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From the Private Secretary

20 April 1990

Dear John,

ECONOMIC AND MONETARY UNION

The Prime Minister had a talk this morning with Sir Michael Butler about his paper on the Second Stage of EMU.

Sir Michael Butler said the City's concern was that the United Kingdom should remain the centre of monetary developments in Europe. They were nervous about the possibility that the other EC Member States might forge ahead without us if we did not subscribe to the aim of EMU. The general assumption in the City was that the EC would inexorably move ahead to full EMU, and there was a surprising (to him) lack of concern at the prospect of a common currency.

Sir Michael Butler continued that he thought the Prime Minister was right to want to retain a sensible element of national control over national policies. The proposals in his paper would give the UK a position in further discussion of EMU which other Member States would regard as credible. The Delors group had left a gap after Stage 1 of EMU. The idea of jumping straight from Stage 1 to Stage 3 was just rhetoric and not practicable. He therefore strongly recommended that the Government should put forward a proposal for an enlarged and strengthened Stage 2. A carefully orchestrated campaign would be required to promote the proposal. This would be more effective if in the meantime the United Kingdom were to join the ERM.

The Prime Minister said that we were very grateful for the work which had gone into the paper. The Treasury had been working in parallel on proposals which were not dissimilar. We had a number of technical difficulties with the Sir Michael's paper. The Germans did not like the concept of a parallel currency.

Sir Michael Butler said that the most important element in the paper was the proposal for a hard écu, which could never depreciate. This would be taken as evidence of the seriousness of our commitment to beat inflation. The Prime Minister asked whether the same effect could not be achieved by linkage to the DM. Sir Michael said that there was no guarantee that the DM would always be the strongest currency. He had discussed with

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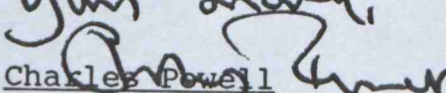
Sir Alan Walters, who had agreed that they would be seen as a strongly, counter-inflationary. Moreover the hard écu was the only really new feature in the paper. Other aspects of it resembled the proposals which the French Government had already put forward to the Delors group. Without the new element, it would simply be seen as backtracking. He was aware that the Bundesbank had always been against the écu because they regarded it as a mediocre currency, but the proposal for a hard écu cut the ground from under their feet. Moreover, the Commission and the French would prefer a hard écu to the DM. He was very ready to discuss the proposals further with the Treasury and the Bank of England.

The Prime Minister accepted that our paper on competing currencies had not commanded much support in the Community, and that we needed to put forward further proposals. Our own thinking was in a generally similar direction to that in Sir Michael's paper. But she did not want our proposal to appear to relate to Stage 2 of Delors alone. It would go considerably further and represented the most which she could envisage for the time being. It should be described as the "next stage" rather than Stage 2. She could not accept a commitment to full EMU as defined in the Delors report. Parliament had already rejected this.

Sir Michael Butler said he had started from the same position as the Prime Minister when he had embarked on the paper. But after talking to many people in Europe, he had concluded that the only way for the United Kingdom to remain in the game was to accept the goal of permanently fixed parities or a single currency. It would be impossible to get away without having at least the aim of full EMU incorporated in any agreement, although it might not be necessary to give any detailed definition of it. It ought not to be too difficult for us to subscribe to a long term aim. We should not give the impression that our own proposal was the last word.

The Prime Minister said she was not proposing to do so: our proposal would be presented as the next stage. But we could not pour ourselves into the Delors mould, which had already been rejected by Parliament. Sir Michael Butler said that he had to advise the Prime Minister that it would be impossible to get away without stating the ultimate aim of permanently fixed currencies. We ought to be able to write into the Treaty that the Community could only move from one stage of EMU to another by unanimity. How and when to go beyond the next stage could be left vague. The Prime Minister said firmly that there was no need to take a decision on the final goal or on a single currency at this stage. We did not know what the Community would be like in ten years time.

I am copying this letter to Stephen Wall (Foreign and Commonwealth Office) and to Sonia Phippard (Cabinet Office).

Yours sincerely,

Charles Powell

John Gieve Esq
HM Treasury.