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(FRAME ECONOMIC)

CHANCELLOR'S EMU PROPOSALS : VIEWS OF THE GOVERNOR OF THE BANK OF FRANCE

SUMMARY

1. LAROSIERE WELCOMES THE SPIRIT OF THE CHANCELLOR'S PROPOSALS, BUT REGRETS THAT THEY WERE NOT TABLED A YEAR AGO. PRELIMINARY DOUBTS ON A NUMBER OF POINTS, BUT FURTHER EXAMINATION BY EXPERTS NECESSARY. PROVIDED POLITICAL PROBLEMS CAN BE MANAGED LAROSIERE FAVOURS SWIFT PROGRESS TO STAGE III TO CONSOLIDATE THE GOOD ANTI-INFLATIONARY PROGRESS ALREADY MADE THROUGH ERM MEMBERSHIP. HE DOES NOT RULE OUT AN INNER GROUP OF COUNTRIES MOVING AHEAD FIRST, WITH OTHERS JOINING LATER. BUT ALL SHOULD FROM THE BEGINNING, HAVE A ROLE IN THE CENTRAL BANKING INSTITUTION. COMMENT IN MIFT.

DETAIL

2. I CALLED ON LAROSIERE, GOVERNOR OF THE BANK OF FRANCE, ON 5 JULY TO SEEK HIS REACTION TO THE CHANCELLOR'S PROPOSALS FOR EMU BEYOND STAGE I. I STRESSED THAT THESE PROPOSALS WERE A SERIOUS AND CONSTRUCTIVE CONTRIBUTION TO THE DEBATE ON EMU UP TO AND THROUGH THE IGC, AND GAVE LAROSIERE AN ADVANCE COPY OF THE ARTICLE BY THE CHANCELLOR THAT APPEARS IN TODAY'S LES ECHOS.

3. LAROSIERE SAID HE WELCOMED THE SPIRIT BEHIND THE CHANCELLOR'S PROPOSALS. IT WAS IMPORTANT THAT THE UNITED KINGDOM SHOULD BE AT THE HEART OF THE EMU DEBATE. HE HAD REFLECTED CAREFULLY ON THE PROPOSALS, THOUGH THEY WOULD REQUIRE FURTHER STUDY BY EXPERTS. HE HAD NOT YET, HOWEVER, DISCUSSED THEM IN DETAIL WITH BEREGOVY, SO HIS COMMENTS SHOULD BE REGARDED AS PERSONAL, AND NOT NECESSARILY REPRESENTATIVE OF THE FRENCH GOVERNMENT'S VIEWS.

4. HIS FIRST COMMENT WAS THAT THE PROPOSALS ARRIVED A LITTLE LATE. THEY WOULD HAVE HAD MORE IMPACT HAD THEY BEEN PUT FORWARD AT THE START OF THE DELORS COMMITTEE'S DISCUSSIONS. THE DELORS COMMITTEE HAD STARTED WORK WITH AN OPEN MIND ABOUT THE MEANS OF ACHIEVING AND

THE DEFINITION OF MONETARY UNION, BUT A STRONG CONSENSUS HAD FORMED IN FAVOUR OF THE APPROACH SET OUT IN ITS REPORT : I E EMU CONSISTING OF IRREVOCABLY FIXED PARITIES LEADING TO A SINGLE CURRENCY, WITH THE NECESSARY COROLLARY OF A COMMON MONETARY POLICY RUN BY AN INDEPENDENT CENTRAL BANK. THE CHANCELLOR'S IDEAS DID NOT FIT WELL INTO THIS APPROACH. THE IDEA OF A PARALLEL CURRENCY HAD BEEN EXAMINED AND SET ASIDE BY THE DELORS COMMITTEE. SO HAD HIS OWN PERSONAL IDEA - SIMILAR IN CONCEPT TO THE CHANCELLOR'S IDEAS - OF AN INTERIM INSTITUTION CARRYING OUT CERTAIN SPECIFIED TASKS WHICH MIGHT PACE THE WAY FOR EMU. HE DOUBTED WHETHER OTHER MEMBER STATES, SUCH AS THE GERMANS AND THE BENELUX, WOULD WANT TO GO OVER THIS GROUND AGAIN.

5. LAROSIERE REPEATED THAT THE TECHNICAL ASPECTS OF THE PROPOSALS WOULD NEED TO BE STUDIED BY EXPERTS. BUT IT WAS NOT CLEAR THAT THE PROPOSALS WOULD LEAD NECESSARILY TO A SINGLE CURRENCY, WHICH WAS WHAT BUSINESSMEN WANTED. INDEED, IT WAS NOT CLEAR THAT THEY WERE INTENDED TO. THE CREATION OF A NEW CURRENCY, WITH ASSETS AND LIABILITIES, WOULD INSTEAD COMPLICATE AND DELAY THE MOVE TOWARDS A SINGLE CURRENCY.

6. THERE WERE MORE DETAILED TECHNICAL OBJECTIONS TOO:

I. IT WAS NOT CLEAR THAT THE PROPOSALS WOULD LEAD TO ECONOMIC CONVERGENCE

II. COMPULSORY DEVALUATION COULD LEAD TO A TRANSFER OF THE EXCHANGE RISK FROM FINANCIAL INSTITUTIONS TO CENTRAL BANKS

III. THE PROPOSED ARRANGEMENTS COULD LEAD TO A SWITCH FROM STRONG CURRENCIES WITH LOW INTEREST RATES TO THE HIGHER-INTEREST BEARING ECU, WITH CONSEQUENCES FOR DOMESTIC MONETARY POLICY

IV. IT WAS NOT CLEAR THAT THE INFLATIONARY LOOP HAD REALLY BEEN CLOSED.

7. I SAID THAT LAROSIERE HAD NOT TOUCHED ON THE VERY DIFFICULT QUESTION OF LOSS OF SOVEREIGNTY INHERENT IN THE DELORS APPROACH, NOR OF THE PROBLEMS OF THE DEMOCRATIC ACCOUNTABILITY OF A CENTRAL BANK. THE TIMESCALE WAS CRUCIAL TOO: WHATEVER ONE SAW AS THE FINAL GOAL, COULD ONE REALLY ENVISAGE WITHIN THE NEXT SAY, 5-10 YEARS, THE DEGREE OF ECONOMIC CONVERGENCE NEEDED TO SUSTAIN EMU, WITHOUT EXCESSIVE BUDGETARY TRANSFERS FROM RICHER TO POORER STATES? AN EVOLUTIONARY APPROACH GENUINELY SEEMED BETTER TO US. FURTHERMORE,

WITH THE DM ZONE STRENGTHENING, BUT WITH THE DM ITSELF SUBJECT TO UNCERTAIN PRESSURES FROM EMU, WAS NOT A HARD ECU A BETTER ROUTE FORWARD?

8. LAROSIERE REPLIED THAT FOR FRANCE THE DEBATE ON LOSS OF SOVEREIGNTY WAS EFFECTIVELY OVER, THOUGH THE POSITIVE SIDE OF THIS WAS, OF COURSE THAT ERM MEMBERSHIP HAD REDUCED INFLATIONARY PRESSURES TO THE STAGE WHERE FRENCH INFLATION WAS ALREADY VIRTUALLY ON A PAR WITH GERMANY'S AND WOULD CERTAINLY BE BY THE END OF THE YEAR. THE ERM WAS BECOMING A EUROPEAN RATHER THAN A DM ZONE. LAROSIERE ADDED THAT IN ANY CASE A CENTRAL BANK ON THE DELORS MODEL WITH ONE MAN ONE VOTE ON THE BOARD, WOULD INCREASE RATHER THAN REDUCE FRENCH CONTROL OVER MONETARY POLICY.

9. LAROSIERE SAID THAT A HARD ECU WOULD NONETHELESS HAVE ATTRACTIONS FOR SOME. HE HAD NOT DISCUSSED THE IDEAS IN DETAIL WITH BEREGOVY, BUT BELIEVED HIM STILL TO BE WEDDED TO THE DELORS ROUTE, THOUGH RIGHTLY CONCERNED AT THE MAGNITUDE OF ADJUSTMENT IN STAGE II. LAROSIERE WAS AT PAINS TO AVOID ANY SUGGESTION THAT THERE WERE DISAGREEMENTS AT MINISTERIAL LEVEL. SOME IN THE TRESOR, HOWEVER, WERE MORE SCEPTICAL ABOUT STAGE III. HE HIMSELF BELIEVED THAT GIVEN THAT PROGRESS ALREADY MADE, AND PROVIDED THE POLITICAL DIFFICULTIES WERE UNDERSTOOD AND MANAGED, GERMANY, FRANCE AND BENELUX WERE ALMOST IN A POSITION NOW TO MOVE TO STAGE III. HE RECOGNISED THAT OTHERS MIGHT NOT BE, BUT COULD ENVISAGE AN INNER GROUP AGREEING TO MOVE AHEAD SEPARATELY PROVIDED THAT:

I. PROVISION WERE MADE FOR OTHERS TO JOIN WHEN THEY WANTED

II. ALL MEMBER STATES JOINED AND TOOK PART IN THE NEW CENTRAL INSTITUTION, THOUGH WITH THE INNER AND THE OUTER GROUPS NO DOUBT PLAYING DIFFERENT ROLES.

10. FINALLY, LAROSIERE REPEATED HIS APPRECIATION OF THE CHANCELLOR'S IDEAS AS A SERIOUS CONTRIBUTION TO THE DEBATE. HIS REMARKS WERE PRELIMINARY, AND SHOULD NOT BE SEEN AS NEGATIVE. BRITAIN MUST PLAY A FULL PART IN THE DEBATE AHEAD.

11. SEE MIFT FOR COMMENT.

12. FCO PLEASE ADVANCE PS/SOS, PS/MR MAUDE, KERR, ARTHUR(FCO) PS/CHANCELLOR, WICKS, SCHOLAR, ODLING-SMEE, EVANS(TSY), PS/GOVERNOR, CROCKETT, ARROWSMITH(B/E).

FERGUSSON

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ADDITIONAL 1

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