

From: The Rt. Hon. JULIAN AMERY, M.P.



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EDP
26/6

Dear Margaret,

hurriedly
It was very good of you to give me the opportunity, on Tuesday, of putting to you some of my views on our policy towards the European Community. I am sorry if I expressed them rather ~~hardly~~ and roughly. I would, of course, have welcomed an exchange of views but knew how pressed for time you were.

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I now enclose two notes which may possibly be of help at Madrid. The first is the general argument, as I see it, including one or two thoughts on strategy and tactics. The other is an outline of a possible intervention you might make with the Delors report comes before the Conference.

Many years ago at this time of year in Madrid, I sat next to a young and attractive girl at dinner. I asked her how she had spent the day. She replied with a rather demure smile that she had just killed her hundredth bull! She turned out to be Conchita Cintron, the famous Colombian rejoneador. I trust you will be awarded both ears and the tail in ~~the~~ Madrid arena.

Julian
Julian Amery

The Rt. Hon. Mrs. Margaret Thatcher, M.P.



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OUTLINE OF A POSSIBLE INTERVENTION BY THE PM AT MADRID.

I turn to the Delors Report. We must all be very grateful to M. Delors and his colleagues, who included the Governor of the Bank of England, for the proposals they have put to us. As we expected when we asked them to put them forward they represent a compromise between maximalist and minimalist views as to how our European Union should order its monetary affairs.

Our first reaction to the Report was, as you will know, negative. This arose from paragraph 39 of the report. This as you know seeks to commit all those concerned to acceptance of the long-term goal of a single currency and a Central Bank before the preliminary steps, some of which may be lengthy, have been covered. There has always been a strong objection in my country to any firm commitment to distant goals only attainable in unforeseeable circumstances. It was a precondition of the invitation to the conference on the Coal and Steel Authority in 1950 which prevented the Labour Government of the day, from joining in the negotiations. A similar precondition led us to decline the invitation to join the Messina negotiations which led to the Treaty of Rome. *There is a philosophical problem here. Descartes v. Locke.*

Some of us have, on occasion, been inclined to think that these preconditions were deliberately layed down by enthusiasts for what has been called "a Charlemagne Europe" to keep Britain out of the talks. I have never believed that myself. Indeed I hope you will agree that we have already made in the fifteen years we have been full members of the Community, a valuable and positive contribution to its development. It is therefore, only natural for me to say that, of course, we would like to take part in the development of an appropriate monetary policy for the European Union which is growing and has been growing now for some thirty years.

The idea that I personally would be opposed to participation in the development of monetary policy for Europe is, of course, absurd. A principle feature, perhaps the principle feature, of what some people like to call "Thatcherism" is an insistence upon "honest money". It is a determination not to manipulate money, by printing or excessive borrowing, to finance policies which in themselves are financially unsound.

The question is therefore, what form should a monetary policy for European Union take? Well, we already have in being the EMS mechanism. I have already said we ^{would} will join "when the time was right" and I think it only right, now that we have the Delors report which we all helped to commission, that at this meeting I should give you some idea of what I mean by "when the time is right"; that is to say under what conditions we could join. And I would express these in general terms as follows:-

Regretably we have a rate of inflation which would make it awkward to join today. I am confident that the steps we are taking to bring down that inflation - and it is in reality $6\frac{1}{2}\%$ not $8\frac{1}{2}\%$ - will prove effective and that by July 1990, the date set in the Delors report, we should have a rate of inflation not so very different from our French and German colleagues. If so that will be one major obstacle out of the way of Britain joining.

The other obstacle is that we ourselves would like to see and see over a twelve to eighteen month period, what effect the lifting of exchange control has on the currencies of those countries that still exercise exchange control.

Inflation at home

Exchange Control Abolition ?

There is one other possible problem. The pound sterling is not as strong as the Deutschmark but there is much more trading in sterling than there is in any of our other European currencies. Can the EMS, ERM system digest this floating mass of what I might call Europounds. If you agree that this presents no problem my third difficulty would be removed.

I would hope therefore that by 1992 we might have become full members of the EMS as it stands today.

But assuming that we can do this in measurable time, the question then arises what will be the next step. Here the Delors report has put forward a detailed plan for the development of a European Reserve Bank with existing currencies locked into a close relationship with each other, with very little variation in exchange rates permitted. I think we have to be careful here. For one thing we need to take account of the reservation recently expressed by Dr. Poehle, the chairman of the Bundesbank. For another we may after 1992 have to consider applications from a number of countries, notably the Scandinavian democracies and Austria, for membership of the Community. I wonder, therefore, whether we can take final decisions on the second stage proposed in the report in advance of knowing what will

be the membership of the European Union after 1992.

However, there are many features in the Delors Report Second Stage which seem to us of a positive character. We would like to study these and discuss these with colleagues in the Committee of Ministers. It may be that we ourselves could put forward some positive proposals. We do have the unique experience, I say unique, because no other European country has done it, of creating a reserve currency out of nothing. When we abandoned Gold Standard in 1931 the pundits thought the heavens would fall in. Instead we sat down and created the Sterling Area. Sterling was never a single currency. It was a reserve currency. The Bank of England was never the Central Bank of the Sterling Area, it was the reserve Bank of the Sterling Area. The politically independent members of the Sterling Area lodged their reserves of gold and dollars with the Bank of England but kept full control of them. They had their own central banks and were responsible for their own money supply and of course their own fiscal policies. They tried their best to keep in line with the British pound sterling but there were variations from time to time as there are in the EMS.

With the agreement of my colleagues, I would like to set in hand with the Bank of England and our Treasury, some concrete suggestions of our own as to how Stage Two might be implemented and discuss these with our partners and hopefully produce the outline of some ideas by the time we meet again in Paris.

But plainly we can't run before we can walk and before we can try to take decisions on the second stage we would have to reach the point which M. Delors proposes for the first stage, namely of Britian joining the EMS as a full member. This, as I explained to you, I would wish to do subject to the conditions which I have put forward today.

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NOTES FOR MADRID

1. PROLOGUE

It was British policy over centuries to prevent the union of Europe under the domination of any single power - Charles V and Philip II of Spain; Louis XIV and Napoleon; the Kaiser and Hitler.

In a world where the standards of power are set by the United States, the Soviet Union and increasingly Japan, it has become British policy to promote the union of Europe. But a Europe united without us could be a Europe united against us.

2. THE SITUATION TODAY

There is a European Union, it has been growing over 40 years.

Like the kingdom of heaven it has many mansions - The coal and steel authority; The Council of Europe; the Western European Union and, most important this weekend, the European Community with its Council of Ministers, its Commission, its judicial body and its Parliament.

This European Union is still very far from being a federation ~~of~~ a confederation. But it already has more institutions than, if not the common patriotism, of the old Commonwealth ~~had~~. It is a political entity and increasingly recognised as such by the United States, Japan and the Comecon countries, and is already busy conducting foreign relations with associated states and, on occasion, in broader international fields.

The direction of its monetary policy therefore is not a purely monetary matter. It has to be seen in the broader context of the influence we wish to exercise over the European Union and the influence we wish to see the Union exercise outside Europe.

3. THE EUROPEAN COMMUNITY

The European Economic Community has grown over the last 30 years into a trading area - the EEC. Over the last 10 years it has also developed into a payments area for most of its members - the EMS.

The European trading area is now heading for the single market to which all its members are agreed. They - ourselves included - have also asked M. Delors and a committee of bankers, including the Governor of the Bank of England, to advise how the payments area might be developed to complement the single market.

The EMS is inevitably the starting point for any further development on European Monetary policy. The British Government have said they would join the EMS "when the time is right".

The Delors Report proposes as its first stage that all members of the Community should join the EMS, as a first step towards monetary convergence in support of the single market.

The immediate question at the Madrid Conference will be, does the British Government accept the first stage of the Delors proposals, involving British adherence to the EMS?

4. WHAT THE BRITISH SIDE SHOULD SAY AT MADRID (1.)

1. We could say that on reflection we have decided that the time is unlikely ever to be right.

In that case we could leave it to the other members of the Community to go ahead with stage one of the Delors proposals without us.

It is just possible that they would refuse to do so in the same way as the French Parliament refused to agree to German rearmament without British participation in the WEU. It is more likely that they would go ahead without us.

In that case, although we would still have access to the single market, we would be abdicating any say in the development of the monetary policies of the Community and thus of the broader evolution of the European Union. This could be crucial, given the emphasis placed by the Delors Report on the need to harmonise fiscal and monetary policies, all of which could prove to be barriers to European free trade.

2. The alternative course would be to define the terms on which we think the time would be right to join the EMS. These might be :-

A. Our success in bringing the British inflation - in reality $6\frac{1}{2}\%$ not $8\frac{1}{2}\%$ - down to Franco/German levels.

B. Experience of the impact on the EMS of the lifting of all exchange controls (direct and indirect) by those countries that still impose them.

C. Acceptance by our partners that the EMS could digest the addition of sterling which, though not a particularly strong currency, is more widely traded than any of the others.

It would not be realistic to put a dateline on fulfilling these conditions. But it should be possible to propose a timetable of a year or two.

5. WHAT THE BRITISH SHOULD SAY AT MADRID (2.)

It seems likely that the French and German Governments will seek a commitment to stages 2 and 3 of the Delors Report.

It is difficult to see how any Government could commit itself to the 3rd stage, namely a single currency and a European Central Bank. No-one can say what will be the membership of the European Community after 1992. The Scandinavian democracies and Austria are already knocking at the door, as well as Malta and Turkey. There may be other candidates. So large a change in membership must affect the rules of the Club.

Stage 2 of the Delors proposals deserve, however, early consideration between the meeting in Madrid and the next meeting in Paris.

Governments will have to take account of the recent reservations of Dr. Poehle, the Chairman of the Bundesbank. There is also the question of how far fiscal and budgetary policies should be harmonised, as distinct from monetary policies which, arguably, should be solely concerned with "honest money" and so kept separate.

Nevertheless, Britain has a unique experience in the development of a reserve currency (which is what the Delors Report proposes for stage 2). When Britain went off the Gold standard in 1931 it created the Sterling Area - this was a reserve currency not a single currency. Its members retained their own central banks, determined their own money supply and interest rates but lodged their reserves of other currencies with the Bank of England while retaining full control of them. They aligned their currencies, as much as possible, on those of the Bank of England but, as necessity required, varied their exchange rates rather as the countries of the EMS do at present.

The Sterling Area functioned as a reserve currency, second only to the dollar, from 1931 until the mid 60s, surviving the world depression of the 30s and World War II and its aftermath.

The British Government believe that, in the light of this experience, it could come forward with advantageous amendments or additions to stage 2 of the Delors proposals. These could be discussed with other Finance Ministers and Heads of Governments, perhaps in time for discussion at the next Summit meeting in Paris.

6. STRATEGY at MADRID

We should aim to avoid being isolated over joining the EMS. This would mean defining "when the time would be right".

We should be seen to take the initiative by proposing to amend stage 2 of the Delors proposals in the light of our own creation of sterling as a world currency.

We might - and this depends on how far we are prepared to go at home, raise the question of how far fiscal and budgetary policy should be separated from monetary policy in the interests of "honest money". Perhaps it would be helpful if our own and other central banks acquired the same relative independence ⁱⁿ of political control that the Bundesbank now enjoys. (Tell that to the Bank of France!)

7. TACTICS

1. In the corridors of the conference we should emphasise the importance of the recent speech by the Governor of the Bundesbank and his reservations about the Delors Report.

2. We should seek to strengthen our overall ties with the French. WEU might well come in handy here, as would our common interest as independent nuclear powers; our common African interests and (to put it delicately) our appreciation of the independence of the Bundesbank from political control. Are the French Government for Vichy or Free French? *Free?*

3. We should emphasise that the European Union, to which we are deeply committed, must have a monetary policy. The proper ordering of monetary policy is essential to what is sometimes called "Thatcherism".

4. We should explain our initial opposition to the Delors report as due to its para. 39 which, in the light of past experience seemed deliberately calculated to exclude Britain.

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