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 INFO ROUTINE UKREP BRUSSELS, PARIS, LUXEMBOURG, BERLIN

FRAME GENERAL

MY 2 IPTS (SECOND NOT TO ALL) UK/FRG SUMMIT, 11 MARCH: GERMAN
 VIEWS ON EMU

SUMMARY

1. EMU WILL BE AN IMPORTANT SUBJECT AT THE BILATERAL SUMMIT ON 11 MARCH. THE GERMAN INTERNAL DEBATE IS EVOLVING IN WAYS WHICH COULD BE HELPFUL TO US. WE NEED TO SEE IF WE CAN ESTABLISH A COOPERATIVE DIALOGUE IN PRIVATE. (PUBLICITY WOULD BE COUNTER PRODUCTIVE). POSSIBLE GAME PLAN IN MIFT.

DETAIL

2. GERMANS INTERESTED IN EMU ARE SPLIT BETWEEN FEDERALISTS LIKE GENSCHER, WHO, FOR BROADER POLITICAL REASONS, WANT TO MAKE RAPID PROGRESS TOWARDS EMU, AND THE FINANCIAL COMMUNITY, REPRESENTED BY POEHL AND WAIGEL, WHO SUBSCRIBE TO EMU BUT WANT TO APPROACH IT ON ITS MERITS AND SUBJECT TO FIRM PRE-CONDITIONS. THE MAIN PRECONDITION IS BEING AN INDEPENDENT EUROPEAN CENTRAL BANK WITH SOLE RESPONSIBILITY FOR MONETARY STABILITY. THE FEDERALISTS ALSO ESPOUSE THE PRE-CONDITIONS, PERHAPS LESS OUT OF CONVICTION THAN OUT OF KNOWLEDGE THAT ON THIS ISSUE THE FINANCIAL COMMUNITY WILL HAVE THE LAST WORD. BUT THEY CONTINUE TO PRESS FOR RAPID PROGRESS AND CONNIVED AT THE SETTING OF A DATE FOR THE BEGINNING OF STAGE 2 BEFORE THE GERMAN FINANCIAL COMMUNITY WERE READY.

3. NEITHER FACTION HAS SO FAR GAINED THE UPPER HAND AND KOHL HOVERS UNEASILY BETWEEN THE TWO. THE FEDERALISTS KNOW THAT THE FINANCIAL COMMUNITY HAVE SOUND ARGUMENTS, AND THAT PUBLIC OPINION - AND THE BUSINESS CONSTITUENCY IMPOTANT TO THE COALITION PARTIES - WOULD NOT BACK ANY MOVE WHICH THREATENED MONETARY STABILITY. WHATEVER SYSTEM RESULTS FROM THE NEGOTIATIONS MUST HAVE THE BUNDESBANK STAMP OF APPROVAL. ON THE OTHER HAND, THE FINANCIAL COMMUNITY KNOWS THAT IT IS VULNERABLE TO THE CHARGE OF HOLDING UP EUROPEAN INTEGRATION AND THAT IT CANNOT DELAY INDEFINITELY.

4. IN THEIR ATTEMPTS TO SPEED UP PROGRESS, THE FEDERALISTS HAVE PROPOSED THAT EMU SHOULD TAKE PLACE AMONG A SMALL GROUP OF THOSE MEMBER STATES WHICH ARE READY TO FULFIL THE CONDITIONS, WITH TRANSITIONAL ARRANGEMENTS FOR THE REST TO FOLLOW LATER. THEY ARE EMBARRASSED, BUT NOT FLOORED, BY THE ARGUMENT THAT THIS IS THE OPPOSITE OF EUROPEAN UNION. SOME MEMBERS OF THE FINANCIAL COMMUNITY HAVE SEEN ATTRACTIONS IN SUCH A PROPOSAL, SINCE IT WOULD AVOID MUCH OF THE EXPENSE AND STRESS OF A RAPID MOVE TO EMU OF ALL TWELVE, BUT THEY HAVE NEVER FULLY ESPOUSED IT AND MANY SAY IN TERMS THAT THEY DO NOT WANT EMU WITHOUT THE UK.

FUTURE OF GERMAN POLICY DEBATE

5. THE FEDERALISTS HAVE OBTAINED A MORE OR LESS BANKABLE COMMITMENT TO A STAGE 2 OF UNKNOWN CONTENT AND A STAGE 3, OF WHICH THE NATURE IS CLEAR BUT THE STARTING DATE UNKNOWN. THE DEBATE HAS NOW BEGUN TO SHIFT TO THE NATURE OF STAGE 2. UNTIL RECENTLY, THE FINANCIAL COMMUNITY HAD GIVEN THIS LITTLE THOUGHT, BECAUSE THEY FEARED THAT PREMATURE DISCUSSION OF STAGE 2 COULD LEAD TO DILUTION OF THEIR PRESCRIPTION FOR STAGE 3. THEY COULD BE MANOEUVRED INTO AN OPEN-ENDED STAGE 2 IN WHICH THE BUNDESBANK'S ABILITY TO MANAGE THE DM WAS CIRCUMSCRIBED WITHOUT CORRESPONDING SAFEGUARDS AT A EUROPEAN LEVEL. THEY APPEAR TO HAVE HOPED THAT STAGE 2 COULD BE KEPT QUITE SHORT. THE BALANCE IS NOW MOVING IN FAVOUR OF A LONGER STAGE 2 THAN WAS PREVIOUSLY THOUGHT DESIRABLE. THE REASONS ARE COMPLEX BUT PROBABLY INCLUDE THE FOLLOWING:

I) SETTING A DATE FOR THE START OF STAGE 2 HAS REMOVED THE POSSIBILITY OF SPINNING OUT STAGE 1.

II) THE BURDENS BEING ASSUMED BY THE DM IN CONNECTION WITH UNIFICATION, EASTERN EUROPE AND THE GULF, TOGETHER WITH THE RECESSIONARY ECONOMIC BACKGROUND IN A NUMBER OF EUROPEAN ECONOMIES, HAVE HEIGHTENED THE RISK INVOLVED IN RAPID EMU OR SHARP JUMPS FROM ONE STAGE TO ANOTHER.

III) THE DIMINISHING CONFIDENCE OF THE FINANCIAL COMMUNITY IN THE WILLINGNESS OF PARTNERS, PARTICULARLY THE FRENCH, TO AGREE TO THE STAGE 3 STRUCTURES WHICH THE GERMANS THINK ESSENTIAL, AND GROWING DOUBTS THAT THOSE STRUCTURES, EVEN IF THEY CAN BE ACHIEVED, WILL OF THEMSELVES BE REALLY SAFE.

6. ALL THIS INCREASES POTENTIAL THE ATTRACTIONS FOR THE FINANCIAL COMMUNITY OF 'LEARNING BY DOING' DURING A LONG STAGE 2. BUT THE FINANCIAL COMMUNITY WOULD NOT UNDER ANY CIRCUMSTANCES WISH TO

COMPROMISE THE BUNDESBANK'S SOVEREIGNTY OR ABANDON NATIONAL CONTROL OF MONETARY POLICY DURING STAGE 2. OUR ANALYSIS, BACKED BY RECENT CONTACTS WITH THE FINANCE MINISTRY AND THE BUNDESBANK, IS THAT THE FINANCIAL COMMUNITY WILL NOW PLAY FOR TIME BOTH BY BUILDING UP THE CONVERGENCE CRITERIA NEEDED TO MOVE FROM STAGE 2 TO STAGE 3 AND BY INSISTING ON A FIRE-BREAK, IE. A FURTHER COUNCIL VOTE PROBABLY LINKED TO CONSULTATION WITH NATIONAL PARLIAMENTS, BEFORE STAGE 3 BEGINS.

7. THE FINANCIAL COMMUNITY WILL HOWEVER NOT ADMIT IN TERMS NOR WISH TO HAVE IT ADVERTISED THAT IT WANTS TO SLOW THINGS DOWN, FOR FEAR OF PROVOKING A POLITICAL BACKLASH FROM THE GERMAN FEDERALISTS AND FROM THE FRENCH. THIS HAS IMPLICATIONS FOR THE SUBSTANCE AND PRESENTATION OF UK POLICY.

THE UK/GERMAN BILATERAL DEBATE

8. GERMAN OPPOSITION TO THE HARD ECU PROPOSAL IS TO BE FOUND IN BOTH THE FEDERALIST AND FINANCIAL CAMPS. THE FEDERALISTS SUSPECT THAT IT IS A PLOY TO DE-RAIL EMU. THE FINANCIAL COMMUNITY DOUBT WHETHER IT WOULD REALLY ACHIEVE ITS PROFESSED AIM OF PROMOTING CONVERGENCE AND, MORE SERIOUSLY, BELIEVE THAT IT WOULD UNDERMINE THE PRIMACY OF THE BUNDESBANK DURING STAGE 2 WITHOUT ESTABLISHING CONSENSUS ON THE NATURE OF STAGE 3. IT COULD BE THE START OF THE SLIPPERY SLOPE TO DILUTION DURING STAGE 2 WHICH THEY FEAR.

9. AT THE MOMENT, BILATERAL DEBATE BETWEEN GERMANY AND THE UK IS RATHER STERILE, PARTLY BECAUSE THE GERMANS ARE NOT PREPARED TO TALK ABOUT ALTERNATIVES TO THEIR IDEA OF A SINGLE CURRENCY, EG THE HARD ECU AS FORMULATED BY US (THOUGH THE BUNDESBANK IS TOYING WITH IDEAS FOR HARDENING THE ECU IN STAGE 2) AND PARTLY BECAUSE THERE IS A STAND-OFF BETWEEN THE GERMAN DEMAND TO DEFINE STAGE 3 BEFORE TALKING ABOUT STAGE 2 AND THE BRITISH DETERMINATION TO AVOID A COMMITMENT TO THE VERY THINGS THE GERMANS WANT IN STAGE 3. THE FINANCIAL COMMUNITY ALSO FEARS THAT BY GETTING TOO CLOSE TO THE BRITISH, IT WILL ATTRACT ACCUSATIONS OF BAD FAITH FROM THE FEDERALISTS. WE NEED TO SEE IF THIS LOG-JAM CAN BE BROKEN AND A GENUINE DIALOGUE ESTABLISHED WITH THE GERMANS ON THE BASIS OF SEEKING COMMON GROUND ABOUT THE CONTENT OF STAGE 2, LEAVING DISCUSSION OF STAGE 3 IN ABEYANCE AS FAR AS POSSIBLE. THIS WOULD HAVE TO BE DONE QUIETLY SINCE ANY PUBLIC AIRING OF IT WOULD CERTAINLY BE COUNTER PRODUCTIVE FOR THE REASONS DESCRIBED. MIFT CONSIDERS WAYS OF TAKING THIS FORWARD DURING THE BILATERAL SUMMIT.

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