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BREAKING THE STERLING LINK:
IRELAND'S DECISION TO ENTER THE EMS

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Abstract

Ireland had been considering a break in the long-standing currency link with sterling for some time when the ideal opportunity of a new exchange rate regime – potentially retaining the sterling link while stabilizing other exchange rates – seemed to offer itself in the form of the "zone of monetary stability in Europe" proposed by France and Germany in April 1978. Based on newly released archives, this paper reviews the evolving attitude of Irish officials and the Irish Government over the following months as the decision gradually shifted to one of breaking the sterling link and rejoining what was little more than an expanded "Snake" arrangement; the UK having decided to stay out. While financial issues were to the fore in the discussions, the final decision to join was based on a strategic vision that Ireland's economic and political future lay with Europe rather than with the former colonial power.

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For over half a century after Independence, Ireland maintained a one-to-one currency peg with sterling. At first, this was not an unusual position for an ex-colony. But, one-by-one, each of the former countries of the sterling area abandoned such a link, typically very soon after independence. Some countries were motivated either by economic nationalism or a desire to exploit the apparent pro-growth potential of an autonomous currency. The break in other countries was driven by unsustainable expansionary money-financed fiscal policy. By the end of 1978 Ireland was the only former sterling area country to have maintained an unchanged parity since independence.

Ireland had begun to toy with a break in the arrangement certainly from 1975 on when sterling took an alarming slide against the US dollar and the currencies of the European Snake linked to the Deutsche Mark. The strongest arguments for a break were (i) the fact that the currency link to what had been the epitome of financial strength no longer provided financial stability, combined with (ii) a perception that the long-period of relative economic decline for the UK would continue and would augur poorly for an economy too closely linked with it. Yet, lacking a clear alternative policy, and fearful of switching to too tough a regime, the Irish authorities had left any decisive step to change currency policy on the long finger.

Suddenly the landscape changed when triggered not least by German Chancellor Schmidt's desire to bring the French franc back into the Snake arrangement, a movement to create a 'zone of monetary stability in Europe' seemed to expand the range of opportunities available. A new type of exchange rate regime, tying Ireland into the apparently more vigorous, less volatile, continental economies with their recent record of lower inflation, seemed to be on the cards.

It was decision-time. Should the Irish government join the new arrangement, even at the risk of having to break the sterling link (if the UK did not join)? Perhaps the new arrangement really would represent something different and more acceptable that the austere Snake – tougher than the sterling link, but weaker than the latter. In the end, for Ireland the exchange rate mechanism (ERM) of the European Monetary System (EMS) proved in practice to be little more than a rebranded and enlarged Snake. Furthermore, with repeated realignments, it lacked a nominal anchor and saw the Irish pound depreciate quite substantially for the first decade. The consequent uncertainty resulted in high nominal and real interest rates.

This paper reviews archival evidence on how that choice was made and the considerations that weighed with public officials. We show that official thinking remained quite ambivalent throughout the discussion. Yes, officials were keen on a stronger exchange rate regime – but feared that a DM-peg would be damagingly over-demanding for Irish industry. Yes, officials and politicians relished the prospect of closer economic and political ties with Europe as a main plank of policy – but were uncomfortable about the possible impact on cementing the still-contested border (international frontier) with Northern Ireland (part of the UK). Yes, it would be good to be freed from the constraints of financial and trade linkages with Britain – but even better to have our cake and eat it, as seemed possible if Britain also joined the new currency arrangements allowing Ireland to maintain the one-for-one link.

In the end, though, the net mood was for regime change if that was the price of continuing to build the new relationship with the European Union. Transitional costs could be absorbed with the benefit of cash transfers which were vigorously, and successfully, pursued.

And any residual desire to stay tied to the apron strings of the sterling link was swept aside when, in an embarrassing and irritating diplomatic *faux pas*, British officials failed to inform their Irish counterparts of the outcome of secret inner discussion between the three largest European Community countries. This seemed to expose Ireland's perceived status as a client of Britain (at least in financial terms), a perception that, for reasons of national pride, had to be scotched.

Our reading of the official papers suggests that there was little formal economic analysis of the policy choices. At best, highly simplified political and economic checklists were employed. Perhaps this explains why Ireland stumbled from a coherent and robust exchange rate regime into a rather dysfunctional one which lacked a nominal anchor and was associated with recurrent crises and exceptionally high nominal and real interest rates. Not surprisingly, twenty years later, comparatively little hue and cry was raised against a return to a fixed peg in the form of euro-zone membership.

2 Growing Doubts about the Link, 1928-77

2.1 Adoption of a Sterling Link Currency Board by Independent Ireland

International thinking about exchange rate regime options in the 1920s was dominated by the desire of many to return to the certainties of the Gold Standard. The German and other hyperinflations of the early 1920s acted as cautionary tales against laxity in currency policy. No wonder then that, in 1928, the government of the newly independent Ireland, led by Cumann na nGael (a party less pre-occupied than their main opposition with nationalist symbolism) followed the recommendation of the Parker Willis Commission (1927)[1] and established a currency board (known as the Currency Commission) to issue banknotes of a new currency, the Saorstát Pound, which maintained the one-for-one parity link with sterling.

The decision to maintain the fixed link with mighty sterling was to ensure the stability and integrity of new state's monetary system, and the decision was in keeping with the conservative, nation-building legacy of the Cumann na nGael government. It must have seemed a safe choice, especially now that sterling was back on gold and that even France – so recently in currency trouble – had opted to stabilize the franc against sterling (Mouré, 2002). Indeed, the fixed parity link was to provide exchange rate stability with Ireland's main trading partner which then accounted for over 90 per cent of Ireland's trade.

Nevertheless, the sudden devaluation of sterling in 1931 and the collapse of the gold-exchange standard was an unexpected hiccup. It presented a reason for the incoming Fianna Fáil administration to reopen the whole question of currency and banking arrangements, which they did by appointing a new commission of inquiry. Nevertheless, cautious public servants ensured that the majority composition of the Banking Commission, as it was known, had a conservative cast; their 1938 report did not suggest any change in the currency link arrangements, though they did advocate the creation of a Central Bank (Honohan, 1997).

Until the mid-1970s, it is fair to say that the question of breaking the link did not attract much policy attention, although there were some mutterings immediately after the sterling depreciations of 1949 and 1967. Both events led to discussion on the merits of adopting of a tougher regime, but the discussion was not sustained and no serious action was taken to investigate alternative exchange rate options (Moynihan, 1975, McCarthy, 1980). It is interesting to note that during this period the pressure for change was generally in the direction of looking for a harder regime.

2.2 Rumblings in the 1970s

That was the case also when the link came under renewed criticism in mid-1970s. The UK had exited the EEC Snake only six weeks after its inception and sterling became a floating currency. Increasing speculation had made it impossible to maintain sterling's value at the target level[2]. For the next seven years Ireland was linked to an unstable and often depreciating pound (Figure 1). In 1972 and 1973 sterling depreciated sharply against the DM, although holding its own on average against the US dollar. In 1975 and 1976, though, sterling fell steeply against the US dollar as well as the DM; losing a third of its value in terms of the dollar in less than two years. The currency link to what had been the epitome of financial strength no longer provided financial stability. Depreciation of sterling was naturally associated with rapid inflation, and this in turn was quickly imported into Ireland. Since Ireland is a small open economy with strong trade and financial links with the UK, the transmission was unsurprisingly rapid and reliable. The close relationship between Irish and UK inflation is shown in Figure 2. Figure 2 also highlights the increasing price divergence of Ireland and UK to that of West Germany in the years before EMS.

The government's inability to control inflation limited their capacity to effectively plan and manage the economy and resulted in serious misgivings about the continuation of Ireland's link with sterling.

A number of others factors conspired to further undermine enthusiasm for the sterling link. There was a perception (documented below) that the long period of relative economic decline for the UK would continue and would augur poorly for an economy too closely linked with it. Furthermore, although the UK remained Ireland's most important trading partner, Ireland's dependence on the UK market had declined quite dramatically over the period 1960 to 1978. As late as 1960 almost three-quarters of Ireland's exports went to the UK and only 5% to the EEC-7 countries (i.e. original six members plus Denmark), while almost half of Ireland's imports came from the UK compared with just 13% from EEC-7. By 1978, though, a remarkable shift had occurred: the share of exports to the UK had dropped to 47% while exports to the EEC-7 had jumped to over 30% to EEC-7. The UK still provided about half of Ireland's imports but imports from the EEC-7 countries had increased to 21%.

By 1976, the Irish Department of Finance was formally examining, in conjunction with the Central Bank of Ireland, the adoption of an alternative exchange rate regime. In Central Bank Governor Murray's (1979) words, "a mood of change [was] in the air"[3] As he documents, three alternative exchange rate regimes were considered at that time: "(a) floating the Irish pound, (b) joining the Snake, or (c) adopting a trade-weighted exchange rate objective." The third option, maintaining stability of the nominal effective (trade-weighted) exchange rate index, was at that stage the only runner as a realistic alternative to the sterling link, essentially because it would offer reasonable nominal exchange rate stability against the currencies of bulk of Ireland's trading partners.

Interestingly, entry into the Snake was rejected because its members accounted for only 16 per cent of Ireland's trade and furthermore "represented a much stronger exchange rate regime which would (in the short-run) lead to considerable deflationary effects on the economy"

Low inflation, protection against speculative pressures and reasonable stability vis-à-vis trading partners seem to have been the main criteria considered for an exchange rate regime. But transition to a stronger regime was considered risky.

Thus, despite the "mood of change", officials felt the time was not yet ripe. In particular, a Department of Finance memo (from 1976)[4] on breaking the link states that the economy was not appropriately positioned to support a change in exchange rate regime. It followed an orthodox line of economic thinking that a change in the exchange rate regime should only be done from a position of strength when it can be supported by fundamentals in the economy; until such time a change would be too much of a "gamble".

2.3 Cost-push and Imported Inflation

Although academic economists were under no illusions about the imported nature of most price inflation under the sterling link (Geary, 1974, Geary and McCarthy, 1975), Nelson (2008) argues that the Irish authorities continued to hold nonmonetary views of inflation throughout the 1970s. He documents this with speeches and articles by politicians, by the Central Bank and by the influential think-tank the Economic Research Institute (later the Economic and Social Research Institute). If inflation was cost-push origin, it could be controlled by manipulating domestic costs and prices directly. This may have reduced the urgency with which politicians approached the question of breaking the link with sterling. According to Nelson, under the Fine Gael[5]-Labour Government of Liam Cosgrave (1973-1977) it was not widely accepted that breaking the link with sterling was a necessary action to reduce inflation. Indeed, Finance Minister Richie Ryan claimed in mid-1975 that there were "other and more realistic ways of putting our house in order"[6]. As long as this was a widely-held view[7], the experienced inflation would not provide a decisive reason to make the break.

However, it would be a mistake to assume that policymakers were ignorant of the exchange rate-inflation link. They were surely correct to state that short-term cost-push pressures from wage increases could result in transitory inflation deviations as well as adverse balance of payments and employment consequences. Imported inflation might dominate in the long-run, but neglect of cost-competitiveness would have a variety of short-term consequences worth avoiding. That the key policymakers clearly understood that inflation in a fixed exchange rate regime was ultimately imported is definitively shown by Governor Whitaker's (1976) statement: "no small country dependent on international trade can defend itself in the end from the inflation prevailing in its main trading partners".[8] Furthermore, he pointed out that as long as a sterling link was in effect control of Ireland's inflation would depend on that of Britain.

2.4 The Time Ripens

By the time Fianna Fáil returned to power in 1977 (under the leadership of Jack Lynch and with Finance Minister George Colley), inflation had slowed in the UK, and the most opportune time to break the link appeared to have passed. Yet choice of exchange rate regime remained a live issue.[9] In a memo undated in the file copy, but likely from Oct/Nov 1977[10], Colley requested his Department to undertake further investigation into suitability of conditions for adopting effective exchange rate in autumn 1978. Could this new impetus have been driven by the nationalist/political attractions for Fianna Fáil of moving further outside the orbit of Britain actually and symbolically? The official files do not suggest such a motive. Instead, the view that the sterling link was no longer an ideal regime maintained a bipartisan - albeit not very strong -- support. The issue simmered in the background: one day, conditions might have improved to the point where the economy might be strong enough to withstand the pressures of adopting a tougher exchange rate regime. It is not altogether clear how the strength of the economy was to be assessed, but presumably the criteria would have been similar to what was specified in the Finance memo on exchange rate change (dated 1976) which included a reduced borrowing requirement, greater control over non capital spending, low inflation and a healthy balance of payments. Whatever the exact criteria, officials felt that the economic situation was improving to the point where Ireland could be in a suitable position to break the link by late 1978, and this motivated their maintaining the momentum of studies. Breaking the link was a policy objective of the two main political parties but it would appear neither was willing to break the link until it was supported by economic fundamentals[11].

The degree to which a regime change was being seriously considered is revealed in a letter dated 9th December 1977 from Tomás Ó Cofaigh, Secretary of the Department of Finance, to Central Bank Governor Murray.[12] This letter outlined the agenda for a forthcoming meeting between the two bodies. Issues to be discussed were domestic conditions necessary before breaking the link, the mechanics of the zero effective exchange rate system, contingency plans on exchange controls and adequate statistics to monitor capital flows.

Yet, still lacking a clear alternative policy, and fearful of switching to too tough a regime, the Irish authorities had left any decisive step to change currency policy on the long finger.

3 A "Zone of Monetary Stability in Europe" Is Mooted: April-June 1978

3.1 Schmidt and Giscard Launch the Proposal at Copenhagen

The proposals which were to form the basis of a new era in European monetary history were sprung by German Chancellor Helmut Schmidt, who was backed by the French President Valéry Giscard d'Estaing, on unsuspecting EEC Heads of State and Government at the European Council meeting in Copenhagen on 7th and 8th April 1978. The proposal was born out of the French Government's desire to rejoin the Snake arrangement and Schmidt's personal desire to have a European currency system that could protect German industry from the loss of competitiveness associated with the US dollar's steady slide against the DM – which had averaged almost 10 per cent per annum for the previous couple of years.

Political factors were to also at play in the drive towards increased monetary cooperation. Schmidt had become increasingly frustrated with the Carter administration's unpredictable security policy and sought increased European defence cooperation. But before any progress could be made on the defence front he recognised that increased political integration in Europe was required and this could be aided by closer European monetary cooperation. According to Giscard, "The money (EMS) was mainly my idea. Defence was that of Chancellor Schmidt."

The stated aim of the Giscard-Schmidt initiative was to 'create a zone of monetary stability' for all EEC members. This would be more flexible than the Snake and would promote trade, growth and economic convergence. The European Monetary System they proposed would use the European Unit of Account (EUA – later renamed the ECU)[13] more extensively both for transactions between EEC central banks and for joint interventions against the dollar and third currencies. It was envisaged that the ECU would become a reserve asset similar to SDRs issued by the IMF. Both men asserted that an important component of the new system was the pooling of up to 20% of member countries' official resources which would enable the efficient function of the system providing members with support funds of short or medium term duration to defend their currency within the system if necessary. The funds were to be managed by a newly created European Monetary Fund which would take over the capital and functions of certain existing Community institutions and facilities, including the European Monetary Cooperation Fund and the European Investment Bank (EIB) and the credit and swap arrangements connected with the Snake (Ludlow, 1982).. Schmidt envisaged that his proposal was "a scheme not to replace the present Snake but to swallow it up"[14].

The finer details of the proposed system including the precise rules for exchange rate fluctuations had yet to be fully examined but even at this early stage the British Prime Minister James Callaghan was less than enthusiastic and raised a number of concerns about the proposed scheme. He questioned the impact the system would have on the US dollar and whether such a scheme challenged the role of the IMF. At Schmidt's request it was agreed that details of the proposals discussed at the meeting would remain secret (he had not yet got approval for them either from the Bundesbank or from his government colleagues).

Like most of his counterparts at the meeting, Lynch welcomed the initiative in principal. Upon his return to Dublin, he circulated his notes on the meeting to Colley and a small number of senior Finance officials. Given the previous analysis of exchange rate regime choice they were well-prepared to provide initial comments on the proposals. The initial official response was generally positive, though some potential drawbacks were noted.

Within two weeks of the Summit, Assistant Secretary Maurice Horgan provided Colley with a written reaction[15] to the proposed scheme. This document gives a glimpse into the frustration officials felt with sterling's instability and the constraints the fixed regime imposed on their freedom of action. Horgan viewed the proposed system as a mechanism which would curtail the movement of sterling and help stabilise the external value of the Irish pound which “at present appreciates and depreciates willy-nilly with sterling”. Neither appreciation nor depreciation was considered desirable: appreciation led to export competitive problems while depreciation led to inflation problems. He also welcomed the proposed extension of the EMCF funding, noting that it could be used to help fund balance of payments deficits. On the other hand he acknowledged that participation in such a scheme would require adherence to new EEC disciplines. Government borrowing requirement would have to be drastically reduced while drawing on the new funds would mean acceptance of external constraints on economic and monetary policies.

There is no indication at this early stage that entry into the system was viewed as an opportunity to break the link with sterling. Interpreting Lynch’s notes of Giscard’s description of the new system as a “Bretton Wood system within nine” Horgan understood the proposed system to be an extension of a system of fixed exchange rates and considered that Ireland’s future in such a scheme would “probably be less difficult for us than for some other EEC countries” given Ireland’s experience under the fixed Sterling link.

It is interesting to note that, when it came down to a definite option, the underlying demand for a tougher exchange rate policy was quickly superseded by anxiety that Ireland would be a persistent deficit country struggling to cope with externally-imposed disciplines. It was a theme that was to colour much of the government discussion on EMS over the duration of negotiations on EMS starting with Colley’s meeting with the Vice President of the European Commission Mr Ortoli on the 21st of April in Dublin. According to the notes of the meeting, Colley informed Ortoli that “the monetary development with movements towards more stability had his full support” stressing that “stability was of paramount importance for a small open economy like ours”. However, he was wary of the possible credit stand bys to be included in the new system and “could not ignore the possibility that the Government’s freedom of action in policy might be reduced” if they were to access these credit channels. Unlike the fixed link with sterling, entry into the EMS was not one which Ireland “could [necessarily] move to alter at any time”.

At the first ECOFIN[16] meeting after the Copenhagen meeting (which took place in Luxembourg on 17th April, the Monetary Committee and the Committee of Central Bank Governors were asked to re-examine the possibility of European monetary integration. This was the obvious mechanism for developing the proposals in detail. Indeed, over the next few months the Irish authorities participated in a series of Monetary Committee and Governors’ meetings. The conclusions of these meetings were summarised and submitted by the ECOFIN at its meeting of 19th June and submitted to the European Council whose next meeting was to take place in Bremen in early July.

Much to the annoyance and frustration of both Committees, Schmidt was unforthcoming with his proposals[17]. Despite the initial uncertainty[18] and this perceived affront, the committees proceeded to examine and discuss a number of viable exchange rate mechanisms along with the necessary credit mechanisms to sustain the system, implications for the dollar and the use of the EUA as the system's unit of account. As its starting point the Monetary Committee "assumed that the Council wishes to see progress towards exchange rate stability even before member states have solved the problem of differences in the inflation rates and balance of payments performance. Such progress on exchange rates could politically, psychologically and technically contribute to improving the convergence of economic policies and trends of member states". At a stroke, this statement undermined the orthodox economic view underlying the official hesitation in Ireland, especially at the Central Bank, about breaking the link with sterling.

3.2 The Group of Three

Unknown at first even to the other member states, and in parallel to the deliberations of the Monetary Committee and Governors, a group of three officials from the three largest member states, also began to prepare proposals for the Bremen meeting. Schmidt was the main instigator of this group of special advisors. His primary motivation for setting up this group was to protect the proposals from being derailed by central bankers and other officials whom he believed would fail to reach agreement and kill the momentum of project. It was also an attempt to bring the UK government into the fold. Despite his reservations, Callaghan agreed, in a secret meeting the morning after the unveiling of the Schmidt-Giscard plan, to nominate a special advisor to the group. Dr Horst Schulman, Chief Economic Advisor in the Chancellor's Office, was nominated by Schmidt, while Giscard chose Bernard Clappier, Governor of the Banque de France. Eventually Callaghan nominated Ken Couzens, Second Permanent Secretary at the Treasury, to the Group of Three.[19]

The Group of Three was charged with developing the plans proposed at Copenhagen. The existence of the group was to remain secret[20], and indeed it remained so until revealed in an article in *The Economist* on May 27th.

Although Clappier was also a member of the Committee of Governors, and actively involved in the discussions with the Monetary Committee, the Franco-German proposals eventually put forward at Bremen did not list a set of specific exchange rate options unlike the Monetary Committee report[21].

3.3 Exchange rates options proposed by the Monetary Committee and Committee of Central Bank Governors

The summary report of the Monetary Committee and Committee of Central Bank Governors series of meetings was interpreted by the Irish officials as presenting three technically feasible exchange rate options with a number of variants:

1) An extended Snake or Boa[22]: under this regime non Snake members would gradually rejoin the Snake. In the initial period (up to nine months) non Snake members would be allowed wider margins of fluctuations and flexibility in changing central rates.

2) Basket type models: under this set of options the non Snake countries could keep their currency value within a margin of +or – 2.25% of the weighed average value of a basket of currencies. A number of possible baskets were considered (a) an effective exchange rate basket where the basket included a countries main trading partners (b) an EUA basket, the currencies of the 9 EEC members weighted by their economic importance (c) a Snake dollar basket containing snake currencies and the dollar.

3) An effective exchange rate target with no intervention obligations. The third set of models considered were the reference zone models which were technically the same as those in option 2 but countries were under no intervention obligation if their currency exceeded the reference zone.

What was the Irish authorities preferred choice among these three? The briefing[23] prepared for the Monetary Committee meeting on 5th and 6th June assesses each of the exchange rate options. In line with the previous domestic analysis, the second set of options was the Irish Government's preferred choice. As before, it was considered to be less stringent and was seen as less open to speculation than the Snake option. Furthermore, Finance officials did not believe the political will existed to ensure the success of the Snake option.

Irish officials monitored and assessed UK's likely position on the matter. At this stage they continued to assume the link with sterling would be maintained and inferred that whatever regime they would enter would be determined by the UK. Indeed, following Healey's willingness at the Monetary Committee meeting on 10th and 11th May to re-examine "the currency skeleton of Copenhagen", officials examined the implications of joining the Boa regime in tandem with the UK despite their clear aversion to the rigours of the Boa type arrangement. The officials viewed the proposals as an effort to restore exchange rate stability but argued that the proposals, in particular the Boa option, could also be considered as a first step toward European Monetary Union. On this basis it is clear the Irish saw the forthcoming Council meeting as an opportunity to reiterate previous arguments that progress towards a new monetary system must be accompanied by a concomitant transfer of resources in order to support economic convergence.

A note submitted by the Central Bank on 15th June introduced a new consideration, however, representing a significant shift in the authorities' thinking and actions.[24] The note approaches the question of European exchange regime choice from a different perspective, arguing that, for Ireland, the choice of regime should be viewed in terms of not only which one provides the greater exchange rate stability but also "is compatible with the one-for-one link [and] at the same time is best suited to breaking the link in the future (at a time of our choosing)". It is the last proviso that represents the new thinking. The note argues that an effective exchange rate index target would have the advantage of not requiring a formal devaluation or revaluation. The note was readily absorbed into the Irish brief prepared for the ECOFIN meeting on the 19th June.

Interestingly, despite the convergence of arguments, the Central Bank cautiously advised the Minister to avoid taking a position on the options at the ECOFIN meeting, given the uncertainties about the UK's preference and technical aspects of the regimes. At this point, therefore, moving without Britain was seen as risky: better, in the Central Bank's view, to let the UK choose their preferred system and then row in behind them.

Nevertheless, and uncharacteristically, it would appear the Minister chose to show the Government's hand. Included in Colley's draft speaking note on the Report of the Experts' Committees on Exchange Rate Convergence to be given during the ECOFIN Council meeting on 19th June was the contention that a return to the Snake was unrealistic and that his own "preliminary assessment [was] that the effective exchange rate index would be the most appropriate choice, reflecting... individual members trade patterns and facilitating measurement of individuals competition"[25].

For Ireland, the effective exchange rate option was still clearly the preferred option. However, very shortly before the Bremen meeting, Finance officials' warmed to the Boa option as is shown by the brief of 29th June prepared for the meeting.[26] It was now considered that the Boa option "permits considerable flexibility [in terms of changes in central rates and wider fluctuation] during the transition to Snake membership". The brief indicates that Ireland could support such a proposal. This is a remarkable turnaround from the view expressed less than a week earlier in a brief prepared for the Council of Foreign Ministers on the 26th and 27th June affairs, in which officials had advised that the effective exchange rate options "constitute an acceptable compromise to the untenable rigour of the Snake and the target zone options". Hostility to Snake or Boa was still evident in the Dept of Economic Planning and Development's submission dated the 28th June which advised that the Boa option "would not be acceptable to Ireland because of the rigorous disciplines it would impose in terms of keeping costs in line" with Snake members .

It is not clear just what had weakened Ireland's opposition to the Boa. One consideration may have been growing awareness that the Boa was the preferred choice of Schmidt and Giscard. There were also indications that the UK was "prepared to go along with Schmidt's Boa idea". This may have induced officials to re-examine the merits of Boa option more closely. Indeed, they appear to have found further solace in a conclusion of Finance Council's (19th June) that the "remaining real disparities in economic performance [should not be prevented] from being reflected in exchange rates".

At this point it was increasingly clear that the main option on the table was some more flexible version of the Snake.

4 Embarrassment at Bremen—and the Consequences

4.1 The Oversight

An incident in the run up to the Bremen European Council meeting on the 6th and 7th of July had a momentous influence on how Ireland approached the meeting.

In the two weeks prior to the Bremen Summit, the French and German members of the Group of Three met and briefed all the EEC members on the proposals to be made at Bremen, with the exception of Ireland and Denmark (as Denmark held the European presidency, it is likely that they had become aware of the proposals through other channels). The oversight reflects the breakdown in the negotiations between Couzens and the other two members of the group, combined with a perception that Ireland was, for monetary purposes, an adjunct of the UK. Reflecting widely-held doubts in UK official circles,[27] by mid June Schulman and Clappier were obliged to proceed without Couzens, although he was kept informed of their work.

Couzens was sceptical about the likely effectiveness of the Schulman-Clappier discussions, and thought that what Schmidt and Giscard (meeting in Hamburg on 24th June) had decided was merely on "procedures for carrying the European monetary reform project further rather than on anything approaching a detailed scheme." He told Downing Street that, following the Hamburg meeting, Schulman and Clappier had prepared a "very broad and general kind" of paper for Bremen. Couzens assumed that the more relaxed pace and more specific nature of the more inclusive Monetary Policy Committee discussions would prevail, and that the UK's reluctance to commit even in principle to a new monetary system would not be tested."[28] Although Couzens knew of plans by Schulman to brief Italy (on 29th June) on the progress of their secret discussions, and "gathered" that Schulman "may be visiting the Danes, and possibly the Belgians and the Dutch, for the same purpose," he did not take it on himself to brief the Irish Government, even though both Schulman and Clappier assumed that he would do so..[29]

The oversight greatly annoyed the Irish government who having learned of the oversight on the 30th of June were agreed to react in a "positive manner". The incident highlighted to the Irish authorities how closely Ireland was perceived to be linked with England by fellow EEC members. Indeed, it appears that such a perception was not unfounded. A reading of the UK summary note on the side meeting between Giscard, Schmidt and Callaghan before the start of Bremen meeting shows how Giscard automatically assumed that Callaghan's initial refusal to agree to the proposals in principle was also the Irish stance. Indeed, Giscard proceeded to discuss plans whereby Ireland and the UK would be given only observer status during the working out of the scheme with the option of joining the scheme later.[30]

The Irish authorities realised that it was a perception they would have to dispel at the Bremen meeting if they were to be taken seriously in negotiations. The Irish authorities immediately demanded meetings with Clappier, Schulman and Couzens. (The respective ambassadors in the Paris, Bonn and London represented the Irish side in these meetings). And at the Bremen meeting, where the Franco-German proposals were presented, Lynch explicitly aired his grievance at the treatment Ireland had received. Lynch's notes of the meeting would suggest it was expressed in a conciliatory fashion while insisting that "we would like the same type of consultation as other members had in a matter of this nature"

Rather than creating an atmosphere of despondency and resentment, though, the incident appears to have strengthened Ireland's determination to be part of EMS.[31] A reading of the brief[32] prepared for the Bremen meeting shows Lynch's position now as being that Ireland would act independently of the UK and would join the system even if it meant breaking the link with sterling provided conditions were appropriate. In other words, Lynch's statement to the press in the immediate aftermath of the Bremen meeting indicating the Government's willingness to break the link with sterling was premeditated. It is as if the affront of being seen as a client of the UK even if only in monetary affairs galvanized a nationalist reaction that severely weakened the cautious instinct to hold onto the security blanket that was the sterling link.

4.2 Decisions at Bremen

As to the proposals themselves (some key features of which are reviewed in the accompanying box), participants at the Bremen meeting were better prepared than at Copenhagen to discuss details. Many concerns were raised on issues such as the speed with which the EMS would be set up, the strictness of the regime, the need to study the effects on less prosperous region. By the end of the meeting it was agreed that the Clappier-Schulman proposals would be accepted as a starting point and a preamble was included in the document outlining the need for further technical discussions which were to be conducted in the following months.

Key features of the Clappier-Schulman proposals – the exchange rate regime and the fund
One of the most significant proposals included in the Franco-German document at the Bremen meeting was the proposition that "the ECU will be at the centre of the system." It was to occupy much of the subsequent technical discussions as two views were formed as to it meaning. Indeed Clappier and Schulman did not entirely agree on what role the ECU should play in the new European Monetary system.
Clappier believed that the ECU should be used as the basis for the intervention system with each currency's central rate and intervention limits calculated exclusively in terms of the ECU. Somehow this was seen as potentially less rigid than the Snake mechanism.
Schulman was more in favour of a parity grid system with central rates set for each country in relation to the ECU. The central rates would then be used to determine the bilateral parties and intervention limits within which the currencies could fluctuate against one another. Schulman believed the ECU should be used mainly for transactions between EEC central banks and for joint interventions against the dollar and third currencies.
As the technical discussions progressed over the next number of months, non-members of the Snake began to accept that the operation of the ECU-based system was too complex and could adversely impact on weaker currencies. It was not possible to solve these problems within the timeline given before the Brussels and a compromise was reached with the parity grid system at the centre of the ERM.
A second important component of the EMS was the European Monetary Co-operation Fund (EMCF). One of its main purposes was to aid countries maintain their central rates in the ERM. It was agreed during the technical discussions that each member countries would deposit 20 per cent of their reserves and in return would be credited with an equivalent amount in ECUs. Countries who encountered current account balance of payment deficits could access ECU credits from the EMCF. The EMCF also included a Very Short Term Financing Facility (VSTFF) which provided central banks with ECU credit to defend their currency in the ERM.

Judging from his pre-meeting brief, Lynch's must have been quite satisfied with the meeting's outcome. Thus, although the government would have preferred a less stringent approach than the Snake type regime, Lynch (backed by the UK and Italy) successfully got agreement at the meeting for "concurrent studies" on complementary actions required to strengthen less prosperous countries – code for some form of resource transfer. Lynch argued that unless there was greater convergence between the economic positions of member countries it was unrealistic to expect less prosperous countries to participate successfully. It was an argument that had been made before in past discussion on EMU and Lynch was well prepared to make this argument especially with the publication of the Joint Committee of the Dáil and the Seanad on Secondary Legislation of the European Communities report on Economic and Monetary Union a few days earlier. The report argued that a greater degree of economic integration within the Community could lead to a strong tendency for richer countries to draw wealth and resources towards them; therefore a redistribution of resources from richer to poorer countries was necessary to protect poorer countries.

After Bremen, the Central Bank of Ireland, perhaps gauging the building political momentum and the Government's now evident desire to participate in EMS, became more wholeheartedly supportive of the position taken by Lynch at Bremen. Governor Murray wrote to Colley on 21st July outlining the criteria against which Ireland's entry into the ERM should be considered. He further added that although the UK's decision to enter had a significant influence on the options available to Ireland, perhaps aware that he was preaching to the converted, he argued this "does not mean we should take a passive role and let the UK make the decision for us."[33]

Clearly the government had no intention of taking a passive role, but instead were seriously considering entering the EMS without UK. The following week (26th July), Colley asked the Central Bank to deepen their knowledge of the functioning of foreign exchange markets. Colley also requested a follow up on an earlier query with the Governor on what impact exchange controls had on the flow of funds in the case of smaller countries of EEC.[34]

4.3 The "Concurrent Studies" on Resource Transfers

As discussions on the technical aspects of the European Monetary System continued so too did the studies on the necessary actions needed to support the less prosperous regions. A successful outcome to discussions on resource transfers were considered by both Bank and Finance as crucial in determining whether the government might enter the EMS without the UK .It was a point that Colley compellingly made at the ECOFIN Council on 20th November stating that if transfers were not forthcoming "It would be difficult if not impossible for Ireland to commit itself to entry to the new system however great the political urge to do so".[35] If the link was to be broken the authorities required community funds on grounds that joining the EMS could hamper Ireland's efforts to converge with Community economic standards. Specifically, the Irish government identified the following reasons[36]:

1) As a member of the system, the Irish government would have to reduce its current account more quickly than was envisaged which would have serious and damaging deflationary consequences for the economy

2) In order to meet with the challenges of Community and EMS membership, the best long term solution would be to increase investment, a process that could be greatly

assisted by the provision of community funds to facilitate the financing of the public capital programme and to offset the adverse effects on the balance of payments that would result from increased imports induced by the necessary acceleration of investment

3) In the initial phase the Irish pound was expected to be above its normal level (as the sterling was expected to depreciate) and Community funds would therefore be necessary to reduce the negative effect on competitiveness. As Irish borrowing requirement as a percentage of GNP was quite high and it was their intention to reduce it, the Irish authorities preferred grants rather than loans.

The Irish government compiled a "shopping list" of infrastructural projects, and requested grants totalling £650m over five years.

It was clear from a very early stage that agreement on the concurrent studies would be difficult. Disagreements centred primarily on the funding mechanism through which Community funds could be channelled and the amount of resources which would be provided. A memo dated 11th August on meeting between Colley and officials J Scully and Seán Murray on the concurrent studies sheds further light on the government strategic plan of action throughout the EMS campaign. Colley did not hold out much hope for success in receiving transfer of resources under the concurrent studies on the scale requested. Reflecting his belief that the best chance of aid was through bilateral transfers and verified by the slow progress in reaching agreement on the concurrent studies, in the two weeks before the ECOFIN Council meeting on 20th November both Colley himself and Lynch had held meetings with each of the member countries. Colley believed that Germany and some other member states were more likely to support Ireland as it would put "pressure on the UK to join and not be the odd man out". Colley felt it was imperative that Ireland was seen to pursue a distinct line from the UK and show Ireland was "not a secret vote for the British". During the meetings he emphasised that Ireland's request for a transfer of resources arose out of the anticipated difficulties of entry to the EMS, unlike the UK who had sought to use the discussion of resource transfers as a forum to raise problems with CAP and budgetary reform.

5 Going It Alone

5.1 UK Remains Out

Having seriously contemplated breaking the link over the previous six years, the initial proposals at Bremen must have seemed like the ideal solution, assuming that the UK joined. On offer seemed to be better bilateral exchange rate stability with many trading partners and a more disciplined (but not too tough) currency policy for sterling – with which the Irish pound could remain linked.

But, by the time of the next European Council meeting, held in Brussels on 4th - 5th December, the decision faced by the Irish authorities was no longer straightforward. In late November, the UK had confirmed their decision to defer entry into EMS (cf. Healey, 1978a). Furthermore, the ERM had become little more than an expanded Snake regime with the ECU to be used only (as far as the determination of exchange rates was concerned) primarily in its role as providing a secondary – and largely ineffective – "indicator of divergence".

The UK's late withdrawal from the ERM was a possibility the Irish authorities had considered long in advance. In mid September an Inter Department Committee began preparing a Memorandum to Government on the EMS. Up to that point, most of the decisions appear to have been based on high level discussion between a small group of officials.[37] The process of preparing the Memorandum enabled greater input from a wider number of officials. Each relevant Department undertook, in consultation with state agencies under its control, an examination of the implications of participation on the sectors they were responsible for. Given the uncertainty about the UK decision to enter the system they were asked to consider three scenarios:

(i) Ireland in and UK out

(ii) Ireland and UK both in and the link is maintained

(iii) Ireland and UK both in but with margins of +/-2.25%.

The draft Memorandum discussed the possible consequences of entry on the macro economy, impact on specific sectors, interest rate policy, effect of exchange controls and Northern Ireland. As such it is revealing of official opinion not only on the monetary management aspects of "going it alone", but the wider strategic and political aspects of driving an exchange wedge between the economies of Ireland and the UK (including Northern Ireland). Successive drafts ensued as it became clearer what the exact form of the new regime would take; it was not until the final draft in December that the Department of Finance inserted their recommendation on entry.

5.2 Monetary officials get cold feet

With British membership in doubt, both Central Bank and Department of Finance revealed considerable doubts about Ireland breaking the link with sterling and going ahead into the new system.

Withholding final judgement until the mechanics of system were agreed upon and the outcome of the resources transfers were known the Central Bank's submission on the EMS to the government dated the 15th of September gives only very qualified support for Ireland's entry into EMS. The Central Bank strongly urged the government to face up to the obligations that the EMS would place on domestic economic policies. Although accepting the need for a pragmatic approach to the timing of exchange regime choice, the Central Bank seriously questioned the government's ability to participate in a hard currency regime given their economic policy stance. Possibly as an effort to force the government to examine its conscience on the transfer of resources issue, the Central Bank asserted that the basic justification for Ireland's participation in the EMS was the prospect of exchange rate stability.

Given these misgivings it comes as something of a surprise that this September document from the Central Bank does favour entry into the system from the outset even without the UK joining on the grounds that sterling was likely to continue to be an unstable and depreciating currency. Therefore, if Ireland was to enter at a future date it would be under more difficult conditions: "a decision not to join EMS unilaterally would amount to a postponement rather than an avoidance of these difficulties". For the Central Bank, then, it appears that the momentum to EMS had taken over from the earlier static analysis of regime options. Saying no to EMS now no longer preserved the status quo ante.

Two months later, the Central Bank's stance had firmed. With the form of the new system agreed upon and final discussions in Brussels less than a fortnight away Governor Murray wrote to Colley summarising the Central Bank analysis to date on the EMS. He concluded that, despite the risk of adverse capital flows, adjustment costs, and increased transaction costs, in the longer term, such costs would be outweighed by gains in output, employment and national welfare. These in turn would come from the lower inflation environment EMS would generate provided "as a nation we are able to exercise the necessary measure of discipline and restraint". This letter may have been the push that the Department of Finance needed and was clearly an important influence on the final form of the Memorandum for Government.[38]

In the Memorandum, dated 1st December, the Department of Finance gave a highly qualified endorsement of Ireland's entry into the EMS, very much along the lines of that given by the Central Bank. Both institutions stressed that EMS entry required a willingness on behalf of the Government to adopt appropriate stricter domestic economic policies and a successful outcome to the transfer of resources issue.

The Memorandum clearly sought to demonstrate that many politically unappealing decisions awaited the government once they had opened the door to EMS. The Memorandum identified a number of areas of domestic economic policy that would have to be addressed. First, income policy would have to be far more restrained in order to bring earnings growth rate in line with anticipated lower future price rises; due to a substantial carryover into 1979 under existing settlements there would be little scope for pay increases in 1979. Second, officials outlined the main objectives of fiscal policy would have to be the strict adherence to the elimination of public sector borrowing for current purposes and the reduction of borrowing in relation to GNP. The Memorandum notes that the "less successful incomes and fiscal policy were, the more restrictive monetary policy would have to be in terms of credit restraint and possibly higher interest rates".

It is worth pausing to ask to what extent senior Department of Finance officials were wholly and unambiguously supportive of Ireland going into the ERM without Britain. Information in the official files on advice given from the Department of Finance during the second half of 1978 is limited. Two documents do suggest, though, that at least some senior officials within the Department of Finance had misgivings. In the brief prepared for the Bremen Council meeting on 6-7th July, the "supplementary note" prepared by Assistant Secretary David McCutcheon on the Boa option is quite opposed to Ireland entering a Boa type regime without the UK. Thus, he advised that "the economic disciplines involved could well prove unduly constraining for a country whose state of development is out of phase with our partners in the Snake. Therefore, unless there were a genuine commitment to giving priority to longer–term stability, at the possible expense of short-run flexibility with respect to economic management, it would be unwise to go it alone in the Snake". [39] Admittedly, this note did not take into account the potential for a compensatory transfer of resources.

Despite the success in attaining transfer of resources, the Department remained fearful of going it alone. A deferral of entry would give them more time to prepare the economy for entry into EMS at a time when it might be clearer as to when the UK might enter the EMS. Deferral of entry would also place them in a better position to assess the most suitable central rate at which to enter the EMS. But, as is confirmed in a note by Governor Charles Murray, by mid-December the Central Bank favoured entry from the start on the grounds that deferral of entry "would most likely lead to a long period of uncertainty, confusion and possibly speculation".

5.3 Prospects for the Macroeconomy

The guarded stance taken over the months of negotiation by officials of both Finance and the Central Bank is not surprising when one views their analysis on the estimated impact of breaking the link on the macro economy. In a letter to Dermot Quigley dated the 22nd November, J.C. (Joe) Holloway, Secretary of the Department of Industry Commerce and Energy, described the figures as "alarming no matter what qualification may be attached to them[40]". The main assumption underlying the calculations was that participation in EMS with adherence to the band limits would lead to an appreciation of the Irish pound relative to the Sterling as Sterling was expected to drift downward. The consequences of entry assuming a 2.5 per cent depreciation in sterling was a 2.5 per cent decrease in GNP, a fall of 12,000 in the number of people employed and an increase in the Balance of Payments deficit by £135 million in 1979 compared with the situation if both countries deferred entry into EMS. It appears the likelihood of Sterling appreciating within the following year as a result of North Sea oil was not considered a plausible scenario worth investigating.

5.4 Strategic prospect for Irish Industry Better with Europe

Although industry was expected to be hit in the short-run by a break with in sterling, the official view from the Department of Industry was not hostile to the EMS. The submission from the industrial promotions agency IDA to the Government Memorandum advised that the decline in UK investment would far outweigh any increase in investment from European countries. They estimated that a 3 to 6 per cent depreciation of sterling would lead to an increase in unemployment in the region of 3000 to 10000 persons.

Given these projected “disastrous” losses, one might therefore have expected officials in the Department of Industry, Commerce and Energy to be strongly against a break with sterling. And indeed, a letter of 19th October from Joe Holloway (Secretary of the Department of Industry Commerce and Energy) to Ó Cofaigh insists that funds would have to be made available to support industries adversely affected.[41] Despite the “serious adverse repercussions” the department did not explicitly reject entry. The main reason can be adduced from the proposition made in the Córas Tráchtála’s submission, with which Department of Industry officials agreed, that to retain the fixed link with sterling would “perpetuate our trade dependence on the UK and tie Ireland to high inflation, historically slow and uncertain growth of the UK economy”[42]. This medium-term strategic view was influential in non-financial circles.

5.4 Exchange Controls

One reason for doubts on the financial side, when it came down to it, was the apparent necessity of introducing exchange controls vis-à-vis the UK. It had long been accepted by the Irish authorities that if Ireland was to break the link with sterling exchange controls were required in order to control speculative flows of money which would undermine efforts to maintain a stable exchange and interest rates. Indeed the surge in speculative flows which began to flow into Ireland when it became more likely the UK would not join the EMS, suggests that the previous effort the Central Bank and Government had put into developing their contingency plan for exchange controls were well justified.[43]

Up to that point, the Irish and UK financial markets had been seamlessly integrated. How would Ireland fare if financial transactions with Britain were made subject to prior administrative approval?

Advising on the financial sector consequences, Charles Smith of the Department of Finance, advised that the exchange controls could have an adverse effect on the supply of domestic credit and financing of investment and production due the restriction on borrowing by Irish banks and other institutes in the UK[44.] The controls could also lead to the possible withdrawal of substantial UK funds, and when other external sources of funding develop there would be a greater cost involved with currency exchange risk.

On the other hand, exchange controls seemed to offer the politically appealing possibility of pursuing an interest rate policy independent of the UK. At the time UK interest rates were the highest in the EEC. The Central Bank advised the Government however that interest policy could not be pursued in complete isolation from the UK, but that there was scope for flexibility for deviation in rates between both countries. They pointed out independence of interest rate policy depends the strength of the regime, the effectiveness of exchange control, how successful they would be was a "matter of experience and not theory"[45]. The fact that EMS membership would introduce a new constraint (albeit tempered by the margin of exchange rate fluctuation in the ERM) to Irish interest rate policy seemed to weigh less with the officials.

One of the primary concerns of introducing the exchange rate controls was possible retaliation by the UK. For this reason, the Irish authorities attempted to keep their UK counterparts informed regarding any exchange control issue when necessary. A report on the discussion between Colley and UK Chancellor of the Exchequer Denis Healey on 9th November certainty left the Irish authorities in no doubt that the UK would be very unhappy with the introduction of exchange controls.[46] Given that the UK did not, in the event, take reciprocal action once the exchange controls were introduced, it could be argued that such ex ante positioning by the UK was part of a strategy to dissuade Ireland from joining the EMS. However, the UK Cabinet had discussed the issue on 5th November and, fearing that a break in the link might prompt speculative outflows into Irish pounds, approved the preparation of legislation that could extend UK exchange controls to Ireland.

5.5 Impact on Relations with Northern Ireland.

Northern Ireland, which was within the remit of the Department of an Taoiseach (Prime Minister's Department) and the Department of Foreign Affairs, received very limited explicit consideration in the Memorandum[47]. It would appear this was a deliberate course of action as national unity remained a very emotive subject and it was feared immaterial EMS consequences on Northern Ireland with no real bearing on the decision to break the sterling could easily be exaggerated.[48] The negative implications here of breaking the link do not appear to have weighed heavily in the official thinking as suggested by the both Departments' submissions prepared by B McHugh Counsellor, Department of Foreign Affairs and Walter Kirwan, Assistant Secretary, Dept of An Taoiseach dated 6th October. It was accepted that a break with sterling would strengthen the psychological and administrative reality of the border with Northern Ireland while it would have a "retrograde" impact[49] on non agriculture trade and the united banking system. However, the "commercial inconveniences and disadvantages would be of relatively little importance as compared with political, security, constitutional, legal and social elements in the attitudes of the unionist population towards unification"[50]. A second argument put forward was that the EMS would strengthen the Irish economy, in turn promoting economic links with Northern Ireland and increasing the likelihood of unification in the future.[51] This more positive long term consideration was emphasized in subsequent public discussion. A reading of the final Memorandum to Government dated the 1st December shows that it was clear that the Northern Ireland aspect would play no meaningful role in the decision making process. The single paragraph on the matter concluded that "if the assessment of the overall economic effects of Irish participation in the proposed system without the UK is favourable to any significant extent, any adverse effects on trade and business relations with Northern Ireland need not be decisive in influencing the government against a positive decision". Although breaking the currency link might represent a new wedge between North and South, this was of negligible practical importance when compared to the political obstacles to a united Ireland.

5.6 The Brussels Meeting

Ahead of the European Council Meeting scheduled for Brussels on 4th and 5th December, 1978, the Irish Government met on 2nd of December to discuss the Memorandum on EMS. The government accepted the recommendations of the Memorandum and gave Lynch a broad authority to negotiate Irish membership at Brussels.

By the time the Brussels meeting began, circumstances appeared less than favourable for a successful outcome on the creation of a European Monetary System. The scale of resource transfer on offer to the weaker entrants (Ireland and Italy) was a key obstacle to the entry of those countries. Despite his enthusiasm for the EMS project, Giscard argued at the meeting that "France cannot upset her own financial arrangements in order to ensure the adhesion of those for whom membership ought to be an act of political will rather than a question of cash."[52] Eventually a compromise offer was reached which consisted of both grants and loans. The grants from the Community to Ireland would total the equivalent of £45m over five years while a total of £1125m in loans would be made available over five years at subsidized interest rates. The grant component was only a small fraction of what had been requested, and the net value of the interest subsidy must have seemed a bit elusive in the heat of the meetings. (The offer of a loan *per se* was relatively meaningless for a country not at that point constrained in international capital markets.)

As a final throw of the dice Lynch requested greater flexibility in what the resources could be used for, asking for them to be applicable to a greater variety of projects than the Irish authorities had initially proposed. The issue of principle here related to distorting subsidies for industry: as indicated above, the Irish Government wanted to be able to subsidize firms facing difficulties in the new regime; their EEC partners on the other hand envisaged the funds being used to strengthen infrastructure. Giscard was in no mood to grant this request either.

Although he had been given full authority by the Government, Lynch (perhaps unsure as to how good the complex financial package would seem at home) repeatedly insisted, according to Callaghan's hand-written notes of the meeting that he would have to consult his Government colleagues over the coming days. In the end he declined to commit to entry.

The Brussels meeting ended with only six countries committed to entry into the EMS. The UK had declared they would not enter at the start while Ireland and Italy were left to consider their respective positions.

5.7 An Enhanced Bilateral Resource Package

Germany was determined not to let a relatively minor issue of resources mar the launch of the new system. Within five days of the Brussels meeting, an Irish delegation attended a secret meeting with German officials in Luxembourg. They were offered a supplementary package of £50 million in grants over two years to be funded by Belgium, Denmark, Netherlands and France and bilateral loans of £250m over two years. Taking account of interest subsidies, it could be calculated that the net present value of the grant and subsidy element of the total package was estimated to be equivalent to a one-time grant of about 3% of 1978 GNP[53]. Although the offer thus still amounted less than half of the original £650m requested, it was accepted.

6 Concluding Remarks: The Aftermath

6.1 Why Ireland Joined

The last-minute haggling reveals the official ambivalence in Ireland towards such a decisive step as breaking the historic link with the former colonial power. The resource transfers finally negotiated were valuable but not of strategic importance in themselves. The narrowly financial policy arguments were finely balanced, as is illustrated by the heavily qualified nature of the support officially offered by the Central Bank and the Department of Finance. Instead, the Government increasingly recognized that this decision was key to Ireland's position vis-à-vis the core members of the EEC. Ireland's future lay in Europe and joining the EMS was an important step in cementing that future. To turn down the offer would have destroyed the goodwill that had built up over the EMS negotiation process. And the offer would not survive a period of waiting until the UK was ready to join.

Besides, the authorities believed that currency volatility with sterling would be short lived as the UK would enter soon after the creation of the system. In this, however, as in the pious hope that the fluctuation margins of the ERM would somehow allow the sterling link to be maintained by an Irish pound within the ERM, they were mistaken On March 30, 1979, just over two weeks after the start of the ERM, the sterling link was broken forever.

6.2 The Overall Negotiating Strategy

Whatever their reservations about breaking the link, as soon as they became aware of the EMS project at Copenhagen, the Irish authorities identified this initiative as potentially offering a solution to the festering issue of Ireland's exchange rate regime. They also sensed how important the project was to the German leadership, determined to cloak Germany's increasing economic strength in a European mantle (Schmidt, 1978).

Accordingly, Ireland declared itself early in favour of the EMS project. Especially after suffering the slight of being taken for granted by the group of three, the aim of the Government's strategy was to disassociate themselves from the UK position and create favour with the other European members. This would increase the likelihood of a successful outcome to the transfer of resources negotiations. It was also hoped this strategy would isolate the UK authorities placing further pressure on them to join, sooner or later.

Although the final amount offered was a fraction of what they originally requested the Irish authorities entered the ERM on the basis that to reject the offer made in the aftermath of the Brussels Council meeting would destroy the level of goodwill generated amongst other members towards Ireland and adversely affect future EEC negotiations on other matters. In the end, therefore, the final decision to break the postcolonial sterling link can be seen as symbolic and political act as much being based on short-term economic or technical financial considerations.

6.3 The Aftermath

Despite all of the preliminary studies that were carried out – none of which involved engaging outside expertise or indeed even any evident systematic review of the academic literature on exchange rate regimes – the outcome did not correspond to expectation. The ERM proved to be a much weaker exchange rate regime for Ireland than the sterling link would have been. Not only did sterling strengthen as a result of North Sea Oil and the anti-inflation policies of the Thatcher Government, but devaluations of the Irish pound were surprisingly frequent with realignments occurring about once a year in the first eight years of the system. Irish inflation soared at first (Figure 2), though it came under control by the mid-1980s. Interest rates, over-adjusting for the risk of realignment, did not fall to German levels but averaged over 2½ percentage points higher in real ex post terms (Conroy and Honohan, 1994).

There is little evidence of the downward trend in the UK's share of Irish exports being either accelerated or slowed by EMS membership (Figure 3a), though the share of imports coming from the UK did at last start to decline (Figure 3b). The long-hoped for participation of the UK in the system finally occurred in October 1990, only for sterling to depart again within two years as the system fell apart in the crisis of 1992-93.

The kind of adjustable peg currency regime at the heart of the EMS subsequently became largely discredited (Fischer, 2001). Ironically, by 1999, less than 20 years after introducing the Irish pound, Ireland abandoned currency autonomy in favour of the euro.

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Table 1: *Timing of key events*

Date	Event	Description
7-8 April 1978	**Copenhagen** Council	Schmidt-Giscard Proposals for a zone of monetary stability for all EEC members
May/June	Series of meetings of the Monetary Committee and the Committee of Central Bank Governors	Group of three (Schulman-Clappier-Couzens) discuss in parallel
6-7 July	**Bremen** Council	Schulman-Clappier proposal presented; agreement to proceed with concurrent studies
August-November	Meetings elaborate design on EMS proposals. Also meetings on concurrent studies	
17 October	Dáil Debate on the EMS proposals	
End-November	Bilateral meetings with all EEC members	Heightened efforts by Lynch and Colley to attract bilateral transfers
4-5 December	**Brussels** Council	Ireland and Italy do not accept proposal and ask for a 'pause for refletion'
11th December	Secret meeting in Luxembourg on resource transfers	
15th December	Lynch declares Ireland will enter EMS	

Figure 1 *Exchange rate movements, 1970-98*
The figure shows the monthly average exchange rate (units of other currency per pound sterling).
Natural log-scale, January 1970=1.
Source: International Financial Statistics

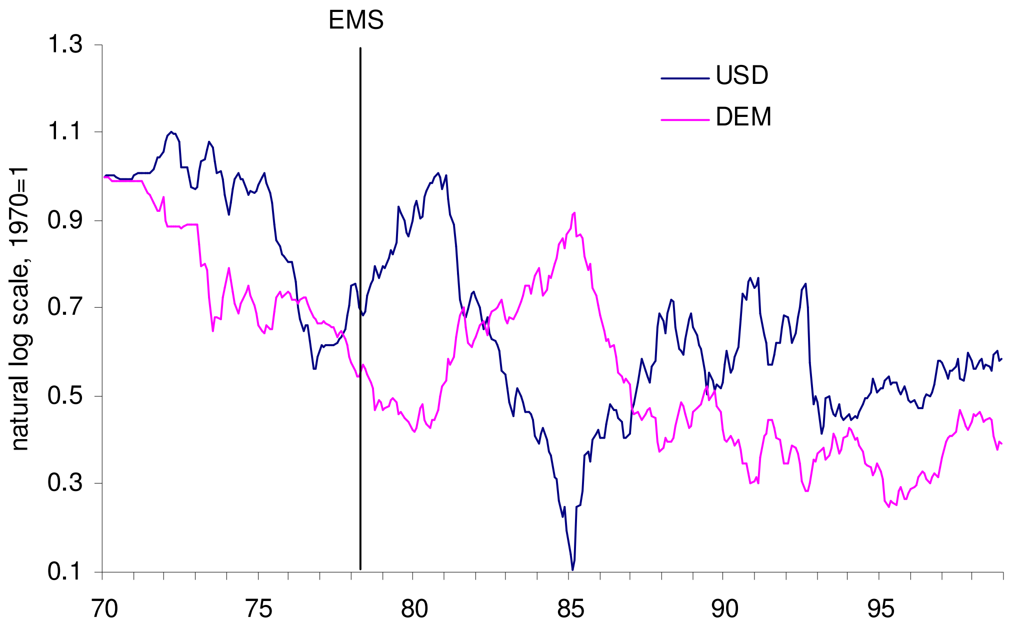


Figure 2: *Consumer Price Indices, Cumulative Average Annual Percentage Increases 1969-2008*
Natural log-scale, January 1949 = 0.
Source: International Financial Statistics

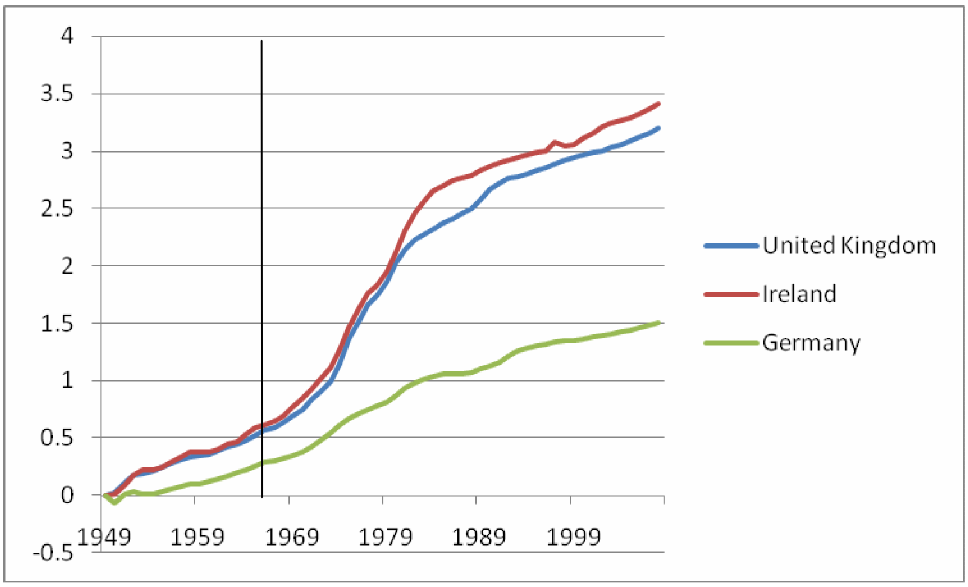


Figure 3a: *Share of Irish exports by destination, 1960-2007*
Source: OECD

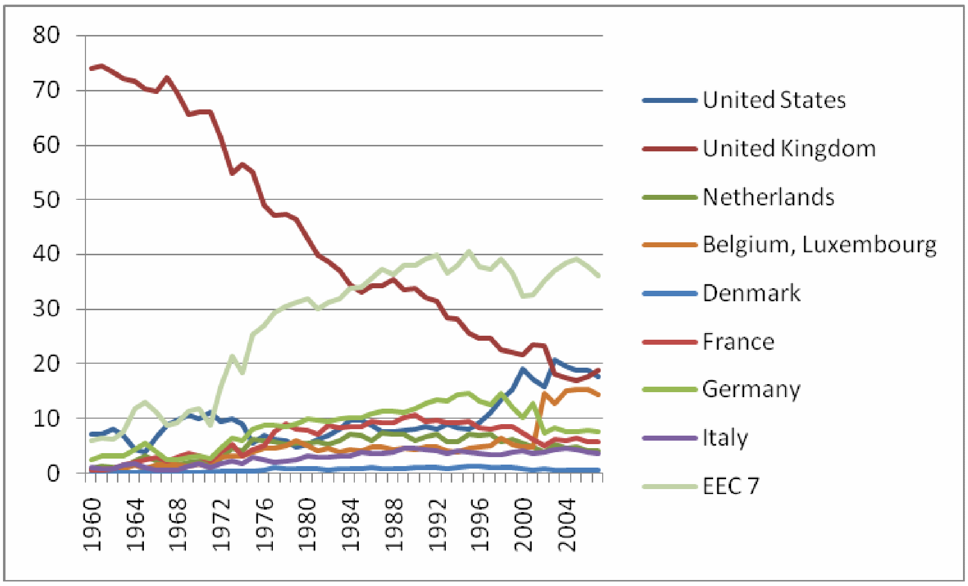
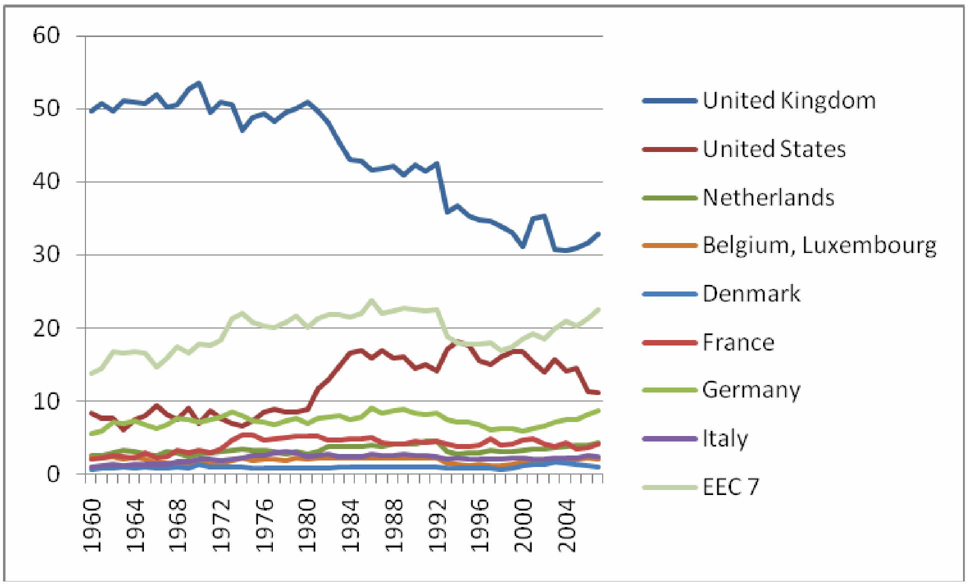


Figure 3b: *Share of Irish imports by destination, 1960-2007*
Source: OECD



Notes

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[1] Named for its chair, Columbia University Professor Henry Parker Willis (Pratschke, 1969).
[2] Ken Couzens, Second Permanent Secretary in Treasury, was to remind Mr Callaghan in a brief prepared for the European Council Meeting at Copenhagen at which the European Monetary Proposal was presented that defence of currency before withdrawing from the Snake cost $2.6 billion in reserves.(about 1½ per cent of GDP) see Margaret Thatcher Foundation
[3] Murray, who was known for his frequent use of never-quite-apposite aphorisms, quoted Burke to the effect that "a State without the means of some change is without the means of its conservation": hardly a decisive argument for abandoning the sterling link, but perhaps sufficient justification for considering alternatives. A comparison of Murray (1979) with Whitaker (1976) shows that the latter is describing more explicitly the internal debate adumbrated in the former.
[4] Reading of memo suggests it was written in the first half of 1976. Copy of memo is included in F1/20/78, earlier files need to be consulted to verify date
[5] Fine Gael were successors to the Cumann na nGael party of the 1920s.
[6] Nelson (2008).
[7] The Central Bank argued in its Annual Report 1976 (p. 11) that it was only when Ireland had reduced its inflation below UK levels that the Government should consider floating the Irish pound..
[8] Authors' translation from the original Irish (Gaelic).
[9] Nelson (2008) observes that this drive to breaking the link does not imply an acceptance of need to follow a tighter monetary policy to fight inflation. It was a move was consistent with "the import price push view of inflation which saw exchange rate stability with key European currencies as automatically restraining inflation".
[10] Although the letter is not dated a subsequent letter from Ó Cofaigh to Murray dated 9th December 1977 outlining the agenda for a forthcoming meeting between the by the Central Bank suggests it was written a month or two earlier.
[11] Indeed, Colley stated as much in the Dáil on 12th October 1978. When responding to a question from Michael O'Leary on contingency arrangements in the event of a break with sterling, he reminded the house "that successive governments have taken the view that a decision to continue or to change the present relationship must be based on an assessment of where the balance of economic advantage lies"
[12] Each Governor of the Central Bank in this period had previously been Secretary of the Department of Finance immediately before appointment as Governor: Whitaker: (Finance 1956-69; Bank 1969-76), Murray (Finance 1969-1976; Bank 1976-1981), Ó Cofaigh (Finance 1977-1981; Bank 1981-1987).
[13] The European Unit of Account was a basket of fixed amounts of the nine EEC countries and was introduced in 1975. At the start of EMS of the EMS, the value and composition of the ECU was set equal to that of the EUA.
[14] Ken Couzens, Second Permanent Secretary in Treasury, summary note of Callaghan's briefing on Schmidt's proposals at Copenhagen meeting, see Margaret Thatcher Foundation .
[15] Letter dated 20th April 1978, Maurice Horgan, Assistant Secretary, Department of Finance to Colley, EMS reaction F 1/19/78.
[16] ECOFIN is the EEC Meeting of Economic and Finance Ministers; the Monetary Committee comprises the top permanent Finance officials.
[17] Dept of Finance note on "Chancellors Schmidt's Currency initiative at Copenhagen" refers to the dissatisfaction expressed at the Monetary Committee meeting, on May 5th/6th, with Schmidt's failure to disclose his plans. Although the Chairman did later meet with German officials, it appears what was discussed was not very substantive. F1/19/78 Part 1.
[18] A telex from Bonn Embassy on April 11th 1978, reports Dr Horst Schulman, Head of the Section on Economic Financial and Social Policy in the Germany attempted to play down Schmidt's proposals in Copenhagen as a "brainstorming session between four former finance ministers" and characterised talk of an extended Snake as "academic speculation". F01/19/78
[19] A detailed account is in Ludlow (1982), and confirmed by British archives released subsequently, see Margaret Thatcher Foundation (undated)..
[20] Schmidt's reluctance to discuss his plans publically or more specifically with the Bundesbank, may be partly due the unsuccessful attempt in 1973 by William Brandt the then Chancellor and Schmidt who was Finance minister to reform the Snake and by establishing a common pool of reserves to back a 'common float' amongst European Countries against the dollar. Their plan was to link the Community member currencies which could be defended by drawing on a pool of reserves. The Bundesbank determined not to allow any threat to price stability

that might come from relinquishing control over Germany's reserves, strongly opposed the initiative. As a result Brandt and Schmidt were forced to abandon their plan.
[21] Cf. Ludlow (1982)
[22] Whereas, member countries of the Snake were obliged to hold their currencies within a band +/- 1.125 per cent around a central rate against each partner currency, the Boa was a proposed variant of the Snake where new member countries would be allowed to enter with wider currency bands. Over time the bands would converge to the narrow +/- 1.125 band.
[23] Brief entitled, "Relaunching the EMU Convergence of Exchange Rates" F 1/19/78
[24] Central Bank note, dated 15th June, on internal discussions on the exchange rate regime choice sent to the Department of Finance FE 1/19/78
[25] Colley's draft speaking note on the Report of the Experts Committees on Exchange Rate Convergence included in ECOFIN 19th June brief F 1/19/78
[26] Draft brief entitled "Greater Exchange rate Stability in the Community" dated 29th June.
[27] A valuable summary of the British experience in the negotiations, together with a large archive of official documents is at http://www.margaretthatcher.org/archive/EMS_1978.asp
[28] A telex from Couzens to UK officials dated 28 June gives his views on the Franco German proposals following discussion with Clappier, http://www.margaretthatcher.org/archive/EMS_1978.asp.
[29] In a note on the meeting between Heaslip (Irish ambassador in London), Couzens and Mrs Hedley-Miller of the UK Treasury, Couzens explains that as the initiative was a "Franco-German one he did not feel that it was for them to explain it or advocate it". Mr Staples, Counsellor, British Embassy was to concede in a meeting on the 4th July with Tomás Ó Cofaigh "that they had been expected to do" so (F 01/19/78). Ludlow (1982, pp. 104-117) links the breakdown of the "Gang of Three" discussions and their failure to inform the Irish authorities before the Bremen meeting.
[30] Note on pre-Bremen meeting on July 6th where Giscard, Schmidt sought Callaghan's agreement in principle to their EMS proposals. http://www.margaretthatcher.org/archive/EMS_1978.asp
[31] The resentment felt by some officials over the UK government's oversight is reflected, for example, in the note by Tomás Ó Cofaigh on the meeting between himself and Mr Staples, Counsellor, British Embassy on 4thJuly where one senses a certain satisfaction by Ó Cofaigh in making Staples "none the wiser" about what the Irish government's stance on the proposals was. He concludes that "he may not have regarded my reply as helpful but it was no more than the record deserved". F01/19/78
[32] Brief prepared for the Bremen meeting F 1/19/78
[33]Letter, 21 July 1978 Murray to Colley re study of EMS F 1/19/78 Part 001
[34] Note, 26 July 1978 Colley requested follow with Central Bank on issues relating to breaking the link F 1/19/78 Part 001
[35] Memorandum to Government on EMS F 1/20/78 Part 1
[36] More detailed discussion in Ludlow (1982)
[37] Letter from Holloway to Secretary of Finance regarding the breath of studies that should be included in the Memorandum of Government F 01/20/78
[38] Indeed one draft version includes the letter in the appendix. F 1/20/78 Part 2
[39] F 1/20/78
[40] Letter dated 22nd November from Holloway (Secretary, Department of Industry, Commerce and Energy) to Dermot Quigley, Memorandum comments F 1/20/78 Part 2
[41] External pressure was placed on the government by groups representing those industries which would most likely be affected further compounded with pressure by the opposition on the matter The demand for funds were taken seriously by the government.
[42] Letter dated 19th October from Holloway to Ó Cofaigh concerning impact of EMS on Irish industry and the need for financial support. F 1/20/78
[43] This point is made by Ludlow (1982)
[44] F 1/20/78 Part 2
[45] Undated note on Central Bank headed paper. Needs further examination to establish approximate date from internal evidence.
[46] F1/19/78 Part 002.
[47] A reading of the Dáil debate on European Monetary System on the 17th October would suggest it was an issue the Government were intentionally glossing over. During the Dáil debate, opposition Deputy John Bruton (Fine Gael,),was clearly dissatisfied with the government attention to the issue, arguing that "it is not something that can be dismissed lightly in a half sentence by the Taoiseach [and] it is not something that can be ignored by the Minister for Finance."

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[48] Letter, dated 6th October, B McHugh Counsellor, Dept Foreign Affairs to Dermot Quigley, Northern Ireland F1/20/78

[49] Letter, dated 6th October, B McHugh Counsellor, Dept Foreign Affairs to Dermot Quigley, Northern Ireland F1/20/78

[50] Memorandum submission, F1/20/78

[51] Healey's (2008b) Memorandum to the UK Cabinet on the Irish pound also noted political implications for Northern Ireland of a break in the link.

[52] Ludlow (1982).

[53] Calculations by McCarthy (1980).