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From the Private Secretary

Prime Minister

EMU.

This paper sets out the line which the Chancellor proposes to take on EMU at the informal ECOFIN. It has only just arrived (22:50). While its broad lines look right, you will want to investigate in rather more detail his ideas for alternatives to the Delors Report. Indeed he appears to intend to floor them in ECOFIN without any



Sort of inter-departmental discussion  
 or consideration.

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PRIME MINISTER

**ECONOMIC AND MONETARY UNION**

1. As you know the informal meeting of EC Finance Ministers and central bank governors this weekend will concentrate on EMU. The French Presidency plan two separate discussions: on Stage 1, and on the longer term.

**STAGE I**

2. The Madrid Council agreed that Stage I should start on 1 July 1990, with no end date. The essential elements of Stage I are completion of the internal market, including capital liberalisation and completion of the single financial area; strengthening Community competition policy (reducing subsidies and other state aids); implementation of the 1988 agreement on doubling the structural funds; strengthening the coordination of both monetary and economic policies; and the inclusion of all Community currencies in the ERM. The only formal step which the Presidency consider to be necessary before Stage I starts is the revision of the 1964 and 1974 Decisions on economic and monetary cooperation. There is a lot of detail to consider here which will take some time.

3. I will reiterate the UK's commitment to Stage I, including membership of the ERM on the basis you set out at Madrid. But Stage I will (a) inevitably take a considerable time to evolve and (b) will, when all its elements are fully in place, constitute a

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massive change in the economy of Europe. Only when we see the result of this change can it be sensible to take decisions on further steps

4. On proposals for strengthening the coordination of monetary and economic policies, we need to insist on three points.

- Formal coordination should be kept to a minimum. Allowing market forces to operate freely throughout the Community is the best way to promote common objectives such as improved economic performance. The discipline of the market also provides a powerful incentive for governments to follow sound budgetary policies.
- The coordination arrangements agreed for Stage 1 should not involve or foreshadow institutional changes : these are for subsequent stages, where decisions have yet to be taken.
- The Commission (and the Central Bank Governors themselves) appear to envisage discussions of monetary policy largely being confined to the Central Bank Governors, rather than Finance Ministers. We need arrangements that acknowledge that the relative roles of Finance Ministers and Governors are different in different countries, and that the best way to deal with this is to have joint discussions involving both Finance Ministers and Governors, on the G7 pattern.



**BEYOND STAGE 1**

5. We are committed as a result of the Hanover and Madrid Councils to progressive realisation of economic and monetary union. Delors has put forward one version of what this entails which we cannot accept. We have therefore undertaken to put forward an alternative version.

6. Against that background my main objectives at Antibes will be:

- to demonstrate the problems with Delors' proposals and to argue for preferable alternatives;
- to agree a programme of ECOFIN studies which will include at least one alternative to Delors;
- to obtain agreement that binding rules on national budgetary policies are neither a necessary nor a desirable part of EMU in any shape or form.

7. The following paragraphs set out the line which I plan to take.

**Problems with Delors**

8. The overwhelming problem with Delors is the loss of political accountability to national governments and, ultimately, national parliaments that follows from the acceptance of a single European currency and Community constraints on national fiscal policy. This is not acceptable to us. I shall need to make clear that we would not be satisfied with some form of democratic accountability operating through a beefed-up European Parliament. National parliaments must retain their central role.



9. And against these considerable constitutional problems it is not clear that there would be any net economic benefit. Most of the potential gains can be achieved by currency stability. There is very little additional gain from a common currency. Furthermore some exchange rate adjustment will be necessary for some time to come especially as capital controls are removed and intra-European trade is increased. (This would be even more necessary if there were any move to equalise labour costs and labour practices in 'social Europe'.)

10. A common currency would need to be clearly less inflationary than the status quo to be worth considering. But we can have no confidence that the proposed European system of central banks will achieve this. Independent central banks have not always done so (eg the Federal Reserve Board in the 1960s and 1970s).

11. On the budgetary side, binding rules for the size of budget deficits are neither necessary nor practical.

12. Essentially the Delors route is for a bureaucratic solution; a treaty setting out the steps in advance; a centralised institution taking on increasing responsibilities; and discrete steps to new arrangements.

#### Alternatives to Delors

13. The alternative route is the market route; where in the absence of controls competition will force each currency to behave as well as the best; where individuals have a choice of currency; and where the pace of change is gradual and dictated by results.

14. The starting point is the position after Stage 1. This will take at least 5 to 10 years. The single European market programme



will have been completed, there will be free capital flows between countries and all currencies will be members of the exchange rate mechanism. It is easy to underestimate the radical nature of Stage 1. This will produce a European economy which is very different from the present one, with individual economies much more open to each other than they are now. In many ways there will already be economic and monetary union: a single European market, a single financial area, integrated capital markets, etc.

15. It is important to see how this works out before going further. Some may say that the ERM cannot survive without controls. That is a pessimistic conclusion. It is equally possible to argue that competition to do as well as the best will produce greater convergence of policies. Only time will tell. We need to build on this experience in going beyond Stage 1. Two principles should guide us. First, the subsidiarity principle according to which policies are not made at the Community level if they can be better made at national level; and, second, the market principle, under which market forces are allowed maximum freedom to determine the nature of European integration with the absolute minimum of central co-ordination. Together, these two principles suggest that each country should retain control of budgetary and monetary policies.

16. There is, however, one step beyond Stage 1 which it would be useful to take. This would be to remove all remaining legal barriers to the use of different national currencies throughout the Community. This would reinforce the discipline on monetary authorities to behave prudently, and it would lead to a more integrated monetary area. I shall therefore argue that this system of freely competing national currencies, together with the effects of completing Stage 1, is a preferable alternative to the Delors version of EMU.

*I doubt the wisdom of raising this at this stage. Indeed it sounds a very messy and confusing prospect.*



17. There is one other step which might be considered. This would be to link all EC currencies to gold or a basket of commodities. This would effectively mean that the nominal anchor for the system was gold or commodities. Under Stage 1 the nominal anchor is in effect provided by the Bundesbank's monetary policy: other countries as well as ourselves might prefer a non-German nominal anchor, and one, incidentally, which is superior to the Delors device of replacing the Bundesbank by a single European Central Bank.

18. I shall offer to put in a paper explaining our ideas about alternatives to Delors in more detail.

#### Fiscal policy

19. The Delors report recommends binding rules for budgetary deficits. Quite apart from the sovereignty issue, there is no need for these, whether the form of monetary union is that proposed by Delors or something else. Fixed exchange rate regimes in the past (eg the gold standard) survived perfectly well without fiscal policy co-ordination, as do the overwhelming majority of federal states with a single currency. Market pressures will discourage unsustainable fiscal behaviour by individual countries. There are no agreed views about exactly how fiscal policy affects the economy, and hence any particular rules for the size of budget deficits would be controversial and could have undesired effects. However, there may be a case for some agreement at Community level about the financing of Budget deficits to prevent deficits being financed by printing money.

20. To sum up, the arrangements for multilateral surveillance which will be put in place under Stage 1 (as part of the revision of the Convergence Decision of 1974), together with the discipline





of the market, should be quite enough to prevent the emergence of unsustainable budgetary policies in individual member states.

### Regional issues

21. We cannot accept the argument in the Delors report that an increase in state transfers to poorer countries is required to narrow disparities and promote a balanced development in the Community. Our own experience of regional grants within the UK shows that they do not help genuine development in the regions, and we have moved away from such policies. The development of the poorer European countries requires them to exploit their advantages (eg low pay and cheaper land) and seek to attract profit-seeking investment from the rest of the Community. Allowing market forces to work in this way will have more beneficial and durable effects than centrally directed public sector capital flows.

### Further work on the longer term

22. The Madrid Council agreed that preparatory work should be undertaken for an Inter-governmental Conference, and that the Conference would meet once Stage I had begun. An extract from the Madrid communique is annexed.

23. We had expected work on longer term issues to be coordinated at this stage by ECOFIN. But despite your discussion with President Mitterrand the French Presidency have set up a high level group of officials, chaired by Mme Gigou from the Elysee, "to identify, analyse and organise the elements which could be included at the appropriate time in a Treaty on Economic and Monetary Union", the group to report to both ECOFIN and the Foreign Affairs Council. This is clearly an attempt to accelerate preparations for an IGC, so that the French will have a positive

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achievement to record at the Strasbourg Council in December. Their aim may be to get formal agreement then for an IGC to meet during the Italian Presidency in the second half of 1990.

24. A meeting of the group is being held today (Tuesday). Mr Wicks and Mr Kerr are attending. I will let you know the outcome at our meeting tomorrow.

25. I propose to say at ECOFIN that the fundamental questions about both Stages 2 and 3, and about alternative approaches, must clearly be taken forward under the auspices of Finance Ministers. It is quite inappropriate at this stage for any parallel work to take place on legal or institutional questions. For that reason having a group reporting to both Finance and Foreign Affairs Ministers is unnecessary and confusing.

26. I will propose that further work on longer term issues should be remitted to existing ECOFIN committees, particularly the Monetary Committee; that any meetings of the new joint high level group (if we cannot scotch it) are delayed as long as possible; and that the group is required to take full account of the results of the ECOFIN work: it must not proceed independently. I will resist any timetable for further work by ECOFIN or anyone else which has Strasbourg as its deadline.

J.S. Gieve  
for [N.L.]

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Approved by the Chancellor  
& signed in his absence

#### 4. RESEARCH AND DEVELOPMENT

Given the progress achieved in the implementation of the framework programme of Community forms of action, together with the work already started by the Commission and the Council on revising it, the European Council took note of the Commission's intention to submit a new framework programme for the period 1990-1994.

This review must provide the occasion to give fresh impetus to action by the Community in this area, which is of capital importance in strengthening the scientific and technological bases of European industry as a whole and increasing its international competitiveness.

#### B. ECONOMIC AND MONETARY UNION

1. The European Council restated its determination progressively to achieve Economic and Monetary Union as provided for in the Single Act and confirmed at the European Council meeting in Hanover. Economic and Monetary Union must be seen in the perspective of the completion of the Internal Market and in the context of economic and social cohesion.
2. The European Council considered that the report by the committee chaired by Jacques DELORS, which defines a process designed to lead by stages to Economic and Monetary Union, fulfilled the mandate given in Hanover. The European Council felt that its realization would have to take account of the parallelism between economic and monetary aspects, respect the principle of "subsidiarity" and allow for the diversity of specific situations.
3. The European Council decided that the first stage of the realization of Economic and Monetary Union would begin on 1 July 1990.

4. The European Council asked the competent bodies (the ECOFIN and General Affairs Councils, the Commission, the Committee of Central Bank Governors and the Monetary Committee):

(a) to adopt the provisions necessary for the launch of the first stage on 1 July 1990;

(b) to carry out the preparatory work for the organization of an intergovernmental conference to lay down the subsequent stages; that conference would meet once the first stage had begun and the preparatory work was sufficiently advanced and would be preceded by full and adequate preparation.

#### C. PEOPLE'S EUROPE

The European Council considered that, despite the results achieved on certain key dossiers of a People's Europe, progress had been inadequate. It requested the Council and the Commission to take stock of progress in that area and draw the necessary conclusions regarding action to be taken. The Council will report back to the next European Council meeting.

#### D. EXTERNAL RELATIONS

In keeping with the Rhodes Declaration on the international role of the European Community, the European Council reviewed developments in relations between the Community and a number of its partners:

(a) The European Council noted with satisfaction the progress made in co-operation with the EFTA countries following the Summit of Heads of Government in Oslo and the joint meeting of Ministers for Foreign Affairs, which were held in March. In this context it emphasized the importance which it attached to the rapid identification of the best ways

