paris
France

Re type final

The Chancellor has asked me to thank you for your letter of 6 July, which he read with interest.

JMG-T-

P-S-

Chancellor

7/10/7



CH/EXCHEQUER	
REC.	07 JUL 1989
ACTION	MR FERETZ
COPIES TO	EST, SIR P. M. DOOLEY
	SIR T. BURRO
	MR WOICES
	MR J. HOLAK
	MR H. PELVAN
	MISS O. MARRA
	MR R. G. ALLEN

Mr. Nigel LAWSON
 Minister of Finance
 H.M. Treasury
 Parliament Street
 SW1P 3AG LONDON
 UNITED KINGDOM

9

6th July 1989

MRS CHAPLIN
 MR TYRIE

Dear Sir,

The Association for the Monetary Union of Europe is pleased to present you with its comments on the monetary decision taken by the European Council during the Summit held in Madrid on 26th and 27th June 1989.

We sincerely hope that this document will be of interest to you.

Yours faithfully,

*Mr Wilson
 I think you're
 already dealing
 with this (brief
 acknowledgment?)
 10/7*

Bertrand De MAIGRET
 Délégué Général

Enc.



**COMMENTS ON THE SUMMIT OF THE EUROPEAN STATES MEETING IN MADRID ON 26TH
AND 27TH JUNE 1989**

(Press release concerning monetary integration: 6th July 1989)

1. Monetary Union: a firmly established principle

The Association welcomes the strong endorsement of the European Council to the progressive achievement of Economic and Monetary Union, as provided for in the Single European Act. The Association is convinced that the position of the Council and the commitments of the twelve European countries will see the successful implementation of the first phase of monetary union as defined in the Delors Report. Indeed, the fixing of a date for the launch of this first phase gives all of the Association's participants great confidence in the progress of this issue. Monetary Union is now a firmly established principle and is certain to guide the decisions of the twelve in strengthening the co-ordination and cohesion of economic and monetary policies. The progress made in this respect since the Single Act and the European Council of Hanover would have been unimaginable two years ago.

2. Steps of practical implementation

The Association is delighted with the common commitment achieved for the first phase of the Delors Report and considers this a bold step forward. Not only is the full removal of trade barriers in Europe with greater economic policy co-ordination intended, but also it is committed to a single financial area, with all member States adhering to the exchange rate mechanism and all impediments to the private use of ecu removed. Furthermore the role of the Committee of Central Bank Governors is strengthened.

The convocation of an inter-governmental conference should provide the necessary impetus which should lead to subsequent stages. The Association would hope that such a conference could meet before the end of 1990 so that its deliberations will be known before the formal realisation of the Single European Market in 1992.

3. Uncertainties

Despite these encouraging signs, certain ambiguities remain for European businesses using the ecu. Stronger government backing would reduce the "wait and see" attitude in the private market. The Association does however notice that previous uncertainties have been clarified:

1. The final statement of the Heads of State and Government clearly acknowledges the *parallel* development of economic and monetary aspects of the European integration. Monetary Union is no longer seen as a "coronation" of previous economic unification. No longer does anybody question the fact that economic union and monetary union go together.
2. After the initial brief of the Delors Committee, the European Council has now charged those bodies competent in this area, the ECO FIN Council, the European Commission, the Committee of Central Bank Governors and the Monetary Committee to prepare the necessary technical and practical ground work for the steps towards full monetary unification. This strengthens the confidence of the Association in future developments.

4. On the right way

Given the political will to achieve monetary union, given the commitment of the twelve countries to achieve phase one successfully, previous obstacles having been lifted and the competent institutions being invited to work together, the Association believes that the European Monetary Union can proceed on course. Nevertheless the process is far from being granted an automatic success and significant imponderabilities remain. For European businessmen these uncertainties restrain the reaping of full benefits of the Single European Act. Balanced but rapid progress for further European monetary integration is desired.

----oOo----

UNCLASSIFIED

FROM: N P WILLIAMS (MG1)

DATE: 11 July 1989

EXT: 5561

1. MISS O'MARA
2. ECONOMIC SECRETARY

cc

Chancellor

Paymaster General

Sir P Middleton

Sir T Burns

Mr Wicks

Mr Scholar o/r

Mr R I G Allen

Mr H P Evans

Mr Odling-Smee

Mr Peretz

Mr Riley

Mr Gieve

Mrs M E Brown

Mr Grice

Miss Simpson

Ms Symes

Mr Nelson

I suspect that the Governor's remarks
on no practical alternatives to
Delors' concept of EMU are likely to attract
attention, plus his implied date for
the end of Stage 1.

indeed

Ch
Doesn't sound v promising,
though could be not a v accurate
report.

Arms 11/7

Some v. formal
Remarks

DELORS REPORT: GOVERNOR'S APPEARANCE BEFORE LORDS
SUB-COMMITTEE A-11 JULY

We thought you might like a short account of the Governor's
evidence on the Delors Report to Lords Sub-Committee A before your
own appearance.

2. The discussion concentrated on Stage 1. Lord Kearton
(Chairman) began by asking about the nature of the enhanced role
for the Central Bank Governors' Committee under Stage 1 and
whether its conclusions would be made public. The Governor said
that procedures would be strengthened (the subject is being
discussed today in Basle), but opinions to ECOFIN would not be
binding on Finance Ministers. Meetings of the Committee would be
covert, but the Governor hoped that the Chairman would sometimes
make public statements on the basis of the Committee's
discussions.

3. In reply to Lord Kearton's comment that the Committee had
received conflicting evidence about whether the ERM would survive
capital liberalisation, the Governor said that, among major EC
countries, exchange controls only remained in France and Italy and

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they are limited. Other member states might need assistance in adjusting to compliance with the Capital Liberalisation Directive (some are not yet in the ERM), but capital liberalisation in those countries would not affect the system.

4. Lord Roll agreed with the Governor: "we are almost there now." He wondered whether joining the ERM would give us a better chance of getting inflation down. The Governor said that ERM membership made it easier for countries to manage their exchange rates with less severe interest rates. But whether a country should join when its interest rates and inflation were out of line was questionable. If we joined now, there would be the risk of early realignments which would be bad for us and the system. It would be hard to join at anything but the market rate, but this raised the question of whether the rate was sustainable.

? (I suppose this is credibility point, but as reported it sounds like 'soft system')

[dangerous]

5. In response to Baroness Serota's question about how long Stage 1 would last, the Governor said he could give no figure but he thought it necessary to be satisfied that the Single Market was working efficiently before proceeding to the next stage. This could be 3-4 years after the completion of the Single Market (ie 1995-6). Moves on monetary union should not be pushed forward in the absence of parallel progress in the economic sphere.

6. Lord Peston wondered whether the Governor's date for the completion of Stage 1 depended on us joining the ERM by 1 July 1990. The Governor said that all member states must join the ERM for completion of Stage 1.

7. In response to Lord Kearton's question about how economic convergence could be achieved, the Governor noted that current members of the ERM had made a lot of progress on a voluntary basis through ECOFIN etc - a new formal machinery was not needed. He envisaged something like the G7 arrangements. Convergence was needed on inflation, interest rates, and budgetary and trade imbalances.

8. The Governor said that the section of the Delors Report on regional policy was one of the least satisfactory. Markets needed

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to work better: regional aid was not the way to achieve this, although it could contribute to development of the infrastructure. Exchange rate adjustment was a way of softening the impact of the Single Market on peripheral areas, although this instrument would cease to be available under full EMU. Lord Peston returned to the problems of peripheral regions and wanted to know, since he was sceptical about the efficacy of market forces, whether there was any alternative to strengthened regional policy. The Governor noted that peripheral regions would get a bad deal whether inside or outside the Community.

9. Lord Bruce wondered whether reduction of the UK's current account deficit should be a condition for joining the ERM. The Governor thought not, provided policies were right, in which case the markets would be content to finance the deficit.

10. Lord Roll was very sceptical about whether some in the Community would wait until 1997-98 (a slight extension of the Governor's 1995-6) before moving on to further stages. There were strong political elements (influenced by talk of German reunification, the need for greater cohesion in NATO, etc) wanting faster progress. The Governor said his timetable might be pessimistic. Mr Flemming said that since a fixed rate regime was subject to speculative attack, a long drawn-out Stage 1 would involve greater risks.

11. The Governor said that since Madrid there had been comment about formulating other definitions of EMU. He did not believe the Delors Report was the only one, but he was sceptical that ^{there} were practical alternatives. The Delors Committee had discussed alternative definitions, but none matched up to the Report's definition which he thought was the right one. If the Committee's parameters were taken as given, it was hard to come to an alternative definition of EMU.

12. The session closed with the Governor saying that, although the City had a head-start over other financial centres, he hoped we would not drag our feet on EMU to the extent of harming the City.

NPW

N P WILLIAMS



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

A large, stylized handwritten signature in the top right corner of the page.

12 July 1989

M. Bertrand de Maigret
Delegue General
Association pour L'Union
Monetaire de l'Europe
26 Rue de la Peniniere
75008 Paris
FRANCE

Dear M. Maigret

The Chancellor has asked me to thank you for your letter of 6 July, which he read with interest.

Yours sincerely
J M G Taylor
J M G TAYLOR
Private Secretary

PERSONAL

CHANCELLOR

*Margaret
of Grayson*

AGT
FROM: A G TYRIE
DATE: 14 July 1989
cc: Mrs Chaplin

I have discussed "who does what" on EMU and all that with Judith. She is happy that she should sit on the Middleton committee and I on Wicks', assuming that's agreeable with you.

2. Could I have a general word about division of responsibilities, at a convenient time? I will, of course, also discuss it with Judith.

OK

Andrews.
A G TYRIE

PMG 20 1989

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CAPTAIN GENERAL	
NO.	20 JUL 1989
NAME	MRS - BROWN
	CX/CST/EST/EST
	SIR P. MIDDLETON
	MR. H.P. EVANS
	MR. SCHOLAR
	MR. RIG AUEN
	MR. SUMES
	MRS. CHAPLIN
	MR. TYRIE

19 July 1989

The Rt Hon Peter Brooke MP
Paymaster General
The Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

PM
See X & Y.
Relevant to our
Exhibit on attached 5s
to John.

Dear Mr Brooke

I thought you might be interested in the attached publication. The Madrid Summit was dominated by the question of Monetary Union within the EC, together with the implications for national budgetary control and, ultimately, sovereignty. However, too little attention is paid to the significance of the financial markets. They already have the ability to make judgements on budgetary excesses - but will the Single Market really give them the crucial freedom to express those judgements by moving their capital accordingly?

I hope that this short report will assist the debate on the conditions necessary for financial markets to exert that necessary discipline.

Yours sincerely

G. P. Bishop

Graham Bishop

The Madrid Summit — European Monetary Union IS Coming

The monetary landscape of Europe is changing irreversibly. In June 1988, the European Community (EC) Heads of State agreed to abolish exchange controls. They also set up a committee chaired by EC President Jacques Delors to study "concrete steps leading towards the progressive realisation of economic and monetary union" (EMU). The Heads of State considered the resulting "Delors Report" at the Madrid Summit on June 28/29, 1989, and agreed to the following agenda:

- The first stage of Economic and Monetary Union will begin on July 1, 1990;
- The preparatory work will be undertaken for an intergovernmental conference to lay the ground for subsequent stages, which would meet after the first stage had begun in 1990.

On July 10, just ten days into the six-month French presidency of the European Council, the EC finance ministers agreed on an aggressive timetable for the preparatory work.

This report analyses these developments from the perspective of the business opportunities that will open up for the financial services industries. Genuine liberalisation of these industries is likely to lead to such a degree of financial integration that monetary union will, effectively, be created by market forces.

The Council has requested the adoption of the "provisions necessary for the launch of the first stage" (see text of communiqué on page 5). The Delors Report names the creation of a Single Financial Area as a key step in Stage One, and much work has already been achieved towards this end, but there are shortcomings in some of the measures and proposals. Current political commitment provides an excellent opportunity to ensure that the "provisions necessary" do, in practice, create a genuinely liberal financial market. This, in turn, will develop a powerful market discipline that should obviate the need for complex and bureaucratic budgetary coordination policies and minimise any functions that need to be delegated to a European System of Central Banks.

On balance, remarkable strides have been made towards achieving the Single Financial Area that will realise the European Council's decision in Madrid. Given a continuation of that degree of political commitment, the remaining problems can be overcome, permitting progress towards monetary union.

Principal Stage One Steps

The Delors Report describes Stage One as "the initiation of the process" of creating EMU. For practical business purposes, the key steps are as follows:

- "In the economic field ...firstly, there would be a complete removal of physical, technical and fiscal barriers. The completion of the internal market would be accompanied by a **strengthening of Community competition policy.**"

- "In the monetary field the focus would be on removing all obstacles to financial integration... Firstly, through the approval and enforcement of the necessary Community Directives, the objective of a single financial area in which all monetary and financial instruments circulate freely, and banking, securities and insurance services are offered uniformly throughout the area would be fully implemented."

The first statement merely reaffirms the principles of the 1992 programme. However, the second statement comprises a remarkably powerful and clear definition of the liberalised financial services market that we should now expect to unfold. **The Heads of State, in accepting Stage One of the Delors Report, have implicitly set a "quality standard" for the directives,** as well as the areas to be covered.

Impact of financial innovation

There is an implicit timetable: Stage One requires not only the approval and enforcement of the directives, but also their "*full implementation*." The importance of this point may have been overlooked: it implies the enactment of enabling legislation in each of the 12 member states. Only then — and probably after a considerable time lag — will the full consequences of liberalisation unfold as financial intermediaries offer new products. The willingness of consumers to purchase these products will determine the degree of permanent and substantial financial innovation that will exist in the Community.

The Delors Report states that "account would also have to be taken of the continued impact of financial innovation on monetary control techniques (which are at present undergoing radical changes in most industrial countries)." The "preparatory work" to develop the "provisions necessary" for the new EC institutions, such as the European System of Central Banks, will certainly need to analyse these "monetary control techniques." The analysis will be difficult in the absence of practical evidence of liberalisation in the markets — and even more difficult if the legislative programme has not even been agreed.

To proceed beyond Stage One to the "subsequent stages" of monetary union requires revision of the Treaty of Rome by an intergovernmental conference. Currently, it seems probable that this conference will be called by majority vote at the earliest possible opportunity — shortly after July 1, 1990. However, because conference decisions require *unanimous* voting, such an early date could be premature: Stage One will have only just started and if any major parts of the Single Financial Area have not even been approved — including agreement on strengthening competition policy — it would be hard to feel that there was enthusiastic, unanimous support for the more difficult stages ahead.

The Single Financial Area — Can The EC Achieve Its Target?

The genuinely liberalised financial markets envisaged by the Delors Report are a quantum leap from the status quo, but progress seems to be accelerating. The French Presidency of the EC could be crucial in creating a climate where the Single Financial Area appears a realistic probability.

The following actions highlight the progress made to date:

Abolition of exchange controls

This historic and far-reaching measure was agreed in June 1988. The major EC countries have agreed to abolish the few remaining controls by July 1, 1990. The most visible exchange controls have, effectively, been abolished already, and the European Monetary System (EMS) has survived remarkably well at a time of sharp dollar fluctuations. The only remaining controls are those preventing individuals from holding foreign currency

bank deposits. Evidence, particularly from the UK, indicates that individuals do not diversify their transaction balances — only their savings — so freeing liquid balances should not create a crisis.

Overall, the agreement to abolish visible exchange controls was *the* change that has probably made the drive towards some form of monetary union irreversible, because of the need to remove the risk of destabilising capital flows. Under *current* scenarios, there seem few reasons to expect abolition of the remaining visible exchange controls in the EC to destabilise the EMS.

However, there is still an array of restrictions on the investment policies of many financial institutions, which has a similar economic effect to exchange controls. These restrictions are analogous to the “nontariff” barriers that have always bedevilled liberalisation of trade in physical goods, and they amount to invisible exchange controls.

Mutual funds

On October 1, 1989, the directive on Undertakings for Collective Investment in Transferable Securities (UCITS) — the first liberalisation — comes into effect. This directive permits qualifying mutual funds to be sold freely throughout the EC. Tested against the Heads of State “quality standard,” the directive falls short, because money market funds are not permitted. However, the principal opponent of such funds — West Germany — is about to permit its own mutual funds to have up to 49% of their assets in money market instruments. Bundesbank President Pöhl recently accepted the likelihood of further changes in West Germany.

Banking

The Spanish Presidency succeeded in obtaining the Council’s agreement on a common position — the vital hurdle — on the Second Banking Directive and the Solvency Ratio Directive. The Second Banking Directive permits an EC bank to offer — in any EC country — the services for which it is authorised in its home country. The Solvency Ratio Directive is the measure that implements the risk-weighted capital adequacy standards proposed by the Cooke Committee of the Bank for International Settlements. Together, these measures seem to go a long way towards meeting the quality standard for banking services (including mortgages). This freedom is expected to be extended fully to foreign banks’ services.

Investment services

The proposed Investment Services Directive would give nonbanks and financial intermediaries the same freedoms as those given to banks by the Second Banking Directive. Progress on this “EC passport” for investment banks seems to be lagging, because, in general, it is only UK-based entities that are affected. In the capital markets, an uneven playing field for banks and nonbanks would not be compatible with the “quality standard.”

Insurance

The directives already approved and proposals made so far do not, realistically, begin to measure up to the Heads of State “quality standard.” The problem stems from the European Court of Justice 1986 rulings on whether there was sufficient harmonisation of EC law to give consumers adequate protection. As a result, the current proposals have avoided the individual consumer and, certainly for the nonlife risks, concentrated on freeing insurance for medium- to larger-sized companies. This focus avoids the very area where the European consumer — who is also the elector — hopes to see tangible benefits from enhanced international competition. However, the Commission plans to address this problem in 1990.

If they are to be prudently and efficiently managed in the liberalised market, insurance companies' assets must reflect properly the type of liabilities undertaken to the public. Thus, foreign assets would not be appropriate where the premiums are likely to be paid out again as claims in a short period. At the other end of the spectrum, a life insurance policy that participates in profits is essentially a savings vehicle with attached insurance against death. That savings element should be free to be invested in an internationally diversified, profit-maximising portfolio.

Life insurance companies play a key role in the EC's capital markets: as the repository of much of the Community's long-term savings, they are major buyers of long-term Government bonds. With a choice of assets constrained only by prudence, the capital markets will have the genuine freedom, not only to judge the budgetary position of member states, but also to exert discipline by moving assets accordingly. The same principles should apply to pension funds.

Unless liberalisation of insurance — both assets and liabilities — meets the Heads of State "quality standard," a vital component of the Single Financial Area will be missing.

Securities issuance

The Prospectus Directive goes some way towards harmonising conditions for issuing securities by requiring member states to recognise a prospectus published in another member state. However, many member states continue to impose conditions that restrict issuance — originally for the proper purpose of ensuring an orderly market. Typically, conditions comprise the nationality of the lead-manager, nationality of the applicable law, physical location of the securities, and nationality of the paying agent. Even the most liberal country — the UK — requires the lead-manager of sterling issues to have a full UK presence. Although the original purpose of these regulations remains necessary, the current regulations have the effect of discriminating against lead-managers outside the member state. If issuance is restricted, then free circulation of financial instruments is effectively limited — contrary to the spirit of the "quality standard." "Mutual recognition" of other member states' standards is necessary.

Competition policy

UK Prime Minister Thatcher has emphasised, particularly, that the European Council had accepted the need for strengthening the Community's competition policy — as specified in Stage One of the Delors Report.

Competition policy potentially covers a wide area, but the current principal topic is the proposed merger regulation. This regulation would give the European Commission power to review "large mergers." The raising of the definition of "large" — perhaps to an annual turnover of ECU5 billion, declining over a period to ECU2 billion — has overcome many objections. There seems to be a reasonable chance that this measure could be approved later this year. However, Prime Minister Thatcher may have broadened the requirement of an acceptable competition policy by highlighting the Delors Report's call for a reduction in state aid.

It seems quite feasible that the EC can meet the "strengthening of Community competition policy" condition set for Stage One.

* * *

Appendix

Extracts from **Presidency Conclusions — European Council**
Madrid, 26 and 27 June 1989

“The European Council, meeting in Madrid, reviewed the situation and the prospects for progress towards European Union.

“...The completion of the Internal Market and the strengthening of economic and social cohesion were the priority objectives of this new chapter in the history of the Community.

“...The European Council noted that the forward thrust in achievement of the Internal Market was making an ever-increasing contribution to expansion and improvement in the employment situation. This thrust had hitherto resulted mainly from the decisions taken to remove technical barriers to trade. It was now necessary to make similar progress towards the elimination of physical and fiscal obstacles with a view to achieving an area without internal frontiers by 31 December 1992 in accordance with the provisions of Article 8a of the Single Act.

“The growing rate at which decisions were being taken meant that well over half the measures listed in the White Paper had been adopted. The Council recalled certain priority fields identified at its meetings in Hanover and Rhodes, and welcomed the fact that important decisions had been taken in the areas of public contracts, banking and financial services, the approximation of technical standards and transport. However, it noted that there were still decisions to be taken in these priority fields, including transport, in particular cabotage, and asked the Council to intensify its work in these sectors.

“The European Council invited the Commission to submit to the Council the remaining proposals provided for in the White Paper at the earliest opportunity, and expected the Council to finalise adoption, as quickly as possible, of the instruments that would permit the completion of the Internal Market.

Economic and Monetary Union

“The European Council restated its determination progressively to achieve Economic and Monetary Union as provided for in the Single Act and confirmed at the European Council meeting in Hanover. Economic and Monetary Union must be seen in the perspective of the completion of the Internal Market and in the context of economic and social cohesion.

“The European Council considered that the report by the committee chaired by Jacques Delors, which defines a process designed to lead by stages to Economic and Monetary Union, fulfilled the mandate given in Hanover and provided a good basis for further work. The European Council felt that its realization would have to take account of the parallelism between economic and monetary aspects, respect the principle of “subsidiarity” and allow for the diversity of specific situations.

“The European Council decided that the first stage of the realization of Economic and Monetary Union would begin on 1 July 1990.

“The European Council asked the competent bodies (the ECOFIN and General Affairs Councils, the Commission, the Committee of Central Bank Governors and the Monetary Committee):

“(a) to adopt the provisions necessary for the launch of the first stage on 1 July 1990;

“(b) to carry out the preparatory work for the organization of an intergovernmental conference to lay down the subsequent stages; that conference would meet once the first stage had begun and would be preceded by full and adequate preparation.”

Other Titles in the "1992 and Beyond" Series

Fortress Europe, Graham Bishop, Salomon Brothers Inc, October 1988.

Banking — Will Liberalisation Itself Lead to a Common Currency?,
Graham Bishop, Salomon Brothers Inc, February 1989.

The Long March to European Monetary Union — Two Practical Steps,
Graham Bishop, Salomon Brothers Inc, May 1989.

*European Banking Integration in 1992 — The Competitive Challenges
Facing U.S. Multinational Banks*, Thomas H. Hanley *et al*, Salomon
Brothers Inc, June 1989.

* * * * *

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ECONOMIC SECRETARY	
REC'D	21 JUL 1989
ACTION	Mrs. M. Brown
COPIES TO	PS/CHx 2 Sir P Middleton,
	Mr Wicks, Mr H. Evans,
	Mr R.I.G. Allen, Mr Peretz,
	Miss O'Mara, Ms Symes,

Mr N.P. Williams, Mr McIntosh,
 Mr Tyrrie.

20 July 1989

Fax: 219 6715

Dear Economic Secretary,

**Sub-Committee A (Finance, Trade and Industry
 and External Relations)**

Delors Committee Report

Thank you very much for agreeing to give evidence to Sub-Committee A on Tuesday 25 July at 11.30. The meeting will take place in Room 4 on the Committee corridor. The Director-General of the CBI will be giving evidence at 10.30.

I enclose a list of possible questions. This differs from the draft sent to Mrs Brown at the end of last week on two questions (questions 13 and 16).

The Sub-Committee are most grateful for your help on this enquiry.

*Yours Sincerely
 W G Sleath*

W G SLEATH
Clerk to Sub-Committee A

Mr Peter Lilley MP
 Economic Secretary
 HM Treasury
 Parliament Street
 LONDON
 SW1P 3AG



European Communities Committee

Sub-Committee A

Possible Questions for the Economic Secretary

1. How would you define the "economic and monetary union" which the Government is committed to implement (most recently, in the Madrid communique)?
2. When would you expect preparations to be complete for the inter-governmental conference? When does the Government expect to publish its alternative proposals for monetary union?
3. How would you interpret the conference's mandate to "lay down the subsequent stages"?
4. Is the Government convinced of the economic benefits of monetary union?
5. What would be the disadvantages to Member States of being "left out" of a Community monetary union?
6. Why did the Madrid communique emphasise the "parallelism between economic and monetary aspects"?
7. Other than membership of the ERM by all Member States, what should "Stage 1" consist of? How long might this stage take to complete? Would there not be pressures to develop full monetary union more quickly if the removal of capital controls jeopardised the current working of the ERM?
8. Can a country which uses the sharp tightening of monetary policy to discipline inflation afford the monetary straightjacket of ERM/EMU?
9. Other than the power to devalue, exactly what powers would be given up by Member States in "Stage 3"?
10. Various alternatives have been suggested to the form of monetary union suggested in the Delors Report. Could all Member States' currencies become legal tender throughout the Community, in the hope that the "good money" would become the most frequently used?
11. The Chancellor of the Exchequer has said that he would be "perfectly happy" with the "quasi-monetary union" of the gold standard system. What would be the advantages and disadvantages of such a system?
12. What was the logic behind the Report's proposal for limits on fiscal and budgetary policy?
13. If the fear was that irresponsible Member States might jeopardise the system by running large budget deficits, would it not suffice to write into the system a rule that such

states would not be bailed out? To what extent will the influence of financial markets act as a discipline?

14. Will monetary union require an increase in Community expenditure?

15. Could national fiscal policy be used to help depressed areas in a monetary union, rather than increasing the Structural Funds?

16. Will not Member States in a monetary union be unwilling to lose the power to give state aids to depressed industries, undermining the Community's competition policy?

17. Are there valid arguments for having a common currency, rather than irrevocably fixed exchange rates?

18. How important is independence for the credibility of central banks?

19. What degree of political accountability would be required in a monetary union? Would Community monetary policy have to be more accountable than the other Community policies currently determined by the Council of Ministers?

*Some good questions! but later
5th draft answers
ASAP!*

PS/Economic Secretary

*PS/Chancellor
Mr Wick
Mr RLG Allen
Mr Perry
Ms O'MARA
Ma Jones
Mr N Williams
Mr Michtoul*

*There are questions from the HoL
see for the ESTs appearance on 25/7*

DRAFT

European Communities Committee

Sub-Committee A

Possible Questions for the Economic Secretary

*Just arrived
14/7*

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*+ Mr Tyrrie
Mrs Cheplie*

by 29/7

- 2 -

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EUROPEAN COMMUNITIES COMMITTEE: SUB-COMMITTEE A
ECONOMIC SECRETARY'S EVIDENCE, TUESDAY 25 JULY 1989

Q1. How would you define the "Economic and Monetary Union" which the Government is committed to implement (most recently in the Madrid Communique)?

This is one of the key questions which the further work agreed on at Madrid will need to cover. The Delors Report gave one definition. We and our fellow member states need to examine the elements of the Delors approach very carefully, and to consider alternatives.

SUPPLEMENTARIES

(a) But you are committed to some form of EMU?

The UK is a signatory to the Single European Act. The preamble to that Act referred to the 1972 Conference at which Heads of State approved the objective of the progressive realisation of Economic and Monetary Union. But the Act itself does not specify any arrangements for implementing EMU, or a timetable. [If pressed: indeed it is worth noting that chapter one of that Act is headed "Cooperation in Economic and Monetary Policy (Economic and Monetary Union)". The Act itself certainly does not suggest that EMU must involve centralised, rather than cooperative, arrangements.]

[List of UK commitments - attached].

(b) Do you agree that monetary union involves a common currency and a single central bank?

The Delors report (in paragraph 22) defines a monetary union as a "currency area in which policies are managed jointly with a view to attaining common macro-economic objectives." It recalls that the Werner report of 1970 laid down 3 conditions for a monetary union. Two have already been met or are in the process of being met, through the single market programme. They are

- the total convertibility of currencies;
- the complete liberalisation of capital transactions and full integration of financial markets.

The third is a decision to lock exchange rates irrevocably, so that national currencies became "increasingly close substitutes".

The Delors report goes on to say (in paragraph 23) that the interlocking of exchange rates would not necessarily mark the end of the process of monetary unification in the Community. It argues that there would be advantages in moving to a single currency. But it states that this would not be "strictly necessary for the creation of a monetary union".

As to a central bank, the report recommends (in paragraph 32) that existing central banks should be part of a new system called a "European System of Central Banks". The system would comprise both a central institution and the national central banks. Member states will need to examine very carefully in the work that has been agreed at Madrid precisely what would be involved in these proposals. [Central banks around the world are constituted in a number of different ways at present, and we need to consider alternative models.]

(c) The Chancellor told the TCSC (Q80) that monetary union "is a single currency ... a single monetary policy ... and a single central bank". The Prime Minister told the House of Commons on 29 June that "The fixed exchange rate ... would come under considerable criticism and people could not do it". Who is right?

The Chancellor was referring to what Delors means by monetary union. As he said, it is quite clear that Delors' concept of full EMU involves interlocked exchange rates, probably a common currency, and an independent central bank. But both the Prime Minister and the Chancellor have stressed that the Government has

fundamental concerns about the surrender of sovereignty that would be involved in the Delors prescription. That is one of the questions to be examined further. I simply cannot say at this stage what the end point may be.

(e) The Governor said Delors was "the right model"?

But I believe he also said Delors was not the only model.

(f) The Prime Minister has said others share her doubts about the Delors prescription for stages 2 and 3. Who are they?

All member states agreed at Madrid that further work was needed. The communique made that clear.

The Governor of the Bundesbank, Herr Pohl, said in a speech on 22 June (the PM quoted this in another place on 29 June):

"I myself doubt whether the time has come for such a comprehensive renunciation of sovereignty, namely the transfer of monetary powers to supra-national institutions. I can only repeat what I said a little while ago. Neither a single currency nor a European Central Bank is necessary for an economic and monetary union to function. What is more important is that the member states pursue a consistent policy."

Q2. When would you expect preparations to be complete for the inter-Governmental conference? When does the Government expect to publish its alternative proposals for monetary union?

i. No date has been agreed. The Madrid European Council concluded that such a conference "would be preceded by full and adequate preparation", and that it would meet only once the first stage had begun (ie. not before 1 July 1990). Finance Ministers will begin discussing the issues involved in the autumn, but a great deal of work to do thereafter.

ii. As the Prime Minister said in her statement to the House of Commons on 29 June after the Madrid Council, we shall be working out alternative proposals, and hope that other people will do so too. Too early to say whether and when we will produce our ideas. But I expect that the Chancellor will want to indicate a number of the areas which we believe need to be reviewed in his discussions with other Finance Ministers at the informal meeting in Antibes on 9-10 September.

SUPPLEMENTARIES

(a) Why did UK agree to inter-governmental conference?

The UK agreed to preparatory work for a Conference, which would meet "once the first stage had begun and would be preceded by full and adequate preparation". There has not yet been a formal decision to call an Inter-Governmental Conference. [Article 236 of the Treaty of Rome provides that such a decision must be preceded by a proposal from any government or the Commission. The Council, after consulting the European Parliament and the Commission, would then vote by single majority for or against calling a conference of representatives of the Governments of member states. If the Council were in favour, a conference would be convened by the President of the Council.]

[Copy of Article 136 attached.]

Article 236

The Government of any Member State or the Commission may submit to the Council proposals for the amendment of this Treaty.

If the Council after consulting the European Parliament and, where appropriate, the Commission, delivers an opinion in favour of calling a conference of representatives of the Governments of the Member States, the conference shall be convened by the President of the Council for the purpose of determining by common accord the amendments to be made to this Treaty.

The amendments shall enter into force after being ratified by all the Member States in accordance with their respective constitutional requirements.

(b) Would UK refuse to attend an IGC?

No. There is no question of an empty chair policy as the Prime Minister made clear in Madrid. We would want to play a full part in any discussions on when and whether to hold an inter-governmental conference, and to influence discussions at such a conference. The Treaty makes clear that any amendments to the Treaty have to be agreed unanimously and ratified by all member states in accordance with their constitutional requirements (ie. in the UK by Parliament).

(c) Might not talk of 'alternatives' be seen as entirely negative?

Far from it. We want to make progress on the steps in Stage 1 as fast as we can, and we have endorsed the recommendation that stage 1 should begin on 1 July 1990. In several areas (eg. exchange control abolition) we are already ahead of many other member states. And we want to see action during Stage 1 on some points the Delors Report did not cover at all: active promotion of the private ecu, increased holding of private ecu in official reserves and their greater use in intervention. But it was clear from the discussions in Madrid and subsequently that we are by no means alone in questioning whether the proposals on longer term developments put forward in the Delors Report are the best route forward.

Q3. How would you interpret the conference's mandate to "lay down the subsequent stages"?

Article 236 of the Treaty of Rome states that an Inter-Governmental Conference "shall be convened ... for the purpose of determining by common accord the amendments to be made to this Treaty". There is no more precise guidance at present, but any Conference would follow extensive preparatory work.

[The Madrid conclusions do not imply that the Council endorsed Stages 2 and 3 of the Delors report. Finance Ministers will need to assess the report's findings in their further work.]

Q4. Is the Government convinced of the economic benefits of monetary union?

All depends on what form of monetary union is envisaged. Currency stability throughout the Community obviously brings savings in transaction costs for industry and travellers. But it would be important that the process did not give rise to unacceptable costs in other areas (eg an expansion of the Community's structural funds or centralisation of budgetary policy). The possible economic benefits have to be weighed against the loss of sovereignty to the UK involved in the Delors prescription for economic and monetary union.

[See also Q6 and Q12].

What benefits would full monetary union confer that ERM membership would not?

On the Delors definition, it would give full exchange rate stability within the Community - and therefore added certainty about currency stability. With the ERM, a realignment always remains a possibility. But there are other considerations (especially national sovereignty) to bear in mind, and various different possible approaches to a single currency area.

A good question. If ERM membership were to be successful, it would confer the benefits of a high degree of exchange rate stability and currency union. Then it is difficult to see what benefits would be conferred by ERM membership ~~if~~ were to be successful, then it might be argued that there is the case for monetary union would be clear or stronger. [Then quote from the 10th letter, last para of p 13.]

In the mean time,

Q5. What would be the disadvantages to member states of being "left out" of a Community monetary union?

There is no question at the moment of anyone being "left out" of developments in the Community. Any Treaty change would have to be agreed unanimously by the 12 member states. ~~For the shorter term,~~ the Prime Minister has made clear that the UK fully supports the implementation of stage 1 on 1 July 1990. She has also made clear that we would participate in an Inter-Governmental Conference.

SUPPLEMENTARIES

(a) What if the 11 decided to proceed with stages 2 and 3 without the UK?

The UK is one of the major economies of Europe. I do not believe that proceeding without us would be in the interests of the Community as a whole, and I ~~am~~^{believe} sure that is the view of our partners.

(b) The Delors Report envisages "a degree of flexibility" concerning the date and conditions of joining certain arrangements. The UK might avail itself of that?

[Delors Report paragraph 44 to be attached].

We have to discuss in much more detail all the arrangements recommended in the Delors Report, including those suggested in paragraph 44.

[Not for use: the Report said "Influence on the management of each set of arrangements would have to be related to the degree of participation by member states". Important to avoid any suggestion that UK would accept such '2 tier' arrangements.]

Q6. Why did the Madrid communique emphasise the "parallelism between economic and monetary aspects"?

Member states obviously need to examine how far cooperation in economic matters needs to progress in parallel with developments in monetary arrangements. As the Chancellor made clear in a recent speech to the Institute of Directors, we do not think the Delors report gets anywhere near sustaining the case for tight economic coordination in order to make a joint monetary policy sustainable.

The Madrid communique also said that further work should respect the principle of "subsidiarity" and allow for diversity of specific situations. Those are equally important points, and highlight the need to cede no more functions to the central institutions of the Community than are strictly necessary.
[See also Q12.]

fiscal

Q7. Other than membership of the ERM by all member states, what should "Stage 1" consist of? How long might this stage take to complete? Would there not be pressures to develop full monetary union more quickly if the removal of capital controls jeopardised the current working of the ERM?

(i) Stage 1 measures are set out in some detail in paragraphs 51-52 of the Delors report, although here too there will have to be more work on precisely what needs to be done. The main elements of Stage I will include: completion of the internal market, in particular the single financial area, and a strengthening of competition policy (which we see as requiring removal of barriers to takeovers and reduction in subsidies); implementation of the agreement to reform the structural funds; revision of both the 1964 Council Decision which established the Committee of Central Bankers and the 1974 Council Decision on economic convergence; and removal of impediments to the private use of the ecu.

[For use as necessary: On the 1964 and 1974 Decisions, we will be seeking to ensure that these texts reflect the free-market approach of this Government, and include more emphasis on medium-term and structural adjustment policies (rather than fine tuning). At the same time we must not overload the Brussels Committee structure.

We will be stressing the need for genuine completion of the single market in financial services and Community wide capital liberalisation:

- progress being made in some areas: welcome agreement on 2nd Banking Directive. But need to move faster in others, notably life assurance and investment;
- also important to ensure that unnecessary restrictions on market access are lifted, including excessive regulation of what financial services can be offered in particular markets and the way they are to be sold, which can amount to hidden barriers to trade;

- full capital liberalisation due by 1 July 1990 for eight major EC countries. Essential for single market. Must include: removal of all remaining controls by Italy and France; rapid progress by remaining four member states (Ireland, Greece, Spain, Portugal) towards removal of controls; and complete integration of banking and other financial markets..

(ii) The second part of the question is entirely hypothetical. We in the UK are putting our efforts into ensuring that Stage I does work. There are different views about the extent to which full-scale capital liberalisation might undermine the ERM. Personally, I would not want to exaggerate the likely consequences.

Q8. Can a country which uses the sharp tightening of monetary policy to discipline inflation afford the monetary straightjacket of ERM/EMU?

First, the ERM is not a straightjacket since realignments are possible. Under full EMU, of course, exchange rates would be irrevocably ~~linked~~ *fixed*.

(a) fluctuations are permitted within margins (b) realignments are

However, if you look at what has actually happened in practice, conflicts between domestic and external policy have been few and far between, since the countries within the ERM have shared the objective of reducing inflation. Thus France has seen its inflation rate fall from 10.7 per cent in 1979 to 3.7 per cent in May this year and Italy's inflation rate has more than halved from nearly 16 per cent in 1979 to 7 per cent last month. The EMS certainly did not prevent those countries from reducing their inflation rates: it provided a credible financial discipline which helped them in the conduct of their monetary policy.

Capping sterling at DM3 has been responsible for subsequent inflationary pressures?

That is far too simplistic an analysis. The increase in UK inflation is part of a worldwide phenomenon.

(The end of 1987)

[IF PRESSED: It is certainly true that, with the benefit of hindsight, monetary policy was too loose at the beginning of 1988. But this represented the authorities' response to the stock market crash of October 1987 which not only we in the UK, but other countries too, thought could have provoked a severe loss of confidence, had steps not been taken to inject more liquidity into the economy. On the balance of risks as we then judged them, I am sure we were right to act as we did. Since then, inflation has picked up worldwide and other countries have responded as we have by raising their interest rates.]

[For further detail, you might draw on your CPS speech.]

Q9. Other than the power to devalue, exactly what powers would be given up by Member States in "Stage 3"?

Under the Delors prescription, member states would lose very considerable control over fiscal policy, and complete control over monetary policy.

In the economic field:

- the Council could impose constraints on national budgets
- and make discretionary changes in Community resources
- and "a new form of representation in arrangements for international policy coordination and in international monetary negotiations would be adopted".

In the monetary field:

- the responsibility for the formulation and implementation of monetary policy in the Community would be transferred to the European System of Central Banks
- decisions on exchange market interventions in third countries would be the sole responsibility of the ESCB Council
- official reserves would be pooled and managed by the ESCB.

We need to investigate the implications of all this very carefully [and to consider whether a more cooperative and voluntary approach would be possible].

Q10. Various alternatives have been suggested to the form of monetary union suggested in the Delors Report. Could all member states' currencies become legal tender throughout the Community, in the hope that the "good money" would become the most frequently used?

(i) I have indeed seen a number of alternative suggestions. For instance, the Treasury and Civil Service Select Committee in its recent report said that "Binding rules on fiscal policy seem to be unnecessary even in stage 3 of a monetary union". There has been discussion of the possibility of a parallel currency, a gold standard approach, or of allowing currencies to compete (the 'Hayekian model'). Delors' proposals on increased regional subsidies have also been challenged by a number of commentators. These are all things to be examined in the Community's further work.

(ii) I have seen suggestions about the currency option you describe. I have also seen it suggested that a single Community currency (usually assumed to be the ecu, although in that case, it could no longer be a basket currency as at present) could be introduced in parallel to the individual Community currencies, with the intention that it would gradually displace them. Another suggestion is that the existing Community currencies might be maintained but at irrevocably fixed rates.

Q11. The Chancellor has said that he would be "perfectly happy" with the "quasi-monetary union" of the gold standard system. What would be the advantages and disadvantages of such a system?

The gold standard offered a system which operated under clearly defined rules, not subject to interpretation or discretion. At the same time, as the Chancellor pointed out to the TCSC, it did not involve an irrevocable transfer of sovereignty: members could depart from it at any time. Moreover, it operated without any centralisation of national fiscal policy and without an international regional policy - two elements which the Delors Committee suggested should be incorporated within full EMU but which the UK disputes would be necessary.

How are circumstances different today?

- i. Gold no longer backs the note issue.
- ii. With the increasing internationalisation of financial markets, capital flows now dominate current transactions. The scale of capital flows across the exchanges is vastly greater. Even in 1986, foreign exchange market turnover in London was \$90 billion a day and was several times this in the world as a whole. Today the figure would be larger still.
- iii. The proportion of those flows represented by individual countries' official holdings of gold is trivial.

Could an alternative to gold be found?

Some have suggested commodities might replace the role of gold in such a system. But clearly a great deal of further work would be needed before any solution of this kind could be discussed in detail.

Q12. What was the logic behind the report's proposal for limits on fiscal and budgetary policy?

The Delors report has essentially two arguments. Firstly, that uncoordinated policies will lead to imbalances between member states in terms of their trading balances, and levels of inflation. Secondly, that without coordination of national budgetary policies "it would be impossible for the Community as a whole to establish a fiscal/monetary policy mix appropriate for internal balance" (paragraph 30 of the Delors Report).

But in our view, while some degree of coordination is necessary or desirable, this does not imply the setting of rigid limits or guidelines. As the Chancellor said in his recent speech to the Institute of Directors, there would need to be a credible rule that if any member country got excessively into debt, there would be no bail-out. But since individual states would not have access to monetary financing if a central bank were in operation, there seems no reason why the Community, rather than the member state's own government, should not control the size of the budget. There is scarcely a single federal nation in the world that has control of the size of individual states' fiscal deficits or the nature of budgetary policies.

Q13. If the fear was that irresponsible Member States might jeopardise the system by running large budget deficits, would it not suffice to write into the system a rule that such states would not be bailed out? To what extent will the influence of financial markets act as a discipline?

It would certainly be very important to convince markets that member states who get into trouble as a result of irresponsible policies will not be bailed out by the rest of the Community. Otherwise countries that do pursue irresponsible policies may not experience the market discipline of a rising risk premium on their borrowing at an early enough stage for them to take action to avoid insolvency. Moreover the costs of irresponsibility will be reduced and the temptation to fiscal expansion will be greater, leading to higher interest rates throughout the Community. This is one of the questions we need to consider with our European partners.

Q14. Will monetary union require an increase in Community expenditure?

It is difficult to answer this until we know much more clearly where we are going. But looking at the Delors model, I see no reason why economic and monetary union should imply any overall increase in expenditure in the Community as a whole.

We certainly do not accept the suggestion in the report that there would have to be further large increases in structural fund spending to secure greater cohesion between the more and less advanced regions of the Community. The important priority must be to complete the internal market and ensure that both capital and labour can move freely. Market-driven adjustments, not massive injections of public money, are the way to reduce disparities in economic performance.

How would the central bank be financed?

That is clearly a matter for discussion if and when ~~we~~ decide ^{it is} ^{that a} ^{Europe} a central bank is necessary.

[IF PRESSED: Clearly one possibility would be that the running costs of the central bank could be met from seignorage. We should in any case need to decide where the benefits of seignorage should accrue - the Community budget should certainly not be increased on the back of them. But discussing such issues now puts the cart in front of the horse.]

Q15. Could national fiscal policy be used to help depressed areas in a monetary union, rather than increasing the Structural Funds?

I reject this, for the same reasons as I reject the need for extra structural funds. We must ensure that there is a genuinely free internal market, so that regions where, for instance, land or labour is relatively cheap can attract new investment. That is the priority for the Community and national governments alike. We need less government spending, not more.

Q16. Will not member states in a monetary union be unwilling to lose the power to give state aids to depressed industries, undermining the Community's competition policy?

Some may. I believe that such subsidies are not appropriate, now or in any future Community arrangements.

Q17. Are there valid arguments for having a common currency rather than irrevocably fixed exchange rates?

The main argument adduced in favour of a common currency is that while separate currencies continue to exist, realignment always remains a possibility - in other words, there is no way of ensuring that exchange rates are fixed irrevocably in practice. Adoption of a common currency would also avoid any transactions costs incurred in exchanging one Community currency for another.

Q18. How important is independence for the credibility of central banks?

The constitutional position of central banks differs widely, reflecting different historical backgrounds. Some have considerably more independence than others. We will want to examine different approaches as part of the further work that has been agreed, [always bearing in mind the need to protect UK national sovereignty].

[Note: you may wish to draw on the supplementary material we have provided on the constitutional position of central banks.]

Supplementaries

What would the statutes of the European central bank be? Would they follow those of the European Reserve Fund in paragraph 53 of the Delors Report?

As paragraph 54 made clear, a number of members of the Committee, including the Governor of the Bank of England, thought the creation of an ERF during Stage 1 would not be opportune. We need more experience of the way in which the Community is going to develop before we create new institutions. For the same reason, it would be quite inappropriate to attempt to define now what the statutes of such an institution might be.

Do you want the European central bank in London?

We have not ~~yet decided whether~~ ^{agreed that} it would be sensible to have a European central bank at all. ~~It is far too early to be talking~~ ^{So} ~~about where it should be situated,~~ ^{don't not answer.}

But the Deputy Governor put in a bid for London

He is well placed to appreciate the advantages of London as a financial centre. But location is a second order issue. ~~But of course there would be a lot of sense in siting the operational area of a central bank where the main financial markets were.~~

Q19. What degree of political accountability would be required in a monetary union? Would Community monetary policy have to be more accountable than other Community policies currently determined by the Council of Ministers?

The Government is quite clear that a high degree of political accountability to national democratic bodies must be retained in ~~any new~~ economic and monetary arrangements. The Delors proposals for an independent central bank, answerable day by day only to an independent board and submitting annual reports to the European Council, give us cause for concern in this respect.

SUPPLEMENTARIES

(i) Why not oversight by the Council, as for other policies?

Monetary policy is implemented day by day, unlike many activities undertaken at Community level. But Finance Ministers will want to examine all this thoroughly in their further work.

(ii) Would accountability be provided by strengthening the European Parliament?

The logical implication of the Delors prescription may ^{LOW} be a fully democratic European Parliament and European Government. I do not think that is what the majority of members of either House of Parliament would wish to see.

EXCHANGE RATE MECHANISM

When will the UK enter the ERM?

As the Prime Minister made clear in a written answer on 12 July (OR Vol 156 No 142 Col 518):

"The decision when to join the exchange rate mechanism will have to be judged against progress in a number of areas. In particular, when the level of United Kingdom inflation is significantly lower, there is capital liberalisation in the Community and real progress has been made towards the completion of the single market, freedom of financial services and strengthened competition policy".

Supplementaries

[Note: you may wish to decline to put any gloss on the above. But if necessary you could draw on the following].

What are the conditions on which the UK will join the ERM?

The decision when to join will have to be judged against progress in a number of areas. In particular:

- UK inflation will need to be significantly lower;
- there must be capital liberalisation ^m throughout the Community;
- real progress must have been made towards the completion of the single market, freedom of financial services and strengthened competition policy.

*Give
Comm
low
black!*

Prime Minister's "conditions" are a delaying tactic

No. UK inflation apart, these conditions are all part of Stage 1
~~No. The Prime Minister was simply restating in a little more detail the position we have always taken.~~ *give details position.*

How far does inflation need to come down? To the Community average?

The Prime Minister made the Government's position perfectly plain. We must get inflation "well down".

Has the Government changed its position?

No. We have always made it plain we shall join when the time is right.

Timetable for sterling's entry

We are not committed to any particular date, *but we will clearly be within the compass of Stage 1 of Delors, which starts on 1 Jan 1990.*

With what band will the UK enter? 2½ per cent or 6 per cent like the Spanish?

Wait and see. It is too soon to be talking about such details as the band within which we will operate or the central rate we will adopt.

Has the entry of Spain into the ERM made any difference to the UK position?

No. The Spanish decision was one for the Spanish Government, just as the decision on sterling's entry is the responsibility of the UK Government.

Policy of shadowing the deutschemark caused present inflationary pressures?

That is far too simplistic an analysis. The increase in UK inflation is part of a worldwide phenomenon.

Should those who participate in the ERM adopt progressively narrower bands?

That would clearly be one way of making the transition between the present situation and full monetary union. But it is not the only way. This is just one of the issues we need to thrash out together over the coming months.

Should non-EC members be allowed to participate in the ERM?

The 1978 Council Resolution setting up the EMS states in Article 5.2 "European countries with particularly close economic and financial ties with the European Communities may participate in the exchange rate and intervention mechanisms." We have received no proposals for participation from non-EC members. If and when we do, the response will be a matter for the Community as a whole to decide.

MAJOR TEXTS ON EMU/EMS

7 JUNE 1971

- Chancellor of Duchy of Lancaster's
statement in negotiations

We shall be ready to discuss after our entry into the Communities what measures might be appropriate to achieve a progressive alignment of the external characteristics of and practices in relation to sterling with those of other currencies in the Community in the context of progress towards economic and monetary union in the enlarged Community, and we are confident that official sterling can be handled in a way which will enable us to take our full part in that progress.

10 June 1971
(Conservative)

- Prime Minister's statement to House of
Commons

We have said three things to the Community. We have said that as members of the enlarged Community we should play our full part in the progress towards economic and monetary union. That was confirmed in my talk with President Pompidou and in my statement to the House. We have said that we are prepared to envisage a gradual and orderly rundown of official sterling balances after our accession. We have said that after accession we would discuss measures by which a progressive alignment of the external characteristics of sterling with those of other Community currencies might be achieved.

19, 20 October 1972

- Communique issued by the Heads of
State of the enlarged Community,
Paris

The Heads of State or of Government reaffirm the determination of the member states of the enlarged European Communities irreversibly to achieve the economic and monetary union confirming all the elements of the instruments adopted by the Council and by the representatives of Member States on 22 March, 1971 and 21 March, 1972.

The necessary decisions should be taken in the course of 1973 so as to allow the transition to the second stage of the economic and monetary union on 1 January 1974 and with a view to its completion not later than 31 December 1980.

April 1973
(Conservative)

- Extracts of the Regulation (EEC) 1970/B of the Council; setting up the EMCF

Whereas the purpose of the Fund must be to contribute to the progressive establishment of an Economic and Monetary Union between the Member States of the European Economic Community, which, in its final stage as regards its monetary aspects will have the following characteristics:

- either the total and irreversible convertibility, at irrevocable parities, of Community currencies against each other;
- or the introduction of a common currency.

December 1974

- Meeting of the Heads of Government of the Community

The Heads of Government having noted that internal and international difficulties have prevented in 1973 and 1974 the accomplishment of expected progress on the road to EMU affirm that in this field their will has not weakened and that their objective had not changed since the Paris Conference.

November 1976
(Labour)

- Hague: European Council

The achievement of Economic and Monetary Union is basic to the consolidation of Community solidarity and the establishment of European Union.

July 1978
(Labour)

- Bremen: European Council

Not later than two years after the start of the scheme, the existing arrangements and institutions will be consolidated in a European Monetary Fund.

December 1978

- Brussels: European Council

(Labour)

We remain firmly resolved to consolidate, not later than two years after the start of the scheme, into a final system the provisions and procedures thus created. This system will entail the creation of the European Monetary Fund as announced in the conclusions of the European Council meeting at Bremen on 6 and 7 July 1978, as well as the full utilization of the ECU as a reserve asset and a means of settlement. It will be based on adequate legislation at the Community as well as the national level.

December 1980

- Luxembourg: European Council

(Conservative)

The European Council confirms its determination to continue strengthening the European Monetary System until its transition to the institutional stage at the appropriate time. It calls upon the Commission and the Council of Ministers to continue their work.

June 1983

- Solemn Declaration on European Union

(Conservative)

European Union is being achieved by deepening and broadening the scope of European activities so that they coherently cover, albeit on a variety of legal bases, a growing proportion of Member States' mutual relations and of their external relations.

February 1986

- Single European Act

(Conservative)

Preamble

Moved by the will to continue the work undertaken on the basis of the Treaties establishing the European Communities and to transfer relations as a whole among their States into a European Union, in accordance with the Solemn Declaration of Stuttgart of 19 June 1983.

Resolved to implement this European Union on the basis, firstly, of the Communities operating in accordance with their own rules and, secondly, of European Cooperation among the signatory states in the sphere of foreign policy and to invest this union with the necessary means of action.

Article 1

The European Communities and European Political Cooperation shall have as their objective to contribute together to making concrete progress towards European unity.

Article 102A

Cooperation in Economic and Monetary policy (Economic and Monetary Union).

1. In order to ensure the convergence of economic and monetary policies which is necessary for the further development of the Community, Member States shall cooperate in accordance with the objectives of Article 104. In so doing, they shall take account of the experience acquired in cooperation within the framework of the European Monetary System (EMS) and in developing the ECU, and shall respect existing powers in this field.

²⁸
27 June 1988

- Hanover: European Council

The European Council recalls that, in adopting the Single Act, the Member States confirmed the objective of progressive realisation of Economic and Monetary Union.

They therefore decided to examine at the European Council meeting in Madrid in June 1989 the means of achieving this Union.

To that end they decided to entrust to a Committee the task of studying and proposing concrete stages leading towards this Union.

30 June 1988

- PM's Statement to Commons

The Committee's task will be to study and propose concrete steps towards the progressive realisation of an economic and monetary union.

That goal was, of course, set in the preamble to the Single European Act which was passed by this House. There is no reference in the Committee's mandate to a European Central Bank.

26, 27 June 1989

- Madrid: European Council

↪ The European Council restated its determination progressively to achieve Economic and Monetary Union as provided for in the Single Market and confirmed at the European Council meeting in Hanover. Economic and Monetary Union must be seen in the perspective of the completion of the Internal Market and in the context of economic and social cohesion.

↪ The European Council considered that the report by the committee chaired by Jacques Delors, which defines a process designed to lead by stages to Economic and Monetary Union, fulfilled the mandate given in Hanover and provided a good basis for further work. The European Council felt that its realisation would have to take account of the parallelism between economic and monetary aspects, respect the principle of "subsidiarity" and allow for the diversity of specific situations.

↪ The European Council decided that the first stage of the realisation of Economic and Monetary Union would begin on 1 July 1990.

← The European Council asked the competent bodies (the ECOFIN and General Affairs Councils, the Commission, the Committee of Central Bank Governors and the Monetary Committee):

(a) to adopt the provisions necessary for the launch of the first stage on 1 July 1990;

(b) to carry out the preparatory work for the organisation of an intergovernmental conference to lay down the subsequent stages; that conference would meet once the first stage had begun and would be preceded by full and adequate preparation.

29 June 1989

- PM's statement to Commons

"..[The Delors report] was accepted as a basis for further work, but not the only basis. It will be possible to bring in other ideas and other approaches.

... No decisions were reached on what should follow [the] first stage [of the Delors report], and stages 2 and 3 were not endorsed. Indeed several delegations - not only the UK - made clear that they had substantial difficulties with them.

... The Government support the objective of closer monetary cooperation but will work for solutions which leave crucial economic decisions in our own hands... I reaffirmed our intention to join the ERM, but we must first get our inflation down.

... The Delors report will not be the only document taken into account in considering how to come to closer monetary and economic union. We shall be able to put up alternative schemes.

INTER-GOVERNMENTAL CONFERENCE

(Extract from Paper by Treasury Officials, April 1989)

Procedure for IGC and Treaty Amendment

7. Apart from the treaties allowing UK, Greek, Portuguese and Spanish accession, there have been six other Treaty amendments since 1965, most recently the 1986 Single European Act (see Annex A).

8. Treaty amendment is provided for under Article 236 of the Treaty of Rome, at Annex B. The basic procedure is:

- any government or the Commission submits a proposal (in practice this could be quite simple);
- the Council, after consulting the European Parliament and the Commission, votes by simple majority for or against calling a conference of representatives of the Governments of member states;
- if the Council is in favour, a conference is called by the President of the Council;
- the Treaty does not lay down rules on who should represent member states nor on determination of

:
terms of reference or timetable. In practice the conclusions would have to be agreed by heads of government who would be required to act unanimously;

- amendments only enter into force if ratified by all member states, in accordance with their constitutional requirements (ie in the UK by Parliament).

9. So an IGC can be called, by simple majority, without any specific prior agreement on terms of reference, timescale, or membership. The Council can of course indicate its wishes on all three.

10. The preparations for the Single European Act provide an illustration, but not a binding precedent. In June 1985 the European Council decided to set up an IGC, formally convened by the FAC in July 1985. There then followed 12 preparatory meetings of officials - led by the Permanent Representative - and 7 meetings of Foreign Ministers. Heads of Government reached agreement some six months later, in the European Council in December 1985, on Treaty revision. Annex C gives details.

PAST TREATY AMENDMENTS

Apart from the accession treaties (UK et al, Greece, Spain, Portugal) there have been six treaty amendments

- i. Treaty establishing a Single Council and a Single Commission (1965).
- ii. Treaty amending Certain Budgetary Provisions (1970); involving a new Article 203, revising the budget procedure and timetable and establishing the maximum rate.
- iii. Treaty amending certain provisions of the Protocol on the Statute of the European Investment Bank (1975); largely to take account of changes in definition and convertibility of the ecu.
- iv. Treaty amending certain Financial Provisions of the Merger Treaty (1975); a further revision of Article 203 involving a new timetable and some procedural changes; modifying the organisation and powers of the Court of Auditors.
- v. Greenland Treaty (1984)
- vi. Single European Act (1986) which commits the EC to the aim of progressively establishing a single market over a period expiring on 31 December 1992. It incorporates Treaty reforms to speed up decision making by extending majority voting to most major areas of the single market programme.

SECTION II: INTER-GOVERNMENTAL CONFERENCE (IGC)

2.1 The European Council in Milan on 28-29 June 1985 decided by majority vote to convene a Conference of Governments of member states to consider institutional reform of the Community and possible treaty amendments, as well as the proposals put forward by the United Kingdom and others for a treaty on foreign policy and security.

2.2 The Foreign Affairs Council on 22 July took the formal decision to convene the Conference at Foreign Minister level. The first meeting was held in Luxembourg on 9 September, with representatives of the Commission, Spain and Portugal attending.

2.3 The Inter-Governmental Conference (IGC) subsequently met six times. The United Kingdom was represented by the Secretary of State for Foreign and Commonwealth Affairs or by the Minister of State (Mr Malcolm Rifkind). Twelve preparatory meetings of officials also took place, led on the United Kingdom side by our Permanent Representative to the European Communities. A full list of IGC and IGC related meetings is at Annex B. Discussion covered the following subjects: internal market, role of the European Parliament, powers of the Commission, technology, environment, cohesion, monetary co-operation, social policy, European Court of Justice.

2.4 At the European Council in Luxembourg on 2-3 December Heads of Government reached agreement, subject to Italian and Danish overall reserves and some outstanding reserves on individual aspects of the texts, on a Single European Act, comprising amendments to the Treaty of Rome in the areas listed in paragraph 2.3, as well as Treaty provisions codifying foreign policy co-operation among the member states. This outcome was reported by the Prime Minister to the House of Commons on 5 December.

2.5 On completion of the internal market the Community set itself a target date of 1992 and agreed to make greater use of majority voting. Unanimity will be maintained on important issues such as fiscal provisions and those relating to the free movement of persons or the rights and interests of employees. The main effect of agreement will be to speed up completion of the common market in goods and services. The agreement does not affect frontier controls to deal with terrorism, drugs or immigration. It includes safeguards enabling the United Kingdom and Republic of Ireland to protect their high standards of animal and plant health.

2.6 As regards the European Parliament, the co-operation procedure which was agreed will give the European Parliament the opportunity to play a more constructive role in Community decisions on the internal market and in other important areas, while leaving the last word with the Council of Ministers. The European Parliament's assent will be required for new accession and association agreements.

8

2.7 The new articles on technology and the environment will update the Treaty of Rome by writing into it the pattern of collaboration already established in the Research and Environment Councils, and will provide a basis for future action. In technology emphasis is placed on market-oriented programmes to improve the competitiveness of European industry.

2.8 The article on cohesion gives a treaty base for the first time to the Regional Fund, which was set up in 1975 and has had a considerable impact on the poorer regions of the European Community, including areas of industrial decline. The structural funds operated by the Community (Regional Fund, Social Fund, Agricultural Guidance Fund) are to be better co-ordinated with one another and with the activities of the European Investment Bank.

2.9 Agreement was reached that a reference should be made to the European Monetary System in the Treaty in a way which records what has already happened in this field without conferring new powers.

2.10 On the European Court of Justice agreement was reached inter alia on new Treaty articles providing power to set up a Court of First Instance. It is hoped that when this power is exercised it will enable the Court of First Instance to deal with staff matters and cases raising complex issues of fact (especially competition and anti-dumping cases). The changes are designed to reduce the Court's heavy workload.

2.11 The new treaty on European Co-operation in the sphere of Foreign Policy, based on the British text tabled earlier in 1985, formalises and strengthens the commitment to consult and concert. It applies to the existing pattern of consultation on the economic and political—but not the defence—aspects of security.

2.12 The European Council also endorsed Commission plans to relieve the burdens of Community requirements on businesses (deregulation) in response to an initiative of the Prime Minister.

2.13 A further meeting of the Inter-Governmental Conference took place in Brussels on 16 December. Discussion centred on relatively minor points which, following the decisions taken at the European Council, require clarification or further work.

9

MEETINGS OF THE INTER-GOVERNMENTAL CONFERENCE AND OTHER IGC RELATED MEETINGS

IGC Meetings (7)

9 September
21/22 October
11 November
19 November
25/26 November
30 November/1 December (conclave)
16 December

Other Ministerial Meetings at which IGC issues were discussed (5)

20/21 September—ECOFIN (Economic and Finance Council)
26/27 October—informal Foreign Ministers
28 October—ECOFIN
18 November—ECOFIN
2/3 December—European Council

Preparatory Group Meetings (13)

30 August
2/3, 17, 24, 30 September
7/8, 14/15, 30/31 October
5/6, 14, 21/23 November
6, 12 December

Other Official Meetings (5)

10, 26 October (Monetary Committee)
9 November (Monetary Committee)
28 November (Legal Experts)
10 December (Legal Experts)

46

Article 236

The Government of any Member State or the Commission may submit to the Council proposals for the amendment of this Treaty.

If the Council after consulting the European Parliament and, where appropriate, the Commission, delivers an opinion in favour of calling a conference of representatives of the Governments of the Member States, the conference shall be convened by the President of the Council for the purpose of determining by common accord the amendments to be made to this Treaty.

The amendments shall enter into force after being ratified by all the Member States in accordance with their respective constitutional requirements.

Constitutional position of central banks

The constitutional position of central banks differs widely.

The Bundesbank Council is accountable only to itself. Its relationship with the Federal Parliament is not covered in the Bundesbank Act nor in the basic law. There is no requirement for the Bundesbank to report to, or be accountable to, the Federal Parliament. The Bundesbank is independent of instructions from the Federal Government but must support the Government's general economic policy, with the proviso that this must not prejudice its performance of its function "to regulate... money... and credit... with the aim of safeguarding the currency". It is also required to advise the Government on monetary policy matters of major importance. There is, of course, extensive co-operation in practice between the Bundesbank and Ministry of Finance.

The Federal Reserve System in the US, by contrast, is independent of the US Administration but accountable to Congress which delegated to it its own powers to "coin money and determine the value thereof" when it was set up in 1907. Congress has modified and can continue to modify the System in the light of changing circumstances and exercises a continuing scrutiny over all aspects of its work.

In France, the Minister of the Economy is directly responsible for the central bank's conduct of monetary policy and it is through him that the bank's policy is examined, criticised and approved by Parliament. Exceptionally, the Governor may be questioned by Parliament. The Banque de France submits an annual report to the President of the Republic and its accounts are controlled by the Public Corporations' Audit Commission.

Similarly, in the Netherlands, it is the Minister of Finance who is accountable to Parliament for the Bank's enforcement of the Bank Act and measures taken under it. In addition, the Bank must publish a weekly summary of its balance sheet and submit its annual accounts to its Supervisory Board.

[Additional background material ^{can be supplied} attached.]