



10 DOWNING STREET

Amanda

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Can you please

find  $\frac{1}{2}$  hr. near

the end of

the month

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6 September 1990

Charles Powell  
10 Downing Street  
London  
SW1

Prime Minister  
This comes back  
yet again to  
the insistence that  
you accept the  
aim of achieving

Dear Charles,

EMU

We agreed on the telephone the day before yesterday that I would prepare a short paper for you to show to the Prime Minister, explaining why I think that the negotiating position requires a tactical move on our part before the end of the month. It is enclosed.

2. I should stress at present the enclosed paper represents only my own views. Naturally, since it is written for the Prime Minister's eyes, I will not show it to my City European Committee. But the matter is on the agenda of the Committee on 12 September and I will let you know if there are any new developments there. So far the Committee has given me strong and unanimous support and I expect that they will approve the general approach in the paper on proposed institutional arrangements for Stage 2.

3. I should be most grateful if the Prime Minister could agree to see me before the end of September.

Yours ever  
Michael

Sir Michael Butler

MDB/JSD

Amoney  
one  
day.  
Are  
you  
prepared  
to see  
him again?  
CDD  
6/9

There is no  
part in doing so but  
I will if he writes  
me

EMU

The present negotiating position and future tactics

1. The negotiating phase has now opened. Our Stage 2 proposals are alive and gaining a little ground in Brussels. But they could only secure an important degree of support if our negotiators were in a position to explain their value as transitional arrangements on the way to an eventual Stage 3. It is clear that the Italian Presidency and several member governments are reluctant to bring our proposals into the centre of the negotiations unless:-

- (a) we accept that the aim of a single currency in Stage 3 can be in the Treaty;
- (b) we spell out how our proposed European Monetary Fund would fit into the institutional and Treaty framework.

2. Meanwhile the Commission, with support from the French and some other member states, are moving ahead with drafts designed to create an insitutional framework for Stage 3, with a fully independent "Eurofed" to manage a single currency, and are talking about a short Stage 2 beginning on 1 January 1993. The obvious disadvantages of any sudden great leap from a situation with 12 (or even 6) monetary authorities, policies and instruments, and currencies to one of each will raise doubts about this option, but the Stage 3 institutional proposals themselves are increasingly attaining sacred cow status.

3. The best outcome which I believe the Prime Minister can hope to achieve at the end of the negotiation (and even this will be very difficult indeed) will be:-

- (a) to get something very like our evolutionary approach accepted as Stage 2 in a three stage process;

- (b) to prevent the Treaty or the Statute of the EMF from spelling out the details or timing of Stage 3, but to accept in the Treaty the aim of achieving a single currency one day;
- (c) to create the institutional and Treaty framework for Stage 2 (along the general lines of the attached paper) which would provide that any move to Stage 3 and consequential amendments to the EMF would be subject to unanimous agreement of all member states.

4. To achieve such an outcome would be a major negotiating triumph. We should have not only to promote our own proposals successfully and to kill the idea of a short Stage 2, but also:-

- (a) to get the negotiations to focus on the institutional arrangements for Stage 2;
- (b) at the end of the day to knock out the now rather solidly entrenched institutional proposals for Stage 3;
- (c) to resist pressure to set a time-table for the passage to Stage 3.

5. The Prime Minister cannot achieve all this herself in the two or three European Councils likely to be held before the final crunch. Probably she will be the only person able to achieve 4(b) and (c) above. But in order to give her a reasonable hand to play, officials and the Chancellor need to get the Presidency to include in the draft going to the IGC (if only in square brackets) language giving effect to 4(a). Otherwise I cannot see how we can get through to the outcome in para 3.

6. I conclude that the Prime Minister needs not later than the end of this month when the ECOFIN Council of 8 October will be being prepared (the last before the European Council of 27 October) to authorise her negotiators:-

- (a) to put forward proposals along the lines of the attached paper, less para 2(b);
- (b) to say that if other member Governments are ready to accept proposals on these lines for Stage 2, she would be willing to consider including the aim of achieving a single currency one day in the Treaty.

If the Prime Minister gave such instructions, I think that her negotiators would stand a reasonable chance of getting the draft negotiating documents into a shape which would permit her to fight a successful battle at her level over the following months.

EMU

Proposed institutional arrangements for Stage 2

1. The objective would be to create a system for Stage 2 under which only those things which need to be decided centrally are put under the control of the European Monetary Fund (EMF).
  
2. (a) The Treaty would create a European System of Central Banks (ESCB) consisting of the twelve national Central Banks and a European Monetary Fund owned and run by the Central Banks, to be operational from day one of Stage 2.  
  
(b) It would also lay down the aim of permanently fixed parities or more probably a single currency in Stage 3.  
  
(c) The aim of price stability would be in the Treaty and in the Statute of the EMF.  
  
(d) The Statute of the EMF would be annexed to the Treaty which would provide that it could be changed by unanimous agreement as necessary.  
  
(e) The Treaty would provide that National authorities (Central Banks, Governments or Parliaments) would not seek to influence EMF policy contrary to its Statute.
  
3. The Statute of the EMF would also provide that in Stage 2 the ESCB shall co-ordinate national monetary policies and the EMF shall control ecu monetary policy. It would create the hard ecu and provide that it should be managed so as to be always as strong as the strongest currency. It would contain the two golden rules - no monetary financing of budget deficits and no money creation to replace national currency converted into ecus. It would provide for convertibility of national currencies into and out of ecus and for the EMF to be a lender of last resort in ecus. It would lay down that the exchange risk on national

currencies converted into ecus would rest with the National Central Banks and that the EMF should have the right to require any member state judged to be breaking the golden rules or running too lax a monetary policy to reconvert into ecus some or all of the balances of its national currency held by the EMF. These provisions would all help to ensure that no Government could take advantage of the system to run a lax monetary policy.

4. On this basis, arrangements for Stage 3 would no doubt require amendments to the EMF Statute but not necessarily to the Treaty. It would be wise at this stage only to create the ESCB as required for Stage 2. No-one can fully foresee at present what will be required for Stage 3.

5. The Chairman of the EMF Council would report to the European Parliament and to Ecofin annually in writing and be available to them in person to answer questions when required.

6. National Central Bank Governors could retain their existing relationships with national Parliaments and Governments and could report to national Parliaments if so desired (provided always that 2 (e) above was respected). In this way the ESCB and the EMF would be protected from political pressure to take action contrary to the EMF's Statute but would remain accountable to national Parliaments as well as to ECOFIN and the European Parliament.

MDB/

6 September 1990.