

The European Monetary System (EMS)

Minutes of a meeting held on Wednesday 25th October in the House of Commons.

Present: Sir Geoffrey Howe, Lord Soames, Francis Pym, John Nott, Nigel Lawson.

In attendance: Mr Ridley, Mr Fallon, Mr May.

Mr Lawson asked to open the discussion, said that in his view Callaghan would not in fact join the proposed scheme, and that such were the existing divergences the scheme was in any case likely to fail. We had to decide first whether it would work or not; then if the terms were right, if we should join. He thought that we should, but it would be wrong to do so without first lifting controls on exchange rates. Politically we should play it on a bipartisan basis - that we support the Government in wanting to become members from the beginning on the right terms. But the situation was very fluid, the negotiations were continuing and we didn't need to come towards a definite conclusion. Sir Geoffrey Howe drew attention to John Biffen's forthcoming speech making the case against.

Mr Nott said that he didn't share John Biffen's views and wanted to build a bridge between the opposing sides. He felt that the issue had little to do with "Europe": it could become a step towards economic and monetary union, but it wasn't at the moment. Even Pro-European Germans were opposed. The real question was whether we go back into the snake: this was a political question but not a "European" one. We didn't know what was going to happen; it was too soon to take a view. Sir Geoffrey Howe pointed out that the date of 1/1/79 was still there and that he or Mrs Thatcher might have to say something in the House. The choice was not a catastrophic one - but there was a political angle: if outside, we would be at the foot of a Franco-German High Table. It was politically important to be in the big league if we could be. There was a strong case in economic terms for creating an alternative monetary unit. On the other hand, we were economically so divergent from the others and in such a scheme there would be constant monetary pressures upon us that we might not be able to sustain until we had got our own monetary policy right.

Mr Pym said that we should be bold. We couldn't decide on the basis of the scheme's minutiae. The only question was whether by going in we were likely to make our own recovery worse and a Tory Chancellor's job more difficult after the election. We should take a view on the scheme's long-term objectives and avoid discussion of the details which we weren't in a position to know.

Lord Soames said that the scheme was essentially a Franco-German initiative. What the British really would have wanted was an agreement to work towards economic convergence with specific targets etc. We were now faced with the fact that the Franco-German scheme would go ahead in 1/1/79. Callaghan probably wanted to go in but considered the difficulties of going in greater than those involved in staying out. We should say that he had played it badly, that it was very important, and that if we didn't go in, it would be for two reasons, because economically we were now too weak and because of the problems in the Labour Party. Our own party had European obligations: we couldn't convey the impression that we were simply waiting to see if it worked before joining.

Mr Nott thought the scheme as constituted was damaging to us. We could make pro-European noises and say that we would want to see a scheme that all three countries could agree upon. For technical reasons, with differing inflation rates we would be taking in substantial support from the Fund. Mr Lawson said that the only advantage was the external discipline that would be impressed on the conduct of UK economic policy. Unpopular measures would be forced upon us and the European cause would suffer. So we really wanted this Government to join, and should do everything possible to make Callaghan's task easier.

Sir Geoffrey Howe thought these points of view reconcilable: we knew where we wanted to get to. Lord Soames said we should use our participation in the scheme to get concessions on the transfer of resources and the reform of the CAP; outside it, we wouldn't get these anyway. If it did collapse, it was better to be in it as it did so. Sir Geoffrey Howe said we wanted a real reduction in our budget contribution and moves towards complete dismantlement of exchange controls; it would be preferable to join when we had sufficient liberalisation and more economic convergence. We didn't want it all imposed on us at once.

Mr Nott emphasised the political difficulty: Ministers would have to come to the House and announce devaluations as a result of agreements abroad. Anti-market feeling would grow; the Party already felt the strength of this argument. Mr Pym said that he recognised this. Sir Geoffrey Howe said that the answer to Biffen's original threat of a Franco-German axis was to put us on the other end and make a real triangle. Mr Nott didn't see why we had to have a line: why couldn't the Party simply debate it while saying that we wanted to be part of it if we could. Mr Lawson said that we should wish Callaghan well and back him on a bi-partism basis.

Sir Geoffrey Howe said that we could argue for relaxation of exchange rate controls, positive moves towards economic convergence, and a new deal on the transfer of resources. But what about CAP reform? Mr Ridley said that entry into EMS gave us a bargaining plus: the balance was already shifting and enlargement would help highlight the problems.

Mr Pym said the main consideration for the Party was the national interest: Britain must get itself into a position where it could actually achieve something. Mr Nott disagreed: we had first to create

a strong economy, and then we would be taken notice of.

Sir Geoffrey Howe thought that if we had been elected in October we would have agreed to go in. Confidence was important - we had to say to ourselves that we would have done it. The scheme's obligations were economically and politically desirable, and would remain so whenever we joined. We should say that if the Government committed itself to a programme providing for economic stability and improvement and liberalisation of exchange rates, then we would favour entry from the outset. We could ask whether the country had the capacity to surmount the technical barriers involved. We should also criticise Mr. Callaghan's past - his handling of the negotiations - while support his future and pointing out who it was who didn't want him to succeed. We could also argue the case for real targets on economic and monetary convergence and pressure for transfer of resources.

Mr. Lawson said there was enormous value in persuading Callaghan to go in: we shouldn't do anything that would make his task harder. Any advice to Mrs. Thatcher should include an assessment of feelings in the Party. Sir Geoffrey Howe said that we needn't suggest a whole-hearted commitment but that respectable noises should be made, presented in European clothing. Our line would be a kind of compromise - that the objectives were desirable, whatever the timetable. Once in office, we could assess the state of the economy and then take a decision.

It was agreed that on the basis of the discussion Sir Geoffrey Howe would write to Mrs. Thatcher.

Conservative Research Department
24 Old Queen Street, London SW1

27th October 1978
MF/HL