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PRIME MINISTER

Madrid European Council: Economic and Monetary Union

1. We have been reflecting on the points you raised at your meeting with us on 20 June, as recorded in Charles Powell's letter of that evening.

2. We recognise the risks, of substance and of presentation, to which you drew attention. But on the substance it remains our joint view that:

- a) an ERM move at Madrid, of the kind we have recommended, would make it possible to defeat an IGC move at Paris, while no UK ERM move at Madrid would make a French autumn campaign for an IGC decision at Paris both certain and probably unstoppable;
- b) the alternative form of UK move at Madrid, which you suggested, would not take the trick. To suggest that "conditions" which might form the criteria for judging the right time for ERM entry should extend beyond UK domestic conditions (ie re-establishing inflation on a downward path) and abolition of exchange controls in the main EC countries (ie implementation of the 1990 stage of the 1988 capital liberalisation directive's timetable) to include Single Market measures irrelevant to ERM would, in our considered view, be counter-productive. Full integration of banking and other financial markets should be pursued in its own right; and in this
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context we may be able to make some use (if we wish to do so) of the Delors Report's explicit acknowledgement (para 22) that it would be a pre-condition for EMU (without of course implying that EMU would follow when it is secured). But it plainly is not a pre-condition for the effective operation of the ERM.

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More generally, our Community partners would not see UK ERM entry as a UK concession, for which they should pay a price, and nor should we.

c) a presentation which does not include a date, if not as a firm commitment at least as an indicative target, would have no chance of settling the matter in the way you and we want.

3. As for presentation, we accept that some at home may be disposed to detect a U-turn in any ERM move. But we believe that the right ERM move could be presented very positively, for it is the key to securing the kind of Conclusions which the Spanish have in mind, killing Delors' para 39 and kicking Stages II and III into the long grass of detailed ECOFIN discussion (with decisions including by implication IGC decisions - deferred for 4 years). We believe that such an outcome would be widely seen at home, and universally seen abroad, as a success for us and a defeat for Delors and the French. Not only would it be a better outcome than will be obtainable in Paris in December, it is far better than could have been obtained at Hanover a year ago, had questions of substance been addressed then. So we would be seen to have turned the whole Delors Group exercise to our advantage. We believe that the package would be well received, in the party, the City, the financial markets,

where it will be found very quickly thrown back into the net of our

Monica - they would be very satisfied - the success of their play.



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and the country. Conversely, a stand-off in Madrid would feed justifiable fears of a slide towards the dangers described in paras 15-21 of our earlier minute.

4. Given the importance of the issue, and the fact that Finance Ministers will not be present in Madrid, we would welcome the opportunity of another talk with you this week about what should be said there.

(GEOFFREY HOWE)

(NIGEL LAWSON)

23 June 1989

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