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SUBJECT cc MASTER



cc: S. Wall, } strictly
D. Hadley } Personal

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

6 September 1989

Dear John,

ECONOMIC AND MONETARY UNION

The Prime Minister had a meeting this morning with the Chancellor to consider how to handle discussion of Economic and Monetary Union at the informal ECOFIN next weekend. Their starting-point was the Chancellor's minute of 5 September.

The Prime Minister and the Chancellor agreed that the procedure proposed by the French Presidency for discussion of longer-term aspects of EMU was unsatisfactory. But since other member states clearly accepted the High-Level Group we should have to go along, while trying to secure the maximum role for ECOFIN (as we in fact agreed at the Madrid European Council).

It was also agreed that the Chancellor should stress the need to complete Stage I of Delors before taking decisions on further steps towards EMU, and insist on the points set out in paragraph 4 of his minute.

Looking beyond Stage I, the Chancellor said that his main task at the informal ECOFIN would be to bring out all the objections to Stages 2 and 3 of Delors. But since the Prime Minister had promised alternative proposals he had commissioned an internal study of other options. This had come up with four possibilities - tightening the ERM by narrowing margins, recreating a sort of sterling area which would in practice be based on the DM, reintroducing a gold standard/basket of commodities to which EC currencies would be linked, and a system of freely competing national currencies. Only the last two had any attractions for us. The Community would in practice be 90 per cent of the way towards competing national currencies with the completion of Stage I, and it would only be a question of removing remaining legal barriers. He proposed to refer to these two possibilities at the informal ECOFIN.

The Prime Minister expressed some doubt whether you could have a system of freely competing national currencies within a fixed exchange rate system like the ERM, especially when the intention was to eliminate margins in due course. Moreover it

could simply pave the way to a common currency, which we wanted to avoid. In her view the only sensible form of EMU was a convergence of sound economic policies, pursued by all the member states. She was dubious whether it would be right for the Chancellor to float his alternative proposals without discussion amongst colleagues on the basis of a full paper.

In further discussion, it was agreed that the Chancellor would trail the idea of competing national currencies at the informal ECOFIN without going into any detail, but would not mention the gold/commodities standard. A fuller paper would be prepared, for discussion by colleagues and eventual circulation at the formal ECOFIN later in the autumn. Meanwhile the Chancellor would arrange for the Trade and Industry Secretary to be fully briefed on the work in hand.

John Gieve
Charles Powell

Charles Powell

John Gieve, Esq.,
H.M. Treasury.