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POSSIBLE UK PROPOSALS FOR EARLY PRACTICAL STEPS TOWARDS ECONOMIC AND MONETARY UNION

Key

A = Poehl likely to support
B = Poehl neutral, or attitude uncertain
C = Poehl likely to oppose

Economic Policy	Comments
(1) Closer co-ordination of economic policies in ECOFIN, based on regular (six-monthly?) surveillance discussion of economic developments in Community countries. Discussions to cover prospects for the fiscal stance in member countries as well as monetary policy. Central bank governors to participate, where appropriate. Discussions to be based on preparatory work carried out by Monetary Committee, Economic Policy Committee, Central Bank Governors' Committee.	A. Participation of central bank Governors is optional. But if it were recommended, that might help secure support of other Governors. Discussions could then be at informal ECOFINs, which Governors attend.
(2) Develop understandings in ECOFIN about level of national budget deficits in a medium-term context, aiming eventually to bring deficits in all countries down to level achieved in best.	A.

(3) Develop guidelines for the financing of national budget deficits, so as to stop monetary financing.

A. A complex subject because of institutional differences in different countries. EC Monetary Committee is already studying the subject the subject, and is making some progress.

[Capital Liberalisation

(4) Implement capital liberalisation directive in all member states as quickly as possible.

B. But all except Ireland, Spain, Portugal and Greece are committed to implementation before July 1990. It may not be realistic to urge them to move faster.

(5) Member states to [agree to amend/ consider amending] directive to repeal safeguard clause, which permits countries to reintroduce controls as a temporary measure, to make capital liberalisation permanent and irreversible.

B. This would provoke strong opposition from Italy and some other Southern European states, and could cause others to try to link it to an agreement to harmonise the taxation of savings. On the other hand, if others do not agree, we could make something of the argument that if they are not ready to take this minor step, then it is idle to talk about faster progress to EMU. However, a proposal to repeal could stir up the issue of Treaty amendment too since it carries with it the implication that Articles 73, 108 and 109 (which contain similiar provisions) should also be revised.]

Increased co-operation on exchange rates

(6) A general move towards increased holdings of EC currencies in member states' reserves and their use, where appropriate, in intervention.

C. This would apply to all EC currencies, whether or not in the ERM. It is useful for central banks to have a range of currencies at their disposal so they can intervene in different currencies depending on where the market pressures are. At present holdings of other EC currencies, and their use for intervention, are inhibited by the EMS inter-central bank agreement. The measure would be permissive only : it would not <u>require</u> such holdings. The Bundesbank oppose : they only hold $s in their reserves, and wish to limit other countries' holdings of DM.

(7) Countries that do not participate in the ERM to be permitted to participate, if they wish, in the very short-term financing facility (VSTF).

B. This would enable the Bank of England to arrange short-term drawings from other EC central banks where necessary and agreed : and in return the Bank would agree to lend to other EC central banks on the same terms.

(8) Use market rate on Government short-term ecu paper as the rate of remuneration on official ecu liabilities arising in the EMS.

A. This is of no significance to the UK while we are outside the ERM, unless (7) were agreed. This would replace the present cumbersome calculation based on a basket of interest rates. It is made possible by the existence of the UK Treasury bill programme.

Promoting use of the private ecu

(9) Increased holdings of private ecu in national reserves, and their use, where appropriate, in intervention.	A. The private ecu can be a useful intervention currency. In the past the Bundesbank have not favoured this proposal because of the weight of the DM, in the ecu basket (see 6), but Poehl's attitude is now more receptive.
(10) Acceptance of private ecu in settlement of VSTF obligations in EMS, rather than official ecu.	B. Like (8) this would only be significant for the UK, as a non-member of the ERM, if (7) were agreed.
(11) Removal of national regulatory impediments that prevent market participants using the ecu in setting prices, for corporate accounts, for contracts and as a means of settlement.	A (B on some aspects).
(12) Other countries to follow UK lead in issuing government debt denominated and payable in ecu.	B.

Further enhancement of Monetary Co-operation

(13) Deepen and strengthen monitoring and co-ordination of national monetary policies in Central Bank Governors' Committee and Monetary Committee including :

A. (Though Bundesbank likely to object to detailed discussion of monetary/exchange rate issues in the Monetary Committee, or ECOFIN.)

- consideration of guidelines for national monetary policies, regular discussion of monetary targets, etc.

- discussion of the overall monetary stance of the Community, and exchange rate relationships with third countries ($, Yen).

- discussion of monetary/fiscal policy mix in the Community.

(14) Provide Central Bank Governors' Committee with a permanent secretariat including a research capacity.

A. Bundesbank strongly favour building up Central Bank Governors' Committee.

Banking Supervision

(15) Central Bank Governors' Committee to start regular consultations concerning matters of common interest in banking supervision.

A. It might be feasible in due course for the Central Bank Governors' Committee to take over much of the work of the Commission's Banking Advisory Committee, with the Central Bank Governors' Secretariat taking over the Commission's functions. But this would raise difficult issues, not least for countries like Germany whose banks are not supervised by the central bank.

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ANGLO-GERMAN SUMMIT: 20-21 FEBRUARY

ECONOMIC AND MONETARY COOPERATION

Our Objectives

General:

- To gain as much German support as possible for pragmatic approach to economic and monetary cooperation and the handling of the Delors Committee report.

Kohl:

- To sound out the personal position of Chancellor Kohl, and to impress on him the political difficulties inherent in proposals emerging from the Delors Committee.

Poehl:

- To encourage early practical steps not requiring Treaty amendment.

German Objectives

- To sound out UK position and, perhaps, to urge early UK membership of the ERM.

Our Arguments

- Important that Delors Committee's Report makes clear that full EMU would require massive shifts of economic and political sovereignty from member states.

- Such a shift would require fundamental amendment to the Treaty, going beyond the competence of members of the Committee who are monetary experts. Heads of State and

Government should draw the constitutional conclusions from the Report - Central Bank Governors should not make such recommendations.

- Report should focus on practical steps within existing Treaty to be taken in immediate future, rather than long-term objective of EMU which is premature and not necessary for the Single Market.

- UK could support practical early measures which do not require Treaty amendment including:-

  i. abolition of exchange controls. An important step that all member states are now committed to. Implementation of this commitment is necessary for the Single Market and must be a priority. (Germany, like us, has removed all exchange controls);

  ii. fiscal policy. A further precondition for the successful economic development of the Community is the gradual elimination of budget deficits, and meanwhile their financing in a non-monetary way;

  iii. monetary cooperation

  - we support continued and strengthened monitoring and coordination of monetary policy (if necessary this might entail a permanent secretarial and research capacity for Central Bank Governors' Committee, which the Germans support);

  - private ecu: removal of national impediments to use of private ecu; government borrowing denominated and payable in ecu (our ecu Treasury Bill programme points the way); and increased use of ecu in reserve holdings and intervention. (The Bundesbank has been unenthusiastic about the ecu, but Poehl has indicated recently that he may be less opposed to its use in intervention);

- reserve diversification and use of Community currencies in intervention. (The Germans will oppose this because they fear the implications of other countries' holdings of DM for domestic monetary control, and hold no currencies other then dollars in their reserves. But the UK proposal is only permissive);

- Procedure When Committee has reported, its work will be complete. It would be a mistake for Madrid Council to refer work back to it. Should remit further work to ECOFIN, with Central Bank Governors present as appropriate.

Our Response To Their Arguments

- [If German support for Treaty change] No. Implies readiness to accept massive shifts of economic and political sovereignty from member states. Major and wasteful diversion of effort from important task of completing Single Market. Treaty change is not required for the jobs that need doing now. UK Parliament will not give a blank cheque - ie enabling powers to be exercised at some undetermined future date.

- [If they raise spectre of "two tier Europe"] Negative development for all concerned - we would deplore it. Great pity that other member states have not yet brought themselves into upper tier by removing exchange controls and modernising archaic financial structures.

- [If European Central Bank raised] No secret that we believe study of this issue is premature to say the least.

German Views

Kohl - cautious pragmatist; has so far kept a low profile on monetary cooperation, but has been influenced by Genscher in the past.

Finance Minister Stoltenberg - pragmatist; concerned that Delors may try to push through radical proposals.

Foreign Minister Genscher - circulated ambitious proposals last March.

Poehl/Bundesbank - Poehl has argued in Delors Committee that EMU presupposes loss of sovereignty over economic and monetary policy that is only likely in context of close and irrevocable political integration. His overriding concern seems to be that if a European Central Bank were established, it should be entirely autonomous and on Bundesbank lines. Bundesbank remains opposed to reserve diversification, although some internal debate on the subject, and unenthusiastic above ecu, although signs of opposition waning.

Background

The Governor's tactics in the Delors Committee were discussed at your meeting of 15 February. You will clearly not wish to foreshadow exactly how the Governor will play this in the Delors Committee.