

The Governor

Bank of England
London EC2R 8AH

1 December 1989

The Rt Hon Margaret Thatcher MP
Prime Minister
10 Downing Street
London
SW1A 2AL

Dear Prime Minister,

ms

Dear Minister
In the light of
this, one asks why
on earth he signed
up to the Delors
Report. CDD 1/xii

Since John Major published his paper on an evolutionary approach to economic and monetary union last month, I have had the opportunity to hear some reactions to it from my central banking colleagues in the Community. Several of them are far from keen to rush headlong into full EMU and they have welcomed the paper, not as an alternative to Stages 2 and 3, but as establishing that Stage 1 will necessitate massive changes in the European economy which will not come about quickly. I think they also agree, as I most definitely do, with the three fundamental principles of price stability, subsidiarity and market forces.

They are however inclined to ask what might happen after Stage 1 and how the notion of "competing monetary policies" could deliver the benefits to European industry and individuals that they believe would flow from some form of economic and monetary union. Moreover those who find objectionable the present dominance of the Bundesbank over other member states' monetary policies are puzzled

that the United Kingdom should seem to be advocating a continuation of this state of affairs.

I think that we should build on the agreement that does exist on the desirability of achieving closer monetary co-operation in the Community and of a free market in capital, labour, goods and services. Rather than suggest that we or anyone else can say with any confidence how long Stage 1 will last or what should follow, we should concentrate on stressing that it is a massive undertaking and encourage agnosticism as to what will be desirable or feasible thereafter. As the Chancellor's paper suggests, the changes to be wrought by the establishment of a free internal market will take time - possibly a long time - to show through and the scale of their effects cannot be predicted. In addition, the impact on the exchange rate mechanism of sterling's eventual membership remains to be seen.

There will be lessons to be learnt over the next few years and we can legitimately question the wisdom of President Mitterrand and others in being determined to move rapidly to negotiate treaty change and establish institutional structures for the long term before Stage 1 is well underway and its effects can be better foreseen. Given the scale and importance of the issues involved, it is right that we should have a much clearer understanding of the options before taking these decisions.

I was not alone in the Delors Committee in arguing that consideration of treaty change, or the establishment of new Community institutions, should wait until the Community is ready, in the light of experience with Stage 1, to take further steps. And of course this is also pretty much what you have already said in Madrid when you insisted on "full and adequate preparation" before an IGC is called.

In sum, there are other member states which have misgivings about making a firm commitment at this stage to new institutional arrangements and definitive long-term plans. We need to play on their concerns, underline the real uncertainties which lie ahead and, while not excluding any particular outcome, rather emphasise

the need for an evolutionary process. This suggests that we should build on the strengths of the Treasury paper as it has been received in other member states.

I am sure we should try to defer an IGC until we have experience of the changes that Stage 1 will bring. However, it seems likely that a majority of the other member states may be willing to embark on an early IGC irrespective of whether they are in a position to resolve the fundamental issues. In that case, the best course may be to concentrate on ensuring that its terms of reference are such that it has to take account of all the changes Stage 1 will bring and, in particular, has to defer any recommendations/decisions on later stages - including specifically institutional and Treaty changes - until that experience can be properly assessed. This could also have the benefit of helping to avoid charges that the UK's evolutionary approach is not intended to extend much beyond Stage 1.

I should be glad to discuss these issues further with you if you would find it useful.

I am copying this letter to John Major and Douglas Hurd.

Yours ever,
Robin