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For my folder please.

DRN

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

27 September 1985

David Norgrove Esq
10 Downing Street
LONDON
SW1

Dear David

ERM

... I attach a joint paper by the Treasury and the Bank for discussion at the Prime Minister's seminar on Monday. The papers for the last seminar in February are of course still relevant.

I am copying this to Len Appleyard (Foreign Office) and John Bartlett (Bank of England).

Yours ever
Rachel.

RACHEL LOMAX
Principal Private Secretary

SECRET

STERLING AND THE EUROPEAN RATE MECHANISM

(Joint Note by Treasury and Bank of England)

Introduction

The public stance of the Government has consistently been that sterling would join the Exchange Rate Mechanism (ERM) when the time was right. Answering Dr Owen on 31 January this year in the House of Commons, the Prime Minister said:

> "We have always said that we shall join the exchange rate mechanism of the EMS when we believe that the time is appropriate. It is kept under review from time to time, but I must make one thing clear. Joining the EMS would not obviate increases in interest rates, it would not obviate the need for financial discipline and, indeed, it might increase it."

2. The subject was last reviewed with the Prime Minister on 13 February and the papers for that seminar are still relevant.

3. Circumstances have changed since February. When we last discussed the question, the dollar had risen sharply. Sterling had fallen not only against the dollar but also against European currencies, reflecting market doubts about the Government's commitment to its counter-inflation strategy. UK interest rates had been forced up sharply.

4. Inflation is now falling. There is a good chance that we will do even better than the Budget forecast of 4½% inflation by mid-1986 and this view is gaining widespread acceptance. Monetary conditions, are consistent with lower inflation. We have pursued a cautious policy towards interest rate reductions. Since 13 February, the pound has risen by 7% against the DM and 32½% against the dollar.

Reinforcing the Strategy

5. In spite of sterling's strength, and the much improved outlook for inflation, we have run into difficulties over the operation and exposition of the Government's financial strategy. Though we may receive credit for the results of our policy, this is offset by criticism of the way in which we operate it.

6. The background of currency upheavals, the removal of controls at home and far-reaching changes in the structure of financial markets has meant that the various measures of money have been difficult to interpret. The target measures have been pointing in different directions. For reasons we discussed at the Prime Minister's monetary seminar in July, we have recently had particular difficulty with £M3 - the measure which in the public mind is most closely associated with our monetary strategy. Although there can be no question of doing without the discipline of monetary targets, we have to recognise that the monetary aggregates have, for the present, become a less reliable guide to the conduct of policy.

7. So we have been forced to place increasing emphasis on the exchange rate. We have always acknowledged that, in assessing monetary conditions, the exchange rate has an important role alongside the monetary indicators. There are those who argue that it is wrong to place weight on the exchange rate when movements can reflect changes in monetary conditions in other countries - particularly the US - and other factors, for example, oil prices, that are independent of UK financial conditions. But the exchange rate has a direct impact on the price level and inflationary expectations and sharp movements have often coincided with changes in the market's perception of monetary ease or stringency.

8. In practice, the exchange rate has had a good record of reflecting domestic monetary conditions. Significant changes have usually been a good guide to interest rate decisions - for example in January this year when the monetary aggregates were giving uncertain signals, partly because of the effects of the

BT privatisation on the statistics. Domestic financial markets too have been increasingly influenced by it. It is clear to them what the direction of the interest rate response of a Government committed to low inflation must be, and market interest rates almost always react to sharp exchange rate changes.

9. We have, however, had considerable difficulty in explaining, at any particular time, what weight it has in policy decisions. This has itself become a source of confusion in presenting policy. Markets and commentators continually speculate about the exchange rate level which the Government would like to see; many different exchange rate bands are hinted at. The Chancellor intends to provide a further explanation of the monetary strategy in his Mansion House Speech on 17 October. He will deal with the issues raised at the Prime Minister's seminar on 16 July. But there will still be an inevitable degree of uncertainty in the minds of commentators and the markets.

10. There is a strong case for greater clarity. It would simplify some of the problems of day to day conduct of policy; it would greatly improve the presentation of policy; it would remove fears that we were exercising too much discretion. The discipline of an exchange rate regime is more readily comprehensible than money supply targets on their own. Better public understanding would itself be valuable both politically and in influencing economic behaviour - by reinforcing the discipline of sound money.

11. The only practicable possibility of strengthening and clarifying this part of our policy would be to join the ERM. It would be no soft option. It would mean linking sterling to the DM, the currency of the strongest economy in Europe, which has an inflation rate of little more than 2%.

12. It would be crucial to retain the MTFS. Like the Germans, we would continue to set and pursue monetary targets. We would need to consider further whether it would be right at the time of joining to make any changes in the chosen target aggregates.

13. Our primary objective would remain to keep monetary conditions firmly in a counter-inflationary direction. Although realignments

are permitted within the rules of the system, we would aim to avoid changes, especially in the first year or so, and build credibility in the market. In the event of realignments we would seek to keep in line with the DM. This should ensure that there is no conflict between keeping the exchange rate within ERM limits and reducing inflation.

Impact on Industry

14. Linking sterling to the DM would be of value in reinforcing industry's determination to control its costs. There have been signs that firms are beginning to ease up on this front, following the strong improvement in their profitability. Manufacturing costs have risen much faster than in other major countries over the past year. Recent statements by the CBI and other industry spokesmen about the need for a lower exchange rate have not been helpful. Such statements both unsettle the markets and encourage firms to believe that they will be bailed out by depreciation.

15. Provided we are satisfied with the realism of the exchange rate at which we join and make it clear that the Government's monetary and fiscal stance remains determinedly counter-inflationary, membership of the ERM would be a valuable discipline. Holding to something like the present £/DM exchange rate would reinforce downward pressure on industrial costs and prices. The CBI, Institute of Directors and others who in recent months have come to support our joining the ERM, could hardly argue publicly against this stance. They know that this is the essence of the ERM, and would have no ready excuse if they found that keeping up with the deutschemark was tough going.

Could We Make It Work?

16. There is no way in which we can confidently rule out the possibility of bouts of heavy pressure against sterling in the ERM. They could arise from differential movements into or out of the dollar if that currency were under pressure either way; or from a severe movement of oil prices; or from a weakening

of confidence if our inflation performance seemed to be faltering. Given the scale of financial flows through London, the pressure on us might be very large. And particularly in the early months, the markets might well seek to test our resolve. If so, we would need to demonstrate that resolve.

17. The view that our reserves were inadequate for membership of the ERM was one of the main concerns expressed at the Prime Minister's seminar in February. We still have smaller reserves in relation to our volume of trade, and even more so in relation to our potential exposure to international capital movements, than other countries of the Community. This remains true even though we recently strengthened our reserves substantially by borrowing $2.5 billion on satisfactory terms.

18. We would not want to spend massive reserves, as the French did in late 1982, in defence of the indefensible. We would hope in the first instance to avoid pressure by maintaining the cautious approach to interest rates that we have followed since the beginning of this year. If in spite of this pressures emerged we would hope to recognise the need for policy change in good time and act on that. In such circumstances we would have to be prepared to adjust domestic interest rates vigorously, as indicated by the exchange rate, and maintain them at these levels for as long as necessary.

19. To a considerable extent we follow this approach now outside the ERM. Though at times in the past it might have seemed more sensible to take part of the pressure on the exchange rate (rather than interest rates), recent experience - particularly around the turn of the year - has clearly demonstrated that this option leads to great problems and in practice it now scarcely exists.

20. Our best protection would be our own financial strategy and performance. Some commentators have drawn attention to the UK's failure to live within the "Snake" in 1972. But the UK's relative fiscal and monetary position is now quite different from what it was in 1972; then monetary conditions were easy

and getting easier, and there was a widespread view that the UK authorities wished to see a lower exchange rate. After a period of achieving a track record and consequent credibility in the ERM we could hope to benefit from the reinforcing effects of membership of a mechanism that has been successful in limiting exchange rate variations among European currencies. The fact of being a member could then help to stabilise expectations and to reduce some of the speculative flows.

Who Decides Parities?

21. At the discussion in February there was some concern about the influence of other Community countries over our exchange rate. The constitutional position is that initial parities and any subsequent changes are decided by unanimous judgement of all Community Finance Ministers, who meet for the purpose at "realignment conferences". At these there is often a good deal of argument as to whether X should devalue or Y revalue (the same thing in market terms but different in terms of political presentation), and at the margins about the amounts of any changes (with a tendency for resistance against demands for large changes).

22. At the end of the day it is usual for a compromise to be reached, but in practice an individual country only really loses its freedom of action when that country is seeking special financial assistance, in which case attempts may well be made by others to impose policy conditions - an IMF-type situation. There is certainly an in-built pressure in the system against devaluation. But that is what we would want.

Conclusions

23. We are able now to contemplate joining the ERM from a position of some strength. This is based on our success in reducing inflation. There is widespread acceptance of our determination to continue in that direction and a growing expectation that we shall succeed.

24. We face a period of difficulty over the conduct and presentation of financial policy.

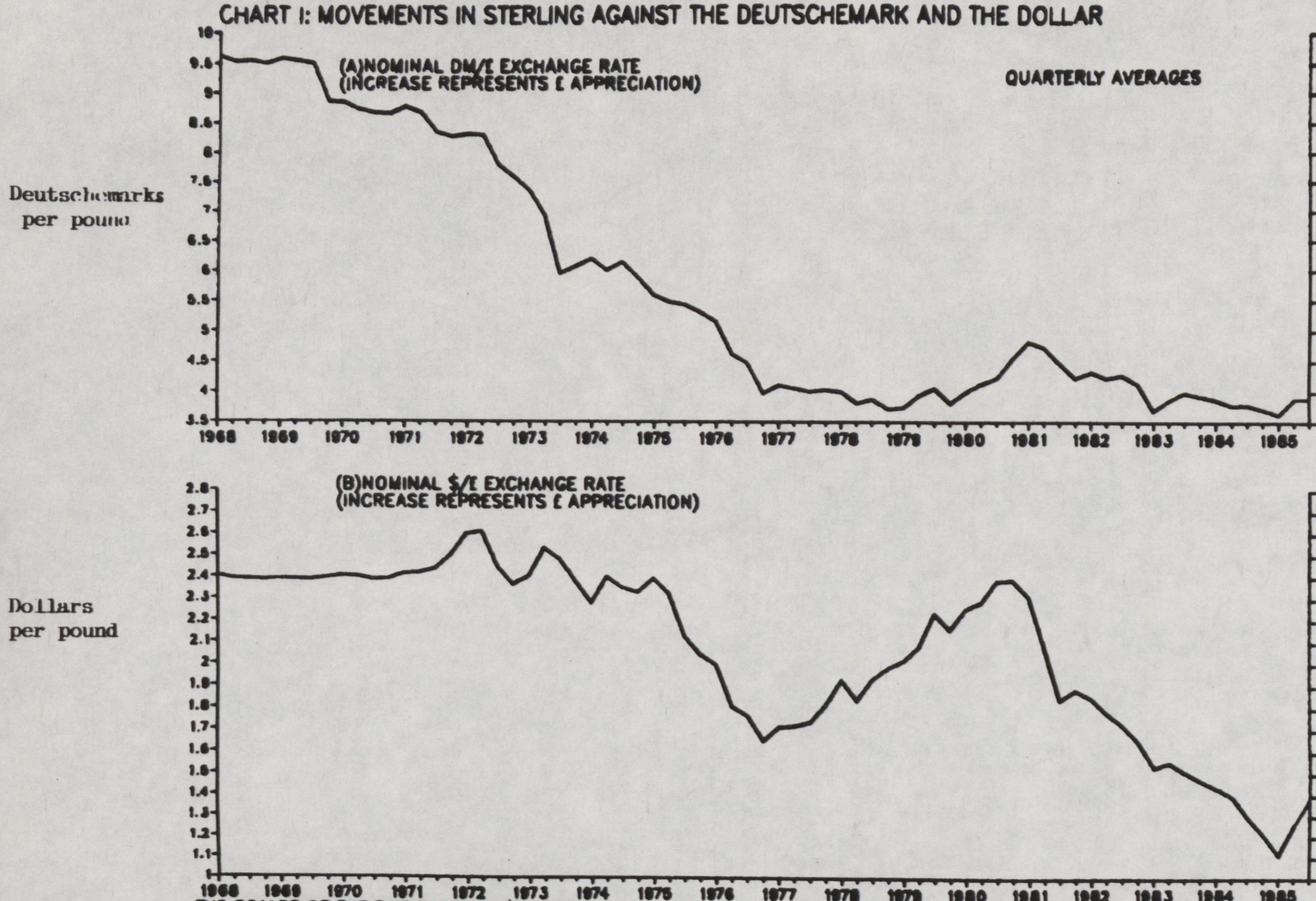
25. Joining the ERM now would reinforce our basic strategy, clarify its operation in some respects and greatly improve its public presentation.

26. Joining the ERM would be a natural extension of the present strategy in which the exchange rate has come to play an increasingly important part in the assessment of monetary conditions.

27. It would impose a discipline on the Government and on industry. It would also be generally well received by the markets. It would be a significant political initiative which we would take care to present as an evolution of present policy, and in no way a relaxation of that policy.

28. There are always risks of severe exchange rate pressures - difficulties which we have not escaped by staying outside the ERM. Interest rates would need to adjust rapidly. But the advantages now outweigh the risks.

29. It is the considered view of the Chancellor and the Governor that we should become full members of the EMS, joining the ERM at the earliest practicable opportunity.

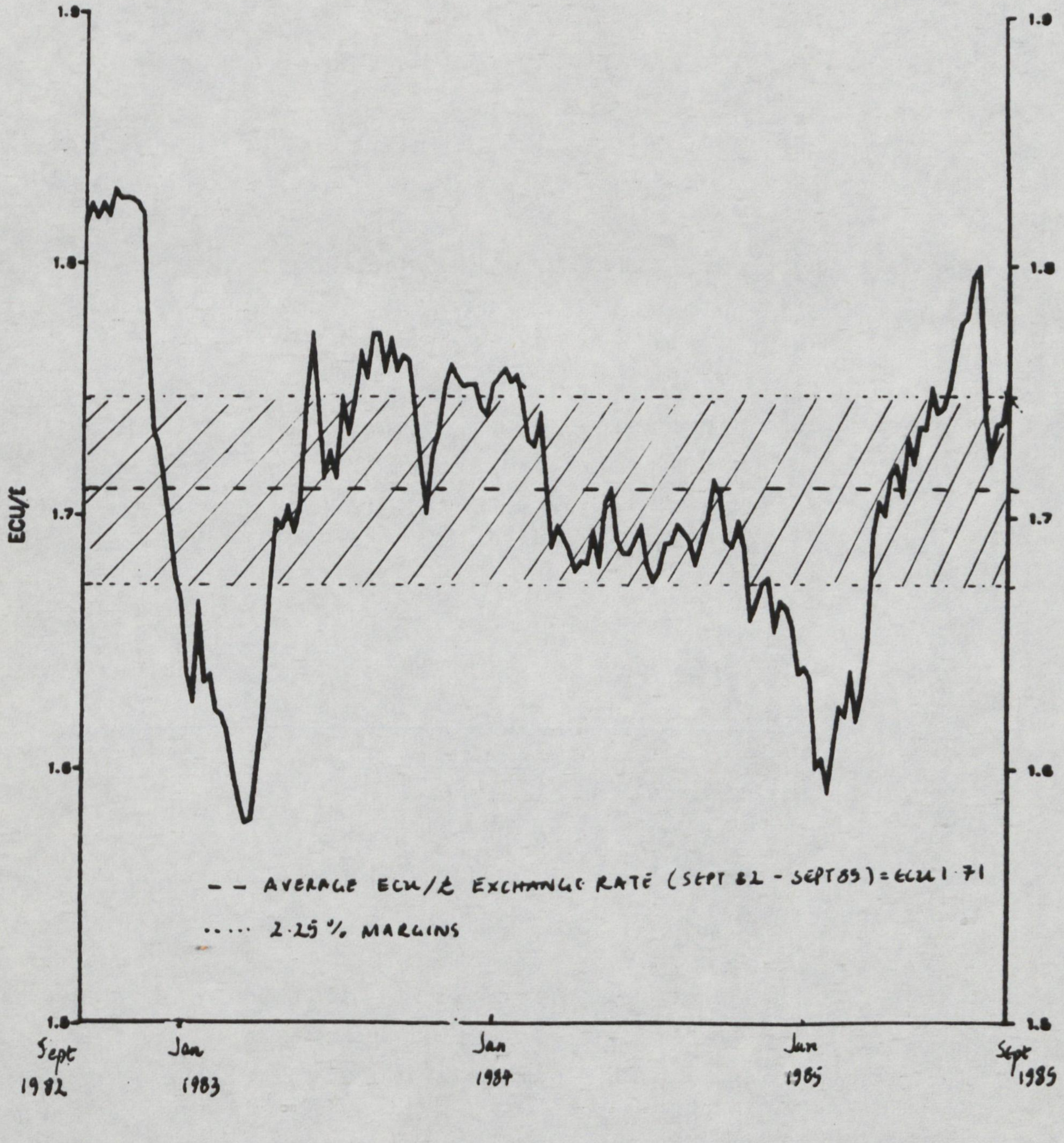


THE SCALES OF THE TWO PANELS ARE SET SO THAT A GIVEN VERTICAL DISTANCE REPRESENTS THE SAME PERCENTAGE APPRECIATION/DEPRECIATION AGAINST BOTH CURRENCIES
THE LAST OBSERVATIONS (1985Q3) ARE BASED PARTLY ON FORECASTS

CHART II: SHORT-TERM MOVEMENTS IN STERLING

(WEEKLY DATA – FRIDAYS)
INCREASE REPRESENTS £ APPRECIATION

NOMINAL ECU/£ EXCHANGE RATE



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ANNEX A

QUESTIONS OF PROCEDURE

In the Community

The formal process of joining would be as follows:

- we would notify our intention to the Commission and to our partners;

- a "realignment" conference would be convened, almost certainly over a weekend (notice could be given as late as Friday evening);

- the form of the conference is a preliminary meeting of the Monetary Committee (Treasury and Bank officials), followed by a meeting of Finance Ministers and Central Bank Governors;

- subject to the possible qualifications mentioned below, the sole purpose of the conference would be to settle the rate at which sterling would join, and the consequent complete new grid of cross-parities and ecu central rates.

2. There are just two qualifications about the substance of the discussion:

- it would have to cover in addition any special points or conditions we wanted to raise: but this does not arise, because a mark of moving into the system strongly would be that we were not seeking special conditions and, in particular, we would be accepting the standard margins of variation of +/- 2.25%;

- there would be additional but by no means insuperable complications if, at the time of our entry, some other Community country wanted to take the opportunity of realigning its own currency.

3. The rate at which sterling would join would, in theory, be an open matter for negotiation with and among all the partners. In practice, there would be a strong sense among all concerned, and this would include the UK, that the chosen rates could not be very far from the prevailing market rates: to choose otherwise would risk confusion when markets re-opened. This still leaves some room for manoeuvre over the precise rates (which could be such as to give an immediate market effect of sterling being in the middle or upper or lower part of the permitted range). We would want to decide for ourselves within this limited room for manoeuvre. We would have to explain and argue for our choice, but there must be a very strong probability that the general satisfaction of others with our joining at all would give us a strong hand to play.

4. With sterling in the ERM, the relationship between sterling and the DM would be particularly important for the authorities of both countries. Indeed, the ERM would become a different animal: a binary system instead of one with satellites around a single currency. The behaviour of the new system is not predictable - a point which we suspect the Germans and others have not fully recognised. We would want after entry to have some intensive discussions with our German opposite numbers on two main points. First, we would want to explore the possibility of a bilateral "swap" arrangement to be used by agreement in order to meet special DM/£ financial flows. Secondly, we would want to establish very close consultation procedures between our Finance Ministries and Central Banks on any measures of developments in the monetary field.

Parliament

5. The previous Labour administration gave an undertaking to consult Parliament in advance if and when there was a decision

by them to join the ERM when it was set up. (Mr Healey on 29
... November 1978 - the passage is well worth reading and is attached). We cannot trace any such undertaking having been given by the present administration.

6. This means that we could choose between the two options of informing Parliament before or after joining. In either case we would need to move fast in order to minimise the risk of any uncertainty and speculation affecting sterling's position in the market or actually or potentially within the ERM. The two options have different implications and problems:

(i) Undoubtedly best from the point of view of minimising market disruption would be to avoid any hint of our intentions up to Friday night; then arrange a weekend "realignment" conference; and begin to operate within the ERM when markets opened on Monday. A Statement to the House would be necessary on the Monday and a very early full debate would be inevitable. We would want and need to present the whole decision to join including the terms and agreed rates as a package and would have to resist any suggestion that we could adjust the rate at which we joined. We would of course have to explain at the weekend conference that there would need to be a debate and vote in Parliament which, if lost, would effectively overturn our decision to join; but we would operate in the market as members at once. We see no reason why this should cause problems with other Community countries - or with markets, provided we made it clear that there was no question of the debate affecting our agreement on the rate.

(ii) The alternative would be a Statement in the House on a Thursday announcing our intention to join "at the current market rate". The last point would be essential to minimise the risk of heavy speculation. But some speculation would be bound to develop - and it could affect existing ERM currencies in ways which would be unwelcome (rumours that a conference on sterling joining could provoke general realignment). There would certainly be pressure from some MPs for us to seek some different rate and for any rate agreed with other Community countries to be subject to reference back to Parliament. This would have to be resisted but could be embarrassing both in Parliament and in the markets. In any case, Parliament would be unlikely to give authority to the Government to negotiate entry without demanding opportunity for debate when the terms were known; so we would still expect to face that problem after the weekend and in the face of well prepared opposition.

7. The mood of some in Parliament would not be helped by such an important decision being effectively taken before they are told of our intention. On the other hand, the double dose of the second option is unlikely to be helpful. And the market arguments point pretty strongly to the advantages of the first option. On balance we judge the first option preferable.

Risk of Leakages

8. The decision on handling Parliament - and on timing generally - may be affected by risks of leakages. We should obviously take all possible steps to avoid these risks. But we cannot do anything to prevent an invented story; and the amount of enthusiasm for a decision to join in some quarters of the press makes such a possibility a real one. For the present our response is that the question is of course under regular/continuous review - leaving the implication that nothing has changed. This position should be held for as long as possible: the moment we depart from it we are at risk of market speculation and a build-up of noisy argument: if we wished to enter we would need to move fast into one of the two options indicated above.

9. The worst risk of leakage would arise if we had to talk in advance with other Community countries or the Commission. We have concluded however that this would **not** be necessary given that our entry must be welcomed and that we would not be seeking special conditions.

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SECRET AND PERSONAL

COPY No: 2 of 17

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

24 September 1985

David Norgrove Esq
10 Downing Street
London SW1

PA

Dear David,

ERM

I attach a nearly final draft of the joint Treasury/Bank paper on ERM for discussion at the Prime Minister's seminar next week. I will be sending you (and the FCO) a final version, complete with charts, by the end of the week.

As agreed, I have sent copies via the FCO bag, to Alan Walters and Brian Griffiths in the United States.

I am also copying to John Bartlett (Bank of England).

Yours ever
Rachel

RACHEL LOMAX

SECRET

STERLING AND THE EUROPEAN RATE MECHANISM

(Joint Note by Treasury and Bank of England)

Introduction

The public stance of the Government has consistently been that sterling would join the Exchange Rate Mechanism (ERM) when the time was right. Answering Dr Owen on 31 January this year in the House of Commons, the Prime Minister said:

> "We have always said that we shall join the exchange rate mechanism of the EMS when we believe that the time is appropriate. It is kept under review from time to time, but I must make one thing clear. Joining the EMS would not obviate increases in interest rates, it would not obviate the need for financial discipline and, indeed, it might increase it."

2. The subject was last reviewed with the Prime Minister on 13 February. Since then circumstances have changed.

3. When we last discussed the question, the dollar had risen sharply. Sterling had fallen not only against the dollar but also against European currencies, reflecting market doubts about the Government's commitment to its counter-inflation strategy. UK interest rates had been forced up sharply.

4. Inflation is now falling. There is a good chance that we will do even better than our Budget forecast of 4½% inflation by mid-1986 and this view is gaining widespread acceptance. Monetary conditions, are consistent with lower inflation. We have pursued a cautious policy towards interest rate reductions. The dollar is now [10%] below its February peak even though it has risen from its late August level. Since 13 February, the pound has risen by [8%] against the DM and [23%] against the dollar.

Reinforcing the Strategy

5. In spite of sterling's strength, and the much improved outlook for inflation, we have run into difficulties over the operation and exposition of the Government's financial strategy. Though we may receive credit for the results of our policy, this is offset by criticism of the way in which we operate it.

6. The background of currency upheavals, the removal of controls at home and far-reaching changes in the structure of financial markets has meant that the various measures of money have been difficult to interpret. The target measures have been pointing in different directions. For reasons we discussed at the Prime Minister's monetary seminar in July, we have recently had particular difficulty with £M3 - the measure which in the public mind is most closely associated with our monetary strategy. Although there can be no question of doing without the discipline of monetary targets, we have to recognise that the monetary aggregates have, for the present, become a less reliable guide to the conduct of policy.

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are permitted within the rules of the system, we would aim to avoid changes, especially in the first year or so, and build credibility in the market. In the event of realignments we would seek to keep in line with the DM. This should ensure that there is no conflict between keeping the exchange rate within ERM limits and reducing inflation.

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18. Our best protection would be our own financial strategy and performance. Some commentators have drawn attention to the UK's failure to live within the "Snake" in 1972. But the UK's relative fiscal and monetary position is now quite different from what it was in 1972; then monetary conditions were easy and getting easier, and there was a widespread view that the UK authorities wished to see a lower exchange rate. After a period of achieving a track record and consequent credibility in the ERM we could hope to benefit from the reinforcing effects of membership of a mechanism that has been successful in limiting exchange rate variations among European currencies. The fact of being a member could then help to stabilise expectations and to reduce some of the speculative flows.

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Conclusions

20. We are able now to contemplate joining the ERM from a position of some strength. This is based on our success in reducing inflation. There is widespread acceptance of our determination to continue in that direction and a growing expectation that we shall succeed.

21. We face a period of difficulty over the conduct and presentation of financial policy.

22. Joining the ERM now would reinforce our basic strategy, clarify its operation in some respects and greatly improve its public presentation.

23. Joining the ERM would be a natural extension of the present in which the exchange rate has come to play an increasingly important part in the assessment of monetary conditions.

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ANNEX A

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(1) Undoubtedly best from the point of view of minimising market disruption would be to avoid any hint of our intentions up to Friday night; then arrange a weekend "realignment" conference; and begin to operate within the ERM when markets opened on Monday. A Statement to the House would be necessary on the Monday and a very early full debate would be inevitable. We would want and need to present the whole decision to join including the terms and agreed rates as a package and would have to resist any suggestion that we could adjust the rate at which we joined. We would of course have to

explain at the weekend conference that there would need to be a debate and vote in Parliament which, if lost, would effectively overturn our decision to join; but we would operate in the market as members at once. We see no reason why this should cause problems with other Community countries - or with markets, provided we made it clear that there was no question of the debate affecting our agreement on the rate.

(2) The alternative would be a Statement in the House on a Thursday announcing our intention to join "at the current market rate". The last point would be essential to minimise the risk of heavy speculation. But some speculation would be bound to develop - and it could affect existing ERM currencies in ways which would be unwelcome (rumours that a conference on sterling joining could provoke general realignment). There would certainly be pressure from some MPs for us to seek some different rate and for any rate agreed with other Community countries to be subject to reference back to Parliament. This would have to be resisted but could be embarrassing both in Parliament and in the markets. In any case, Parliament would be unlikely to give authority to the Government to negotiate entry without demanding opportunity for debate when the terms were known; so we would still expect to face that problem after the weekend and in the face of well prepared opposition.

7. The mood of some in Parliament would not be helped by such an important decision being effectively taken before they are told

of our intention. On the other hand, the double dose of the second option is unlikely to be helpful. And the market arguments point pretty strongly to the advantages of the first option. On balance we judge the first option preferable.

<u>Risk of Leakages</u>

8. The decision on handling Parliament - and on timing generally - may be affected by risks of leakages. We should obviously take all possible steps to avoid these risks. But we cannot do anything to prevent an invented story; and the amount of enthusiasm for a decision to join in some quarters of the press makes such a possibility a real one. For the present our response is that the question is of course under regular/continuous review - leaving the implication that nothing has changed. This position should be held for as long as possible: the moment we depart from it we are at risk of market speculation and a build-up of noisy argument: if we wished to enter we would need to move fast into one of the two options indicated above.

9. The worst risk of leakage would arise if we had to talk in advance with other Community countries or the Commission. We have concluded however that this would <u>not</u> be necessary given that our entry must be welcomed and that we would not be seeking special conditions.

Mr.Healey:

On the other hand, if the changes which I have described, and for which the Government are pressing, are made in the exchange rate regime in the next few days —and many other countries besides ourselves are pressing for these changes— if the Heads of Government were to agree next week on the necessary commitment to concerted action and resource transfers, and if, therefore, the Government decided that it would be in Britain's interest to join the exchange rate regime, then—I was asked this question at Question Time the other day—the Government would submit their view to Parliament for debate, and, if necessary, a vote, before the regime came into operation at the beginning of January.

I hope that that allays the anxieties which some of my hon. Friends, and indeed some of my right hon. Friends, have expressed.

Mr. J. Enoch Powell (Down, South): When the right hon. Gentleman says " before the regime came into operation ", does he mean before this country is committed to participate in it or after we are committed but before it begins to operate?

Mr. Healey : If the House were to take a view that was different from that of the Government, on a matter of this importance, it would indeed be a very serious matter. There is not the slightest question but that the Government would be guided by the views of the House. But I hope that the right hon. Gentleman, who is a stickler for constitutional precedent here, is not suggesting that the Head of the British Government should go to an international conference and enter into negotiations and reach conclusions *ad referendum* to votes in this House. I think that that would be a total breach of all historical precedent. If the right hon. Gentleman was suggesting it, he would have difficulty in reconciling it with his views on many other issues of a constitutional nature.

I have made it absolutely clear that the essence of democracy in this country is that the Government repeatedly have to take decisions on many matters and submit them to the view of the House. If the House rejects their views, they either resign or change their policies.

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(file) D. Hargrove's instruction

Joining the ERM: An Annotated Agenda

1. **Reasons for considering now?**

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a) [Is it accepted that if we were to join it would best be done at time of a Budget, when it can be presented as a coherent part of monetary/fiscal strategy?]

b) What are the difficulties in maintaining downward pressure on inflation by sticking to the existing strategy and targets?

2. **Purpose of membership and implication for macro-economic policy**

a) Is it agreed that the purpose would be to reinforce - not to relax - financial discipline - with the implication that our firm intention would be not to realign against the DM?

b) In principle, keeping up with DM would require more rapid progress against inflation than the present plans. Do we want/could we achieve this. What would be the implications for interest rates and fiscal policy, and would these be acceptable?

3. **Exchange rate vs monetary targets**

a) Could we continue to have monetary targets? If so, how would we resolve conflicts when they occurred? (presumably in the short run we would have to give precedence to the exchange rate).

b) To be consistent with parity with DM, should we reduce the target ranges for the monetary aggregates?

4. **Presentation of policy**

a) There have undoubtedly been problems with market understanding of present policy - in particular the role of the exchange rate. How far would membership of the ERM help in providing a simpler framework?

b) And how far would it be damaging, given the difficult of explaining the continuity of policy, and the presentational capital built into the strategy as set out in successive MTFS's.

5. **Practicality of keeping the £ within the permitted bands**

a) How great a problem, in general, would it pose having two reserve currencies in the system, in neither case with exchange controls? And how difficult would the petro-currency factor be?

b) How would we operate to withstand pressure, when it came (accepting particular importance of doing so successfully on the first occasion, for obvious market reasons)? Do we think we could hold the position, when the market had a possible weekend realignment conference in its sights, without very large scale intervention? If so, how high would short term interest rates have to go, and how far could base rates and mortgage rates be insulated? [If not, how much larger reserves do we need than at present; and how much foreign borrowing should we be undertaking? (cf. French experience in 1983; and our experience in 1972 in the "snake").]

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c) Could there be exceptional arrangements (automatic realignment, or temporary withdrawal) in the case of fluctuations caused by oil? (And could the conditions be defined closely enough to reassure markets there was no relaxation of financial discipline?)

6. **Political Arguments**

a) Joining would be a symbol of our European commitment and welcomed by our partners. How much weight should we give that? Is there anything we could look for in return?

b) Is there any difficulty about accepting, as a condition of joining, that our partners would have to agree to any realignment for sterling (and might on occasion seek to attach some form of policy conditions to that agreement)?

7. **Timing**

a) What is the case for and against waiting for:

i) a calmer oil market;

(ii) ~~the long expected~~ a further fall in the $ against the DM?

b) How long would the necessary preparations take? (especially rebuilding reserves, if that were thought sensible).

8. **Operational issues**

What view do we take of other operational questions summarised at the end of Paper 2: in particular the procedure for determining a central rate, the width of fluctuation margin, and possible mutual bilateral support arrangements with the Germans?