

From
THE CHAIRMAN OF THE PARTY
The Rt. Hon. The Lord Thorneycroft

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PT/EMS

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Jin.*

25th October 1978

Dear Margaret

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You have, I imagine, seen Simon May's paper
on EMS.

I attach, in case it should be useful to you,
a note of my meeting with Jeremy Morse.

*Yours
Jin*

Rt Hon Margaret Thatcher MP

SECRET

EUROPEAN MONETARY SYSTEM

Note of a meeting held at Lloyds Bank, 71 Lombard Street, E C 3, at 4.00 p.m. on Monday, 23rd October 1978

Present: Sir Jeremy Morse
Lord Thorneycroft
Adam Ridley
Simon May
Alan Howarth

In a discussion on EMS Sir Jeremy made the following points:-

1. British interests, opportunities and problems in connection with EMS are not very different from those of the French. But the French have put a positive face on the whole question.

Mr Ken Couzens, from the Treasury, handled these matters particularly unfortunately. He really threw away the opportunity to be in the driving troika.

2. Mr Callaghan and Mr Healey have been asking some of the right questions and putting the right case, at least in part.

3. The current discussions should be seen as a second attempt, in the wake of the Werner exercise in the early 1970's. There might have to be further such attempts. It is important that each attempt should move forward and achieve something lasting, even if it doesn't get the whole way.

4. Schmidt and Giscard are trying to move too fast.

5. The world must move away from the \$ as a reserve currency. The SDR system should ultimately replace the \$ in this capacity, but a European currency could fulfil that role on the way to a world currency.

6. What is being attempted is to create in effect a modified Bretton Woods system (and a good deal of what is now being proposed derives from the IMF's Committee of Twenty exercise with which Sir Jeremy was concerned).

7. Sir Jeremy personally favours stable exchange rates. Permanent devaluation means that your industry goes overmarket, being obliged to sell on price.

7. Bretton Woods was a basket and this is theoretically a better system. It is not true that a basket system is necessarily more inflationary.

There is at the moment, however, a practical difficulty about measuring in a basket system. When the \$ is at the centre other currencies can be measured against it, but since the ECU is not yet dealt in it would not be very practical to use it as a reference point. Foreign exchange dealers prefer a grid system.

8. There are a host of new technical elements in the discussion. There's now a more realistic and sophisticated approach to exchange rates.

9. The arrangements for credit to support currencies under pressure which are now being proposed are on a scale that would be significant and might actually work.

10. It is a mistake for Heads of State to get involved in technical discussion. The French have a weakness for the impulsive gesture and for announcing to the world that they have fixed everything. Giscard's trip to Aachen was "ludicrous".

11. The issue of which particular system will be adopted is not basic to the decision as to whether or not we should go in to an EMS.

12. Given the diplomatic impasse there are attractions in the Belgian compromise.

13. The most fundamental argument is about who is going to bear the main burden of adjustments. Even if it is the D-Mark that is always out of line it won't always be the Germans who make the adjustments.

14. The question of convergence of economic policies was almost casually mentioned at the end of the Bremen communique, but it ought to be considered far more seriously than has so far been the case. Admittedly there has been a convergence in the sense that British Government policies have altered a lot, but this isn't said aloud.

It is vital to discuss realistically what the comparative inflation rates will be in the various countries next year and the year after. Will the Germans go up a notch to get the rest of us down two notches? Serious work is needed on forward planning between

the participant countries on growth rates, unemployment rates, etc.

There is a danger of too much weight being attached to locking exchange rates too far in advance of converging economic policies. At Bremen there was argument between the "monetarists" who believe that an agreement on money can be used to "zip the bag together". and "economists" who believe that it will all tear apart if the underlying economies are not adequately aligned.

The Bremen ideas on money represent a marked advance on Werner, but what is missing is the economic convergence element. There is an inclination to rush into a technical agreement insufficiently supported by other agreement.

15. North Sea Oil does now give Britain the chance to run her economy on a basis which will permit her to stay in a European Monetary System. We are much better placed for this than we were in 1973.

We should take this opportunity. To be out would be horrifying, both for our reputation and for our influence.

16. The French and the Germans will do something on 1st January 1978, even though the timetable is rushed.

17. The EMS will not, however, work unless everybody joins. The French surely understand this even if they are scoring some points on the way. Our bargaining position may not, therefore, be as weak as is commonly said.

18. It is time for some positive public speaking in Britain on EMS. It is important that the public should realise that there are great prizes to be gained.

19. The most helpful move by the Conservative Party would be to make firm commitments in support of entering an EMS. Trust is what matters.

20. Sir Jeremy agreed with Lord Thorneycroft's suggestion that this could alter the atmosphere of negotiation. He was interested in Lord Thorneycroft's recollection that towards the end of a government Mr Churchill had called Mr Attlee into discussions on the future of Europe.

There could be possibilities of the Conservative Party strengthening the Prime Minister's hand in the national interest in negotiations over EMS.

In such circumstances British objections to technical aspects of the proposals could then appear constructive rather than negative.

20. We should consider putting arguments for delaying the launch of the EMS beyond 1st January. Prospects for success would be improved if the technical arrangements had been thoroughly worked out, and the scheme were launched when a favourable conjunction of affairs presented itself. It would be possible to prepare a scheme and then hold it for launching at the right moment.

|| The moment to launch EMS with best prospects of success would be when the \$ storm had died down and when the inflation rates of the participant countries had moved closer together.

In this area of discussion we would be asked about our own plans and timetable for getting inflation down.

|| 21. One of the great difficulties in designing a system is to build in the right arrangements for parity adjustments within it. Only experience will show whether a system incorporating flexibility will provide the discipline which is self-sustaining and beneficial.
An unstable par value system would be as bad as a floating system.

This problem has been considerably discussed, and provision for flexibility will probably be built in. Revaluations of strong currencies could turn ~~them~~ out to be more frequent than devaluations of weak ones.

22. In the integrated international post-war economy the weight of mobile money must impose strains on any par-value exchange system. The present structure of exchange controls would have to be preserved.

23. The operation of EMS would entail regular discussions between Central Bankers in advance of budgets, adjustments to parities and other critical moments. It would also entail discussions at a high political level about longer-term trends.