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PRIME MINISTER

MADRID EUROPEAN COUNCIL: ERM

You have a meeting tomorrow afternoon with the Foreign Secretary and the Chancellor to discuss their joint minute about the handling of economic and monetary matters at the European Council in Madrid.

My understanding from this afternoon's preparatory meeting was that you might be prepared to elaborate our present position on membership of the ERM by saying something on the following lines:

"Our position remains that we shall join when the time is right. When that will be depends on a number of factors. ^① We for our part must get the inflation rate down. ^② And we shall want to be convinced that the process of completing the Single Market and removing all barriers to trade and financial services is being genuinely implemented throughout the Community. In particular we shall want to see the abolition of all controls on free movement of capital and complete freedom of financial markets implemented and sustained for a reasonable period so that we are able to judge the effect of these steps on the ERM itself. ^③ The final decision will remain the sole responsibility of the British Government. But the fulfilment of the conditions which I have set out would clearly have a positive effect both on the Community itself and our decision whether to bring sterling into the ERM."

I think that the questions which you need to consider with the Chancellor and the Foreign Secretary tomorrow are:

- do we actually need to say anything new at Madrid on sterling and the ERM? Gonzalez did not mention it today, and the Delors Report does not make membership of the ERM an absolute condition of Stage 1 of EMU

(saying only that "it would be important").

- would an amplification of our position on the ERM actually achieve the aim of sterilising further discussion of Stages 2 and 3 of the Delors Report for several years? Or will the French not just pocket any concession, and move for an early Intergovernmental Conference at the European Council in December? Once our concession is made, we cannot take it back.
- given that we are determined not to embark on Stages 2 and 3 while the others seem determined to do so, shall we not eventually part company with them anyway? In which case why make the concession at all?
- is it necessarily so bad to be left outside while the others go their own corporatist way on EMU? Might we not actually gain by pursuing much more free market policies outside EMU?
- if we decide to elaborate our position on ERM, then it must be clear that we are doing it in order to achieve positive changes in the way the Single Market operates e.g. genuine free movement of capital and free financial markets. How can we best present it to achieve that?

You might then propose the form of words suggested above, making clear this represents the furthest you are prepared to go, and that in no circumstances are you prepared to set a date or imply automaticity of joining the ERM. We cannot promise a date if we don't know that we can deliver.

I enclose some of the background papers which you saw before today's meeting.

CDP
Charles Powell

19 June 1989