



Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

COP24.

29 March 1990

Richard Gozney Esq
Private Secretary to the
Secretary of State for Foreign
and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
LONDON
SW1A 2AL

Dear Richard,

VISIT BY FRENCH PRIME MINISTER: M MICHEL ROCARD

The Chancellor saw Prime Minister Rocard on Monday morning, 26 March, at Admiralty House. M Petit, Mme Guigou, Mme Quincy (M Rocard's EC Adviser), M Hannezo (Beregovoy's Cabinet) the French Ambassador, M Thierry, Sir Peter Middleton, Mr R I G Allen and Sir Ewen Fergusson were also present.

M Rocard said the purpose of his visit was to investigate the changing European scenery. Continuing, he said his main message was that it was important, in the face of plans for German economic and monetary union (GEMU), to make some gesture of EC solidarity. It was important that this should come before GEMU, since otherwise it might appear that there was some loss of cohesion or purpose in Europe. This would have special significance in the financial field. UK entry into the ERM would be such a sign. Accelerating work on EMU - by advancing the IGC or by setting a finishing date as some had suggested - might be another.

The Chancellor said that the UK Government had not allowed itself to be rushed into joining the ERM. This was right. However, the conditions for entry into the ERM had now been decided, and were set out in the Madrid conditions. Some of those were internal - progress on inflation - some external - eg the abolition of exchange controls. (He noted that France had recently made moves on this.) The UK had committed itself. But we had never regarded the ERM as a panacea: it had not been for the French (M. Rocard



agreed). Far from making monetary discipline easier, entry into the ERM would constitute an even stronger commitment to monetary controls.

Continuing, he said that GEMU might well take longer than had originally been envisaged. There were difficult choices to be made on conversion rates and mechanisms, and between higher taxation and a tighter monetary stance. On EMU, it was no secret that the UK thought the calling an IGC in December premature. But we had said we would be there and we would participate constructively. The IGC should continue work until it had produced the right solutions for the future: rushing the conclusion would be likely to reduce the level of agreement which could be reached. The UK's views were set out in his paper on an evolutionary approach which had set out some very real fears, eg that the Delors plan would lead to convergence on only average inflation performance.

M. Rocard agreed that GEMU might take longer than had been supposed. It would also be very expensive (DM50 billion might be the cost of monetary conversion alone). It would reduce Germany's surplus. He would not welcome the pressure for higher interest rates, though he recognised that this might be necessary. On the risk of inflation converging on the average, he noted that in recent months French inflation had been lower than in Germany. His advisers thought that this was a potentially lasting development. Reverting to developments in Germany, he said that "politics could do damage to the economic situation". A collective sign of commitment was needed. Sterling entry into the ERM would do that and create an environment which made GEMU "easier to digest".

Continuing, he agreed that the IGC would need adequate preparation. He agreed that it would be dangerous to rush discussions. But the opening date was not so significant in technical terms as in the political message it would convey vis a vis Germany. If the Dublin informal Summit decided to accelerate work on EMU, no harm would be done.

The Chancellor said that the differential between the UK's inflation rate and inflation in ERM currencies was a genuine concern, not only for the UK but for the ERM itself. He outlined the prospects for domestic inflation over the next 18 months. He believed that fiscal and monetary policy were right and would take the UK nearer to the Madrid conditions. But premature entry into the ERM might lead to upward pressure on sterling which in turn would force a reduction in interest rates before domestic circumstances warranted. M Rocard persisted: what about a public declaration that the UK would enter in Spring 1991? The Chancellor said that if a date was set long in advance market pressure would force earlier entry. He understood Rocard's desire to see a signal. But we could not risk losing control of events. However there should be no doubt about the UK's commitment. He



referred to his Budget speech and newspaper interviews the previous weekend.

M Rocard said he had a personal message from M Beregovoy on IMF quotas. It was not easy for France to find the quota share it needed to be able to join the UK in fourth place since this would mean reducing the US's quota share. So there would need to be further discussion. The Chancellor outlined the UK's position. We had agreed an unprecedented reduction in our quota share. It would not be politically feasible to go further. M Beregovoy would have taken the same line in his position. And he had told M. Beregovoy that he would take the matter to the Interim Committee if necessary. M Rocard said that this suggested the need was for discussions with the other G7 countries. However, he was grateful that the UK had avoided using arguments of national pride.

On the EBRD, France had not pressed the case for Paris. He agreed that a European capital should be chosen. He had discussed London with President Mitterand, and they had originally agreed that there was a strong case. However, following subsequent discussion with non-EC members of G41 he was now much more pessimistic about London's chances.

The Chancellor that he would be very sorry if the decision went against London. It was hard to argue against the overwhelming logic of the case for London (M Rocard interjected that the French did not do so). London was clearly the best answer for the Bank itself. And the UK would take it as a very perverse signal from the rest of Europe if, for extraneous reasons, the Bank were to be sited elsewhere.

The meeting ended with an exchange of courtesies.

I am copying this letter to Charles Powell (No.10), Paul Tucker (Bank of England) and Sonia Phippard (Cabinet Office).

Tomasz Tarkowski
T TARKOWSKI
Private Secretary

