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UK ATTITUDE TOWARDS THE DELORS REPORT
AND MEMBERSHIP OF THE EXCHANGE RATE MECHANISM

In the course of their bilateral meeting today, the Prime Minister and the Chancellor had a discussion about the handling of the Delors report and possible UK membership of the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS).

The Prime Minister said that the over-riding priority for UK economic policy now was to get down the rate of inflation; at around 8 per cent this was a major worry. It would be quite wrong to adopt a parallel objective of exchange rate stability, thereby giving up control over the monetary system. That was what had happened in late 1987 and early 1988 when, it appeared, the UK had been trying to shadow the ERM, and had intervened very heavily to prevent a revaluation of the sterling exchange rate. This ultimately unsuccessful attempt had seriously compromised the anti-inflationary objective. She did not believe that the Delors report altered the balance of argument in favour of joining the ERM; on the contrary, following the Delors report the EMS would not stay the same and we should certainly not be drawn further into it. Sterling was in a substantially different position to currencies within the ERM, including the deutschmark, and she saw no advantage in attempting to tie sterling to the German economy. Being in the ERM gave no protection from variability against the \$ and Yen. Everything that could be done inside the ERM could be done outside it; and by remaining outside the system the UK's ability to act independently was maintained. She did not accept the premise that it was necessary to join the ERM in order to prevent developments we did not like; and she thought the idea of setting a target date for joining sometime in the future was particularly damaging.

The Chancellor said he took a different view. The Delors report presented the UK with serious risks in relation to the future development of the Community. He believed that a way of ensuring that the EMS stayed the same and of resisting pressure for movement towards stages 2 and 3 of the Delors report was for the UK to join the ERM. It was not a question

of serving two masters; downward pressure on inflation would remain the paramount objective and could be achieved within the ERM; it was for example perfectly possible to revalue in the system. (The Prime Minister interjected that we had resisted revaluation in 1987-88 by intervention and lower interest rates). He believed that the UK could do everything within the ERM that we either wished to do or were able to do while we remained outside the system. D

Summing up the discussion, the Prime Minister said that she did not want the issue of UK membership of the ERM to be raised at this stage. The key requirement at present was for the UK Government to re-establish its counter-inflationary credentials, which had been compromised by the events of the last 18 months.

(PAUL GRAY)

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