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2 November 1989

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PS/Prime Minister  
10 Downing Street  
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*Prime Minister*  
I think this is  
very good.  
C.D.P.  
2/11/89

*Dear Charles,*

**EMU DEBATE: 2 NOVEMBER**

...

I enclose a copy of the latest draft of the Chancellor's speech for tomorrow's debate, on which he will be working further tomorrow morning.

I am also sending copies to Steve Catling (Lord President's Office) Stephen Wall (FCO) Neil Thornton (DTI) and Paul Tucker (Bank of England).

*Yours,*

*Moira Wallace*

**MOIRA WALLACE**



2ND REVISE - 1 NOVEMBER

ADJOURNMENT DEBATE ON ECONOMIC AND MONETARY UNION,  
2 NOVEMBER 1989

CHANCELLOR'S OPENING SPEECH

Mr Speaker, I very much welcome this opportunity for a debate on economic and monetary union in the European Community. This is an important debate and one on which the views of the House need to be heard.

2. The idea of moving towards economic and monetary union in the Community is not new. It has a long history. As long ago as 1970, a report by M. Pierre Werner, then Prime Minister of Luxembourg, made detailed proposals for progressing to EMU: transferring major economic policy decisions to Community level, adopting a single currency and setting up a single central bank. The Community endorsed these proposals in 1972 and agreed that full EMU would be achieved by December 1980 at the latest. Mr Speaker, after that endorsement other events intervened and nothing much came of the Werner proposals. They were effectively buried.

3. Nevertheless throughout the seventies the Community continued to endorse the principle of progressing towards economic and monetary union. It was reaffirmed



again at the European Council in Brussels in 1977. And the objective of the progressive realisation of EMU is recalled also in the Single European Act of 1986. It has since been reaffirmed again at the European Councils of Hanover and Madrid. There is thus a long-standing commitment to the objective of the progressive realisation of EMU. But there is no universal view of what EMU means or what it entails. That is the issue before us now.

or when  
it should  
be  
achieved.

4. One definition was offered in the Delors report which was published in April this year. The Governor of the Bank of England, a member of the Delors Committee, explained their approach to the Treasury and Civil Service Select Committee in May. They devoted themselves - and I quote -

"very much to how economic and monetary union might be achieved, rather than whether or when. We took the view that whether or when was a matter for political leaders".

It was - and we should be quite clear about this - a report from a group of technical monetary experts.

5. The Delors report was considered by the European Council in Madrid in June. The Council agreed to adopt



the first stage of its proposals, and set in hand further preparatory work on developments beyond that stage.

6. The Council of Finance Ministers and the General Affairs Council are now engaged in that further work. My Rt Hon Friend the Foreign Secretary will be attending a meeting of the General Affairs Council next Monday at which economic and monetary union will be on the agenda. It will then be the central subject for discussion at the ECOFIN Council on Monday 13 November when I will present a paper setting out the British Government's view. Copies of this have been placed in the Library of the House and put in the Vote Office. Following the ECOFIN discussion it will again be discussed in December at the European Council. So this debate is a timely opportunity for the House to express its views as we prepare for these important discussions.

7. As I said a moment ago there is no agreed definition of what actually constitutes economic and monetary union. But there is a large measure of agreement amongst all Member States about what we want to achieve. We seek currency stability, and price stability. We want to achieve a single market, with free movement of people, services, and goods; free movement of capital, and equal access to capital and financial services for all citizens and businesses in the Community; and a strong competition policy.



8. We want these things for three practical reasons: because they will make our businesses and industries strong and flexible enough to compete in world markets; because they will enable our economies to grow; and because they will bring higher living standards, and greater choice.

9. There is no real controversy about these objectives either in the Community or in this House. The disagreement lies elsewhere. It is about the timing and the means by which we move towards these.

10. There is a fundamental question that determines the positions in that debate. It is this: do we want to start moving towards a federal Europe, with all that implies; or do we instead concentrate on developing a closer partnership, a partnership of individual nation states, and achieving in that way the objectives on which we all agree.

11. It will be no surprise to the House that this Government favours the second approach. It harnesses the strength of our national traditions and political structures. It builds on the policies - the liberal free market policies - that we have followed both here and in Europe, and which have brought success. And it



respects both Parliamentary accountability and the diversity of Member States. It takes the sting and controversy out of moving to our shared aims.

12. It is this approach that we have adopted to the debate on EMU, and the Delors Report.

13. We have already agreed to implement Stage I of the Delors prescription. The elements of this are familiar: they include establishing a genuinely single market in goods, services, and capital; the strengthening of competition policy; and the development of coordination of member states' economic and monetary policies. The Commission's proposals for revised coordination arrangements are among the documents listed for our debate today.

✓ 14. Stage I of course, also requires all Community currencies to join the Exchange Rate Mechanism of the European monetary system on the same terms. This we will do, as I told the House on Tuesday, when the level of UK inflation is significantly lower, when there is capital liberalisation in the Community, and when real progress has been made towards completion of the single market, freedom of financial services and strengthened competition policy.

15. Our position on Stage I is clear and constructive. We are committed to it both as the first stage on the



road to EMU and as a desirable end in itself. But we part company with the Delors recipe on the next steps. Let us be clear what the report proposes: permanently fixed exchange rates; a single Community currency; binding central rules on national budgetary policies; a European System of Central Banks, with sole responsibility for formulating Community monetary and exchange rate policy.

16. The Government - and I suspect the overwhelming majority of this House - has very great difficulty with these proposals.

17. We do not believe that Community rules on national budget deficits are either necessary or desirable. They are unnecessary because monetary unions can and do tolerate diversity of budgetary positions. [That is true for example in the United States in the Federal Republic of Germany - indeed in nearly all existing federal states]. It is markets which impose a discipline and prevent deficits getting too far out of line. On the desirability of binding rules, I can do no better than quote the conclusion of the Treasury and Civil Service Select Committee:

"The power of the House of Commons over the centuries has depended fundamentally on the control of money, both taxation and expenditure. This would be jeopardised by the form of monetary union



proposed by the Delors Report which would involve central undemocratic direction from within Europe of domestic budgetary policies."

18. I hope our partners in Europe recognise the seriousness of this issue to us. It is fundamental to our Parliamentary constitution and practice, and is not a matter that can be bargained away or cast aside.

19. Delors' proposals for increased regional and structural aid also seem to us to be misconceived. There must, of course, be greater opportunities for the living standards of the less prosperous regions to rise. No one denies that. Indeed, the Community's structural funds are already being doubled in the five years between 1988 and 1993 for precisely that reason. But there is no reason whatever to believe that a route to EMU which relies primarily on the operation of the market - rather than government intervention - would harm the less prosperous areas. Indeed I believe the reverse to be the case.

20. Thirdly the Delors Report's proposals on monetary union are unacceptable. For monetary policy is at the very heart of macroeconomic policy. And the proposals in the report make no provision for accountability for monetary policy to national Governments or national



Parliaments. Yet the electorate would still hold Governments and national authorities responsible for their economic well being.

21. Moreover there would be no effective means of bringing the central banking system to account for major failings - and there can be no guarantee that it would pursue successful anti-inflationary policies, whatever treaties might say. Indeed by eliminating competition between monetary policies it seems likely that the proposals would lead to harmonisation not on the best inflation performance but on the average.

22. In short, the Government's fundamental objection to the Delors approach beyond Stage 1 is that its ~~is~~ prescription for economic and monetary union centralises power. It relies on administrative fiat and institutional change. It skates over vital issues of political accountability. It ignores the basic fact that changes in economic and monetary arrangements must reflect real changes in economic behaviour in the market place - they must work with the grain of the market and not against it. The Delors route is quite simply the wrong way for Europe. And there is a better way to meet our agreed objectives.

23. It is set out in the paper we published earlier today. This proposes an alternative approach, an



evolutionary approach, to economic and monetary union. It represents the contribution we promised to the debate within the Community.

24. We start from three principles:

- the overriding objective of price stability;
- increasing the influence of markets and competition;
- retaining national control over economic policy-making to the maximum extent possible.

25. Our proposal builds on the agreed market-related approach to the Single Market and fully reflects the principle of subsidiarity to which the Community rightly attaches such importance.

26. Recent debate in Europe seems to leap over the main work we currently face to complete the many steps necessary for Stage 1 of the Delors Report. Stage 1 is a massive enterprise in itself. It will have very far-reaching consequences for all our economies; a profound effect on monetary policy; and give a significant impulse to economic convergence.

27. It means establishing a genuinely Single Market in capital movements and removing all exchange controls. A



✓ timetable has been agreed, starting with France and Italy by next summer. We of course are ten years down that track. We welcome the commitment by others to follow suit. The sooner the better.

28. Second, it means completing the Single Market. This is a huge task, and the dominant priority for the Community between now and 1992. Over half the legislative programme has been agreed, but there are tough issues still to be resolved. And of course all members of states must implement the Directives agreed. On this, the record of this country is significantly better than in many of those proponents of a great leap forward on monetary union. By any standard, we have one of the best records - we are good Europeans.

*Third,*  
29. *L* It means strengthening Community competition policy. A single financial area needs a level playing field. Which patently does not exist when one large member state gives some eight times as much subsidy to manufacturing industry as does the UK. The Commission have powers to tackle this. They must use them.

30. More generally, the completion of the single market will progressively increase freedom of trade in all goods and services, and freedom of movement of capital and labour. Regulations and technical barriers will be



drastically reduced; industries will be restructured; businesses become more efficient; consumers will benefit.

31. So before we consider the Delors prescription for what should happen after Stage 1, let us not overlook the importance of Stage 1 itself, and the firm UK commitment to its early implementation.

32. All this has a particular importance for monetary policy. For Stage 1 will create powerful pressures on member States to adopt low inflation policies. With the removal of exchange controls and the creation of a single financial area, the capital markets will react more quickly and directly when they fear that a country is not operating sufficiently sound monetary policies. This will be a powerful discipline. Greater stability of prices will in turn mean greater stability of exchange rates. All this will be achieved through the market - not through centralised regulation and direction. It achieves the Delors aims without the Delors apparatus.

33. What our paper proposes is that we should take the market approach of Stage 1 forward to its logical conclusion rather than switching in mid-stream to a bureaucratic and centralised plan. Even after Stage 1 is complete, market forces will be muted by a number of unnecessary restrictions. For example some countries



restrict the currency in which pension funds and life assurance companies may hold their assets, or forbid the issue of foreign currency debt by their residents, or the purchase of their Government debt by overseas residents. Our proposal is that, as a priority post-1992, all restrictions of this kind should be examined and, where possible, removed, so that the competition between currencies and this between monetary policies is further sharpened.

34. This is not, as some people fancifully suggest, a matter of paying for a pint of beer at your local with Italian Lira or Greek Drachma. The proposal is a serious one. With competing currencies, the pressure will be for community monetary policies to harmonise at the level of the best. This will inevitably strengthen the process of convergence on price and exchange rate stability. Realignments should become rarer, fluctuations within the bands of the Exchange Rate Mechanism should become smaller, and we could eventually see a system of more or less fixed exchange rates. With minimal exchange rate uncertainty and reduced costs of switching between currencies, our approach will lead to a multi-currency solution with increasingly inter-changeable Community currencies. In this way we would achieve a practical monetary union as the result of a gradual evolutionary process, but without disruptive constitutional change.



35. Let me deal here with one argument for a single currency in which I know some see attractions. A single currency, they say, would reduce transaction costs for businessmen and travellers in the community. Of course, they are right - by definition transactions costs must be reduced if there is one currency rather than 12. But consider at what price, at what risk.

36. By going for one currency, enormous faith is placed in the ability of the ESCB to keep inflation down. Much safer our approach which maintains national monetary policies and allows currencies to compete to provide the non-inflationary anchor in the European Monetary System.

37. That apart there is the lack of political accountability to national electorates of an ESCB, to which I have already referred. And I suspect, too, that the requirement to abolish the pound, and the franc would be deeply unpopular both in this and other countries in any event, I am sure that as the single market develops, the costs of changing between the community currencies will be reduced as a result of technological improvements and increase competition between banks and our market approach is intended to encourage just that process.

38. Mr Speaker, there are those who seek to portray as foot-dragging the UK's advocacy of a step-by-step approach to EMU. I emphatically reject that view. That



is not at all how we see it. We advocate an evolutionary approach, not because it is slow. It would not be. There is no reason to suppose it would be any slower than the Delors route. The merit of our approach is that it is evolutionary. And it is practical. It is also robust. More robust than the Delors approach, which courts great risks, needlessly, by proposing that decisions should be taken on the next stage of the process before we have had a chance to assess the outcome of the first stage.

39. I can assure the House that we will be not swept into unwise and premature decisions. The Delors Report is not definitive. As the Madrid Council agreed, it is a basis for consideration. And it was also agreed that more work was needed. That work must be very thorough and very well considered. It must not be rushed. For the future development of Europe is of enormous significance.

40. Mr Speaker, I hope it will be clear to the House - and clear to our partners in Europe - that it is our policy to play a constructive part in the debate on Economic and Monetary Union in the European Community. Our commitment to its objectives is just as strong, just as deep, as that of any of our European partners. Britain is playing a full part in Europe. We intend that to continue.

41. Mr Speaker, I commend our approach to the House.



