Thursday, October 19, 1989

THE TIMES

EMS stand comes under fire

25

The Government argument that Britain must overcome inflation before taking the pound fully into the European Monetary System is challenged in a paper published today by the Conservative-backed Centre for Policy Studies.

In the paper, Professor Harold James of Princeton University says the argument is incorrect, as Britain's greatest immediate gain would be in using the EMS as an anti-inflationary strategy more localized in its effects than its high interest rate regime. He urges full membership as soon as possible.

Professor James dismisses the view that the EMS is a stalking horse for wider political developments in Europe: "EMS's attractions lie not in political dreams about a European future, but in offering a practical way of addressing two endemic British problems: high levels of inflation and high interest rates."

Replace dollar, page 26

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PARLIAMENT AND POLITICS

ECONOMIC AND MONETARY UNION

Labour 'willing to look at Emu'

10 "

By David Buchan in Brussels

THE Labour Party was ready, unlike the Tory Government, to contemplate the possibility that Britain might join its EC partners in an economic and monetary union (Emu), Mr John Smith, the shadow Chancellor, told a press conference in Brussels last night.

Having earlier in the day signalled the Labour Party's "eagerness" to join the current European Monetary System (EMS) parity regime, Mr Smith said that, should a conference of the 12 governments be called to negotiate an Emu arrangement, the Labour Party would want to extend the negotiations beyond monetary matters.

Macroeconomic, regional development, education and environmental issues should also be renegotiated by the EC, he suggested.

Earlier Mr Smith saw Mr Jacques Delors, the Commission president whose monetary committee report has been taken by many governments as the blueprint for the way forward to Emu.

Mr Smith said he had found the Delors report's recommendation for binding limits on individual state's budget deficits "less than convincing," but he was happy yesterday to have been reassured by Mr Delors himself that the report was "not the final word" in the em[illegible]rging debate on future monetary arrangements.

M[illegible] Smith, accompanied by Mr Gordon Brown, another member of Labour's Treasury team, a[illegible]so addressed the European [illegible]rliament's socialist group, which the British Labour [illegible]s are – since the June elect[illegible] to the European assembly – [illegible]e largest single national con[illegible]ent.

The Labou[illegible]rty, he told the group, "are ea[illegible]er to negotiate early entr[illegible] into the exchange rate mechanism of the EMS." But he acknowledged that there were potential instabilities in the system arising from current account imbalances, such as the German surplus and the deficit of the UK and other EC states.

To achieve balanced growth throughout the Community, Labour would call for the 12 countries to co-ordinate a growth strategy, to provide greater regional transfers of funds to the poorer areas, and to co-operate, through central banks, to fight speculation. These, he said, were concerns that many in the socialist group shared. Mr Smith pledged that Labour would play a full part in the emerging Emu debate.

Mr Smith said Labour fully supported the proposed European social charter, on which he said the Thatcher Government was isolated from every other EC member. As he was speaking to the socialist MEPs, the European Confederation of Trade Unions, was holding a rally nearby to demonstrate support for the charter.

Some 7,000 union activists, from all EC countries including the UK, heard union federation leaders warn against any attempts to water down the charter to attract UK Government support.

SENIOR ministers are ready to establish the Government's "Star Chamber" if negotiations between the Treasury and three Whitehall deparatments fail to resolve disputes over next year's public spending.

Officials said a number of members of the Cabinet had been put on "stand-by" so that the Star Chamber can be convened at short notice if the current talks between the Treasury and the departments of Education, Transport and Social Security remain deadlocked.

The Star Chamber, which would be chaired by Sir Geoffrey Howe, the deputy Prime Minister, and would include four other Cabinet ministers as well as Mr Norman Lamont, the Chief Secretary to the Treasury.

John Smith: signalled readiness to join EMS

EMS POLICY

Call to PM to distance herself from Walters view

By Philip Stephens, Political Editor

THE Labour Party yesterday called on Mrs Margaret Thatcher to disassociate herself from her chief economic adviser, Sir Alan Walters, over his stated position on the European Monetary System.

Sir Alan was reported in this week's Financial Times as referring to the EMS as "half-baked" and adding that arguments for the exchange rate system have "never attained even a minimum level of plausibility."

His remarks were seized upon yesterday by Labour frontbench spokesman who claimed they were evidence that the Government's policy towards taking sterling into the system remained in disarray.

The Government is expected agree to a full-scale Commons debate on the economy next week – probably on Tuesday – but Mr Nigel Lawson, the Chancellor of the Exchequer, is likely to be pressed on Sir Alan's comments when he answers Treasury questions in the Commons later today.

Whitehall officials insisted that the Government's position on the EMS had not changed and that it would join when the conditions laid down at the Madrid European summit were met. Downing Street said that no efforts had been made yesterday to seek clarification from Sir Alan about his position.

Mr Lawson, however, was said to have been irritated by Sir Alan's intervention as it will be used by Labour to exploit the differences on exchange rate policy which emerged last year between the Chancellor and Mrs Thatcher.

Mr John Smith, the shadow Chancellor, said that "the open hostility" of Sir Alan to full British membership of the EMS was in direct contradiction to the views of the Chancellor. The credibility of the Government's exchange rate policy was being "fatally undermined," he added.

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Thursday, October 19, 1989

[Daily] Telegraph

Cold comfort from Lawson on call for monetary union

25-

By Anne Segall

NIGEL Lawson, Chancellor, will tonight dash City hopes of a major initiative to solve Britain's economic problems when he speaks to leading bankers and businessmen at the annual Mansion House dinner.

He will make it clear that the Government is not prepared to speed up entry into the European Monetary System.

His speech, anxiously awaited after a turbulent week, first in currency and then stock markets, could undermine sentiment after the disappointment over his Conservative party conference address.

The weakness of sterling has created a bandwagon of support in the City and industry for a firm link with the currencies of Europe.

Tensions over the question of EMS entry will be increased after the claim yesterday by Henning Christophersen, the Common Market commissioner for finance, that inflation in Britain is not so high as to rule out immediate membership of the exchange rate mechanism of the EMS.

Mr Lawson is likely to draw attention to the Madrid terms under which the Government committed itself to joining the EMS at some stage during phase one of the Delors programme for monetary union, due to be launched next summer.

The exact timing will depend on how well the system weathers the lifting of exchange controls in France and Italy and on bringing British inflation closer to the European average.

Whitehall sources believe that if all goes to plan, Britain could be in a position to join by 1991.

Supporters of immediate entry believe sterling would be safer from speculative pressure if it could shelter behind the German mark and other European currencies, in theory drawing on the reserves of member countries to prevent a sharp devaluation.

They also hope that membership of the exchange rate mechanism will break the cycle of inflationary expectations in Britain.

In practice, however, it is up to weak currency countries to defend themselves, with the Germans under no obligation to spend their marks.

Mr Lawson will spell out more details of an alternative approach for monetary union in Europe, rejecting the European Commission's plan for a single currency and recommending instead that steps are taken to create a genuinely free market.

High interest rates will remain the key weapon for controlling inflation. On the day that the Bank of England publishes its latest money supply figures, the Chancellor is expected to make a new commitment to controlling M0 while rejecting popular City remedies like "overfunding."

Robin Leigh-Pemberton, Governor of the Bank of England, will provide backing for Mr Lawson in his speech at the dinner, arguing that the time is not ripe for British participation in the ERM.

British membership would also add to the strains in the system which have emerged recently, with currencies like the Danish krone, Belgian franc and Italian lira looking vulnerable and the Germans keen to tackle the problem of European trade imbalances through a major realignment.

FINANCIAL TIMES

French cloud on the EMS

"70

POLITICAL NOTEBOOK

AS Mr nigel Lawson prepares to face Commons questions today and later deliver his annual Mansion House speech on monetary policy, his Cabinet colleagues are discounting the possibility of anything new on the European Monetary System.

In spite of the latest remarks by Sir Alan Walters – which prompted intense irritation in Conservative ranks yesterday – senior ministers insist that the compromise reached at the Madrid summit still holds.

[As] Sir Geoffrey Howe [sta]ted this week, Britain wi[ll jo]in the exchange rate mechanism when its inflation rate is much closer to the European average and after the EMS has shown it can survive the removal of exchange controls by France and Italy in July 1990.

From Mrs Thatcher's perspective that points to a decision being deferred until after the next general election.

It is far from clear, however, whether she or her ministers have considered seriously another possibility – that France might try to force the issue at the Strasbourg summit in December by bringing forward the removal of its currency controls.

That, according to one informed view at Westminster, could put Mrs Thatcher under intense pressure to join in mid-1990 – by which time both conditions should have been met. Sir Alan notwithstanding, it might even give the Prime Minister an excuse to change her mind.

Meanwhile both the Labour Party and the newly-renamed Liberal Democrats signalled yesterday that as long as the Government stood on the sidelines they would do everything possible to demonstrate their pro-EMS credentials.

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Thursday, October 19, 1989

FINANCIAL TIMES

Lawson will reaffirm inflation strategy

26

By Simon Holberton and Philip Stephens

MR NIGEL LAWSON, the Chancellor, will stress the need to get inflation down when he delivers a strong reaffirmation of the Government's economic policy in his Mansion House speech tonight.

Whitehall officials said yesterday the Chancellor would not reopen the debate on Britain's full membership of the European Monetary System. The Government's position is that the UK will join the exchange rate mechanism of the EMS after remaining exchange controls are lifted by other members of the system and when the time is ripe.

In Whitehall, the speech is being billed as one which contains few surprises, but it is expected to address current issues in monetary policy, notably the consistent overrunning of M0, the Treasury's main indicator of monetary conditions which counts mostly notes and coins, and funding policy.

Officials said Mr Lawson was not expected to announce any fundamental changes to current monetary policy, but it has been speculated in the City that the Chancellor might change the way the Bank of England funds foreign exchange intervention.

Currently the Bank "sterilises" its purchases of sterling in foreign currency markets by acquiring an equivalent amount of government stocks in the open market – thereby neutralising any effect on the domestic money supply.

A decision not to sterilise currency market intervention, or operate a more flexible approach to it would, at the present time, lead to a tightening of monetary conditions. This would keep short term interest rates firm and lend support to the pound.

Mr Lawson's speech tonight at the Mansion House is expected to be followed next week by a full-scale Commons debate on the economy, which has been demanded by the Labour Party.

In the meantime, Labour indicated yesterday that it plans to make maximum political capital out of remarks by Sir Alan Walters, the Prime Minister's economic adviser, attacking the case for full British membership of the European Monetary System.

Mr John Smith, Labour's shadow Chancellor, contrasted his party's growing enthusiasm for the EMS exchange rate mechanism with what he called the "continuing confusion and disarray" in government policy.

Speaking in Brussels, where he discussed the EMS during a meeting with Mr Jacques Delors, the European Commission president, Mr Smith said that Mr Lawson's policy was being "fatally undermined" by Sir Alan.

Sir Alan's comments were discounted as unimportant by senior Whitehall officials, but they are seen by the Opposition as offering an ideal opportunity to maintain pressure on Mr Lawson.

The proximity of the Mansion House speech added to a restrained mood on London's financial markets. The pound ended higher against the D-Mark yesterday at DM2.9450 compared with DM2.9325 on Tuesday. It was a touch stronger against the dollar at $1.5885 and up 0.3 on the Bank of England's trade-weighted sterling index at 89.3.

Technical factors prompted a scramble for scarce stock among marketmakers. The FT-SE 100 Share Index ended 34.6 higher at 2,170.1.

The Mail ON SUNDAY

Maggie's man hits at 'half-baked' EMS

9

By GORDON GREIG
Political Editor

MRS THATCHER'S personal economic advisor, Sir Alan Walters, has again attacked the European Monetary System.

It is, he claims, 'half-baked'. The professor says he still has to hear an argument for joining which attains 'even a minimum level of plausibility'.

His remarks in an interview with the American Economist could hardly have come at a more sensitive time for Nigel Lawson.

Tonight the Chancellor is expected to explain his financial objectives to City VIPs at the Mansion House banquet.

Next week he faces an attack by Labour on the way he has tried to manipulate the pound and the exchange rates of the dollar and the German deutschmark to keep sterling 'shadowing' the EMS rates.

Sir Alan says he is not against the development of a European currency controlled by a European central bank.

But he suggests it would have to be preceded by absolutely fixed exchange rates which would be his equivalent of going back to the gold standard.

Meanwhile Liberal Democrats leader Paddy Ashdown has steered his party to the Left with a soak-the-rich plea.

He has written to Mr Lawson urging a major shift in tax policy to hit the better-off.

Mr Ashdown and Treasury spokesman Alan Beith want more than £2billion squeezed out of the economy to follow up entry into the Exchange Rate Mechanism of the EMS from January 1. Everyone earning over £325 a week would be be hit by the abolition of the ceiling on employees' National Insurance contributions.

It would mean higher earners would pay a 9 per cent premium on their incomes, taking the effective top tax rate to 49 per cent. Mr Ashdown also wants mortgage interest tax relief limited to the basic rate of income tax.

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THE TIMES

SLD moves left on economy

By John Lewis
Political Staff 12"

The Liberal Democrats announced yesterday a high-risk economic policy that would have the effect of squeezing the income of the better off.

Mr Paddy Ashdown, the Liberal Democrat leader, spelt it out in a letter to Mr Nigel Lawson on the eve of the Chancellor's important address at the Mansion House today. He denied at a press conference at Westminster that he was adopting a policy of "soaking the rich", but in some respects the policy is farther to the left than Labour's.

The main ingredients are:

- A declaration by Britain that it will join the exchange rate mechanism of the European Monetary System (EMS) on January 1, initially in the wide band.
- A tightening of fiscal policy to take up the slack created by a loosening of monetary policy as a result of lower interest rates flowing from EMS membership.
- The Liberal Democrats would take £2 billion out of the economy as interest rates began to fall. To do that, they would abolish the ceiling on employees' national insurance contributions so that they would pay 9 per cent on all earnings above £325 a week.

Mr Ashdown: We are not trying to "soak the rich"

Mortgage interest tax relief would also be stopped at the higher rate of tax. Everyone would receive the standard rate. The national insurance change would yield £1.6billion; the mortgage change, £330 million.

They would also want the Chancellor to abandon his pledge to reduce taxes to 20p in the pound.

- Tax incentives to encourage savings.
- A new funding policy under which the Government would use the budget surplus to buy short-term Treasury bills instead of buying back government debt and pouring more money into the economy.

Mr Ashdown said that Britain was now balanced on a knife-edge of double-digit inflation and a recession. The other choice was to return to "stagflation".

"We believe that the Chancellor must make a change of course and it is right for him to do it at the Mansion House tomorrow", he said.

DAILY EXPRESS

Low opinion 44

CONCERNING The Guardian's public opinion poll regarding the Chancellor of the Exchequer, I have been carrying out an independent public opinion poll among a broad cross-section of people concerning The Guardian for a very long time, and am still doing so.

The open question is as follows: "Have you confidence in the political opinions of The Guardian?" The result, which has been remarkably consistent, is as follows: Yes, approximately ... per cent. No, approximately ... per cent.

L. Gorden,
London, SW1.

FINANCIAL TIMES

DEMOCRATS' CALL

Warning by Ashdown on recession 10

By Our Political Editor

LIBERAL Democrats yesterday called on Mr Nigel Lawson, the Chancellor of the Exchequer, to combine full British membership of the European Monetary System with a significant tightening of the Government's fiscal policy.

In a letter to Mr Lawson ahead of today's Mansion House speech, Mr Paddy Ashdown, the Liberal Democrat leader, called for a package of measures to avert the risk of Britain's economy suffering a sharp rise in inflation or a deep recession.

Mr Ashdown said that the Chancellor should use his speech to announce that he will take sterling into the EMS exchange rate mechanism from January next year, operating under the wide fluctuation bands currently applied to the Italian lira.

Such a move would allow interest rates to fall from their present high levels, but the Government should counterbalance that by taking £2bn out of the economy through changes in the tax and national insurance systems.

In a letter to Mr Lawson, Mr Ashdown said that he should remove the present ceiling on employees' national insurance contributions so that high earners would pay 9 per cent on all income over £325 per week.

At the same time the Chancellor should restrict mortgage interest rate relief to the basic rate of tax, ending "the unsupportable practice of giving the largest state housing subsidies to the wealthiest home-owners."

Mr Ashdown said that the reforms – which should also include increased tax incentives for saving – should be accompanied by an announcement that next year's Budget would not reduce tax rates overall.

Mr Lawson should also drop his pledge eventually to reduce the basic rate of tax to 20p from the present 25p, and should resume the policy of reducing the liquidity of the London money markets by "overfunding" the Government's borrowing requirements.

Announcing his proposals at a Westminster press conference, Mr Ashdown said that Mr Lawson faced a clear choice in today's speech. On the one side lay the route of full EMS membership and fiscal responsibility; on the other lay continuing confusion and the prospect of ever rising interest rates.

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Thursday, October 19, 1989
Times

15"

RETURN OF SERVICE

Whatever was contained in the vision of Europe outlined by M Delors this week to the College of Europe, the President of the European Commission must have calculated that it would be read as an exercise in the right of reply. Failure to counter Mrs Thatcher's thesis that the future of the European Community must lie with cooperation between sovereign states would have appeared to concede the field, and M Delors is not the man to leave a gauntlet lying.

There were barbs enough — the pointed citation of Sir Geoffrey Howe's view of the merits of shared sovereignty, his dismissal of those "who offer us nothing more than the laws of the market as ultimate reference" or the *cavalier seul* attitude of "certain countries". M Delors was not, however, out merely to score points. In general terms, he set out to reassure those, in Britain and other countries, who share Mrs Thatcher's distrust of supranationalism. On specific issues, European monetary union in particular, he set out to outflank opposition.

On the central question of national sovereignty, M Delors asserted that building the Community involves "no plot against the nation" and that "no one is being asked to renounce legitimate patriotism". The key word here is, of course, "legitimate", the key question who defines legitimacy.

M Delors' attempt to square the circle relies on the word "subsidiarity". This he defined to mean that federalist methods, and the goal of a united Europe, could be reconciled with national loyalties by decentralised organization of responsibilities. His assertion that this implied "never entrusting to a larger unit what could best be carried out by a smaller one", and that "the Commission must never succumb to the drunkenness of its powers", extended something resembling an olive branch to Downing Street.

The Prime Minister should inspect it seriously. It is a pledge which implicitly acknowledges that Mrs Thatcher is not isolated in her suspicions of a European superstate. And it is one to which the Commission must rigorously be held in the battles foreshadowed elsewhere in M Delors' speech.

The first will be over EMU, described by M Delors as "the point of confluence between economic and political integration". M Delors argued that the rapid changes in eastern Europe — and the accompanying danger of a dilution of West Germany's commitment to the Community — require the Community to "accelerate". He therefore called on the 12 to take the political decisions at the Strasbourg summit in seven weeks' time, committing them to the end result of EMU, which would enable a treaty of economic and monetary union to be ratified by national parliaments before the end of 1992.

This smacks of railroading. The date for a conference to discuss EMU has not yet been set. Still more importantly, the 12 have specifically not agreed that their acceptance of stage one of the Delors report on monetary union entails support for its later stages. The "institutional framework" is by no means as settled as M Delors appeared to suggest.

M Delors should also be asked to spell out what he means by suggesting that the Community's existing machinery, the "triangle" of Council of Ministers, European Parliament and Commission, should be radically overhauled. The practical objection is that the Community could be deflected from the urgent business of completing the Single Market if it embarks on redesigning its institutions.

The larger question raised is that of power — a word which figured prominently in M Delors' address. The fact that M Delors declared himself firmly against the incrementalism favoured by Mrs Thatcher and allied himself with those who favour a "top down" approach to European integration should inspire scepticism of these institutional ambitions.

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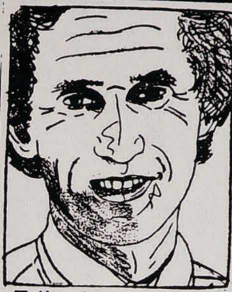
Thursday, October 19, 1989

When will the Chancellor put joining the European money system on menu?

The Guardian

Euro Notebook



Edited by
Alex Brummer

AFTER the angst of Blackpool and the apoplexy of the Footsie, the Chancellor will face the assembled bankers and financiers at the Mansion House in better shape tonight. What they are all dying to hear is what he failed to say in Blackpool last week: that Britain is ready to join the Exchange Rate Mechanism of the European Monetary System.

This is one subject, at least, in which the City, industry and now the Labour Party are all at one. As they look over the horizon at the next set of trade figures on Tuesday and the next potential twitch for sterling, the promise of ERM may look even more enticing. It is plain, for instance, that invisible earnings, damaged by an exchange rate which is too strong and constrained by a tax regime which makes London an unattractive centre for holding companies and unit trusts, will not be in any ma[illegible]r sufficient to bail out the s[illegible]ll on physical trade.

Just in case [illegible] Lawson, under the influe[illegible] of the Prime Minister, app[illegible]d to be backing away from Britain's Madrid obligations on EMS, Chancellor Kohl of West Germany and the Italian Prime Minister, Guilio Andreotti, yesterday argued that talks on monetary union should begin in 1990 with preparatory talks to start before the end of this year.

The pressure for firm commitments was also being applied by Europe's *de facto* Central Banker, Dr Otto Poehl, who argued that current monetary arrangements based around the German Mark and the Bundesbank already had provided "a healthy compulsion to price and cost discipline".

He made it clear that he believed it would be a mistake to subsitute a mark-anchored currency system with the European Central Bank unless the participants were to accept a genuine European currency, which is issued by a European Central Bank and has a guaranteed value. But, like the Bundesbank, it would have to be fully committed to "price stability" of a Germanic kind — not simply an average of inflation rates around the community.

In other words, he effectively wants Bundesbank-style control. Dr Poehl could perhaps have been more diplomatic. But what he says makes good sense to all of those whipsawed by extraordinarily high money costs.

Pipe dreams?

DR POEHL'S musing about the difficulties of creating a single European currency could apply with equal force to Europe's stock markets. Though an ambitious programme of co-operation (known as Pipe) is taking its first steps, a true Euro-bourse looks a long way off.

But just as the Deutschmark and the Bundesbank stand ready to act as the core of a European system in the absence of a more co-operative arrangement, so the London stock market could use its existing clout to force the pace if diplomacy fails.

The point was well illustrated this week as stock markets bore the brunt of last Friday's Wall Street fall-out. In London the "fast market" signs — showing prices changing too quickly for the system to keep up — were seen relatively briefly.

Brussels and Amsterdam, however, have both suffered computer problems which disrupted trading. On Monday, the French CAC 40 index of blue chip stocks was effectively calculated on a guestimated basis because of the temporary suspension of some of its constituents as prices moved too sharply.

Trading in German stocks on London's SEAQ International on Monday was three times the normal daily average; dealings in French stocks were up by 50 per cent, though in both cases absolute volumes are still relatively low.

Like Dr Poehl, the London exchange has already said it prefers co-operation. And though its bargaining position should not be overrated, it has made it clear it will push the expansion of SEAQ if that is not forthcoming. Put that in your Pipe, perhaps.

Human capital

WHAT made the West German economic miracle? Part of the explanation lies in the ideas of a curious group of economic thinkers, many of whom had been persecuted for their politically and economically liberal views under the Nazis: the Ordo-Kreis or Ordo-liberals. Their influence is celebrated in the publication today of two books by the Trade PolResearch Centre which — who knows? — could become essential reading for the new leadership across the Berlin Wall.

The movement passionately advocates individual and economic freedom, which gives their work a distinctly Thatcherite ring. However, they are also firm believers in the need for the Government to set certain rules if the liberal order is to work. This is where they differ so much from the Austrian school of Friedrich von Hayek.

Where the Austrians advocate private currencies issued by banks, which would compete to maintain the value of money, the Ordo-liberals argue for a strong independent monetary institution such as the Bundesbank. Where the Austrians believe that the threat of takeover is enough to keep businesses on their toes, the Ordo-liberals founded the Bundescartelamt (a militant anti-trust office) to make sure that monopolies were given short shrift.

It is a moot point, though, whether the Ordo-liberal ideas which have influenced all the political parties in the Federal Republic have many lessons for Britain.

The real gap to close with our German partners and competitors is in the provision of education and training. The reason why the Germans were able to rebound so quickly after the war was only partly because their capital equipment had to be renewed. It was only partly the Marshall Plan. It was only partly the influx of nine million immigrants from the eastern lands.

The main reason was that the war had not destroyed the German commitment to self-improvement, education and training. Nor had it destroyed its human capital. A developed economy needs above all sophisticated, intelligent, motivated people. With that in place, Ordo-liberalism might help.

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Thursday, October 19, 1989
The Guardian

Economy debate coincides with trade figures

8 ⁻

THE Government now faces a full Labour-initiated economic debate on Tuesday, the day when the September trade figures will indicate an improvement or further deterioration of the prospective £20 billion balance of payments deficit, *writes Michael White.*

Suggestions that ministerial acquiescence might indicate an upturn in the figures were authoritatively discounted.

After playing a cautious hand during the turbulence on the stock markets the Opposition chose to use one of its two remaining supply days in the current session, at a time when the Government had little room for manoeuvre because it needs to get its outstanding legislation through. Tuesday is the best day for Labour — and the only available one for the Government.

In a separate development the shadow Chancellor, Mr John Smith, seized on published remarks of Sir Alan Walters, Mrs Thatcher's personal economic advisor, which underline his hostility to the European Monetary System. Sir Alan's remarks were not timed to embarrass Mr Nigel Lawson since they appear in a biographical essay in the United States. But Mr Smith claimed that Mrs Thatcher's willingness to permit Sir Alan's attacks "fatally undermines" credibility in the Government's exchange rate and EMS policies.

THE GUARDIAN
Thursday October 19 1989

Rate stance 'could risk recession'

5

John Palmer in Brussels

THE European Commission yesterday warned the Government not to risk an economic recession by excessive reliance on interest rates and monetary policy to curb inflation.

Mr Henning Christophersen, the commissioner for economic affairs, said it may now be time to use other instruments — such as tax policy and public expenditure — in the battle against inflation.

And in presenting the commission's annual economic report, Mr Christophersen also painted a gloomy picture of declining economic growth in Britain over the next two years.

The warning — coming just 24 hours after the commission's president, Mr Jacques Delors, launched a public rebuttal of Mrs Thatcher's arguments against greater European monetary union — is bound to add to the friction between London and Brussels over the Government's reluctance to join the exchange rate mechanism of the European Monetary System.

Although the commission believes growth will slow from 4.2 per cent this year to 2.25 per cent next year and 2 per cent in 1991, Mr Christophersen said even this could be at risk if governments such as Britain's went too far in relying on interest rates to control inflation.

He went on: "It is good that monetary authorities recognise the need to control inflation, but we . . . may be in danger of overloading one policy instrument, namely interest rates.

"If this goes on too long, there could be dangerous complications which could affect economic growth. It may be appropriate now to use other instruments such as tax policy and public expenditure."

Mr Christophersen also pressed Britain to abandon its reluctance to become full members of the EMS. He admitted there were potential strains in the EMS because of the West German trade surplus, but noted that EMS membership had helped France achieve the same inflation rate as West Germany.

Mr John Smith, the shadow Chancellor, told Mr Delors of Labour's growing enthusiasm for full British participation in the EMS. Addressing Socialist members of the European parliament in Brussels, he went further than before in praising the EMS and emphasising the benefits of British participation in its exchange rate mechanism.

He said: "The EMS has, over the last 10 years, surprised its critics in promoting both exchange rate and price stability. We hope these achievements can be extended and sustained."

Mr Smith said later that important issues remained to be solved, including the risk that the present system had a deflationary bias. "We want a collaborative growth strategy that, in particular, seeks to raise important employment levels throughout the community.

"But I must make it clear we are not looking for excuses not to join or coming up with ludicrous statements like Mrs Thatcher's 'we will join when the time is right'."

The commission's annual report predicts continued growth in most of the 12 community countries, thanks in part to a boom in exports and industrial investment.

But, with an eye on the recent turmoil on the international financial markets, it concludes that continued progress will require the introduction of steps towards eventual full European economic and monetary union.

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Thursday, October 19, 1989
THE INDEPENDENT

Smith signals support for EMS

10

JOHN SMITH, Labour's shadow Chancellor, last night emerged from talks with the President of the EC Commission, Jacques Delors, signalling fresh enthusiasm for joining the exchange rate discipline of the European Monetary System.

Mr Smith, who is mid-way through a tour of Continental capitals, also said after the meeting that the Labour Party favoured the principle, at least, of economic and monetary union, entailing a central banking system and a single currency.

His remarks set a new tidemark in the Labour Party's rising commitment to the European Community, which is clearly aimed at showing up well-publicised divisions over Europe inside the Government. He even took up suggestions by Mr Delors that the inter-governmental conference on amending the EC Treaty in time for monetary union, likely to take place late next year, should consider wider extensions of EC powers.

He told Socialist MEPs: "We are keen to play a full and constructive part in the debate on progress towards monetary union." However, he later conceded that he was opposed to the central banking system becoming politically independent or that there should be a parallel binding of national budget policies.

As for membership of the EMS, Mr Smith said he was encouraged by Mr Delors, who had assured him that the sytem of central bank swaps — in which banks move to support other countries in the mechanism — was working better than expected. This has been set as a main condition for Labour's support.

He said he had not decided whether a Labour government would seek to enter sterling with a wide residual margin for fluctuation or, as support for monetary union would imply, inside a stricter and more narrow margin. But he said Labour was "aware of the contradictions as between going for the flexibility of a wider band as opposed to the danger of a lower level of stability".

DAVID USBORNE
in Brussels

THE INDEPENDENT

Ashdown urges monetary union

10

A SHIFT of government economic policy should be signalled by Nigel Lawson, Chancellor of the Exchequer, when he makes his Mansion House speech in the City of London tonight, Paddy Ashdown, leader of the Liberal Democrats, said yesterday.

Urging adoption of a four-point policy package, Mr Ashdown said in a letter to Mr Lawson: "You should announce immediately that Britain will join the exchange rate mechanism of the European Monetary System on 1 January 1990 and that membership will be accompanied by a tightening of fiscal policy."

Mr Ashdown told a Westminster press conference that tax reforms designed to take £2bn out of the economy would be necessary because of the loosening of monetary policy caused by the fall in interest rates which would follow full EMS membership.

He proposed abolition of the £325-a-week ceiling on employees' National Insurance Contributions — which would raise £1.65bn a year from those earning more than £16,900 a year — and restriction of mortgage interest tax relief to the basic rate of income tax — which would save the Exchequer £330m.

But in response to a question, Mr Ashdown said: "The idea that those at the top band of National Insurance Contributions are going to be squeezed until the pips squeak, or the idea that we take away the ludicrous and unjust situation where those who are richest have the greatest amount of state subsidy to buy their houses, is hardly squeezing the rich."

His letter also called on the Chancellor to introduce tax incentives to encourage savings, and suggested a curb on the use of the budget surplus to buy back government debt.

Alan Beith, the party's Treasury spokesman, said: "The Chancellor must insist on the Prime Minister's support of a clear and unambiguous announcement that we will join the exchange rate mechanism as soon as possible, without blocking preconditions."

ANTHONY BEVINS
Political Editor

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THE INDEPENDENT Thursday 19 October 1989

EC censures Lawson's policy

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From David Usborne
in Brussels

THE EUROPEAN Commission yesterday delivered a sharp warning to the Chancellor, Nigel Lawson, against relying exclusively on raising interest rates to combat inflation and repeated its calls for British entry into the European exchange rate mechanism.

The increased levels of inflation in several EC states are highlighted in the Commission's latest annual economic report released yesterday. The report also singles out worsening trade imbalances, including Britain's trade deficit.

In spite of these difficulties and the heavy budget deficits of some member states, the report predicts an only slightly reduced rate of economic growth in 1990 at 3.0 per cent, compared with 3.5 per cent expected for this year and 3.8 per cent achieved in 1988.

Significantly, however, Britain is forecast to achieve an economic growth rate of only 2 per cent in 1990, lower than in any other EC country and down from 4.2 per cent in 1988 and a forecast of 2.25 per cent for this year.

Presenting the report, Henning Christophersen, the economic affairs commissioner, made a veiled reference to Britain by warning against the use of purely monetary remedies to curb inflation.

"We are now in a situation where we risk overloading the monetary boat," he said.

He hinted that tax increases or credit controls could be deployed to dampen inflation. "The use of monetary instruments has limitations. We should have a broader policy mix with member states also taking into account some fiscal and public finance measures".

It was probably no coincidence that on Tuesday Mr Christophersen held lengthy talks in Brussels with Labour's shadow Chancellor, John Smith, who strongly advocates credit controls.

Yesterday Mr Smith also met the commission president, Jacques Delors, to discuss Britain's entry into the ERM under a future Labour government.

Mr Christophersen also pursued the argument for British membership, stressing that it would help curb UK inflation. Referring to the declarations made by Margaret Thatcher at the last EC summit in Spain, he added: "I'm sure that's why the United Kingdom promised in Madrid last June to join when inflation starts going down. I must say we are all looking forward to that event".

On the difficulties caused by internal trade imbalances, the report warns that West Germany's surplus shows no sign of narrowing and that, to the contrary, it could approach 6 per cent of national GNP in 1990, representing "a danger for exchange rate stability".

Mr Christophersen would not be drawn into commenting on recent calls from within West Germany for a revaluation of the mark.

Britain is one of five states identified as suffering from unacceptable trade deficits.

While the report notes below-potential growth is expected to narrow the gap next year, it points a finger at rising UK wage costs, warning that they are increasing by 8 per cent a year — a rate double that of the EC average.

Supporting the case for British membership of the ERM and looking ahead to economic and monetary union, Mr Christophersen pointed to the recent Bundesbank-led hike in European interest rates. "It is interesting to see how limited monetary sovereignty is these days. It now lasts for no more than 35 or 40 minutes".

His report makes it clear monetary union should not mean a straight-jacketing of the economic policies of governments. "Economic policy co-ordination cannot be successfully achieved through a centralised decision-making procedure with obligations imposed on member staes," it says. "Instead a system of multilateral surveillance should be developed in which objectives are progressively set in common and member states recognise mutual commitments with consequences for their own policies".

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Pound waits for speech tonight

THE DOLLAR ended yesterday little changed but the pound firmed slightly ahead of tonight's keynote speech on the economy by Nigel Lawson, the Chancellor, at the Mansion House banquet.

World stock markets were in a more positive mood, leading to a quiet day in the foreign exchange market.

The FT-SE 100 index closed up 34.6 at 2,170.1 as Wall Street shrugged off early nervousness in the wake of the Californian earthquake.

Despite a relatively quiet day, there was growing speculation that a realignment of the European Monetary System may eventually prove unavoidable.

There is a growing belief in financial markets that a revaluation of the Deutschemark against other European countries is inevitable, although France has insisted it would match any revaluation.

In London the dollar closed little changed at DM1.8520 and Y141.55. Sterling firmed one pfennig to DM2.9427 and against the dollar it was 0.45 cents higher at $1.5870.

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THE TIMES

Plumb wants Ecu to replace dollar

By Colin Narbrough, Economics Correspondent 26

Lord Plumb, the former president of the European Parliament, has proposed that a single European currency should replace the volatile dollar as the main unit for international transactions.

Replacing the dollar with the European Currency Unit would avoid damaging swings in domestic prices for much of the European Community's imports and exports, he told a Libertad/Business Forum conference in Westminster.

The Conservative MEP said an effective single market would inevitably require a single currency.

Expecting business to deal with separate currencies with variable exchange rates in a single market after 1992 was a "handicap almost as serious as would be the instability of weights and measures." Could businessmen imagine operating with a "floating" metre or kilo? he asked.

Lord Plumb drew attention to the cost of converting currencies and the duplication of maintaining separate units. "If the Ecu could replace the dollar as the main unit for international transactions, and fixing commodity prices, the European economy would avoid the constant fluctuation in terms of domestic prices of many of its imports and exports," he said.

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DAILY EXPRESS

Will unity divide?

8

EUROPEAN Community president Jacques Delors warns that the 12 Community partners must bind themselves even more firmly together so as not to be pulled apart by increasing ties with Eastern Europe.

In particular, M. Delors fears that the German longing for re-unification threatens the stability of Western Europe.

It is not necessary to agree with his answers — economic and monetary union for the Community — to recognise he has put his finger on a looming problem. He could not have known that barely 24 hours after his Brussels speech the resignation of East Germany's leader, Erich Honecker, would give his warning extra urgency.

Honecker's disappearance is almost certain to accelerate the pace of German togetherness.

A Germany re-united economically and commercially looks likely to become a reality in our lifetime. Which way would it face? To the West, or to the East, as in the past?

A re-united Germany — perhaps encouraging more Eastern bloc states to come aboard — could not help but disrupt the Community, which already has problems accommodating present members.

NATO, too, would be put under intolerable strain if its most strategically-important frontline member, West Germany, were to be neutralised by fusing with one of the leading members of the Warsaw Pact.

And the main question being discussed in private, if not yet in public, is whether in the light of two world wars we could trust and live safely alongside a united economic superpower reborn out of nationalist fervour in the heart of Europe.

THE INDEPENDENT

Entry rates in the EMS

28

From Professor Alan Day

Sir: You advocate immediate entry into the European Monetary System in your leading article (16 October). It would be very helpful if you (along with all the other serious advocates of this policy) were to make clear what is the order of magnitude of the exchange rate at which we should go in. At the Deutschmark 3.25 of not long ago, the 3.15 of more recent months, the 2.90 which the rate has approached, or even lower?

In answering this question, at least two things need to be borne in mind. One is that in a stable fixed exchange rate system with free capital flows, interest rates must be approximately uniform throughout the area. So British interest rates would need to fall steeply relative to those of the core of the EMS, namely the inner Deutschmark area of West Germany, Benelux and Denmark. This would have marked implications for capital flows into the country, which have been attracted by our high interest rates.

Second, it is necessary to bear in mind our competitiveness in world markets for goods and services (reflected in the current account deficit) along with the prospect that even if we do get our inflation rate down again to the official targets, this would still be substantially higher than that of the core countries of the EMS.

A repeated lesson of British history is that entry to a fixed exchange rate system at too high an exchange rate is a recipe for grave troubles. It would be sad if we were to repeat that mistake yet again.

Yours faithfully,
ALAN DAY
Paris
17 October

The writer is Professor Emeritus of Economics at the London School of Economics.

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