

RR



Box

HOUSE OF COMMONS
LONDON SW1A 0AA

30th October, 1978.

To: Mrs. Thatcher

cc: Sir Geoffrey Howe
Mr. Francis Pym
Lord Thorneycroft
Lord Soames
Mr. John Nott
Mr. Douglas Hurd
Mr. Adam Ridley

The European Monetary System

1. Adam Ridley's note of 23rd October on the EMS was designed "to put forward some important issues which should determine what we prepare to say on the subject in the next few days." This note has been somewhat hurriedly prepared for the same purpose, as a complement to Adam's note. I should make it clear at the outset, however, that my own view is that we should avoid committing ourselves to any firm position on the EMS for as long as possible. For a happy few Eurofanatics and Europhobes this is a clear-cut issue on which we can and must stand up and be counted. For most of those who are neither Eurofanatic nor Europhobe, however, and who have taken the trouble to study the matter, it is a hideously complex and awkward issue, both economically and (more important) politically - and the interaction of the economic and political considerations serves only to make it worse. Moreover, the situation is a rapidly moving one, and we are not privy to the negotiations going on: this makes it all the more important to avoid taking a position which would risk our being seriously wrong-footed by subsequent events.
2. It is, in this context, worth noting at the outset that, as a nation, we are now paying a high price for the present Government's wholly negative and passive attitude to Europe. Had we adopted a more positive and constructive approach, we could have been promoting a new European initiative of our own, possibly outside the monetary field altogether, and one that harmonised with our own national interest. As it is, however, the only European initiative on the table is one designed by Germany and France, which undoubtedly presents the UK with a number of

difficulties, and to which we are obliged to react - in the knowledge that a hostile reaction would inevitably be construed as hostility not to the proposed means, but to the professed end, simply because we have not put forward any alternative means towards the further progress of European unity. This in turn creates problems with our partners in the Community (and also, to some extent, within the Conservative Party.) It is fair to suggest that a Conservative Government would have been thinking in terms of a UK-designed European initiative, rather than simply reacting, belatedly, to Franco-German initiatives as and when they arise.

3. As implied above, both Schmidt and Giscard see the EMS as the next stage in the progress of European unity. They also undoubtedly see it as an important step in the consolidation of the Franco-German entente which they both see as the cornerstone of their foreign policy. However, it is essential to look behind this and understand why this particular economic proposal has been chosen by them as the means to these wholly political ends. The fact of the matter is that both Schmidt and Giscard see the scheme as being in their own specific national interest, albeit for somewhat different reasons. For both men there is an immediate and a longer-term argument. At the present time, Schmidt is faced with a serious problem arising from the acute weakness of the dollar and the accompanying flood of money into Germany. If this is allowed to be resolved by market forces - i.e. if the Deutschmark is allowed to float cleanly, and appreciate steadily not merely in terms of the dollar but also in terms of other European currencies - then German exports will be faced with a growing problem of competitiveness and German industry with a growing loss of profitability and of markets. If, however, to prevent this, the appreciation of the Deutschmark is reduced (as it has been so far) by an active intervention policy, i.e. the purchase by the German monetary authorities of large quantities of dollars, then the result is an excessive growth of Germany's money supply and the undermining of her hitherto successful anti-inflation policy. Hence the attraction of the EMS: if other European currencies can be helped to float upwards against the dollar, in line with the Deutschmark, then (a) the problems for German exports and German industry will be very much less acute and (b) the monetary consequences of any continuing influx of dollars - which in any case should be diminished in scale, since the case for intervention in support of the dollar will have been largely removed - will tend to be spread rather than concentrated on Germany.

