



MARGARET, THE LADY THATCHER, O.M., P.C., F.R.S.

HOUSE OF LORDS

LONDON SW1A 0PW

25th November 1992

Dear Allen

I attach a copy of a speech to be delivered by Lady Thatcher in Frankfurt tonight. It will not be released to the Press here until first thing tomorrow morning.

We must lunch. I will call early in the New Year and hope that you might have a free hour.

Yours sincerely

A handwritten signature in dark ink, appearing to read 'Julian', with a horizontal line underneath.

JULIAN SEYMOUR

Director, Lady Thatcher's Private Office

A. Allen Esq.

Prime Minister cc JSLW
what we have come JIhd
to expect Alan G.O.D.
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SPEECH BY BARONESS THATCHER OF KESTEVEN OM PC FRs
TO THE BOYDEN FORUM IN FRANKFURT, GERMANY
ON WEDNESDAY 25TH NOVEMBER 1992

(Mr Chairman, Ladies and Gentlemen)

It is a great privilege to address this distinguished audience. It is you, who within a framework of law favourable to enterprise, create the wealth of nations. That wealth not only enhances material standards of living but raises the quality of life; enriching the arts, music, literature and the environment. Germany has a cardinal place in such matters.

It is fitting that we should be meeting in the historic city of Frankfurt, once the capital of the Holy Roman Empire, and the birth-place of Goethe. It was also the town where, in 1848, Germany saw the contest between the liberal and the authoritarian philosophies that did so much to shape her modern history. It was in St Paul's Church, after the revolutions of that year, that liberals debated Germany's future; alas their words were stronger than their actions. And as the English poet Yeats observed in another connection: "The centre cannot hold, the best lack all conviction and the worst are full of passionate intensity". How often history has reflected those words. Incidentally, I am delighted to see Professor Lothar Gall among you to-night: his outstanding biography of Bismarck has been a key document which illuminates that bygone era.

Perhaps I should not have said 'bygone', for the contest between the liberal and the authoritarian views is ever-present. Modern Germany has been a splendid exponent of liberal values. The Ordoliberalen, who were responsible for the German recovery inherited the mantle of that liberal tradition of 1848. Their concept of the state was moral, not mechanical. Freedom was established under the rule of law. Honest money in the form of a hard currency put an end to the nightmares of inflation which Germany had known so well. She became a nation built on sound money and the energy of trade.

In his recent Ludwig Erhard Memorial Lecture on economic and monetary union Dr Hans Tietmeyer pointed out that in the mid 1950s "no other country called so strongly for comprehensive liberalisation as did Germany". He also reminded us that Ludwig Erhard's goal of free trade "was never restricted to Europe. He always saw matters from a global perspective." Erhard's vision should be just as applicable to the Europe of the 1990s as it was in the 1950s.

I greatly admire the liberalism that is enshrined in the post-war constitution. It was this which led Germany to be extremely generous in granting refuge to the victims of the killing-fields in Bosnia. Frau Inge Trautluft, in Zagreb, who has organized much of this, has been one of the saints of our time and the journalists of the Frankfurter Allgemeine Zeitung in particular have been brave and outspoken on the side of right. Germany has generously taken on a burden which most other European countries have refused. But how much better it would have been if the West had not only given humanitarian aid but had struck at this problem's very root by preventing the terrible atrocities which have occurred. Alas, we

tried to act on the basis of consensus and, as so often happens, consensus led to paralysis when effective leadership was needed. The contrast with the Gulf War is all too apparent, for then we had the United States willing to take the lead and the aggressor was stopped. In the new world order Europe must have the courage to show conviction. As the poet Grillparzer said, of the old Habsburg Monarchy: 'This is the curse of our old house/ half-way means and half-way steps/warily treading to half-way aims.'

Tonight I shall deal first with the economic aspects of the challenge ahead and then go more deeply into the political problems in the context of both history and the present. We all understand that this is a time for deep reflection about the future of your country, of mine, and indeed of Europe.

The monetary challenge of the late 20th century.

Since the discovery of money in the Ancient Near East about 850 BC, the management of the currency has been one of the most difficult tasks facing mankind. The problems and the debates sometimes appear to be entirely theoretical in character, but they always have important practical consequences. I want to talk today about perhaps the greatest ever challenge in currency management.

For most of recorded history Man chose a commodity to serve as his money, a precious metal, such as gold. The choice of precious metals has been ridiculed as primitive and superstitious, even in one of John Meynard Keynes' famous phrases - as "barbarous". But the gold standard had one overwhelming virtue which must never be forgotten. The quantity of gold was limited to the stock of the metal inherited from the past and the small annual increases in that stock due to mining. Apart from the chance discovery of rich new sources, these increases were only a tiny fraction of the existing stock. This was of immense benefit to mankind. When gold was the only kind of money, and when later paper money had to be converted into gold at a fixed rate, the slowness of the increase in the quantity of money prevented inflation. While gold was the basis of nations' currencies, no currency suffered from high and systematic inflation over a prolonged period.

Britain was the traditional defender of the gold standard, but it abandoned this role in 1931. Nevertheless, gold remained the bedrock of the Bretton Woods system of fixed exchange rates in the 1950s and 1960s, with the American Government pledged to maintain the fixed gold price of \$35 an ounce. Since 1971, when President Nixon suspended the dollar's convertibility into gold, no major currency has been pegged to a precious metal. Inflation is no longer checked, as it had been for all those centuries, by keeping the value of a currency stable in terms of gold. We have to find new ways of providing a sound currency, which is both stable in value and widely acceptable in payment. That is the monetary challenge of the late 20th Century. Man has to develop a stable currency based exclusively on paper and his intelligence, rather than on a precious metal and his superstitions. Keynes saw this new problem in his short 1923 book, *A Tract on Monetary Reform*. He said, "And - most important of all - in the modern world of paper currency and bank credit there is no escape from a 'managed' currency, whether we wish it or not".

The achievement of the Bundesbank: a role-model for other central banks

The task of management falls on governments and central banks, with the relative importance of the government's and central bank's role varying from country to country. In Germany you have decided that the stability of the currency should be entrusted mainly to an independent central bank, the Bundesbank. In Britain we decided after the Second World War that our central bank, the Bank of England, should have a subordinate position in monetary policy, taking its instructions from the government of the day. There is an active and lively debate in our country on whether that was a good decision.

Here may I pay you a tribute. From the 20 years of experience since the Americans broke the link with gold it is clear that the Bundesbank - more than any other central bank in the world - has understood how a fiat currency system can be made to work. You realised early on that the best way to maintain the value of money was to keep the quantity of money under tight control. You were right to introduce money supply targets in late 1974 and you have been right to continue to base interest rate decisions primarily on domestic monetary trends since then. The Bundesbank has gone further than any other central bank in meeting the monetary challenge of the last part of the 20th century.

I should perhaps add that usually it has been free from political interference and its actions have not been undermined by a lax fiscal policy.

External versus domestic objectives in monetary policy.

Compared with Germany you may wonder why Britain has had a poor record of monetary management in the last 40 years. There are many possible answers. One is that the German people are frightened of inflation because they have suffered from two catastrophic hyperinflations in the 20th century and are therefore willing to accept the disciplines of sound monetary control. But I wonder whether that identifies the root of the explanation for the contrasting inflation performances of our two countries. We British have shown over the last 20 years that we are prepared to undergo severe recessions in order to combat inflation, far more severe recessions than those seen in Germany in the same period. Instead I think that much of the answer reflects the beliefs of influential economists, both in British universities and Whitehall.

The standard British economist's answer to the inflation problem is to fix the exchange rate and to impose an incomes policy, because - as far as he is concerned - a falling exchange rate and rapid wage increases are responsible for inflation. The standard German economist's answer is to recommend a reduction in monetary growth. Perhaps I am simplifying. But I think that I am being fair - I have had to listen to far too many economists in the last 15 years! Fortunately, I had Alan Walters as my advisor who took the monetary view, as did the famous Liverpool six. But there were 364 economists on the other side!

European Economic and Monetary Union

Britain has not been alone in failing to find an adequate response to the monetary challenge of the late 20th Century. Most European currencies have been devalued against the DM at some point or other in the last 20 years and every European country has suffered from a measure of continuous inflation. The question arises, "why have the governments of Europe been so inadequate in their efforts to control inflation?". Is the explanation to be sought in a lack of political will or in widely-shared weaknesses of analysis and interpretation?

Large Countries

It should not be controversial that the only viable approach for a large country, an economic superpower, is for monetary policy to focus on the quantity of money, by a deliberate policy of money supply targets. The United States of America is clearly in this position. The American Federal Reserve cannot sensibly let the dollar's exchange rate against any other country dominate the behaviour of its own interest rates, because the American economy is more than twice the size of the world's second-largest, namely Japan. Similarly, Japan has such a large economy that it must - to a large degree - be autonomous in monetary policy.

Small Countries

At the other extreme are some small countries, where the share of traded goods in economic activity may be remarkably high and cross-border capital flows can dwarf domestic savings. They have sometimes chosen to fix the value of their currencies to that of a larger country because the level of economic activity depends on that of their larger neighbours.

Medium Sized Countries

But where does that leave medium-sized countries like Germany, France, Britain and Italy? In particular, what is the appropriate monetary regime for the four significant European nations, which - in a world context - are all only medium-sized countries? There is no obvious criterion for choosing between a domestic focus for monetary policy and an external focus.

In practice, the nations of Europe have met this challenge by associating themselves, to a greater or lesser degree, with the monetary policies of Germany with the consequences we now know. At the time Britain joined the ERM in 1990, it was not a rigid system. Recent events since then have confirmed the view that Britain would do best to organize its monetary policies with its own domestic economic situation as its central concern just as the Bundesbank does.

An even more dangerous response to our monetary problems is to try to overcome the dilemmas created by our medium-sized status by forging a larger monetary area, by concocting an ambitious scheme for European economic and monetary union in which we adopt the same currency. I think that the most generous interpretation of this enterprise is that it is intended to ensure that all European nations play their fair share in international monetary matters. Specifically, the thinking may be that, when the dollar is weak, the

obligation to intervene in its defence should be shared between the central banks of Germany, France, Britain and Italy, and even some of the smaller countries. This was, after all, the original motive for creating the ERM in 1978, when Mr Helmut Schmidt thought that Germany was having to do too much intervention to help the dollar. One theme in the case for EMU today is undoubtedly that Europe would have a currency which in global importance may match, or even exceed, the dollar. My view is that these technical arguments about desirable patterns of foreign exchange intervention are minor compared with the wider consequences of EMU.

EMU would involve the massive upheaval, not just in our monetary affairs but in our economic and political institutions.

As Karl Blessing pointed out as early as 1963, after the first proposal for monetary union "the final goal of the Commission is a European Monetary Union... As a European, I would be ready to approve of European Monetary Union and to accept a centrally directed federal banking system; as a responsible central banking practitioner, and realist, I cannot however avoid pointing out the difficulties which stand in the way. A common currency and a federal central banking system are only feasible if, apart from a common trade policy, there is also a common finance and budget policy, a common economic policy, a common social and wage policy - a common policy all round. In brief, this would only happen if there was a [European] Federal State with a European parliament with a legislative power in respect of all member countries."

Got it in one!

Europe - where next? - The political choice

This point brings us face to face with the political choices between the two different visions of Europe.

First, a Europe of nation states based upon the idea of co-operation between independent sovereign countries, loosely linked in a free trade area with competition between tax and regulatory systems and their own currency.

Second, the federalist vision of Europe, run increasingly from Brussels, united by a common citizenship, harmonised by bureaucratic regulation, equipped with common economic, foreign and defence policies, using a single currency, and acquiring all the flags, anthems and symbols of nationhood.

I. It was the first vision that inspired the post-War international order and led to the formation of the United Nations, the IMF and the GATT. In such a world, multi-lateral and non-discriminatory, a small nation had nothing to fear because it was small - its independence was unimpaired.

This kind of Europe would accommodate the countries of Eastern Europe and give them reasonable stability. It would maintain and not jeopardise our relations with our great friend and defender the United States. But some people object to this vision: they equate

nationhood to nationalism which they argue has been responsible for many of the world's troubles.

But the concept of nationhood is as old as the Bible itself.

"Righteousness createth a nation" (Prov. 14).

"Nation shall not lift up sword against nation" (Isaiah 2).

National pride in combination with liberty and the rule of law powerfully strengthen democratic government. The vital ingredient of democracy - public opinion - can then come into being. People will consent to be governed and accept common sacrifices most readily when they feel themselves to be part and parcel of one another, with a shared history, similar institutions and loyalties, above all a common language and culture. This is precisely what has happened with the unification of East with West Germany.

It is true that nations can fall under the sway of a tyrant like Saddam Hussein. But, as we discovered in the Gulf War, it takes nation states to defeat the despot.

We must not confuse the nation state with whatever unstable status-quo happens to be at hand. There were those who wanted to retain the Soviet Union as a structure, as others wanted to keep Yugoslavia. They were wrong. What we are witnessing is the collapse of Communism and artificial states with no real roots and precious little freedom. The fact is, we have now seen the collapse of both the Versailles and the Yalta Treaties. We should by now have learned that national sentiment cannot be created by bureaucratic fiat.

The conventional objection to this approach is that it creates a multitude of economically inefficient small states. But free trade under the GATT creates its own economic network regardless of the size of the nation. Taiwan, a nation of 20 million, is a bigger creditor nation than China - or for that matter the United States. With free trade you can have both large scale economic efficiency and small scale political decentralisation. People then enjoy the stability of their own nationhood, the benefits of free trade and local and international co-operation.

It is only socialism that requires government to be large, remote and bureaucratic to contain people and companies over a wide area.

II. This argument leads me to address the second vision, that of a European Union with rights of citizenship, a single currency, monetary and economic policy, a common defence and foreign policy, and an enlarged bureaucracy.

As I have already pointed out - and events this week have once again demonstrated - fixed exchange rates between countries with vastly different economies just won't work; and the suggestion that they could, especially in today's circumstances, has led to deeper recession than we need have suffered and to turmoil in the markets.

At least under the ERM there is an escape hatch which would not be the case with a single

currency. In my view, the Bundesbank cannot and should not be blamed for carrying out its statutory duty of protecting the value of the DM. But as the ERM transmits your high interest rates to other countries when their need is for a low interest rate, the answer has to be to realign or to leave the system. And there should be nothing unusual or shameful about that. There is no substitute for each nation taking responsibility for running its own economic and financial and fiscal affairs.

Naturally your own people wish to keep the DM and so would I in their position!

During the debate on the matter in the Bundestag all parties agreed on the necessity of another vote before Germany decides whether or not to join EMU. I think that is sensible and right; but with respect that's not what the Treaty of Maastricht says. The UK has a protocol to that effect before the 3rd stage of EMU but Germany did not request one. The UK also has a protocol against the Social Charter.

Why do some people contend that every new European initiative requires the participation of all members of the Community? It will sometimes be the case - especially after enlargement - that only some Community members will want to move forward to another stage of integration. For an enlarged Community can only function if we build in flexibility of that kind.

Within a common market, we should aim at a multi-track Europe in which ad hoc groups of different states, such as the Schengen Group already, forge varying levels of co-operation and integration, on a case by case basis. We should not try to pour different countries into the same mould. The test should be: will it work? And do the peoples of those countries want it? That way you avoid the strains and fractures that will otherwise occur.

The fact is that the people of many European countries are unhappy about the Maastricht Treaty. Scepticism is on the increase. People feel that their governments have gone ahead too fast - and they are not sure about the direction either. The trouble is that European Ministers spend so much time in each others' company, they get out of touch with the people and too much in touch with themselves. People do not want to become citizens of a European superstate. Denmark exercised her freedom to say No. And let no one try to bully her out of it. The veto is at the root of the Rome Treaty. Each nation, large or small, must have equal rights in this respect.

It is argued that the undefinable word "subsidiarity" will prevent the centre from becoming stronger. On the contrary, that thought is based on the notion that the Community has the power which it then parcels out to Member States. The true situation should be the reverse. Maastricht is much more than just a technical adjustment to the Treaty of Rome. That provides for the Commission to have sole right of initiative in 11 areas of policy. In Maastricht that reaches 20 to which have to be added 5 other areas of co-operation where the Commission is fully involved, monetary, judicial and immigration matters as well as foreign policy and defence. This alternative model is spawning bureaucracy at the expense of democracy.

Further, most federal states have experienced a steady trend towards centralisation as central governments have a natural appetite for more expenditure and therefore more taxation. The

Commission is already demanding more resources and yet more again for 'cohesion'. Germany is the largest contributor, but has enough to cope with at present without being called upon for more. The UK is second largest. This year £2.6 billion net (DM 6.25 billion) will go to the EC; that exceeds the amount we give to the developing world. And already both we and Germany are having to borrow more than we think wise.

Which Europe?

In deciding between the two visions of Europe it is not a question of whether we are 'European' or not but of what kind of a Europe we wish to build.

We are all bound - and will remain bound - by the Treaty of Rome and by the Single European Act which does not fully take effect until next year.

No member nation can be excluded from these two Acts.

But in considering the future and especially the Maastricht Treaty we must learn from past experience and take into account the vastly changed circumstances and the feelings of the people.

Would it not be better to pause and consider the matter afresh?

There are so many urgent tasks requiring our immediate attention.

For you there is still the problem of the full integration of East Germany. You know only too well the strains this has caused. We have all watched with great distress some of the extreme demonstrations in your country. We share your anxieties and I know that you are profoundly aware of the importance of defending Germany's liberal culture.

But we must look further afield too. In Central Europe memories of the rule of law, parliamentary institutions and private property were still just alive in 1989. They have returned now - and with some vigour - in countries such as Poland, Hungary and in the Czech Republic. But in Russia where since 1917 Communism, the most total tyranny of all, has been enforced, recollection of these traditions was virtually dead. And although the Communist system has collapsed there are still Communists around who can frustrate political freedom and the emergence of an enterprise economy. Yet there is something astonishing about Russia. If her talent and resources were harnessed she would be one of the richest nations in the world. She has the second largest oil reserves, and is the largest exporter of natural gas - of which you are a big consumer; and there is hardly a raw material, rare or abundantly encountered, that she does not produce.

When, before 1914, the rule of law extended across Tsarist Russia, her economy flourished. In the old days, we maybe accepted the Stalinist lies that old Russia had been backward. Not so. When she had a gold standard in place, with a legal system and a growth of private property, she did astonishingly well. In fact, she had the highest growth rates in the world, and if you go to some of the old cities - Kiev, St Petersburg - you can still see quite easily that these were European cities of energy and promise. That excellent German historian,

Professor Heinz Dietrich Loewe, even tells us that the Russian peasants had more calories in their diet in 1900 than the West German population of 1952!

It was a German Chancellor, Bethmann Hollweg, who said in 1914: "Russia grows and grows, and weighs upon us like a nightmare". In Bethmann Hollweg's time this caused panic in Central Europe, and an alliance against Russia. Now our problem is quite different: it is how to bring Russia back to the Concert of European nations that Communism forced her to abandon. The task is enormous. Yes, she has gained political liberty thanks to President Gorbachev's reforms and President Yeltsin's courage. But the fruits of economic liberty are far harder to win and it can only be achieved with international co-operation.

In Germany, at the heart of Europe, you understand this more than others. East Germany, plugged into the whole economic structure of liberty, central bank, single currency, rule of law, private property, available financial resources. Nevertheless she is encountering very real human and practical difficulties in making the transition. But in East Germany whatever the faults of the one-to-one exchange between your own and the old Communist currency, you have not had to face hyper-inflation along with everything else. That is the danger in Russia now and in other countries of the former Soviet empire. I feel that we should all be doing far more than we have done to help untangle the financial chaos there.

If Russia does not succeed economically and politically then future generations may apportion quite a lot of the blame to us. Should we not therefore be more generous in our help? And may I say at once that Germany has set an example. But let them not say we hid our heads in the Maastricht sands and haggled with the Americans over rape seed oil, while Russia burned.

Conclusion

Ladies and Gentlemen

Germany is the greatest economic power in Europe and will for the foreseeable future remain so. Her post-War success in entrenching democracy and building prosperity is one of the wonders of our age. I have said that a multi-track Europe, in which Germany finds herself on one track and Britain on another, holds no worries for me - nor should it for you. But, that said, Germany is in a special way the heart of Europe - culturally, geographically and now, more than ever, economically. It is, therefore, vital to Europe that Germany's approach to Europe's future development is sound - and not just for your people but for mine. There is always a danger that countries come to forget the sources of their security and strength. We did so in 1960s and 1970s in Britain - and then had to retrace once more the path back to liberal economics from which we had strayed. It is vital that you in Germany do not make the same mistake. Complacency, corporatism and consensus - these three perpetual temptations to all successful, civilised countries - are always waiting to do their worst: and they must be resisted.

This is even more important at a time when extremists are challenging our institutions. For there is no more favourable climate for extremism than one in which the respectable established political parties become remote from the worries of ordinary people.

The main threat to Germany's, Britain's and Europe's well being is a failure to remember the foundations of past success - compounded by a failure to look outwards to the new world emerging beyond our shores and frontiers.

The nineteenth century liberals who met in Frankfurt were unsuccessful. Until 1945 Germany chose under different regimes to adopt various formulae of cartels, state intervention and protectionism. But since then the principles of the liberal economy and the limited state have brought Germany to a pinnacle of prosperity and influence. Germany sets the tone in Europe, even more than she sets the monetary disciplines. I would like to hear the arguments for free enterprise and open trade put still more vigorously - and then carried through - by Europe's most powerful participant.

I would also like to see Germany and Britain ensure that truly global thinking replaces the narrow Europeanism which plagues the European Community. The Community has to realise that the world is changing fast. Economic power is passing to the far East: it is crucial that we combine, not to keep their products out, but to bring our ideas in, ensuring that freedom and democracy march side by side with economic liberty and growing wealth. And let us not have any doubt that Russia will remain a great power. It is in our interests, as well as being our moral duty, that she looks to our European countries as a source of help and ideas.

Nor are these matters of global policy to be left to learned professors or smooth talking diplomats. Global issues are now national issues.

If we lose sight of the arguments for global free trade, excluding the products of the poorer ex-Communist countries, desperate for access to our markets, then those streams of immigrants will, legally or illegally, pour across our borders, fuelling a racist reaction.

If we fail to export democracy along with our goods, then armed dictators may come to power and pose new threats to our security.

If we indulge in the fantastic nonsense of seeking to create a European super-state, competing with the United States, we will have only ourselves to blame if our countries have to raise taxes to pay for stronger armaments necessitated by American withdrawal from the defence of Europe and from the leadership of NATO.

That flame of liberal democracy which flickered in Frankfurt all those years ago has since lit up Germany and the rest of Europe too. Of course, the enemies of freedom remain - Nazis chanting hatred on the streets, crypto-Communists slipping quietly back into power. The totalitarian tendency is always with us. But it is only a tendency. The bracing creed of liberty is the more potent. In memory of the Frankfurt liberals - and in memory of all those other Germans who lost their lives in the prison camps and torture chambers devised with equal, devilish ingenuity by Left and Right - let us resolve to mark the coming millenium with freedom's triumph in every corner of our earth.