"Personal" copy Mr Stowe

QZ 0601

PERSONAL AND CONFIDENTIAL

SIR JOHN HUNT

h. cc. Mr Mountfield
Mr Walsh

EMS

You may like to have this account of where things stand.

2. At the July Finance Council, the work was farmed out rather as we expected but the Chancellor did not register as firmly as I had expected some of the guidelines we had worked out in advance. However, the EPC which was charged with the "concurrent studies" on how to help the weaker economies got off to a reasonably good start when it met, against the EEC holiday conventions, on 11 August. We had a strong team led by Ian Byatt and Michael Butler. The Commission were asked to produce the kind of factual papers we wanted to show the gap between the stronger and weaker economies and the perversity of the Community's budgetary operations. However the papers the Commission have produced for the next meeting of the EPC on 6 September are not particularly helpful to us. The general thrust - which will no doubt gain French and German support - is that the effects of the Community budget on individual Member States' balance of payments are relatively unimportant (except in the case of Germany! ) and that the best way to help the weaker economies is to offer more loans for industrial reconstruction and development. On the monetary side itself, the effect of farming the proposition out to Central Bank experts has been, predictably, to cumulate all the technical difficulties; but the principal development has been the clear indication that, at any rate so far as the Bundesbank is concerned, there is no pooling of reserves. The 50 million dollars trumpeted by Jenkins and Schmidt after Bremen as the amount of support to be given to the new system was described by the German representatives at the Monetary Committee as a "misunderstanding". On the other hand, there seems to be a reasonable consensus on the need to allow rate adjustments, although there will be problems over how much consultation or agreement this will require.

3. Internally, the Treasury economists have been working on a paper assessing the possible consequences for the UK economy. This leans heavily on the hypothesis that entry into the scheme will inevitably mean that our rate will be held higher than it otherwise would be and thus, using the

Treasury model, predicts some alarming consequences for the balance of payments and GNP. The FCO have contested the assumption that we shall not in the event be free to adjust our rate as and when we want to. This paper is, for the moment, only going to the Chancellor, and, given the subjective nature of the judgment about the different levels of our rate in and out, it is in my view not a suitable paper for collective Ministerial discussion in its present form.

4. We have had Departments working on what we might get out of the "concurrent studies" including the review of the CAP. Our public Ministerial statements about the commitment to review the CAP have naturally produced adverse reactions within the Commission and we cannot expect too much help from that quarter particularly over anything which smacks of a budgetary ceiling on agriculture. Within Whitehall however we have a consensus in favour of making it a major aim to get something on the CAP out of these studies; to concentrate on commitments about the prices for surplus products and to look for the budgetary saving as an adjunct rather than as an end in itself. The general view is that a switch to using the EUA for agriculture would help us in the long run to hold down prices but that it is not something on which we should expend a lot of negotiable capital. There is some difference between MAFF who do not want to accept any limitation on our freedom to change the Green £ and DPCP with some support from the Treasury, who think there might be a price worth paying if in return we could screw down the German price level more. On non-agriculture expenditure, the universal view is that our chances of getting something specific and significant are minimal and that rather than go e.g. for an increase in the Regional Fund (which on enlargement might prove to be a boomerang) we should think in terms of a general commitment from the European Council that the Community should progressively adjust its policies so that they contribute to (rather than as in some cases at the moment frustrate) economic convergence. There is an open question whether we should go for a change in the "own resources" system. This will depend in the first instance whether we get a useful report out of the Commission this autumn introducing the concept of "progressivity" for a new tranche of VAT or other source of Community financing. This is potentially ~~important and~~ very significant for us and the

Treasury are inclined to think that we ought to go for it in December. Donald Maitland doubts whether this is realistic and points out that when the time actually comes for the Community to need more money, we shall have a very powerful negotiating lever to get the system of contribution we want. This is something Ministers will have to decide nearer December. We shall know more when the Commission have decided whether to put their report out this year or not. They are having a "brain-storming" session in mid-September and this is one of the issues they will probably discuss.

4. There is a meeting of GEN 136 on 12 September. This will review what has been happening in Brussels and the line the Chancellor will take at the next Finance Council on 18 September. It will have a Treasury paper listing all the considerations which will have to be in Ministers' minds in deciding eventually on EMS. We have had the opportunity to comment on the draft which, sensibly, is in fairly general terms at this stage. It ends up, wisely enough, with the implications of staying out. On this, I think Ken Couzens is inclined to be less concerned than the rest of us. This is based partly on the view that we might be very happy to have kept out of something which breaks down after a few months and partly on the expectation that Italy and Ireland at least would stay out with us. Personally I agree about Ireland but I certainly would not count on the Italians not deciding politically to take the risk and perhaps being bribed to do so by the Germans.

5. I might mention that Bob Hormats came to see me yesterday. He was in London but wanted to talk about EMS. He said quite firmly that the US was not hostile to EMS but was very interested in and wanted to follow closely what was going on. He said the French seemed particularly anxious to have a numeraire which gave less weight to the DM than the present snake arrangements and on "flexibility", meaning not only that Member States could change their rate but move in and out. I gather, incidentally, the

PERSONAL AND CONFIDENTIAL

Treasury intend to have bilateral talks with the French shortly. I am sure this is right: on the nature of the scheme, our interests are likely to be very close together.

M D M FRANKLIN

1 September 1978