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AT 21/6

PRIME MINISTER

cc Mr. Powell

Mr. Potter

OBJECTIVE STANDARDS

You have been thinking about objective standards such as a commodity standard in three contexts

- as an alternative to EMU
- as a way of operating an EMU where one established
- as the basis for a new monetary order.

(i) An alternative to EMU

The aim was to find an alternative model to which other Community countries can turn if they begin to develop doubts about the Delors model. But they are not going to down tools on the IGC to look at something which is as embryonic as the Commodity Standard. But in any case we have now come up with something better, i.e. the hard ECU. This grows out of existing Community constructs and can also be seen as a development of the UK's paper on competing currencies. It is flexible - it can be a parallel currency, countries can adopt it individually or they can use it in groups as a common currency.

(ii) A basis for operating EMU

Alan Walters' paper envisaged his ECOM as the way the monetary policy of an EMU might be operated. It would also deal with the problem of accountability. You have objected to a Eurofed of twelve persons determining monetary policy but being inadequately accountable to Parliament. If, however, they were required to operate an automatic framework they would have little discretion and hence little to account for. But there is no mileage for you in pressing objective standard in this context as you oppose a single currency. Your position is an absolute not a conditional one; you do not want it for this country in the foreseeable future; it is not that it would be acceptable if operated differently.

(iii) A basis for a new monetary order

You have wondered whether to launch the idea of an objective standard in Houston. There is, however, an important pitfall here. The term objective standard has echoes of the gold standard. It will therefore be interpreted as a proposal about exchange rates. With the French proposal for a new Bretton Woods

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in the air, observers may conclude that you are proposing a new regime of fixed exchange rates between dollar, yen and the EMS, only using a commodity index as the basis rather than gold.

You have always taken a sceptical view of attempts to fix exchange rates between the major currencies, including attempts such as Plaza and Louvre to do so informally, and I do not see any reason for you to depart from that now. You have argued that the major currencies should run their monetary policies in a firm way but that having done that they should allow exchange rates to adjust freely. If monetary policy succeeds in keeping inflation low and major savings/investment imbalances (fiscal deficits) are not allowed to develop, the resulting exchange rate movements should not be excessive.

It would be important, therefore, to make clear that the purpose of objective standards is to provide a guide to the conduct of monetary policy in individual countries, not directly as the basis for a new system of fixed exchange rates. With payments imbalances as large as they are, to fix exchange rates would be positively harmful. agreed.

Given the scope for misunderstanding, I think it would be unwise to float the idea publicly at Houston. It would look too much like a specific operational proposal for exchange rates. It would fit better in a philosophical speech about monetary policy and inflation where the arguments about discretion versus rules could be rehearsed.

The question that will then need to be answered is why given the choice between having monetary policy run by Alan Greenspan and/or placing it in a predetermined framework, one should choose the latter —

AT  
ANDREW TURNBULL

20 June 1990

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as an example of good faith  
that each of us is doing our  
utmost to work with each other  
on sound monetary policies. We do not  
then need more.

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