PRIME MINISTER

BILATERAL WITH MR. LUBBERS

Mr. Lubbers and Mr. Van den Broek are coming to your hotel tomorrow evening for a drink to discuss the European Council. Their party did quite well in the European elections: but Mr. Lubbers remains only a caretaker Prime Minister and will have to proceed with some caution. Even so, they look like our best hope of getting some sympathetic support at the Council.

In broad terms, we can expect some help from the Dutch on Economic and Monetary Union, but very little on the Social Charter. You will want to focus on Economic and Monetary Union in talking to them.

You will remember from the talk at Chequers that they accept the overall goal of Economic and Monetary Union. But they are not committed to Stages 2 and 3 of the Delors Report, and are not looking for an early Intergovernmental Conference or Treaty amendment. They are therefore potential allies for an approach which accepts Stage 1 of Delors - indeed enlarges it by adding additional measures such as promotion of private use of the ecu and increased holdings to EC currencies in Central Bank reserves - while playing away Stages 2 and 3. They will look for some confirmation that you remain committed to sterling joining the ERM: but I doubt they will press for a specific date (unless egged on by others on our side). They will hope that you will refrain from rubbishing the goal of Economic and Monetary Union: it seems to me the best way to deal with this is to refer to the commitment which you accepted in the Single European Act which refers to "Cooperation on economic and monetary matters (Economic and Monetary Union)". If no-one tries to push you beyond that, you will not object. But it cannot be for us alone to indicate flexibility. You look to the Dutch to help us in getting others to rally to a reasonable position with which everyone can live, and in resisting the renewed all or nothing approach of Delors.

You will want to explain thereafter why we cannot accept the Social Charter: there is no need to impose uniformity on varying national practices. We will be happy with an approach which recognises that there is a social dimension to 1992 and commits member states in the most general terms to continue to provide good social conditions: but recognises that each country has its own way of doing this.

You may also like to encourage them to support a strong statement on the need for further progress with the Single Market: firm conclusions on fraud; and a statement on China which expresses understanding for the position of Hong Kong.

A fuller note by the FCO is in the folder with a telegram from The Hague.

C.D.?

CHARLES POWELL
24 June 1989

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3. **The principal steps in stage o**

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50. Stage one represents the initiation of the process of creating an economic and monetary union. It would aim at a greater convergence of economic performance through the strengthening of economic and monetary policy co-ordination within the existing institutional framework. In the institutional field, by the time of the transition to stage two, it would be necessary to have prepared and ratified the Treaty change.

51. In the economic field the steps would centre on the completion of the internal market and the reduction of existing disparities through programmes of budgetary consolidation in those countries concerned and more effective structural and regional policies. In particular, there would be action in three directions.

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Firstly, there would be a complete removal of physical, technical and fiscal barriers within the Community, in line with the internal market programme. The completion of the internal market would be accompanied by a strengthening of Community competition policy. Take-over in FRG?

Secondly, the reform of the structural funds and doubling of their resources would be fully implemented in order to enhance the ability of Community policies to promote regional development and to correct economic imbalances.

Thirdly, the 1974 Council Decision on economic convergence would be replaced by a new procedure that would strengthen economic and fiscal policy co-ordination and would, in addition, provide a comprehensive framework for an assessment of the consequences and consistency of the overall policies of member states. On the basis of this assessment, recommendations would be made aimed at achieving a more effective co-ordination of economic policies, taking due account of the views of the Committee of Central Bank Governors. The task of economic policy co-ordination should be the primary responsibility of the Council of Economic and Finance Ministers (ECOFIN). Consistency between monetary and economic policies would be facilitated by the participation of the Chairman of the Committee of Central Bank Governors in appropriate Council meetings. In particular, the revised 1974 Decision on convergence would:

How? what

How? What

- establish a process of multilateral surveillance of economic developments and policies based on agreed indicators. Where performances were judged inadequate or detrimental to commonly set objectives, policy consultations would take place at the Community level and recommendations would be formulated with a view to promoting the necessary corrections in national policies;
- set up a new procedure for budgetary policy co-ordination, with precise quantitative guidelines and medium-term orientations;
- provide for concerted budgetary action by the member countries.

52. In the monetary field the focus would be on removing all obstacles to financial integration and on intensifying co-operation and the co-ordination of monetary policies. In this connection consideration should be given to extending the scope of central banks' autonomy. Realignments of exchange rates would still be possible, but an effort would be made by every country to make the functioning of other adjustment mechanisms more effective. Action would be taken along several lines.

Firstly, through the approval and enforcement of the necessary Community Directives, the objective of a single financial area in which all monetary and financial instruments circulate freely and banking, securities and insurance services are offered uniformly throughout the area would be fully implemented.

Secondly, it would be important to include all Community currencies in the EMS exchange rate mechanism. The same rules would apply to all the participants in the exchange rate mechanism.

Thirdly, all impediments to the private use of the ECU would be removed.

Fourthly, the 1964 Council Decision defining the mandate of the Committee of Central Bank Governors would be replaced by a new Decision. According to this decision the Committee of Central Bank Governors should:

No.

- formulate opinions on the overall orientation of monetary and exchange rate policy, as well as on measures taken in these fields by individual countries. In particular, the Committee would normally be consulted in advance of national decisions on the course of monetary policy, such as the setting of annual domestic monetary and credit targets;
- express opinions to individual governments and the Council of Ministers on policies that could affect the internal and external monetary situation in the Community, especially the functioning of the EMS. The outcome of the Committee's deliberations could be made public by the Chairman of the Committee;
- submit an annual report on its activities and on the monetary situation of the Community to the European Parliament and the European Council.

The Committee could express majority opinions, although at this stage they would not be binding. In order to make its policy co-ordination function more effective, the Committee would set up three sub-committees, with a greater research and advisory role than those existing hitherto, and provide them with a permanent research staff:

- a monetary policy committee would define common surveillance indicators, propose harmonised objectives and instruments and help to gradually bring about a change from ex post analysis to an ex ante approach to monetary policy co-operation;
- a foreign exchange policy committee would monitor and analyse exchange market developments and assist in the search for effective intervention strategies;
- an advisory committee would hold regular consultations on matters of common interest in the field of banking supervision policy.

53. A number of Committee members advocated the creation of a European Reserve Fund (ERF) that would foreshadow the future European System of Central Banks. The main objectives of the ERF would be:

- to serve as a training ground for implementing a better co-ordination of monetary analysis and decisions;
- to facilitate, from a Community point of view, the concerted management of exchange rates and possibly to intervene visibly (in third and participating currencies) on the foreign exchange market at the request of the participating central banks;
- to be the symbol of the political will of the European countries and thus reinforce the credibility of the process towards economic and monetary union.

The resources of the Fund would be provided by the pooling of a limited amount of reserves (for instance 10% at the start) by participating central banks. The Fund would, moreover, require a permanent structure and staff in order to carry out its tasks, viz.:

- managing the pooled reserves;
- intervening on the exchange markets as decided by the members;

- analysing monetary trends, from a collective perspective, in order to enhance policy co-ordination.

All EC central banks would be eligible to join the Fund. However, membership would be subject to their participation in the exchange rate mechanism, the reason being that the EMS implies specific constraints on monetary policy and foreign exchange interventions, both of which require a common approach on the part of the central banks concerned.

The ERF would consist of:

- a Board of Directors, which would comprise, ex officio, the Governors of all the central banks participating in the ERF;
- an Executive Committee, whose members would be selected by the Committee of Governors on the basis of competence. This Executive Committee would be small in size, consisting of three or four members who would have direct responsibility for the different departments of the ERF;
- the three Committees, namely the Foreign Exchange Policy Committee, the Monetary Policy Committee and the Committee on Banking Supervision Policy;
- two departments: a Foreign Exchange and Reserve Management Department and a Monetary Policy Department.

54. Other members of the Committee felt that the creation of an ERF was not opportune at this stage. Their reservations stem from the following considerations:

- too much emphasis is placed on external considerations; common interventions by such a Fund cannot be a substitute for economic adjustment to correct imbalances within the Community;
- the proposal involves an institutional change which, in accordance with Article 102A of the amended Treaty of Rome, would fall under the procedure stipulated in Article 236 and require a new Treaty: the setting-up of a Fund under the same procedures as those applied in establishing the EMS is not considered possible;
- they consider that some functions of the Fund could be performed by the Committee of Governors if it were given wider powers; thus there is no need to set up a new institution immediately;
- what, in the view of these members, is essential is co-ordination of intervention policies rather than the technique of common interventions. Such co-ordination can provide the necessary training ground while avoiding the unnecessary complication of instituting an additional intervention window.