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INFO DESKBY 260800Z DUBLIN
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FRAME ECONOMIC

DUBLIN FOR SECRETARY OF STATES PARTY

MY TELNO 768 : CHANCELLOR'S SPEECH ON EMU

SUMMARY

1. DEPUTY PRESIDENT OF THE BUNDESBANK DOUBTS THAT UK PROPOSALS CAN ACHIEVE THEIR STATED AIMS. BUT THE BUNDESBANK WILL CAREFULLY ANALYSE THE CHANCELLOR'S SPEECH AND HE IS OPEN TO FURTHER ARGUMENT.

DETAIL

2. MINISTER CALLED ON SCHLESINGER AT THE BUNDESBANK ON 25 JUNE. DUDLER (HEAD OF MONEY AND CAPITAL MARKETS DIVISION) ALSO TOOK PART IN THE DISCUSSION WHICH LASTED NEARLY AN HOUR AND A HALF. SCHLESINGER HAD BEFORE HIM THE TEXT OF THE CHANCELLOR'S SPEECH TOGETHER WITH THE BANK OF ENGLAND EXPLANATORY STATEMENT. HE SAID THAT THE BUNDESBANK PRESIDENT, POEHL, WOULD PROBABLY REFER TO THE PROPOSALS WHEN HE SPEAKS IN LONDON ON 2 JULY BECAUSE HE COULD NOT DO OTHERWISE, BUT HE WOULD NOT SAY MUCH (SCHLESINGER DID NOT MENTION POEHL'S CALL ON THE PRIME MINISTER).

3. SCHLESINGER NOTED THAT WHILE THE CHANCELLOR HAD CONCENTRATED ON STAGE 2, HIS PROPOSALS AFFECTIVELY WENT INTO STAGE 3. GOING THROUGH THE TEXT IN DETAIL WITH DUDLER AND THE MINISTER, HE THEN SET OUT RESERVATIONS ON THE FOLLOWING FRONTS.

4. FIRST, AND MOST IMPORTANT, HE WAS PREDICTABLY WORRIED ABOUT THE EFFECT ON THE D-MARK OF A PARALLEL CURRENCY, EVEN IF IT WERE QUOTE HARD UNQUOTE. THIS TOOK THE FORM OF SAYING THAT HE DID NOT SEE HOW THE PROPOSED SYSTEM COULD GUARANTEE THAT THE HARDEST CURRENCY WOULD REMAIN AS STRONG AS IT WOULD OTHERWISE BE. THIS WAS BECAUSE HE WAS SCEPTICAL ABOUT THE ABILITY OF THE SYSTEM TO REMAIN NON-INFLATIONARY. EMPHASISING THAT HE WAS NOT SURE HE FULLY GRASPED HOW THE EMF WAS INTENDED TO WORK, HE MADE THE FOLLOWING SUBSIDIARY

POINTS CONCERNING THE EXTENT TO WHICH HE SAW THE DISCIPLINES OF THE SYSTEM BEING EVADED.

- HE NOTED THAT IN THE EMS, AN OBLIGATION TO PURCHASE OWN CURRENCY ALREADY EXISTED WHICH WAS NOT ALWAYS ADHERED TO.
- HE THOUGHT THE OBLIGATION TO PURCHASE OWN CURRENCY, IF MET, ITSELF ADDED TO LIQUIDITY POTENTIALLY AVAILABLE TO GOVERNMENT WHICH WOULD NOT NECESSARILY BE NEUTRALISED. HE NOTED THAT IN ANY CASE CONTROLS SUCH AS A REQUIREMENT FOR MINIMUM RESERVES AND REDISCOUNT QUOTAS, TO WHICH HE ATTACHED MUCH IMPORTANCE, DID NOT EXIST IN ALL MEMBER STATES.
- A THIRD DIFFICULTY WAS THE POSSIBILITY OF THE EXTENSION OF BORROWING WITHIN A MEMBER STATE WHICH EITHER EQUALLED OR EXCEEDED THE CONTRACTIVE EFFECT OF THE OBLIGATIONS OF THE MONETARY SYSTEM. HE DID NOT THINK BRITISH IDEAS WERE NEARLY DEVELOPED ENOUGH TO GUARD AGAINST THIS REAL DANGER OF INFLATIONARY PRESSURE.

5. SCHLESINGER NOTED THAT THE EMF WOULD HAVE POWERS (AND DUTIES) OF INTERVENTION VIS A VIS THIRD CURRENCIES. HE MADE TWO POINTS. FIRST, THIS POWER MEANT THAT CURRENCIES, ONCE THEY HAD GOT ONTO THE INTERNATIONAL MARKET, HAD EFFECTIVELY ESCAPED THE CONTROL OF THE SYSTEM. SECONDLY, HE DID NOT SEE HOW, WITH THE LIMITED POWERS AT ITS DISPOSAL, THE EMF WOULD EFFECTIVELY MANAGE INTERVENTION.

Coordinate

6. SCHLESINGER REFLECTED THE BUNDESBANK'S WELL-KNOWN SUSPICION OF THE ECU. HE DID NOT THINK THAT AN ECU WOULD EVER BE ATTRACTIVE, HARD OR OTHERWISE, PARTICULARLY TO INVESTORS WITHIN THE D-MARK ZONE. HE ARGUED THAT A REAL LIVE HARD CURRENCY ALREADY EXISTED AS WELL AS AN ECONOMICALLY CONVERGENT BLOC IN WHICH IT, THE D-MARK, WAS ALREADY DOMINANT. THE BELGIANS WERE MAKING THE LAST NECESSARY MOVES AND IF THE FRENCH WERE TO ALTER THEIR INTEREST RATE POLICY, THE PROBLEM OF A WEAK FRANC WOULD BE DEALT WITH. HE THOUGHT THE MOMENTUM TOWARDS A SINGLE MARKET WAS NOW GREAT ENOUGH FOR THIS PRECONDITION FOR MAKING FURTHER PROGRESS TO EMU TO HAVE BEEN NEARLY MET. AGAINST THIS BACKGROUND, HE DISMISSED THE ADVANTAGES OF A HARD ECU ON SUCH ISSUES AS TRANSACTION COSTS, SAYING THESE WERE ALREADY LOW WITHIN THE AREA WHERE EXCHANGE RATES HAD BEEN STABLE FOR THREE AND A HALF YEARS. ALL IN ALL HE THOUGHT THE CHANCELLOR'S IDEAS NEARER FRENCH THAN GERMAN THINKING.

COMMENT

7. RUNNING THROUGH SCHLESINGER'S COMMENT WAS THE BELIEF THAT MEMBER STATES SIMPLY WOULD NOT PURSUE POLICIES OF PRICE STABILITY LEFT WITH THE DEGREE OF FREEDOM ALLOWED THEM IN BRITISH PROPOSALS. HE DID NOT USE THE WORD SOVEREIGNTY ONCE AND WAS NOT INTERESTED IN THIS ASPECT. NOR DID HE GO INTO INSTITUTIONAL QUESTIONS. HE WAS INTERESTED PURELY IN THE ABILITY OF THE BRITISH PROPOSALS WITHIN THEIR OWN TERMS TO LIVE UP TO THEIR CLAIMS. HE WAS VERY DOUBTFUL. HE MADE CLEAR HOWEVER THAT HE WOULD LIKE FURTHER CLARIFICATION OF HOW BRITISH IDEAS WOULD WORK IN PRACTICE AND THAT HE WAS OPEN TO FURTHER ARGUMENT (BEYOND THE EXTENSIVE DISCUSSION ALREADY CONDUCTED WITH HIM). HE SAID HE WOULD WELCOME SEEING THE MINISTER AGAIN BEFORE THE CENTRAL BANK GOVERNORS MEET ON 9-10 JULY. SCHLESINGER UNDOUBTEDLY WISHES TO SEE THE UK STAY IN PLAY. AT ONE POINT HE SAID THAT HE HAD NOT CHANGED HIS VIEW THAT EMU SHOULD NOT BE BUILT WITHOUT THE UK. THIS HOWEVER CAME AFTER HIS ASSESSMENT IN PARA 6 AND IT SEEMED CLEAR THAT HE ACCEPTED THAT A SMALLER GROUP OF STATES COULD AND MIGHT MOVE AHEAD MORE QUICKLY THAN THE REST.

8. SEE SEPARATE TELEGRAM (NOT TO ALL) ON SUGGESTION FOR FOLLOW UP.

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