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Secretary of State for Foreign  
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Dear Richard,

**CHANCELLOR'S LUNCH FOR JEAN-CLAUDE JUNCKER, LUXEMBOURG MINISTER OF FINANCE**

The Chancellor gave lunch in No.11 to Jean-Claude Juncker, Luxembourg Minister of Finance, on Wednesday, 16 January. Yves Mersch (Director, Luxembourg Treasury), Gaston Reinesch (Government Commissioner) and Edouard Molitor (the Ambassador), Mr Wicks and Mr Bostock were present.

Apart from a bare reference to Luxembourg's priorities for their Presidency - on which Juncker explained that he hopes to bring the VAT issue to the brink of completion, but allow the Dutch to clinch a deal - the discussion was devoted entirely to the EMU IGC.

The discussion was very disjointed, and I have not attempted here to eliminate all repetition.

IGC procedure

Juncker said that the Commission's draft Treaty was a useful 'technical' document. It would be necessary to take account of the Commission's views as well of those of the UK and others. But he did not want the Commission draft to be the sole document for the IGC. His aim was, by the end of the six months of his



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Presidency, to be able to put forward a full Presidency text for the IGC to consider.

The procedure on which they had settled - working through the Treaty articles in sequence - would avoid bringing problems to a head and dramatising differences. The aim was a rapid series of 'first readings' which would elicit rival suggestions for Treaty texts and expose the various views. He would aim to come forward with Presidency texts reflecting these first reading discussions. The aim would be to have a proper Conference document by the end of the process, not merely a Commission document. He would not necessarily wait until the process was completed before issuing Presidency texts: he envisaged circulating texts bit by bit as the IGC worked through the articles, though he would not necessarily circulate Presidency texts after every meeting. He emphasised that the aim was to avoid reliance on 'outside' documents, or 'one party' documents. Mr Wicks commented that, since the structure of the Treaty was connected, it made sense to get an overview before going back to concentrate on the details.

Bilateral contacts

Mr Juncker said he had had meetings with all his colleagues the previous September. He expected that the IGC would get under way slowly and that the real politics would come only at the end of the process. It might be that a further round of Ministerial contacts in May or June would be useful, but for the moment he was not planning a further round, though this discussion with the Chancellor had seemed sensible. He emphasised that what he wanted was 'a result of the member states'.

Overlap with the political union IGC

M Mersch said that there was considerable overlap between the IGCs. But Rome II had been helpful in distinguishing which questions should go to the political union IGC. Also, Rome II had helpfully rejected majority voting on tax matters. The EMU IGC, in contrast, had been set the relatively circumscribed task of saying how the Treaty would need to be amended in the light of the EMU. Mr Wicks said that the UK's position on tax matters was clear: they were not for either Treaty. It would be better not to discuss them. Allowing the political union IGC to take the lead - the question was on their agenda - was not the best way to a sensible result. Mersch said that only the Belgians and the Spanish - who had a very long wish list - wanted this anyway.

French attitude to EMU

Juncker said that he expected the French to publish proposals, possibly at the Ministerial IGC on the 28th. However, there were disagreements between the Finance and Foreign Ministries over a common text, though the nature of the difficulties was not clear.





Mersch thought they were most probably over the nature of Stage 2, though Juncker remarked that Beregovoy himself was open minded on this.

Juncker's impression was that Beregovoy wanted more time. Mr Wicks thought this was odd, no elections were in prospect. Mersch pointed out the French had hitherto argued for short, essentially technical, Stage 2. Beregovoy had now moved away from this. His principle concern, he thought, was the current German policy mix.

### Delors

There was general agreement that Delors' periodic outbursts were unwise. Juncker recalled that Delors' had subsequently made clear that the most recent had not been directed specifically to the UK: he (ie Delors) had worries about the 'loyalty' of Beregovoy, Kok, Waigel and Solchaga too. When he had seen him he had counselled against the idea of an extraordinary summit in the Spring, and against the 'political crisis' scenario. The Chancellor commented that, despite the later clarification, Delors' attack had been construed as anti-UK by the UK press.

### UK approach

The Chancellor said that there were differences, or perhaps 'ambiguities', over the end point, but that there was a lot of common ground on the more immediate issues. He hoped that there need not be a great theological argument at the outset. The issues would, of course, need to be faced in due course but he hoped later rather than sooner. Politics need not rear its head at the beginning. Juncker agreed: he would try to bat away trouble to the end of the IGC. It would be impossible to avoid differences entirely in the opening meetings. But he did not want to make heavy weather over them. He was very anxious to avoid an 11-1 split. The Chancellor added that such a split would be more theoretical than real.

### Germany

Juncker said that he thought the Chancellor's approach more constructive than, for example, Waigel's. Mr Wicks commented that the German position remained very unclear. Mersch said that Koehler had been surprisingly positive at the personal representatives meeting on 15 January on the subject of the hard ecu which he described as a very good idea. There would of course be a new German Government, albeit, with Waigel. The Chancellor asked whether CSU and CDU views on EMU differed. Juncker said it was difficult to divine. There would be a big change in internal German politics because the CDU and the Liberals did not need the Bavarians any longer. However, Kohl's





ambition for a gesture on a European scale to follow GEMU was the key factor. Waigel was more reluctant, hence Delors' remarks. The Chancellor commented that this was a classic story.

#### ECOFIN

Juncker said that the morning would be devoted to surveillance. Delors wanted to make 'reality' of Stage 1, by improving the, hitherto unsatisfactory, surveillance discussions. There was a possibility - not strong - that the discussion would be critical of German policy.

#### IGC

Juncker said that Mersch would report on the special representatives meeting and the range of opinions expressed. He did not intend to 'deepen' the discussion.

The Chancellor suggested that economic union, where there was a larger measure of agreement, might be fruitful territory. Juncker agreed, though he did not sound convinced. Mersch said that this subject had not yet been prepared by officials. The plan was to stick to the objectives and principles which had been discussed by special representatives on 15 January. The IGC was about drafting, not substance (sic). Juncker said that he was open to guidance from others, but that the present plan was to discuss the economic articles in February.

#### Objectives and principles

Mersch described the differences which had emerged in the opening session on 15 January on what should be said about EMU in the introductory treaty articles. Juncker said that some delegations wished to add to the principles, eg on social cohesion, the single market, the environment etc. Mersch said that cohesion and the environment fell, under Rome II, to the political union IGC. The EMU IGC could look at them in the light of discussion in the political IGC. He repeated that the mandate on EMU was to decide how the Treaty needed amending in the light of EMU, not to judge whether EMU would be satisfactory.

#### Monetary Union

Looking ahead to the discussion of the monetary articles, Mersch said he thought this would not be the most difficult discussion. It was an area where some convergence had already been achieved (he noted the similarities between the various texts already on offer). A great deal of common ground could be put down on paper already. The Chancellor noted that, on accountability, the UK text merely gave alternatives. There were marked French and German differences on this. Juncker agreed. He thought these would persist throughout the IGC. The Germans were very strong on the need for independence. Meanwhile, Beregovoy had told the





Frankfurter Allgemeine that he saw no need to change the legal status of the Banque de France until a very late stage in Stage 2. He wanted democratic accountability to embrace not only ECOFIN but also the European and National Parliaments. The French had not made up their minds on the detail - he referred to unformed ideas about a COREPER III. They were opposed to letting Central Bank Governors have things their own way.

### Stage 2

The Chancellor noted that there had also been Franco-German differences on the length and content of Stage 2. Juncker, supported by Mersch thought that this gap was narrowing. The key issue was whether an ESCB or an EMF should be given real powers in Stage 2. Recently the French had become more positive on the possibility of setting up an institution earlier within Stage 2. But a potential problem had emerged over exchange rate stability, which Trichet had mentioned at the Special Representatives' meeting on 15 January. Mr Wicks said that this was likely to provoke a row within the Central Bank Governors' Committee.

### Binding budgetary rules

Juncker asked whether the political IGC should look at the issue of binding budgetary rules. How far National Parliaments retained control was a substantive question. The Chancellor demurred at the idea that this was for the other IGC. Mersch said that no one disagreed that budgetary matters should remain in the realm of national sovereignty. The issue related to the balance between revenue and expenditure, both of which would remain firmly in national control. It would be for individual countries to decide whether to act on tax or the expenditure side in reducing a deficit. Mr Wicks pointed out that effective sanctions would infringe national sovereignty. He could not envisage a time when a Council could override the budgetary decisions of National Parliaments on the basis of qualified majority voting. Mersch suggested that the withdrawal of access to Community funds, as a last resort, might be effective. It could be argued that such withdrawal would be voluntary on the part of a country not reducing an excessive deficit. He noted that the Commission itself had ridden back from its original position on binding rules. Juncker recalled that the German 'golden rule' which was enshrined in federal law, had turned out to be without effective sanction.

Mersch wondered whether the differences here could be solved by leaving the issue to secondary legislation. If there was the political will to push a Treaty through this might be an answer. Juncker thought that the Germans would balk at this. Mr Wicks said that others too would be unhappy at fudging this issue. He outlined the UK position on binding budgetary rules, citing the example of the Canadian provinces. The Mersch route would sell the pass.





### Stage 3

M Mersch thought not. It would be possible to leave the issue of binding budgetary rules for Stage 3 and make the trigger for a move to Stage 3 dependent on national Parliaments. Mr Wicks agreed that it might be best to separate the legal texts allowing for Stage 2 from the texts relating to Stage 3, which should be subject to a trigger involving the agreement of national Parliaments. He saw two reasons: first, issues of sovereignty, which affected national Parliaments, were principally raised at Stage 3. Second, the economics of Stage 3 would be different from the economics of Stage 2 and there was a case for clarifying the difference by keeping the two stages separate in the Treaty. Mersch pointed out that the existence of a blank chapter called 'transitional arrangements' in the Commission draft was helpful in this respect. He suggested that there might also be scope for derogations. After all, as the Chancellor pointed out, Spain, Greece and others had needed lengthy derogations on the timing of moves towards a single financial area.

### "If peoples and Governments so choose"

Juncker asked, in response to an invitation from the Chancellor, what our formula really meant. The Chancellor said he would wish to see two things. First, that the hard ecu was being increasingly used and had developed towards being a proper monetary instrument. Second, that national Governments should retain the right to decide whether or not it should be the single currency in their own countries. This could not be a decision imposed on one country by the decision of 11 others. Mr Wicks added that there could be no compulsion, nor commitment. However, we recognised the aspirations of others and did not wish to stand in their way.

Mersch wondered whether this issue would be for the political or the EMU IGC. This finally provoked the Chancellor into saying that he did not wish to see all the difficult issues on EMU referred to the political union IGC. The Prime Minister and the Foreign Secretary would back him up in this.

Juncker asked how our formula could be given legal form. The Chancellor said he would be willing to think about that. Juncker said he was anxious to keep the 12 together. What was needed was to put forward a political formula which would combine the aspirations of the 11, set out in Treaty language, and including references to objectives and principles. Perhaps we could reach a substantive agreement on Stage 2 and a political compromise on Stage 3 in legal language which would reserve Stage 3 to a further political decision of 12 (ie not by QM).

The Chancellor said he was sure that a marriage of the two aspirations could take place if there was the political will.





He was probably at the cautious end within the UK Government. But he was quite optimistic that the problems could be solved if we were not forced to a definitional clarity which we could not accept. What did it matter if different routes led towards ends which could turn out to be the same? Juncker said it was too early to put such ideas to the IGC but they might provide a way through. The Chancellor said it would be a mistake to explore possible outcomes too deeply in advance.

#### Defining a single currency and/or EMU

Mr Bostock noted the striking absence of any definition of a single market in the original EC Treaty. It was defined only in terms of operational clauses. He commended this approach. The Chancellor added that it would be sensible to talk in terms of a 'European currency' rather than a 'single currency'.

#### Conclusion

The lunch ended with a cursory discussion of ECOFIN standards - Greece, Russia etc which I need not report.

Juncker ended by asking whether the UK would say at the end of the IGC, 'goodbye - see you later, perhaps'. If this could be put into legal language it would be a good result. The Chancellor thought Vera Lynn might be closer 'we'll meet again, don't know where, don't know when'.

I am copying this letter to Sir Charles Powell (No.10) and Sir John Kerr (UKREP Brussels).

*Tarkowski*

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Private Secretary