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EHG(B)(82)5 (Revise)

COPY NO

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23 March 1982

EUROPEAN COUNCIL, BRUSSELS

29/30 MARCH 1982

EUROPEAN MONETARY SYSTEM

Brief by HM Treasury

Objective

If there is continued disturbance in currency markets, to leave the discussion to others. Otherwise, to note Ecofin Council's report about the future development of the system.

Points to make

2. (On Ecofin report). Convergence and co-ordination of economic policies are clearly the key to the future health of the EMS. UK ready to join in further study of possibilities by competent committees. In the meantime, ready to take note of Ecofin Council's report.
3. (Realignment procedures - assuming no very recent realignment). Procedures and arrangements for February realignment conference unsatisfactory. Too many leaks and too much publicity before, during and after meeting. Welcome forthcoming review of procedures by Ecofin.
4. (Sterling's membership of margins arrangements). We keep the matter under review.

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Background

5. (Current situation - will necessarily not be fully up to date on 29-30 March). Since October 1981 there have been two EMS realignments involving in each case more than one currency; another early general realignment seems to be in prospect. This contrasts with experience between the beginning of the EMS (March 1979) and October 1981 - during which period there was only one major realignment involving more than one currency. Many saw this earlier stability as temporary, reflecting in part the general weakness of the Deutschemark against the dollar: it certainly did not reflect any underlying economic convergence between EC countries. In recent weeks the French in particular have been having to give heavy support to the Franc in the foreign exchange markets, and also had to raise short term interest rates from under 15% to 18% in the week ending 19 March. The Franc has been at the bottom of the EMS band, but the Belgian franc, Lira and also the Irish Punt have come under downward pressure. The Belgians let it be known at the last realignment that they wanted a larger devaluation than they achieved and this has no doubt accounted for some of the pressure on their currency. The foreign exchange markets are now expecting a further realignment shortly; it is as always possible that such expectation will become self fulfilling.

Conclusions of Ecofin Council

6. Discussion of the future of the system is overshadowed at present by the disturbed state of the currency markets.

7. The November European Council agreed that the time was not right for a move to the so-called "institutional" stage of the EMS, when there would be a European Monetary Fund, probably with powers

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similar to those of a central bank. It commissioned the Ecofin Council to report back to its meeting in March on the scope for "non-institutional" developments in the EMS. The Report from the Ecofin Council fulfils this mandate.

8. Ecofin had considered a somewhat more ambitious package of measures proposed by the Commission. These were not adopted, largely because of opposition from the Germans and the Dutch. The Germans in particular do not want to be forced to take more than 50 per cent ecus in settlement of intervention debts within the system. They do not want other countries to be able to demand automatic access to DM for intervention within the margin limits. They are sceptical about the Commission's desire somehow to enforce the private use of ecu denomination. They emphasise that convergence of economic performance, not minor technical changes, is the real foundation for the wellbeing of the EMS.

9. So the Ecofin report had to be more muted than the Commission (and the French) wished. It refers to the success of the present arrangements, and the importance of convergence and close co-ordination of economic and monetary policies. It refers to the possibility of a few marginal improvements in the field of private use of the ecu, and in conducting the external relationships of the system. It does, finally, call for further study by the competent bodies of the scope for other changes which Ecofin can look at again in May. It remains to be seen whether this search will be more productive than the last.

10. The UK seeks to play a sensible and forthcoming role in all the discussions. It is unlikely that, given the German position, with which we have some sympathy, any UK interest will be threatened.

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Realignment proceedings on 21 February

11. These were not satisfactory. The Belgian request for a 12 per cent devaluation was large and disruptive, and the Danish request for 7 per cent was hastily tagged on without adequate justification. The Chancellor of the Exchequer had to take the chair because the Belgians and the Danes were interested parties. He was dismayed at the procedures, especially at the publicity surrounding the original request and built up during the day by a series of improvised press conferences. Ecofin have asked the Monetary Committee to re-examine procedures. The eventual outcome of 8½ per cent for the Belgians and 3 per cent for the Danes was not unreasonable although it is not clear that the outlook is stable.

Sterling

12. These events may have made most countries reluctant to choose the present time to press us to join the margins arrangements. Our line remains one of support for the EMS, and full participation in all aspects except the exchange rate arrangements. We have good reason for caution : there are a number of factors that mark sterling out as different from other EMS currencies, and in particular as a major international currency we face the possibility of having to deal with potentially huge flows of mobile international funds between sterling and the Deutschemark whenever conditions in the market are unsettled. Although we do not yet feel able to join the mechanism, it is a matter we keep under review as circumstances change.

HM Treasury  
23 March 1982

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EHG(B)(82)5 Addendum  
24 March 1982

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EUROPEAN COUNCIL, BRUSSELS

29/30 MARCH 1982

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EUROPEAN MONETARY SYSTEM :

CONCLUSIONS OF THE ECO/FIN COUNCIL OF 15 MARCH 1982

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The Council is pleased to note that the European Monetary System has worked well during the past three years, and has been an essential factor in achieving a more stable and orderly development of exchange relations in the Community and economic and monetary policies with a greater emphasis on stability and economic development. However, the attempt at the convergence of economic policies, especially as regards budgets, production costs and employment, must be reinforced if the aim of the creation of a zone of monetary stability in Europe is to be attained.

2. The Council thus, is agreed on the importance of increasing in a realistic but meaningful manner the internal strength of the EMS and its capacity for external expression.

3. To this end the Council, after thorough discussion, concluded that it was possible and desirable to develop the EMS further by more actively co-ordinating the Member States' economic and monetary policies of the Member States, by pragmatically strengthening the technical mechanisms for mutual assistance, by encouraging and developing the use of the ECU and by improving monetary co-operation between the Community and third countries.

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4. The Council signified its political agreement on many points, in particular the Commission's suggestions on the private use of the ECU, the measures to enhance convergence and the organizational features of the external relations of the EMS. It considers, however, that the EMS mechanisms have to go even further.

5. The Council requests the Monetary Committee and the Committee of Governors to co-operate closely in submitting the opinions necessary for the Council to adopt a resolution and take positive decisions at its May meeting.

HM Treasury  
24 March 1982