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7 December 1989

Charles Powell Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
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Dear Charles,

**ECONOMIC AND MONETARY UNION: VIEWS OF THE EUROPEAN COMMITTEE OF
THE BRITISH INVISIBLE EXPORTS COUNCIL (BIEC)**

The Chancellor saw Sir Michael Butler, Chairman of the European Committee of the British Invisible Exports Council (BIEC) on Tuesday 5 December. Sir Michael was accompanied by Sir Michael Franklin (Deputy Chairman of the Committee), and Sir Jeremy Morse. The Financial Secretary, Mr Wicks, Mr R I G Allen and Mr Tyrie were also present.

Sir Michael outlined the Committee's fears that London's position as the main financial centre in Europe might be damaged by the perception in the EC and elsewhere that movement towards economic and monetary union in Europe might go ahead without Britain. They felt it was important for the UK to be seen to be playing a constructive role, not least so as to be able to influence developments. His Committee was concerned that the Government's paper setting out the UK's evolutionary approach did not go far enough to be regarded by other member governments as a sufficient alternative to Stages II and III of the Delors plan. To be taken seriously in Europe it was urgently necessary to develop the ideas in the paper on what should happen after Stage I of the Delors plan into firmer proposals. In particular, he suggested that the UK should work up a more detailed scheme for the development of the private ecu. On this basis, it would be easier for the UK to



argue that the substance of EMU had to be fully considered before the case for institutional change could be considered.

The Chancellor said that he recognised these concerns. However the fact was that there would be substantial pressure at Strasbourg to initiate processes designed to lead to institutional change. Given that the UK would not support the calling of an IGC he thought it would be difficult to make headway in presenting a case on the lines suggested by Sir Michael.

Sir Michael Butler said that, in the EC context, there was always a temptation to talk in terms of institutions rather than substance. He felt the UK's negotiating objective should be to ensure that the terms of reference for any IGC reflected and built on the ideas in the UK's paper. But we would need to offer a view on the objectives for monetary policies and exchange rates in the Community by the end of Stage I and what the next set of issues would be. The aim should be to lay out in the Strasbourg conclusions a suitable basis for further work, to put alongside the Guigou questionnaire.

The Chancellor said that the term EMU had never been given a precise meaning. He saw a need to gain acceptance in other member states that the interpretation implicit in the Delors Report was not the only one. Sir Michael Butler thought that it would be counter-productive to open this question. In particular, any suggestion that EMU did not imply fixed exchange rates would run into considerable opposition.

Sir Jeremy Morse said that a possible "market" definition of EMU which respected the principle of subsidiarity might require only as much fiscal and monetary harmonisation as was necessary to underpin permanently fixed exchange rates.

Sir Michael Franklin agreed that there would be no mileage in questioning the meaning of EMU. It would be easier, and more productive, to pursue our objectives in the context of the answers to the Guigou questionnaire. He also saw dangers in insisting too strongly on the contrasts between an "institutional" and an "evolutionary" approach. While this made sense to financial practitioners, it lacked political appeal in Europe. We should refer instead to phases, stages etc. Other member states would accept that the process should be gradual. They would not accept, however, that there should be no progress at all beyond Stage 1.

The Chancellor asked what the consequences would be for the City if EMU went ahead without the UK. Sir Michael Butler said there was a risk that business would be lost to Paris and other European financial centres, such as Frankfurt, Amsterdam and Luxembourg. London had reaped the benefits of early deregulation, but others were now following suit. He accepted that, whatever the outcome

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on EMU, we would face increasing competition. At present, London exerted a strong attraction for financial institutions. But this could change if there was a perception that London would be left on the sidelines. The Financial Secretary wondered whether the City would not in fact profit most from being offshore from a centralised, over-regulated, single financial area with no exchange controls. We might then be able to benefit in the same way as we had on eurodollars as a result of the US "Regulation Q". Sir Michael Butler thought that it was dangerous to rely on the European market remaining more highly regulated than the City. The Financial Services Act had already changed the relative advantage of London.

Sir Jeremy Morse agreed there was a risk that the City would lose some of its power to attract financial businesses. He thought there might also be some impact on the Bank of England's standing among bank regulators, eg at Basle, where the Bank's skill and experience were highly regarded. This was one area where the Bank, rather than the Bundesbank, was the recognised leader. A second worry concerned the instruments through which monetary policy was conducted. The Delors Report recognised that the principle of subsidiarity should apply, but he doubted whether, under a co-ordinated monetary policy, that would be feasible in practice. He thought we should aim to get the Bank's methods adopted as the technical basis for co-operation in money market management.

The Chancellor asked what the City felt would be the desirable outcome in the longer term. Sir Michael Butler thought that we should aim to take co-operation on interest and exchange rates and fiscal policy further, under a "system" of central banks which need be no less accountable than at present, and which could retain the existing division of powers and responsibilities. The aim should be to make Stage I work. Beyond that there should be progress towards fixed parities. Sir Jeremy Morse added that, with the UK's financial experience, we should be aiming to play a leading role within the Community on these matters.

The Chancellor thanked Sir Michael and his colleagues, and noted the views put forward. However, the UK remained committed to the approach set out in his paper, which rejected Delors Stages 2 and 3, or indeed the possibility of envisaging now what might be feasible or desirable after Stage 1.

I am copying this letter to Stephen Wall (FCO).

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