Part. A.

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PART A

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PART A

Chancellor's (Howe) Papers:

EUROPEAN FINANCE COUNCIL
JULY 1981

Disposal Directions: 25 Years

26/7/95

BRIEF 5 (attachment) 1

Recd 25/VI/81

COMMISSION
OF THE
EUROPEAN COMMUNITIES

DIRECTORATE-GENERAL
FOR ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 17 June 1981

II/294/81-EN

~~c. M. Ashford – HMT~~

BUDGETARY OUTLOOK FOR 1982

(Commission staff paper
for the meeting of the Economic Policy Committee (budgets)
on 30 June 1981)

1. Introduction : application of a new procedure

Last year, the Economic Policy Committee decided that examination of the budget guidelines would in future be carried out in two phases. The Working Party on Public Finance would first of all examine the analyses and quantitative forecasts drawn up by the Directorate-General for Economic and Financial Affairs. The Working Party would then present a report to the Committee so as to allow it to consider the basic features of budgetary policy on the basis of figures that had been checked by the experts.

This memo has been drafted before preparation of the quantitative guidelines enters its final phase. The memo draws the Committee's attention to the main problems to be examined and to the choices to be made.

2. The overall economic context

During the first half of 1981, the Community continued to feel the effects of the second oil shock, which in 1980 had resulted in a slowdown in growth, a worsening in the employment situation, an acceleration in inflation and a sharp deterioration in the current balance of payments.

In 1981, the Community's gross domestic product will probably fall by about 1/2 %, the rise in consumer prices will probably amount to 11.5 % as in 1980, the unemployment rate is expected to increase from 6.1 % to 7.7 % and the current account deficit to be still some $ 40 000 million.

In the second half of 1981, economic activity could recover somewhat as a result of stronger export growth and, in some countries, greater buoyancy in private consumption and in stockbuilding.

However, the scale of this recovery remains uncertain, since the sharp rise in the cost of borrowing could curb investment. The fall in the value of European currencies against the dollar has led to an acceleration in price rises during recent months, and this is also likely to delay the recovery in economic activity.

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Nevertheless, for 1982, the prospects of a recovery in growth, giving a 2 to 2.5 % increase in the Community's gross domestic product, seem plausible. Growth of this order would not be sufficient to bring down the unemployment rate. The rise in prices could slow down, though still reaching fairly high levels, while the current account deficit could be reduced somewhat.

3. Trend of budgetary aggregates and the borrowing requirement

The deterioration in the economic situation in 1981 as compared with the initial forecasts led to larger budget deficits. In particular, it adversely affected the growth of tax revenue (to a lesser extent in the countries with high inflation such as Greece, Italy and Ireland), while the increase in public expenditure continued at more or less the 1980 rate, except in the Netherlands and the United Kingdom where restrictive measures helped to slow down the increase.

As a result, the general government borrowing requirement was very high (above 10 % of GDP) in Ireland and Belgium, around 8.5 % in Italy and Denmark and an uncomfortable 3 to 4 % in Germany, the Netherlands and Luxembourg.

4. The build-up of deficits during the last five years, without any sufficiently clear prospects of a reversal in the trend, is particularly worrying since it jeopardizes the chances of recovery in the medium term, notably because of the disproportionate rise in interest charges which it entails. The effect of this phenomenon has now been reinforced by the appreciable rise in short and long-term interest rates.

The impact of the budget deficit is also destabilizing in the short term :

- in the countries where the borrowing requirement is particularly high, there is clearly a link between the balance of payments deficit and the budget deficit;
- substantial monetary financing cannot be avoided where there is a large-scale deficit, and this tends to weaken the restrictive impact of monetary policy;
- where financing is possible in the long term, there are grounds for fearing that, in view of the real interest rates currently prevailing, private investors may be crowded out.

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5. Guidelines for the borrowing requirement

The Commission had recommended that, as a guideline for 1981, a worsening of the budget deficit should be accepted if it was linked to a weakening of economic activity, except in member countries where the borrowing requirement was in danger of becoming excessively high.

It would be possible to argue against maintaining this recommendation for 1982 if it were shown that, in present circumstances, the "built-in-stabilizers" do in fact have a destabilizing effect by accentuating the balance of payments deficit or by indirectly causing an acceleration in price rises. In addition, in the light of the arguments cited in the previous paragraph, a reduction in the budget deficit could in any case prove essential. However, the situation varies from one country to another, and each particular case should be examined carefully.

In determining guidelines, reference must also be made to the requirements imposed by medium-term economic trends. In this connection, it should be noted that the preliminary draft of the medium-term economic policy programme (see point 1.5.3 of the introduction) explicitly calls for a reduction in budget deficits so as to back up the fight against inflation and to broaden the potential for growth.

6. Possible ways of reducing the budget deficit

Though it is difficult to set a standard for the burden of taxation and parafiscal charges, the general consensus is that this burden should not be increased any further.

This general view does not mean that there should not be shifts between the various categories of taxes and charges. Thus, in the present economic situation, it might be desirable to reduce taxes on businesses so as to stimulate investment, and to offset this by raising the rate of a number of indirect taxes so as to hold down consumption. In some cases, an increase in social security contributions cannot be ruled out if such a measure is necessary for the purpose of balancing social security finances.

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Lastly, the public deficit is so large in some countries that it will be necessary not to neutralize fiscal drag, at least for the majority of tax-payers.

It is clear, therefore, that reducing the budget deficit will have to be achieved essentially by way of tighter managment of spending, with efforts spread over a number of years as part of a consistent programme.

In this connection, the preliminary draft of the medium-term economic policy programme recommends (see point 1.5.3) that the overall increase in public spending in the period 1980-85 should be below the increase in national income; if this is to be achieved, the expansion in transfers to households will have to be curbed significantly in most cases.

These medium-term pointers can serve as the basis for an analysis of the rate of public expenditure growth in 1982.

Examination of the prospects for this year reveals a wide range of constraints when we consider how the budgetary aggregates could be adjusted :

- In a number of countries, interest on the public debt absorbs a high and, in many cases, growing proportion of public resources. In 1982, for instance, miscellaneous current expenditure (made up almost entirely of interest payments) will account for 43 % of the increase in general government current expenditure in Belgium, for 30 % in Ireland and for around 15 % in Germany, Denmark, Italy and the Netherlands. Since such expenditure is irreducible, an all the more determined effort must be made to curb the increase under other headings if the target of an increase in aggregate spending below that in national income is to be achieved. In countries such as Belgium, Denmark and Ireland, it is not sufficient under the circumstances to aim for zero growth in real terms in other budgetary spending.

- As for current transfers, the aggregate figures for the Community do not indicate any relative slowdown in 1982, the rate of increase being the same as that for total current budgetary expenditure (12 %).

  In some countries, the share of transfers to households in the increase of total current expenditure is particularly high (52 % in France and the Netherlands, 47 % in the United Kingdom and 42 % in Luxembourg), reflecting the increase in certain welfare benefits or the particular buoyancy of spending under the sickness-insurance and social security schemes.

- By contrast, current transfers to the company sector are increasing only insignificantly or even contracting in a number of countries (Germany, United Kingdom, Greece).
  This development is probably tied up with the greater efforts being made to limit subsidies so as to ensure that prices more closely reflect costs. The overall figures do not shed any light on the impact that the deteriorating position of firms in some industries is having. The Working Party on Public Finance has begun to look into this matter and the bilateral talks that will take place in the national capitals will no doubt provide the Economic Policy Committee with some provisional indications on this subject.

- Some countries are making a remarkable effort to curb public consumption as part of an overall policy of wage restraint. The relative share of the compensation of general government employees in the increase in current expenditure in 1982 is, for instance, only 14 % in the Netherlands, 20 % in the United Kingdom and 22 % in Belgium (compared with an average of some 25 %) while a significantly above-average figure is recorded in Denmark (36 %) and in Greece (45 %).

- Direct investment will grow more slowly in 1982 (9.5 %) than current expenditure (13 %) and will fall slightly in real terms. The situation will be somewhat better than in 1981, a year of widely differing growth rates (4.5 % for investment as against 13.5 % for current expenditure).
  None the less, if account is also taken of the unchanged position of capital transfers in 1982, it is clear that expenditure cuts will continue to fall unduly on public capital expenditure in 1982.

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Final remarks and questions

All in all, the prospects for general government budgets in 1982, which are normally based on the assumption of unchanged policies, do not indicate any tendency at Community level for the borrowing requirement to decline significantly or for the growth rate of expenditure to fall below that of gross domestic product.

It will be the Committee's task to ascertain to what extent it will be possible and advisable to correct these trends by adopting appropriate budgetary guidelines.

With this in mind, the Committee could look at the following points as they affect each country :

1. Do the foreseeable developments in the economic situation point to a spontaneous improvement in the net budgetary position in 1982 ?

2. If so, can these developments be regarded as satisfactory or should they be reinforced and, if so, to what extent ? It no such improvement is expected, what corrective action will be needed in 1982 and in the medium term ?

3. Among the discretionary measures to reduce the budget deficit, should consideration still be given to major tax measures ? Which countries intend to allow fiscal drag to operate without restriction ?

4. On the expenditure side, what would be the extent of the cuts to be made ?
   - Is there scope for changes in national legislation or rules that will make it possible to limit the growth of social transfers ?
   - Taking account of recruitment policy and in view of the scope for wage and income restraint, what are the longer-term prospects for the trend in public consumption ?
   - Are there plans to encourage both public and private investment and what measures are planned in priority sectors such as energy ?

Dépenses, recettes et soldes de l'ensemble des administrations publiques

Expenditure, receipts and balance of General Government

Ausgaben, Einnahmen und Finanzierungssalden des Gesamtstaats

Concepts des comptes nationaux – National accounts definitions – Definition der Volkswirtshaftlichen Gesamtrechnung

	Dépenses Expenditure Ausgaben			Recettes Receipts Einnahmen			Soldes nets Net balance Nettofinanzierungssalden					
	Chiffres absolus-Absolute figures-Absolute Zahlen (1)						Valeur-Value-Werte (1)			en % du PIB-as % of GDP in % des BIP		
	1980	1981	1982	1980	1981	1982	1980	1981	1982	1980	1981	1982
NMARK	218,1	250,7	280,1	197,7	215,6	244,1	- 20,4	- 35,1	- 36,0	- 5,4	- 8,6	- 7,9
UTSCHLAND (BR)	698,7	737,4	770,8	646,6	675,3	715,8	- 52,1	- 62,1	- ~~[illegible]~~ 55	- 3,5	- 4,0	- 3,3
LAS	:	:	:	520,5	632,0	783,0	:	:	:	:	:	:
ANCE	1 272,7	1 486,7	1 750,0	1 283,1	1 436,5	1 677,0	10,4	- 50,2	- 73,0	0,4	- 1,6	- 2,0
ELAND	4 674	5 733	6 571	3 544	4 216	5 003	-1 130	-1 517	-1 568	- 13,3	-15,2	-13,3
ALIA	153 692	192 100	233 000	127 511	160 100	196 000	-26 181	- 32000	- 37 000	- 7,8	- 8,0	- 7,6
DERLAND	190,4	204,9	220,0	181,2	193,9	212,5	- 9,2	- 11,0	- 7,5	- 2,9	- 3,3	- 2,1
LGIQUE/BELGIË	1 868,8	2 075,3	2 121,5	1 549,6	1 651,0	1 805,5	-319,2	-424,3	-416,0	- 9,3	-11,7	-10,8
XEMBOURG	71,9	79,4	85,5	71,1	74,8	79,5	- 0,8	- 4,6	- 6,0	- 0,6	- 3,5	- 4,3
ITED KINGDOM	102 891	112 232	123 100	93 499	108 113	119 700	- 9 392	- 4 119	- 3 400	- 4,1	- 1,7	- 1,3

Mrd DKR, DM, DR, FF; Mio IRL; Mrd LIT, HFL, BFR, LFR; Mio UKL

Tableau 1a - Tabelle 1a - Table 1a

Dépenses, recettes et soldes de l'ensemble des administrations publiques

Expenditure, receipts and balance of General Government

Ausgaben, Einnahmen und Finanzierungssalden des Gesamtstaats

Concepts des comptes nationaux - National accounts definitions - Definition der Volkswirtshaftlichen Gesamtrechnung

	Dépenses Expenditure Ausgaben			Recettes Receipts Einnahmen			Soldes nets Net balance Nettofinanzierungssalden					
	variations en % - percentage change Veränderungen in %						Valeur-Value-Werte (1)			en % du PIB-as % of GDP in % des BIP		
	1980	1981	1982	1980	1981	1982	1980	1981	1982	1980	1981	1982
MARK	15,2	14,9	11,7	11,1	9,1	13,2	- 20,4	- 35,1	- 36,0	- 5,4	- 8,6	- 7,9
TSCHLAND (BR)	7,9	5,5 ~~4,1~~	4,5 ~~6,1~~	6,5	4,4	6,0	- 52,1	- 62,1	- ~~58,3~~ 55	- 3,5	- 4,0	- 3,3
AS	:	:	:	:	21,4	23,9	:	:	:	:	:	:
NCE	15,6	16,8	17,7	18,8	11,8	16,7	10,4	- 50,2	- 73,0	0,4	- 1,6	- 2,0
LAND	27,4	22,7	14,6	29,2	19,0	18,6	-1 130	-1 517	- 1 568	-13,3	-15,2	-13,3
LIA	21,4	25,0	21,3	31,0	25,6	22,4	-26 181	-32 000	-37 000	- 7,8	- 8,0	- 7,6
ERLAND	7,3	7,6	7,4	8,2	7,0	9,6	- 9,2	- 11,0	- 7,5	- 2,9	- 3,3	- 2,1
GIQUE/BELGIË	10,2	11,0	2,2	5,1	6,5	9,4	- 319,2	-424,3	- 416,0	- 9,3	-11,7	-10,8
EMBOURG	14,5	10,4	7,7	10,2	5,2	6,3	- 0,8	- 4,6	- 6,0	- 0,6	- 3,5	- 4,3
TED KINGDOM	29,3	9,1	9,7	26,0	15,6	10,7	-9 392	- 4 119	- 3 400	- 4,1	- 1,7	- 1,3

Mrd DKR, DM, DR, FF; Mio IRL; Mrd LIT, HFL, BFR, LFR; Mio UKL

Tableau/Table/Tabelle : 2

II/305/81-FR-EN-

Dépenses, recettes et soldes nets des budgets des administrations centrales

Expenditure, receipts and net balance of central government budgets

Ausgaben, Einnahmen und Nettofinanzierungssalden der Haushalte der Zentralstaaten

Exécution en termes budgétaires - Outturn according to budget definitions - Ist Ergebnis-Haushaltsabgrenzung

	Dépenses Expenditure Ausgaben			Recettes Receipts Einnahmen			Soldes nets Net balance Nettofinanzierungssalden					
	Chiffres absolus-Absolute figures-Absolute Zahlen (1)						Valeur-Value-Werte (1)			en % du PIB-as % of GDP in % des BIP		
	1980	1981	1982	1980	1981	1982	1980	1981	1982	1980	1981	1982
NMARK	124,8	145,2	160,8	107,2	114,2	126,8	- 17,5	- 31,0	- 34,0	- 4,6	- 7,5	- 7,5
UTSCHLAND (BR)	409,7	436,1	~~457,9~~ 453,5	358,4	375,6	398,1	- 51,3	- 60,5	- ~~59,8~~ 55,5	- 3,4	- 3,9	- 3,~~6~~3
.AS	410,2	534,9	659,0	361,4	466,3	585,5	- 48,8	- 68,6	- 73,5	- 2,8	- 3,2	- 2,7
ANCE	590,8	693,0	811,0	560,5	632,0	729,0	- 30,3	- 61,0	- 82,0	- 1,1	- 2,0	- 2,2
ELAND	4462,5	5452	6031	3245,7	3750	4431	-1216,8	-1702	-1600	- 14,3	- 17,1	- 13,6
ALIA	123.973	153.200	186.000	88.084	113.200	140.000	-35.889	-40.000	-46.000	- 10,6	- 10,0	- 9,5
DERLAND	110,2	117,4	124,0	95,1	100,8	111,0	-15,1	- 16,6	-13,0	- 4,7	- 5,0	- 3,6
LGIQUE/BELGIË	1354,4	1485,0	1572,0	1039,9	1105,0	1207,0	-314,5	-380,0	-365,0	- 9,2	- 10,4	- 9,4
EMBOURG	45,0	50,0	54,0	44,1	45,8	48,2	- 0,9	- 4,2	- 5,4	- 0,7	- 3,2	- 3,9
ITED KINGDOM (2)	93.820	105.036	115.153	80.656	93.075	105.604	-13.164	-11.961	-9.549	- 5,8	- 4,8	- 3,4

) Mrd DKR, DM, DR, FF; Mio IRL; Mrd LIT, HFL, BFR, LFR; Mio UKL.

) Années financières/Financial years/Haushaltsjahre 1980-1981, 1981-1982, 1982-1983.

Table 3

Translation of the budgetary guidelines into usual budgetary concepts used in Member States (*).

		1980	1981	1982
DANMARK (1) (DKR bn)	- Net borrowing requirement of the central government	- 17.5	- 31.0	- 34.0
DEUTSCHLAND (DM bn)	- Net borrowing requirement of the Bund (without Special Funds) .... - Net borrowing requirement of Bund, Länder and local authorities consolidated	- 56.4	- 68.5	- 63.0
ELLAS (DR bn)	- Net borrowing requirement of the central government	- 48.8	- 68.6	- 73.5
FRANCE (1) (FF bn)	- Net borrowing requirement of the central government	- 30.3	- 61.0	- 82.0
IRELAND (1) (IRL mn)	- Exchequer borrowing requirement - Current budget deficit	-1 217 547	-1 702 (2) 783	-1 600 650
ITALIA (LIT bn)	- Domestic market borrowing of the enlarged public sector ...	-40 600	-44 000	-49 000
NEDERLAND	- Net borrowing requirement of general government in cash terms, as a % of national income	7.5	7.0	5.5
BELGIQUE/BELGIE (BFR bn)	- Current budget balance ..... - Net borrowing requirement of the central government (without Special Funds)	-122.7 -250.5	-190 -315	-175 -300
LUXEMBOURG (LFR bn)	- Net borrowing requirement of the central government	- 0.9	- 2.5	- 4.0
UNITED KINGDOM (UKL mn)	- Public sector borrowing requirement	-13 900	-11 400	-9 800

(*) All figures are forecasts based on actual expenditure and receipts, which may be different from the initial forecast.

(1) Identical to community guidelines

(2) This figure could be reduced by up to IRL 100 Mio if the target for private sector participation in the Public Capital Programme is reached.

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BRIEF 5 (attachment A)

12

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(81) 324 final

Brussels, 18 June 1981

Will become 7961

THE ECONOMIC AND SOCIAL SITUATION IN THE COMMUNITY

(Commission communication to the European Council, Luxembourg, 29 and 30 June 1981)

5A

Short-term developments and prospects

Since the last meeting of the European Council there have been some signs of improvement in the European business cycle and an easing of world oil market pressures; but also worrying movements in interest and exchange rates across the Atlantic and much too limited progress in fundamental aspects of economic policy and performance in Europe.

Production in the Community probably reached its low-point in the early months of this year. The immediate outlook is subject to conflicting influences. The business cycle is showing signs of moving into the recovery stage, with some strengthening of export and private consumption demand. Community business surveys show this. But the balance of the changing trend as between a halt to the recession and a beginning of the upturn is still difficult to discern. For 1981 as a whole the Commission expects a fall of about 1/2 % in GDP volume, with an improving second half of the year leading to positive growth in 1982 perhaps slightly in excess of 2 %. This would be barely sufficient to stop the rise in unemployment in the course of next year. For the time being unemployment is still rising sharply and has reached 7.7 % of the labour force.

A negative influence has been the higher interest rates, and the general international monetary instability. Since the beginning of this year short-term interest rates have been forced up on average in the Community by over 3 points (to 15 % for 3 month inter-bank rates), restoring approximate parity with United States rates. Nevertheless even greater movements have been seen in exchange rates, with the ECU now having depreciated 21 % against the dollar and 24 % against the Yen in twelve months.

In time this depreciation should lead to substantial European gains in world export markets. Moreover the Community's large balance of payments current account deficit (nearly 40 $ billion in 1981, compared to a modest surplus in the United States, and a modest deficit in Japan) leaves no doubt about the need in Europe for a substantial adjustment. Some progress in reducing this deficit is likely in 1982, but a multi-year strategy adjustment in investment and world trading performance is basically necessary.

The depreciation of the ECU means that Europe is currently experiencing a wave of import price increases as severe as last year when oil prices were the main cause. This is seriously retarding progress in reducing inflation. The average consumer price rise is now expected to be 11 1/2% in 1981 (up 1 point since the forecasts before the last European Council meeting, with the divergence between countries now ranging from 5,8% to 24%) and could well be still as high as 10 1/2% in 1982. As in the case of the oil price rise, it is vital to ensure that this unavoidable deterioration in the terms of trade does not have repercussions which lead to an increase in domestic inflation. This reinforces the importance of certain Member States to adjust extremely comprehensive and fast-acting income indexation mechanisms. As stated at the European Council's last meeting, this is in contradiction with the main aim of creating a zone of monetary stability in Europe.

The effects of the recession on public budgets is seen in an upward revision of the expected deficit of the general government accounts for 1981 from 4.0 to 4.3 % of GDP for the Community as a whole (compared to 3.6 % in 1980). For some countries, a stabilising effect from the budget should be accepted, and indeed welcomed, for example in Germany where there are already signs that stronger exports will soon take over as the main support to economic activity. In France, which alone among Community countries actually experienced a small budget surplus in 1980, some limited deficit in 1981 should not encounter financing problems if kept within prudent proportions. In several other countries, however, measures to restrict current public expenditure and deficits are overdue. Each year's delay increases the future burden of adjustment. Double-digit deficits as a share of GDP are not stable propositions, yet this is the order of magnitude of the Belgian deficit and nearly so in Italy; Denmark's deficit also appears to be increasing alarmingly, while that of Ireland, already 15% of GDP, has recently been increased by substantial subsidies to households for food and housing items.

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Medium-term challenges

The Council will shortly have to adopt a medium-term economic policy programme for the period 1981-1985. Preparatory work by experts has been completed (in the Economic Policy Committee), and on this basis the Commission plans to submit a draft programme to the Council before the summer recess.

Projections for a five-year period are notoriously difficult to make, and those done by the Commission for 1981-1985 on the basis of present policies and historical economic behaviour - remain open to surprises for better or for worse. Subject to these important reserves, and assuming a moderate economic recovery from now to 1982, the projections suggest an annual average rate of growth in the Community as a whole of 2 1/2% in the four years 1982 to 1985 (1.9% for the five years 1981-1985), which compares with around 2.2% for the years 1974 to 1980, and a trend of 4 1/2% in the preceding decade. Assuming a 5% growth in world trade the present large balance of payments current account deficit could well be reduced very substantially by 1985 even with some renewed, but gradual,increase in the real price of oil. Progress in reducing public sector deficits seems likely to be more modest; the rate of inflation might on average decelerate to about 7 1/2% compared to the present 11%. The modest rate of real growth means that there is likely to be approximate stability in the total employment level. Combined with the exceptionally fast demographic expansion of the labour force (nearly 1% per year for the whole quinquennium), unemployment is quite likely - on the basis of spontaneous trends - to continue to rise still from the present average level of 7.7%.

Of course these trends are not immutable. Policy can, and in several respects should, change. Economic behaviour can change, and must be encouraged in the right direction. The uncertainties are not all negative risks. For example, we may manage to achieve faster progress in energy adjustment than expected, and we may underrate the capacity of the economy more generally to adjust for the better once given the right signals steadily over a period of years.

.../...

But the fundamental message is that the Community cannot hope that a new cyclical recovery - itself fragile and uncertain - will lead the economy back automatically onto a satisfactory trajectory assuring a substantial and durable improvement in employment prospects. It is not a question of waiting with a little more patience for trends to improve. The European economy needs still to embark on deep and lasting changes in public policy and in the economic performance of the social partners and households before we can hope for a much better economic future; i.e. to assure the development of the competitive capacity of our economies and their aptitude to respond to the opportunities of growing markets. Investment and savings must be increased. Consumption, employment costs and current public expenditure must be moderated. Investment and employment in energy production and saving in particular must be a massive priority as also the development of industries based on new technologies. Present investment trends in the Community are not yet on a par with that seen in the United States and Japan. The Community can and should provide a financial boost to this priority (in this connection proposals for a renovation of the New Community Instrument for investment financing are before the Council awaiting decision).

While abundantly debated, these issues are still not being sufficiently acted upon in many Member States. If this state of affairs persists the risks are for a relapse of the Community into serious financial and monetary instability and thence into great losses. For the Community as a whole this could mean eroding the achievements even of the Common Market as well as of the European Monetary System, and for individual Member States there would be the prospects of the large economic and social costs that always ultimately result from excessively delayed economic adjustment. A longer period of delayed adjustment and slow growth would also endanger the social and political balance in our countries and undermine the degree of social consensus so far achieved.

Current developments demonstrate the necessity for a stable framework for international economic relations. The Community should therefore intensify its policy of cooperation with third countries, especially establishing increased monetary and financial cooperation between industrialised countries, also with a view to aiding the economic situation of developing countries.

.../...

Summary and Conclusions

The Commission suggests to the European Council the following assessment and policy orientations:

(i) It may be that the recession has now passed its low point in Europe, and that the chances for a moderate recovery are fairly good. However, great risks surround this uncertain and fragile improvement. With the short-term easing of the oil market, the main risks at present lie in the management of economic policy within the Community and internationally. The Social Partners also have an important rôle.

(ii) Within the Community, particular risks follow from the failure so far of several Member States to progress with urgently required public finance and income stabilisation measures. These failures weaken the cohesion of the European Monetary System. The Commission recommends to these countries accelerated programmes of economic adjustment. On the other hand, Germany, where a strong export recovery seems now assured, should not unduly precipitate the desirable medium-term reduction of its public deficits. In general, all Member States must aim at balance in the use of monetary and budgetary policies, and desist from descriminatory measures in either domain that threaten the basic economic principles of the Community; the prospects for export-led recovery can only be based on keeping open markets for trade.

(iii) The large depreciation of the ECU against the dollar and yen over the past months means that the Community have a new opportunity to improve its share in world markets, and increase investment and employment. But the inflationary impact of the depreciation must be contained, and this is a further reason why adjustments must urgently be made in indexation practices in some Member States, and expectations for real income gains be still lowered more generally for the time being.

(iv) Internationally, moreover, the volatility of interest and exchange rates is of major concern; indeed it represents a serious threat to Europe's incipient economic recovery, notably because of the great fluctuations in costs and in the continuing uncertainties that the enterprise sector has to face. The Community should pursue these issues in depth in discussions with the other major monetary powers. The Community, the United States and Japan basically share the same monetary policy objectives and there is much to be done, including in the Community (as mentioned with regard to budgets and incomes) to relieve the strain on monetary policies.

However the United States should also bear in mind the significant international consequences of different choices that are open to it in the framing and execution of its budgetary and monetary policies. The main policy stance of the major industrial countries does affect the functioning of the world economy and should, therefore, be discussed in the forthcoming international meetings.

(v) The medium-term outlook reinforces the need for the accentuation of adjustment policies in many Member States, and persistance throughout the Community in efforts to promote investment in energy saving and production and in new industrial capacity, and to moderate labour costs (including both incomes and social security levies).

(vi) ~~The Joint Council of Ministers of Employment and Social Affairs and of Financial Affairs, which was held on 11 June 1981, discussed the unemployment situation and the type of strategy and actions which needed to be adopted in order to ensure a fundamental improvement. It was generally agreed that unemployment and inflation were problems which should be tackled jointly and that an improvement in the overall economic situation, and hence in employment, could be assisted through reinforced action at Community level. The Commission accepted to follow up certain policy issues, in particular: the review of methods for combating inflation and encouraging economic growth; the development of investment and new areas of employment growth; analysis of public expenditure and the financing of social security; the promotion of flexibility in working time; and the development of an integrated framework of education, training and work opportunities for young people. It was foreseen to follow up these questions in a further Joint Council.~~

(vi) above has been amended. An English translation of the final French version reads as follows:-

"(vi) Unemployment and inflation are problems which ought to be tackled jointly, as was generally agreed at the recent Joint Council of Ministers of Employment and Social Affairs. An improvement in the global economic situation and hence in employment - implies sustained action and effort for several years in the major social and economic fields as well as specific urgent measures to combat the high unemployment rate among the young. The effectiveness of national policies can be improved by increased coordination and cooperation between Member States as well as reinforced action at Community level."

Table 1: Main Economic Aggregates, 1979-81

	1979	1980	1981		1979	1980	1981
	GDP volume, % change				Private consumption deflator, % change		
B	2,4	1,1	-0,6		3,5	6,3	7,2
DK	3,5	-0,8	0,1		9,5	11,0	10,0
D	4,6	1,9	-0,6		3,9	5,4	5,8
GR	3,8	1,7	1,5		17,7	23,7	23,3
F	3,2	1,8	0,5		10,5	13,5	13,0
IRL	1,9	0,9	1,9		12,2	18,2	17,5
I	5,0	4,0	-0,2		14,9	20,3	21,0
L	3,6	0,4	-3,1		5,8	6,3	7,5
NL	2,2	0,9	-0,6		4,6	6,9	7,3
UK	1,3	-1,4	-2,2		12,2	15,5	11,2
EC	3,5	1,4	-0,4		8,9	11,7	11,5
	Unemployment rate, % of civilian labour force				Current account of balance of payments % GDP		
B	8,6	9,3	11,0		-2,9	-5,7	-7,3
DK	5,3	6,2	8,2		-4,6	-3,8	-3,8
D	3,4	3,4	4,6		-0,7	-1,7	-1,9
GR(1)	(2,2)	(2,9)	(3,2)		-2,9	-2,4	-2,6
F	6,1	6,5	7,7		+0,1	-1,4	-1,6
IRL	7,9	8,2	9,7		-10,1	-8,6	-14,2
I	7,6	8,1	8,4		+1,6	-2,5	-2,3
L	0,7	0,7	1,1		+28,7	+22,8	+20,8
NL	4,2	5,0	7,2		-1,4	-1,5	+0,7
UK	5,4	6,9	10,5		-0,9	+1,2	+0,6
EC	5,5	6,1	7,7		-0,5	-1,4	-1,7
	General government net lending (+) or borrowing (-), % GDP				Money supply, % change end of year		
B	-7,2	-9,3	-11,0	(M2H)	6,0	2,8	3,9
DK	-3,1	-5,4	-8,6	(M2)	9,9	10,9	8,1
D	-3,0	-3,5	-4,0	(M3)	6,0	6,2	5,4
GR	:	:	:	(M3)	18,4	25,2	22,4
F	-0,8	0,4	-1,6	(M2)	14,4	9,7	12,5
IRL	-11,9	-13,2	-15,2	(M3)	19,0	16,9	12,2
I	-9,4	-7,8	-8,5	(M2)	20,3	12,0	11,0
L	+0,1	-1,4	-2,5		:	:	:
NL	-2,0	-2,8	-3,3	(M2)	7,6	3,6	6,2
UK	-3,3	-3,7	-2,3	(£M3)	12,7	18,6	8,5
EC	-3,6	-3,6	-4,3		11,9	10,2	8,8

(1) Not comparable with other countries

Source: Commission services, base[d on data] available to early June 1981

BRIEF 5 20
25/6/81.

SECOND QUARTERLY EXAMINATION OF THE ECONOMIC SITUATION IN THE COMMUNITY

Purpose of the discussion

Article 4 of the Council Decision of February 1974 - the so-called Convergence Decision - requires the Council to hold three meetings a year to discuss the economic situation in the Community. At the third of these meetings (usually in December) the Council establishes economic guidelines (essentially budgetary objectives) to be followed by each member state in the ensuing year. The guidelines are reviewed at the first meeting of the new year (usually in February). The July Council is the second meeting. At this meeting the Council is required to:

> "lay down appropriate guidelines for the main elements of the preliminary economic budgets. Within this framework, quantitative guidelines for the draft public budgets for the following year shall be fixed before these budgets are finally adopted..."

5. QUARTERLY REPORT + GUIDELINES

2. There will be two Commission documents for the meeting. The first is the paper on the economic and social situation prepared for the European Council of 29/30 June (attachment A) The second document will set out the proposed budgetary guidelines with figures for each country showing how they translate into budget deficits in 1982. However, this document will not be circulated in advance and we are unsure of its precise form or content. We think it will conflate two documents presented to the Economic Policy Committee on 30 June and these are attached (attachment C.)

Aims of the discussion

3. The Council will not be in a position to "lay down" the guidelines. You could follow last year's precedent and suggest that it simply takes note of them as the Commission's advice to member Governments. This procedure is likely to be accepted by other member countries. At last week's meeting of COREPER, the Italians, Irish and Danes all said they would refuse to endorse the guidelines at the July Council.

4. M Ortoli will introduce the Commission's paper on the economic and social situation. Your proposed handling of the subsequent discussion were set out in Sir Douglas Wass's telex to members of the Co-ordinating Group. You will wish to avoid the usual tour de table

BRIEF 5 (cont.)
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on the situation of individual member states: and concentrate instead on major themes in the Commission document. There will be an opportunity for any Minister, if he wants, to inform his colleagues about recent developments in his own country; but you may not wish to encourage this.

Points for summing up

(A) Economic and Social Situation

5. Commission paper notes that chances for a recovery of activity - albeit a moderate one - are now fairly good. But inflation and unemployment will remain serious problems for some time to come. Significant differences between performance of member states likely to persist.

6. Co-ordination of policies within Community and between Community and third countries clearly important. But setting of policies will inevitably reflect circumstances of individual countries and their perception of constraints. There are some which take the view that their fiscal position offers them some room for manoeuvre. Others, though, feel that the coherence of their anti-inflation policies depends on maintaining a restrictive fiscal stance in support of their monetary objectives. On this view fiscal prudence is not deflationary because it improves the climate for private investment and consumption by reducing the pressure on interest rates. Sure we all agree it would be regrettable if differing national perceptions of constraints or policy priorities led to still more divergence between our economies.

(B) The Guidelines

The Council takes note of the Commission's guidelines.

UK Points to make (Economic Situation)

i) Prudent policies ensuring better adjustment to second oil shock than to first: EC output has fallen less, earnings rather better contained, investment fairly resilient in many countries, and energy use is being reduced.

ii) Recovery now in sight. Share concern that it is likely to be modest and that unemployment likely to rise further.

iii) Inflation remains uncomfortably high. Well aware in the UK of short term economic and social costs of reducing it. But premature relaxation of policy would risk throwing away real and hard won gains of last two years.

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iv) Commission paper rightly draws our attention to general upward trend in public sector deficits. Many of us have reached the point where the growth of public expenditure has outstripped willingness or ability of tax payers to pay for it.

v) Community economies also display structural weakness which stand in the way of reduced unemployment and higher growth. Macro-economic policies need to be supplemented by a range of micro-policies to improve productivity and reduce proneness to inflation.

vi) Note Commission's views on UK guidelines. They imply a slightly higher PSBR in 1982/83 than our medium term strategy envisages. But don't think it necessary to go into this now.

Background

a) The guidelines

7. The following background is subject to revision in the light of the Commission's document which will be circulated at the Council.

8. The Commission appears to be suggesting rather more restrictive guidelines for 1982 than were adopted in 1981. The 1981 guidelines were broadly that a worsening of budget deficits should be accepted if it was linked to a weakening of economic activity, except in member countries where the borrowing requirement was in danger of becoming excessively high. However, in paragraph 5 of the attached document prepared for the Economic Policy Committee (11/294/81), the Commission says:

> "it would be possible to argue against maintaining this recommendation for 1982 if it were shown that the "built-in stabilizers" do in fact have a destabilizing effect by accentuating the balance of payments deficit or by indirectly causing an acceleration in price rises".

9. The Commission seems to be particularly concerned about the size of budget deficits in Ireland, Belgium, Italy and Denmark. We expect M Ortoli to point the finger at these countries when he introduces the Commission's paper.

10. The following table, prepared with incomplete information, translates the Commission's assumed guidelines for individual countries' budget deficits in 1982 into percentages of GDP; 1981 figures are shown for comparison

General government deficits as a % of GDP

	1981	1982
Germany	- 4.0	- 3.5
France	- 1.6	- 1.9
Italy	- 8.0	- 7.6
Belgium	-11.7	-10.8
Netherlands	- 3.3	- 2.1
Denmark	- 8.6	- 7.9
Ireland	-15.2	-13.3
Greece	na	na
Luxembourg	- 3.5	- 4.3
UK*	- 1.7	- 1.3
(UK: PSBR)	- 4.6	- 3.5

* Fiscal years 1981/82 and 1982/83

11. The figure for UK PSBR as a proportion of GDP in 1982/83 compares with the MTFS figure of 3¼ per cent for the same year. The Commission is believed to think that there might be some scope for a higher level of public sector investment in the UK.

b) Economic situation in the Community

12. The Commission's paper is reasonably straightforward. It summarises the short term prospects for the Community economies (based on the Commission's May forecasts); and stresses the importance of medium term measures to bring about structural change and greater efficiency.

13. The main features of the Commission's forecasts are:

i) a fall in the GDP of about ½ per cent in 1981 and growth of more than 2 per cent next year

ii) an EC inflation rate (consumer prices) of 11½ per cent in 1981, declining to 10½ per cent in 1982

iii) an EC current account deficit of $40 billion this year, but of rather less in 1982.

14. On GNP, the Commission is a good deal more optimistic than either the OECD or the WEP for 1981; and a bit more so for 1982. The OECD believes that the net effect of currency depreciation on the EC economies in 1981 will be depressant (ie higher inflation will reduce demand by more than higher export volume raises it). On this basis, the OECD expects a 1.7 per cent fall in EC GNP in 1981. The Commission appears to believe that the depreciation of the EMS currencies against the dollar that has already taken place will stimulate EC output both this year and next. (see also para 15 of the briefing on monetary relations). Our position is rather agnostic, though in theory the Commissions view is the more compelling. The recent WEP expects a fall in EC GNP of about 1 per cent in 1981. For the UK, the Commission expects a larger fall in GNP in 1981 than the Treasury (-2.6 per cent against -2.0 per cent).

15. The Commission's inflation forecast is plausible, if depressing. The WEP expects some rise in the year on year rate for the EC as a whole towards the end of this year. This reflects the effects of the higher dollar on the more heavily indexed European Economies; a higher real oil price caused by the dollar's rise; and, in France, the result of policy changes.

16. We think that the Commission's current balance forecasts are pessimistic. The WEP expects fairly substantial falls this year in the German, French and Italian deficits, whereas the Commission is forecasting a rise in each case. The difference is of some significance. The development of EC current balances this year, as compared with the US current balance, will probably be an important influence on exchange rate developments and the degree of external constraint experienced by the European economies.

17. The major themes in the paper are:

i) the urgent need for "public finance and income stabilisation measures" in several member states. There is something of a public lecture to the Belgians, Irish and Danes about the importance of cutting current public expenditure. On the other hand it is pointed out that the French, whose general government financial balance was in surplus in 1980, could

BRIEF 5 (cont.)
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live with a prudent move into deficit. And the Commission recommends that Germany, "where a strong export recovery now seems assured", should not "unduly precipitate" the medium term reduction of its budget deficit.

ii) the need to aim for balance in the use of monetary and budgetary policies.

iii) the need for "the accentuation of adjustment policies" and persistent efforts to promote investment and higher productivity.

18. The Presidency summary of the proceedings of the 29/30 June European Council stated that "the general orientation of the paper" was "received with unanimous approval." Unlike the OECD Ministerial Communique it did not explicitly refer to differences over the appropriate stance of policies. Instead it accommodated the views of the new French Government (and many of the smaller EC countries) with a reference to the need for national governments to "take account of the different economic situations in each member state and of their particular possibilities and of the constraints with which they are faced".

CST
FST
Sir D [illegible]ss
Mr R Burns
Mr Ryrie
Mr Middleton
Mr Hancock
Mrs Hedley-Miller
Mr Lavelle
Sir K Couzens

CONFIDENTIAL

BRIEF 4 (attachment)

25/6/81. 26

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

INTERNATIONAL ECONOMIC SITUATION: US INTEREST RATE POLICIES

In his report to you of 12 June about the Vancouver meeting of personal representatives to prepare for the Ottawa Economic Summit, Sir Robert Armstrong has described the strong attack, led by the German representative, upon the United States Administration for the effects of the high level and volatility of their interest rates upon the economies and the exchange rates of their partner countries.

2. The atmosphere at the Finance Council in Luxembourg on 15 June - when we discussed the matter, formally and informally, at some length - was more restrained. We had the benefit of a full (oral) report from Gordon Richardson, as Chairman of the Committee of European Community Central Bank Governors: he had just come from their regular meeting in Basle. As recorded in Luxembourg telegram No.96 of 15 June, the Chairman, van der Stee, was able to record in his summing-up agreement that Finance Ministers should urge their Heads of State and Government to adopt a cautious approach on this subject at the Ottawa Summit. The Finance Council instructed the Monetary Committee to study the effect of interest rates on the economies of the Member States and to report in good time for a further discussion by the Finance Council at its next meeting on 6 July.

3. Other developments may alter the perspective before 19 July. But we cannot be sure what line Schmidt and Mitterrand will take

/on this issue

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on this issue at the European Council later this month and at the Ottawa Summit. They may decide, despite the moderate tone of Monday's Council, to criticise the United States sharply. We need therefore to think carefully about the line that the United Kingdom should adopt.

4. On the substance, our position appears to allow us to adopt a line intermediate between Europe and America. This may offer a chance of averting anything like a publicised quarrel between the two sides of Ottawa. A summit ending in tension and dispute on this issue could only be unhelpful to the financial and foreign exchange markets, and thus to everyone's efforts to bring better balance to their economies.

5. You have made it clear that we support all the main lines of United States policy. They are closely parallel to our own. Moreover, there are ambiguities about the European position. They claim to support the priority given to countering inflation. They have to acknowledge that a weak dollar has in the past brought severe disadvantages. They are not at all specific about what the United States should do to get lower interest rates while adhering to the basic policy and the anti-inflationary campaign. Neither France nor Italy, nor perhaps even Germany, can at present claim that they are entitled to criticise President Reagan's efforts. And the size of the German current account deficit is one reason why they - unlike the Japanese, whose current account is strong - have had to endure high interest rates in the wake of American conditions: it is not all the Americans' fault.

6. But we too are suffering in some degree from the behaviour of US interest rates. They have played a part in the recent fall in sterling, and have worsened our inflationary prospect. If, as we must expect, our current account weakens from the extreme strength of the end of 1980, we shall be more exposed to US

/interest rates.

interest rates. It would be very hard if the effort made and embodied in this year's Budget, so as to get our interest rates down, was nullified because the US was trying to reach its monetary targets too much through interest rates and not enough through expenditure cuts or tax measures. And we cannot deny that the seemingly endless switchback movement of US interest rates is destabilising and damaging.

7. So there is good reason why we should not distance ourselves from Europe by siding wholly with the Americans, however firm our support for the thrust of President Reagan's policies.

8. Can we help to find a practical outcome to the dispute? I think we might. For one thing I am told that the American Treasury Under Secretaries with whom the issues have been discussed in several fora over recent weeks may now begin to understand more clearly that they should not expect simply to set in place policies in the United States which affect others closely, and receive uncomplaining acquiescence. At the very least there should be greater willingness to explain and discuss, and an awareness of others' problems. The Europeans for their part cannot possibly expect, and indeed would not really want, any radical departure from the American anti-inflationary policy.

9. So the line might be that we all fully support the American determination to reduce inflation and to control monetary growth. But if too much weight has to be put on high interest rates in pursuit of these objectives, harmful burdens are thrust on to the other industrialised countries, who already face their own manifold difficulties in getting their economies on to a better basis. So it is fair to ask that enough of the burden should be carried by fiscal policy. And it would be helpful if the Americans could do more to make it plain that they are not relying solely on high interest rates, that their fiscal policy

/is designed to buttress

is designed to buttress their monetary policy, and that it will continue to do so not only this year but as the subsequent years of the President's programmes evolve. In addition we invite the Americans to consider again very earnestly whether they cannot reduce the volatility of their interest rates. This might involve looking at major changes in methods: but one thing which might be avoided somehow is the apparently excessive attention paid to the published weekly figures - in the UK we try to avoid too much emphasis being given even to monthly figures. Finally, we ask the Americans to bear in mind more generally that the fact that the dollar is the main world reserve currency does impose responsibilities on US policy-making, which include having regard to the effects of policy on others.

10. The European countries might want to press still harder the point about the US having responsibilities to others. But I do not believe that, when it comes to the point, Chancellor Schmidt would be able to bring himself to deny the correctness of the anti-inflationary stance; and I have not heard that any of the Europeans have more positive proposals to make about US methods of achieving their ends than the ones I have outlined. So I think that if you were to speak on broadly these lines you might find that you had made a contribution to a more harmonious Summit.

11. I am very conscious of the need not to part company from the Germans over this, if we can help it, since we need their support over other important Community matters in the coming months. But we do support President Reagan's approach. And, however frank the discussion in the course of the Ottawa Summit, it would be very serious if it could not be brought, at the end, to some kind of an agreed conclusion.

12. We shall be offering you a speaking note for the European Council.

13. I am sending copies of this minute to the Foreign Secretary and to Sir Robert Armstrong.

GH. (G.H.)

Mr Schröder ✓
c Mr Bottrill
BRIEF 4 (attachment)

EUROPEAN COMMUNITIES

Monetary Committee

Brussels, 25 June 1981
II/299/81 - EN - final

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DIFFUSION TRES RESTREINTE

OPINION ON DOLLAR INTEREST RATE AND EXCHANGE RATE DEVELOPMENTS

1. As requested by the Council on 15 June 1981, in full awareness that the difficulties experienced by Community countries are of both internal and external origin, the Monetary Committee has examined the consequences of dollar interest rate and exchange rate developments for the Community economy. The present Opinion, adopted at its session of 25 June, sets out the main results of its discussion.

2. In the twenty months since the change in techniques of monetary control announced by the Federal Reserve Board on October 6, 1979, US interest rates throughout the maturity spectrum have fluctuated over a very wide range, both in nominal and in real terms, thus attracting unprecedented attention to their variations and their level. European interest rates were broadly compelled to follow the upward movement of US rates, but did so on a generally steadier course. Both short and long term nominal interest rates within the Community are now either at or close to record levels, and in the lower inflation countries real interest rates are also extremely high.

3. Many factors affect exchange rates but, among these, high and variable US interest rates in 1980-81 have powerfully contributed to a marked fluctuation in the dollar exchange rate around a strongly rising trend against EMS participating currencies, which have however remained remarkably stable vis-à-vis each other. In the twelve months to mid-June 1981, the dollar has appreciated by between 35 % and 42 % against EMS currencies.

4. It is in the interest of the world economy that US inflation should come down as rapidly as possible : the Community should thus firmly support the general anti-inflationary thrust of US policy. At the same time it is important that the United States take into account the international consequences of the choices in the framing and executing of monetary, budgetary and public debt management policies, all the more so at the present time when the prospects for improved growth and employment are so tenuous.

.../...

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5. The Committee considered the main problems raised by the above developments, taking in turn the variability of interest rates, the level of interest rates and exchange rate developments. It draws attention on the following aspects of these three problems :

a) variability of interest rates

- changes in interest rates affect relative costs, resource allocation and economic behaviour;
- large and erratic variations in interest rates, and particularly large switch-back movements over a considerable period, entail - on the one hand - a climate of uncertainty and wait and see attitudes which upset investment decisions and - on the other - destabilise markets, especially at the long end;
- high interest rate volatility entails an increased recourse to variable rate financing and to short-term market instruments to finance longer term investments : although firms and banks can then benefit more rapidly from a fall in inflation, they become more vulnerable to adverse financial developments;
- techniques of monetary control play an especially important role in determining interest rate volatility; in the Committee's view these techniques should pay attention to the trend movement in the target aggregate rather than to short-term deviations;
- consequently, measures such as a staggering and a "de-dramatisation" of the publication of money supply figures, with an emphasis on the medium-term trend, have been suggested as means to reducing interest rate volatility. The recourse to more diversified instruments for controlling the growth of the monetary aggregates would go in the same direction.

b) level of interest rates

- high interest rates are a consequence of high rates of inflation and, at the same time, an essential part of a determined fight against inflation through a strict monetary policy;

- in general the level of interest rates can be reduced, whilst not relaxing anti-inflationary policy, by substantially reducing the government deficit. This is not only valid for the US, taking into account the savings rate, but also for Community member countries, where the policy mix is far from adequate and where relatively restrictive monetary policies exist alongside large and persistent public sector deficits;

- as fiscal treatment of interest rate payments by households in the US allows relatively considerable deductions, interest rates have to be really very high to have an effect on personal borrowers;

- while in most Community countries there are domestically-generated reasons for relatively high interest rates, peaks in US rates may have led, in a number of member countries, to higher interest rates than generally warranted by purely domestic considerations;

- excessively high real interest rates, if long continued, penalise productive investment at a time when structural adjustment requires, for both internal and external reasons, and in particular to reabsorb unemployment, an increase in the share of investments in aggregate demand;

- high interest rates weigh heavily on the service of the public debt of many industrialised countries;

- high real interest rates add to the debt servicing burden of non-oil developing countries which have had recourse to variable interest rate loans. This debt service is absorbing a rising share of their export revenues, at a time when slow world growth restricts their export markets.

.../...

c) exchange rates

- the fluctuations of US short-term interest rates have been an important, although not exclusive, cause of the marked variability of exchange rates and may have strengthened "overshooting";

- a strong divergence of exchange rate trends from relative price and cost developments could store up further currency unrest in the future, because inflation differentials might eventually predominate among the factors, including the current account positions, which affect exchange rates;

- because of the depreciation of its currencies, Europe is now experiencing a new, strong wave of import price increases, analogous to that caused by an oil shock;

- developments since the transition to generalised floating in 1973 indicate that there is a need for some degree of foreign exchange intervention to deal with disorderly market conditions and erratic movements, in line with IMF guidelines and articles. The US policy on exchange rate intervention as recently outlined to Congress seems to go too far in limiting its use in disorderly market conditions. In a world in which reserve holders tend to currency diversification, it is, in particular, essential that the reactions of the authorities of the various reserve centres be mutually consistent and complementary.

6. On this occasion, the Committee wishes to stress that, although high and volatile US interest rates and strongly fluctuating exchange rates undoubtedly contribute to the difficulties experienced by Community member countries, these difficulties are to a large degree domestically-generated and that, as a general principle, responsibility for combating inflation by all appropriate means begins at home.

*

* *

In conclusion, the Committee stresses the over-riding importance, in an increasingly interdependent world, of close international coördination and cooperation : no country should frame its domestic policies without due regard to their international consequences, and large economies and leading reserve currency centres have a special responsibility in this respect.

EUROPEAN COMMUNITIES
THE COUNCIL

Brussels, 30 June 1981 (01.07)

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ECOFIN 45

TRANSLATION OF LETTER

from : Mr J-Y. HABERER, Chairman of the Monetary Committee

dated: 29 June 1981

to : Mr C.A. van der KLAAUW, President of the Council of the European Communities

Subject: Opinion on dollar interest rate and exchange rate developments (1)

Sir,

Please find enclosed the opinion on dollar interest rates and exchange rate developments which the Monetary Committee adopted on 25 June 1981.

(Complimentary close).

(s.) J-Y. HABERER

Encl.: II/299/81 final

(1) This document was sent to the General Secretariat of the Council in English, French and German only.

BRIEF 4 (attachment)

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~~25th~~ 30th June 1981

Committee of Governors of the
Central Banks of the Member States
of the European Economic Community

~~DRAFT~~ REPORT ~~FOR PRESENTATION~~ TO THE ~~ECOFIN~~ COUNCIL ~~IN JULY~~
ON THE CO-ORDINATION OF INTEREST AND EXCHANGE RATE POLICIES
VIS-A-VIS THIRD COUNTRIES

In accordance with the wishes of the Council of Finance Ministers held on 16th March and of the informal meeting of Finance Ministers held in Breda on 3rd and 4th April, the Committee of Governors of the Community central banks have devoted much of their meetings since then to studying how best to co-ordinate interest and exchange rate policies towards third countries, notably the United States, and what might be the most promising means of seeking the co-operation of the US authorities in this domain.

It is relevant by way of bringing up to date the factual record to note two developments which have occurred since the Governors reported to the Council in March. The first is that there ~~has on balance~~ been a renewed hardening of US interest rates which has again ~~widened~~ opened up the gap between short-term US rates and those in most Community countries and that this together with other factors has contributed to a very significant strengthening of the dollar against the EMS currencies. The second consists in the statement of position on foreign exchange intervention made to Congress on 4th May by the US Under-Secretary for monetary affairs which made clear that it is now the US Administration's declared aim "to return to the more limited pre-1978 concept of intervention by intervening only when necessary to counter conditions of disorder in the market". In accordance with this change of policy the US authorities have not intervened at all in exchange markets since March 1981.

This last development confirms the view that the new US Administration is resolved to allow market forces to play the dominant rôle in the determination not only of interest rates but also of exchange rates and this in turn strengthens the concerns which are widely felt on this side of the Atlantic about the repercussions of United States' policies on the stability and cohesion of the EMS currencies. These concerns stem from the high average level of US interest rates for many months now and the unpredictable fluctuations in these rates, both of which in rather different ways can be damaging not only to the member countries of the EEC but more generally in the world. In pointing to these consequences the Governors, however, wish to stress that they fully support the US government's determination to reduce inflation, not least given the overwhelming importance of the US dollar to the international monetary system. In addition, they recognise that tensions which have affected currencies within the European Monetary System also reflect inadequate performances within and divergences of performance between the member countries in spite of the policies of internal stabilisation and external adjustment that Community governments are striving to pursue.

Against that background, coupled with the fact that nearly all EEC countries have, unlike the USA and Japan, large current account deficits to finance and that in the short run at least interest rate relativities rather than inflation differentials appear to be the main determinant of exchange rate movements, the monetary authorities in most EEC countries are faced with what appears to be a choice of evils. Either they must deliberately adjust their interest rates upwards to the point where a reasonable stability of their currencies is achieved against the US dollar even if, as is the case for low-inflation countries, their interest rates are already significant in real terms, or they must continue to allow their currencies to depreciate against the dollar until an equilibrium point is reached, with all the inflationary consequences that would entail. In either case they might find it necessary to intervene in the foreign exchange markets in order to smooth out temporary fluctuations and to avoid disorderly conditions, but it is generally agreed that interventions against third currencies cannot by themselves assure the desired objective, and furthermore the responsibility for those interventions would now have to be borne solely by the European countries. In these circumstances, even if the EEC countries willingly chose to permit a further depreciation of their currencies against the dollar, a new equilibrium level that was acceptable would probably still have to come about primarily by an increase in interest rates in the countries concerned.

Because of this dilemma it is naturally tempting to believe that it would be in the Community's interest to seek to persuade the US authorities that by one means or another they should reduce the general level of their interest rates and ensure that they were less volatile than has been the case in the last 18 months. To press home the first point in this argument, without asking the US authorities to ease up on their counter-inflationary policies, it would be necessary for the Community to persuade them that the mix of their monetary and economic policies was too heavily weighted on monetary restraint, leading thereby to a very high average level of interest rates. The Committee of Governors have given much thought to this point, since it would seem to be the most promising means of conducting a dialogue with the US authorities.

There are admittedly shades of opinion in the United States about the likely course of the US economy in the next 18 months or so. On the side of the Administration those concerned with the framing of budgetary policy believe that the budget proposals which they have put to Congress will bring about, at least in the next fiscal year, a significant reduction in the Federal government's deficit and more speedily produce beneficial effects for inflation, from which lower interest rates should be the result.. There are others, however, who fear that this paints too optimistic a picture, or at any rate that the time scale for improvement is a slower one. If these fears prove justified, then monetary policy would for some time continue to carry the main burden of the struggle against inflation.

In the light of these differences of opinion, it would perhaps be justifiable for the countries of Europe to draw to the attention of the US Administration the risk that developments during the course of this year may run counter to the fiscal strategy of the Administration, the thrust of which, if developments were favourable, is to be welcomed. The Governors believe, however, that any representations of this kind should be handled with considerable caution. The Governors note, for instance, that the US fiscal deficit as a proportion of national income compares favourably with that of the majority of the EEC countries. Suggestions to the US Administration, therefore, that it should radically alter its policy mix away from monetary stringency would, in the Governors' view, risk a rebuff.

The other question that must seriously be considered is whether the US authorities should be invited to reconsider their techniques of monetary control which have led to what many of us would regard as an excessive and unpredictable volatility in US short-term interest rates. In this area, the Governors believe that there may be some prospect for improvement, and that this could come about not so much by direct criticism from EEC countries as by a continuing dialogue with the US authorities in which every opportunity would be taken to bring to their notice, as occasion arose, the unsatisfactory consequences of sudden and erratic swings in money market conditions in New York.

The Governors believe that such action would stand more chance of falling on receptive ears than an outright attack on US monetary control techniques. This latter would imply that the European side would have to recommend alternative techniques to the US authorities, techniques which might be suited to this or that country within the Community but which could not necessarily be readily transplanted to the political and structural circumstances in the United States. In this respect, therefore, the

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Governors remain of the view, after further intensive discussion, that it would be unwise to invite the US authorities to change their techniques when there was no solid agreement amongst European countries as to what the optimum alternative could be in the US circumstances.

london: 1 july 1981

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subject: council of the economic communities (economic and financial questions) on monday 6 july 1981

1. the chancellor of the exchequer has asked me to seek your help in preparing the discussion of the current economic situation at the council meeting on 6 july so as to ensure that it focuses on the issues of greatest interest to members of the council.

2. there are two items on the agenda about the economic situation: monetary relations between the community and third countries: and the second quarterly examination of the economic situation in the community. discussion of the first item will begin with the reports from the monetary committee and the committee of central bank governors. the chancellor then proposes to invite his colleagues to focus their remarks on the following three questions:

> 1. to what extent do recent interest rate changes reflect domestic as opposed to international factors?
>
> 2. what effects are recent exchange rate changes having on our economies?
>
> 3. what should be advise the community representatives to say on this subject at ottawa?

~~3 the second item will begin~~

3. the second item will begin with a statement by the commission representative who will no doubt introduce the commission's paper. thereafter the chancellor proposes that discussion should concetrate on any major themes identified in the commission document which we have not yet seen in london. sir geoffrey howe does not intend to ~~call for the~~
call for the usual tour de table on the economic situation in the individual member states of the community. but he will of course give the floor to any minister who wishes to inform his colleagues about recent developments or policy measures in his own country.

4. i am sending a copy of this telex for information to the chairman of the monetary committee, the chairman of the committee of governors and the secretary general of the council secretariat.

regards

douglas wass
668405 trsy g

General Secretariat
of the Council

Brussels, 2 July 1981

COUNCIL

(Economic and Financial Affairs)

NOTE

for the President
719th session
- 6 July 1981 -

The Lunch

The Council meeting will start at 14.30H and will be preceded by the customary lunch at 12.30H. At the lunch the President could:-

(a) announce his intention to take in restricted session all the substantive items except the New Community Instrument and Other Business;

(b) inform his colleagues that he proposes to suspend business for one or two minutes between each of the items in the restricted session so that they can change their assistant if they wish to do so;

(c) ask his colleagues whether there are any items of such a delicate nature that they would wish to discuss them at the lunch in the presence of Ministers only, bearing in mind that restricted sessions offer better linguistic facilities and working conditions.

For the President's information

The Danish Minister has given notice that he has a problem over the budgetary guidelines which the Commission envisage in his country. He may wish to raise this at lunch or he may be content to let it be discussed in restricted session.

./.

The Netherlands Minister has given notice that he would like an exchange of views on the visits to various capitals by Monsieur TRUDEAU in connection with the preparation of the Ottawa Economic Summit. This question could perhaps best be discussed in restricted session under item 4. which deals primarily with the problem of interest rates.

EUROPEAN COMMUNITIES
HE COUNCIL

Brussels, 2 July 1981 (03.07)

7962/81	
	RESTREINT

OJ/CONS 35
ECOFIN 48

PROVISIONAL AGENDA

for: 719th meeting of the COUNCIL OF THE EUROPEAN COMMUNITIES
(Economic and Financial Questions)

Brussels, Monday 6 July 1981 (14.30)

1. Adoption of the agenda

2. Adoption of the list of "A" items

   7963/81 PTS A 31

3. Second quarterly examination of the economic situation in the Community (Article 3 of the "convergence" Decision of 18 February 1974)

   7961/81 ECOFIN 47

4. Monetary relations between the Community and third countries

   7877/81 ECOFIN 45 (R/LIMITE)
   7964/81 ECOFIN 49 (R/LIMITE)

5. Export credits: Adjustment of the Arrangement on Guidelines

   7770/81 CCG 30

6. Proposal for a Council Decision empowering the Commission to contract loans for the promotion of investments in the Community (NIC II)

   7821/81 ECOFIN 43 + ADD 1
   7823/81 ECOFIN 44

7. Other business

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EUROPEAN COMMUNITIES
THE COUNCIL

Brussels, 2 July 1981

7964/81

R/LIMITE

ECOFIN 49

COPY OF LETTER

from : Committee of Governors of the Central Banks, signed by Mr A. BASCOUL, Secretary General

dated : 30 June 1981

to : Sir Geoffrey HOWE, President of the Council of the European Communities

Subject : Report to the Council on the co-ordination of interest and exchange rate policies vis-à-vis third countries (1)

Sir,

On behalf of Governor Richardson, Chairman of the Committee of Governors of EEC central banks, I have the honour to send you herewith a report of the Committee on the co-ordination of interest and exchange rate policies vis-à-vis third countries.

This document has been drawn up by the Committee in accordance with the wishes of the Council of EEC Finance Ministers; its substance was presented orally by Governor Richardson to the Finance Ministers on 15th June 1981.

(Complimentary close.)

(s.) A. BASCOUL

Encl.: doc. of 30 June 1981

(1) The Council Secretariat received this report in English, French and German only.

WELCOME BOHME BRUTON VANDEPUTTE 45

EUROPEAN COMMUNITIES
THE COUNCIL

Brussels, 2 July 1981 (03.07)

7962/81

RESTREINT

OJ/CONS 35
ECOFIN 48

A) INFORMAL: 30/31 October
– London: Fri. p.m. to Sat lunch.
Should Governors come? Or President only?

→ CONSENSUS MTCP

PROVISIONAL AGENDA

for: 719th meeting of the COUNCIL OF THE EUROPEAN COMMUNITIES
(Economic and Financial Questions)

Brussels, Monday 6 July 1981 (14.30)

1½–2 UP ← RATES
→ JAPAN
– CREDIT MIXTES
– CO-OP ON MOTORS & IRON/STEEL

1. Adoption of the agenda

B) September ① > ½ day
② Commission report on mandate
– Orientation debate

2. Adoption of the list of "A" items
7963/81 PTS A 31

C) Agenda ③ IMF Speech –

3. Second quarterly examination of the economic situation in the Community (Article 3 of the "convergence" Decision of 18 February 1974)
7961/81 ECOFIN 47

4. Monetary relations between the Community and third countries
7877/81 ECOFIN 45 (R/LIMITE)
7964/81 ECOFIN 49 (R/LIMITE)

DELORS: What kind of discussion?

5. Export credits: Adjustment of the Arrangement on Guidelines
7770/81 CCG 30

Credit mixte

6. Proposal for a Council Decision empowering the Commission to contract loans for the promotion of investments in the Community (NIC II)
7821/81 ECOFIN 43 + ADD 1
7823/81 ECOFIN 44

BOHME

7. Other business

D) Danish – Budget guidelines
E) Dutch – Trudeau visit

7962/81 OJ/CONS 35 ECOFIN 48 R ard/LG/ch E

VON DER STEE:

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3

the need to maintain OECD consensus + to have a common position for those negotiations

EXPORT CREDITS

Ministers had a general discussion of this subject ~~over lunch and briefly in restricted session~~. There was general agreement on:-

(i) the need for a significant increase in interest rates;

(ii) the need to establish a common position on the problems created for the consensus by low interest rate countries;

(iii) the desirability of greater transparency in the arrangements for mixed credits.

A number of detailed points were remitted to COREPER for further study and COREPER were invited to prepare for consideration by the Council at its next session on 17 September a draft negotiating brief for use by the Community representatives at the next round of the consensus negotiations in October.

4.

Not yet broken through.
But hopes of progress @ Scottish meeting.

2

Ministers found agreed ~~discussed~~ the [illegible] on an approach to the subject in particular, unanimously that the importance of the American objective of defeating inflation

MONETARY RELATIONS BETWEEN THE COMMUNITY AND THIRD COUNTRIES

The Council discussed the question of monetary relations between the Community and third countries in the light of their previous discussion in Luxembourg on 15 June and the European Council meeting on 29/30 June. The Council received reports from the Monetary Committee and the Committee of Central Bank Governors. In discussion, it was stressed that the problems of the European economies were to a significant ~~large~~ extent the result of domestic conditions and that the remedy to this aspect of the problem lay in our own hands. Even so, it was agreed that the movements of US interest rates and of ~~the~~ exchange rates with the dollar have important implications for the efforts of Community countries to get their economic problems under control.

It was suggested that the most constructuve approach to the Ottawa Summit would be to identify the common goals being pursued by the industrial countries and then to consider whether the measures taken by each country in pursuing the agreed objectives were compatible with the achievement of those same objectives in other countries.

The Council invited the Monetary Committee to pursue their studies between now and the Ottawa Summit to see whether some more quantitative evidence could be produced of the effect of high and volatile interest rates and of exchange rates movements on ~~the~~ Community economies and economies of LDCs

CHANCELLOR

Copied to: [illegible] as attached list.

FINANCE COUNCIL 6 JULY 1981

This will be the first Finance Council under UK Presidency. You will Chair the meeting and the Financial Secretary will represent the UK.

2. An index to the detailed briefing is attached.

3. The agenda is somewhat thin. The most important item is probably the discussion on US interest rates. It would be most helpful if the Germans were to lift their reserve on the New Community Instrument. We would then have a positive achievement to announce to the press.

Lunch Items

4. Over lunch you could indicate your plans for the informal meeting of Finance Ministers on 30/31 October. You could also suggest that the next Finance Council discuss budget restructuring. You might warn your colleagues that in any case the agenda for the September Council is likely to be rather heavy and may require an all day session. Finally you could mention that you propose to reorder slightly the afternoon's agenda and to take the export credits and US interest rates items in restricted session.

5. If you could find a moment alone with Herr Böhme, who is representing Germany, you might ask if he intends to lift Germany's reserve on the New Community Instrument.

Export Credits

6. The substantive discussion of the Community mandate for the next round of the OECD negotiations will be a matter for the September Council. However, the French have specifically asked

for the subject to be discussed at the July Council. M. Delors mentioned at the June Council that he should be able to make a substantive contribution today. Clearly we should do nothing to discourage any possibility of a more positive French line. The Commission would also welcome an indication at Ministerial level of the new French Government's general position on this matter before they proceed to exploratory discussions with the Americans and Japanese later in the month.

US Interest Rates

7. Sir Douglas Wass informed the members of the Co-ordinating Group that you intend to focus discussion on three questions.

(1) To what extent do recent interest rate changes reflect domestic as opposed to international factors?

(2) What effect are recent exchange rate changes having on our economies?

(3) What should we advise the Community representatives to say on this subject at Ottowa?

Discussion of the first two questions will be preceded by the reports from the Monetary Committee and the Committee of Governors. The former will probably be oral and the latter written. The text of both are included in the briefing.

8. Our main objective is to ensure that the Americans are approached as allies in a way which does not invite a rebuff. The approach should not be formalised or take place in advance of Ottowa.

9. Mr Christofas' brief suggests that you might give an account of M. Trudeau's visit to London and invite those colleagues whose capitals have also been visited by M. Trudeau to do likewise. We do not particularly support this suggestion. If you adopt it, we recommend you to ensure that such reports are brief. There is a risk of long rambling interventions.

10. In general Mr Christofas' brief does not take account of Sir Douglas Wass' message. This may be an oversight, or it may be that he disapproves of the fact that the message was sent!

Quarterly Report

11. This is one of the regular discussions of the economic situation required by the 1974 convergants decision. The Council is supposed to lay down appropriate budgetary guidelines for member states. In practice it refuses to do so and merely takes note.

12. Our objective is to minimise unproductive discussion. Sir Douglas Wass' message noted that you do not intend to hold the usual tour de table of the economic situation in the individual member states of the Community, although you would of course be prepared to give the floor to any Minister who wished to inform his colleagues about recent developments or policy measures in his own country.

New Community Instrument

13. Everything turns on whether the Germans lift their reserve. If they do, the aim is to reach substantial agreement, so that the matter can come back to a subsequent Council for final agreement as an 'A' point. If they do not, the aim is to put pressure on the Germans with a view to final agreement at the September Council.

Other Business

14. The convention is that items raised under "other business" are not open for general discussion. We understand that M. Ortoli may wish to talke about the Fifth Medium Term Programme. If he does, our objective is to ensure that we are left free to handle future discussion of the programme as we think fit. We have also heard that the Netherlands may wish to ask M. Ortoli what action the Commission have taken on the Italian import deposit measures.

Meeting with Mr Christofas

15. We suggest that you meet Mr Christofas in the Council Building soon after 11.30. He may have some last-minute or sensitive information to give you. On your side, it might be tactful to mention to him that over lunch you intend to suggest that budget restructuring be discussed at the September Council, and that an all day meeting may prove necessary.

CONFIDENTIAL

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Press

16. If the New Community Instrument is not agreed, there will be little to announce to the Press. The only achievement will be agreement on what we are to say at Ottowa. But it will be difficult to make much of that since we are not prepared to reveal exactly what we intend to say.

J. Scholes

J SCHOLES
3 July 1981

CIRCULATION

<u>With attachments:</u>

Principal Private Secretary

Financial Secretary	
Mr Hancock	
Mrs Gilmore	
PS/Governor	B/E
Mr Balfour	B/E
Mr Wentworth	Cabinet Office
Mr Fry	FCO
Mr Butt	UKREP (3 copies)
Mr Appleyard	Paris
Mr Beamish	Bonn
Mr Anson	Washington
Mr Adams	Rome

<u>Steering Brief only:</u>

Chief Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir K Couzens
Mr Byatt
Mr Kemp
Mrs Hedley-Miller
Mr Mountfield
Mr Ashford
Mr Bottrill
Mr Edwards
Mr Hawtin
Mr Mercer
Mr Ridley

FINANCE COUNCIL : 6 JULY 1981

INDEX OF BRIEFS

*Chancellor, Financial Secretary and Mr Hancock only.

**Chancellor and Financial Secretary only.

3/7/81. 55

O ADMIN. ARRANGEMENTS

FINANCE COUNCIL: 6 JULY 1981 BRIEF O

ADMINISTRATIVE ARRANGEMENTS

You will chair the meeting and the Financial Secretary will represent the UK. You will be accompanied by Mr Hancock, Mrs Gilmore and Mr Wiggins. The Governor will also be attending in his capacity as Chairman of the Committee of Governors.

2. It is possible that there will be difficulty with the Air Traffic Controllers. The basic plan is for you to leave Heathrow at 07.45 on Monday, arriving in Brussels at 09.40. Mr Wiggins is trying to arrange a contingency plan whereby the party would leave on an RAF plane sometime after 9 o'clock on Monday morning. If it proves necessary to activate this plan he will endeavour to ring those affected on Sunday evening.

3. Assuming you get the 7.45 flight, we suggest you go straight to UKREP for a briefing meeting with Sir Michael Butler. Shortly after 11.30 you could move across to the council building for a meeting with Mr Christofas before lunch at 12.30. The Council meeting is due to begin at 14.30.

4. We suggest you aim to finish the Council meeting before 17.30 to give you time to meet the press for half-an-hour before leaving for the airport. Your return flight takes off at 18.45, arriving at Heathrow at 18.45.

5. The Financial Secretary is remaining in Brussels overnight. He will be joined by Mr Willetts in time for supper with Mr Butt. I understand he is staying overnight with Mr Nicholl and returning on Tuesday on the 15.45 flight.

FINANCE COUNCIL : 6 JULY 1981 BRIEF 2

2. LUNCH ITEMS

LUNCH ITEMS

1. You might like to raise the following topics over lunch:

1. informal meeting 30-31 October (indicate your plans)
2. next Finance Council 17 September (warn of heavy agenda etc.)
3. restricted sessions in the afternoon
4. (with Herr Boehme, who is representing Germany) NIC

POINTS TO MAKE (FOR CHANCELLOR)

Informal meeting

2. Plans - 30/31 October, beginning in the afternoon on Friday and finishing with lunch on Saturday

- meeting in London /discussions at Lancaster House, visit to Covent Garden/

- agenda not yet clear, perhaps one general economic topic and a further discussion of budget restructuring

3. Invite views on whether Governors should be invited.

September Council

4. I should just like to say a word about the Commission's report on the 'mandate'. We have only had this a little while, and we shall all need time to reflect on it. So I do not think it would be sensible to start a discussion today.

5. But the Community institutions will have to make fairly rapid progress after the summer break, if we are to meet the targets we have set ourselves. I suggest, therefore, that it would be helpful for us to have a general exchange of views at our meeting in September. Unless there is any objection, I shall arrange for that.

6. I know that our permanent representatives are setting in hand some purely factual and technical work, and I hope that that will help to prepare for our discussion.

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7. In any case likely to be a heavy agenda because of the need to reach agreement on export credits. May be necessary to have an all day session.

8. Would be very helpful if we could arrange for the speech for the Bank/Fund meetings to be discussed in the Monetary Committee and cleared by correspondence.

Restricted Sessions

9. Propose to take the export credit and US interest rate items in restricted session ('those round the table'), and to take export credit item first. (immediately after adoption of agenda and 'A' points). Hope this does not cause any difficulties.

BACKGROUND

10. Informal meeting You agreed with your colleagues at the last Council that we would hold an informal meeting of Finance Ministers in the UK in the autumn and that you would let them know the date on 6 July.

11. There are three possibilities for the Governors:

- invite none
- invite the Chairman of the Governors' Committee (Mr Richardson) alone
- invite all.

The purpose of our discussion will be to give Finance Ministers an opportunity to express their general attitudes to the Commission's report. Our aim should be to agree some broad conclusions. This may of course not be possible. Whether it is or not, I will report the outcome of the discussion faithfully to the Foreign Secretary who is in charge of the preparations for the November European Council so that he can take account of the views expressed by Finance Ministers in preparing the documents for that Council.

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Item 5. : Export Credits
- Changes to the Arrangement on Guidelines

At its meeting on 15 June 1981, the ECO/FIN Council invited the Permanent Representatives Committee to continue its work on this question and agreed to resume the discussion at the present Council meeting. The Permanent Representatives Committee agreed to invite the Council to debate three policy questions (which are set out in doc. 7770/81 CCG 30).

The President could invite the President of the Permanent Representatives Committee Part I (Mr NICOLL) to introduce the report by the Permanent Representatives Committee. He could then invite the French Finance Minister to inform the Council of the results of the reflections of the new French Government (M. DELORS having promised at the Council meeting on 15 June 1981 that he would be ready to say something on this subject at this present Council meeting).

For the President's information

It is not essential for the Council to reach any final decisions at this meeting. The Council must however adopt a new negotiating brief at its September meeting at the latest so that the Community can have an adequate negotiating brief for the meeting of the Participants in the Arrangement which is due to take place from 5 to 7 October 1981. The object of the present discussion is to try to get the French Government to show a willingness to move sufficiently in September. Otherwise there is a real risk that the Arrangement will break down and that we shall find that the world is involved in an export credit war in which all the members of the Community will be losers.

DANGER OF DISINTEGRATION if [illegible] DRAWN

Proposed Conclusion

COMMON POSN

The President could propose that the Council invite the Permanent Representatives Committee, in the light of today's discussion, to prepare a draft negotiating brief for approval by the Council at its meeting on 17 September 1981.

RESTRICTED

3/7/81. 60

BRIEF 3

EXPORT CREDIT CONSENSUS

3 EXPORT CREDIT CONSENSUS

PURPOSE OF DISCUSSION

A "débat d' orientation" to enable Ministers - in particular M. Delors who was not ready to contribute to the discussion at the June meeting - to indicate their general views on the three main issues on which a new Community position is needed before Consensus negotiations are resumed in October. The issues, which are set out in a short paper circulated by the Secretariat of the official EC Co-ordination Group on Export Credits, are:-

i. the size of the increase in Consensus minimum interest rates

ii. the problem of low interest rate countries, notably Japan

iii. improved transparency for mixed credits.

It is not intended that hard and fast decisions about the EC position should be taken at this stage - that will be for the September Council, and in the meantime the Commission should be allowed room for manoeuvre to develop proposals for a negotiating mandate.

PRESIDENCY OBJECTIVES

We suggest you should aim to sum up on the following lines:-

i. agreement on the importance of holding the Consensus together and hence on the need for the Community to agree on new proposals covering the three key issues identified

ii. the Commission to take note of points made in discussion, and work up specific proposals, in consultation with the official group

iii. these proposals to be brought to ECOFIN for decision on 17 September, when the aim should be to agree a constructive package which offers the prospect of agreement with other Consensus participants in the Autumn.

POINTS TO MAKE FOR THE UK

1. General

a. The Consensus is a valuable means of controlling export credit competition but changes are necessary if its collapse is to be avoided.

b. We agree that a new Community package must include positive proposals on the three issues identified - a substantial increase in interest rates, arrangements to overcome the Japanese problem and improved transparency on mixed credits.

2. Interest Rate Increase

The UK could accept a 2-2½% increase (because of prior commitments, an increase agreed in the Autumn would not in practice be fully implemented until 1982). We would prefer a flat rate increase for all categories of recipient, though, for the sake of EC unanimity, we would be prepared to consider a slightly smaller increase for relatively poor countries. But we believe an increase of at least 2% for this category is necessary to provide a basis for agreement with the Americans.

3. Japanese Problem

The Japanese must not be accorded a privileged position under the Consensus, but some compromise should be offered. While the Japanese cannot be expected to change their system, if they want to offer officially supported export finance at lower than Consensus rates, then they should pay some price for being allowed to do so. We are content that various possible approaches should be explored further by the Commission in consultation with the official group. The Japanese must also be pressed to allow foreign exporters access to yen financing on terms comparable with those available to their own exporters.

4. Credits Mixtes

Given the spread of mixed credit systems the need for improved transparency is greater than before. We hope that the French can now accept the Commission proposals for prior notification of such credits.

BACKGROUND

CURRENT STATE OF NEGOTIATIONS

1. Little progress was made at the May meeting of Consensus participants in Paris. The Community did not have any new proposals to put forward because of French unwillingness to move before their Presidential Election, and the EC proposal already on the table for a small increase in minimum rates (1% for rich and intermediate countries, 0.8% for poor countries) was again unacceptable to the Japanese without a concession to allow them to offer lower rates.

2. The US, whose position was closely allied with Japan, did however put forward a possible package of proposals which would have involved an immediate increase in rates of the size proposed by the Community; further staged increases towards the SDR-weighted average of world market rates; and agreement that, for a trial period, low interest rate countries (notably Japan) should be allowed to charge their market rates, on the basis that other countries could also finance in those currencies at market rates. The Americans also made it clear that they intended to apply pressure on various fronts (eg. derogations on credit length, action in GATT) to encourage progress on Consensus reform.

3. The Commission undertook to consider the US proposals and there is to be a further meeting of the OECD Consensus Group in October, at which the Community will be expected to make a constructive response. Progress at this meeting is essential if the Consensus is to be held together.

EC Position

4. Since the May meeting the Commission have sought to put greater impetus into the preparation of a Community position which might provide the basis for compromise agreement. When the matter was discussed at ECOFIN on 15 June, M.Delors asked that the new French Government should be given more time to consider the matter, but said that he should be in a position to join in a substantive discussion at the July meeting. The matter has accordingly been placed on the ECOFIN agenda again, so as to enable M.Delors and other Ministers to indicate their general views on the main issues and what the

Community's objectives should now be. But agreement on detailed proposals is <u>not</u> being sought at this stage. The Commission will be having informal exploratory talks with the Americans and Japanese later this month (they have stressed that these are not negotiations and do not therefore require the Council's authority). They will then put forward proposals for a new negotiating mandate which will be discussed at the ECOFIN meeting on 17 September. For the present, it is very desirable that member states should not take up hard and fast positions which might constrain the Commission's freedom of manoeuvre in developing ideas for a possible compromise deal.

5. Following discussion last week in the Co-ordination Group on Export Credits, the Council Secretariat have circulated a short paper, drawing attention to the need for the Community to have an improved mandate for the resumed negotiations in October, covering the three key issues of increases in Consensus rates, the Japanese problem and mixed credits.

<u>Interest Rates</u>

6. US pressure to bring Consensus rates more in line with the current level of world market rates is now such as to seriously endanger the continued existence of the Consensus. Only a significant increase will satisfy the US and others that the Consensus can respond to changing world trading conditions and not remain an artificial and uncontrollably expensive mechanism for standardising export credit terms. An increase would of course be very welcome to us in relieving the budgetary burden of these subsidies, and one would expect that the French would also welcome such relief.

7. Any proposed increase should strike a balance between satisfying the US demand for a move towards current market rates and the need to avoid exacerbating the Japanese problem. In the Co-ordination Group, all countries except France have indicated that an increase of 2-2½% or (in some cases) more is likely to be acceptable. Views differ on whether the increase should be the same for all categories, or lower for relatively poor countries: the French and the Italians strongly favour preferential treatment for developing countries, but most other countries appear to share our preference for a flat rate increase. The present Consensus matrix already favours the poorer countries, and to widen the differential would further blur the

distinction between commercial export credits and aid. We believe the French may be difficult about an increase as high as 2% for developing countries. (They may have in mind a figure of 1½% or 1¾% for the relatively poor category.) But we share the Commission's view that an increase of at least 2% will be necessary to satisfy the US and encourage them to put pressure on the Japanese to show flexibility. If a 2% increase for relatively poor countries could be agreed, the possibility of achieving some differentiation through a higher increase for richer countries could be considered.

8. The table annexed shows the effect of an increase of 2½% for rich and intermediate countries and 2% for poor countries. For comparison, the OECD's latest calculation of average market interest rates, on an SDR-weighted basis, gives a figure of 11¾%.

Japanese Problem

9. The Consensus applies to officially supported export credits. In the past Japan, through its official ExIm Bank, has adhered to the Consensus interest rates by ensuring that the resultant blended rate between the 60-70% ExIm Bank share and the 40-30% commercial bank share respects the Consensus minimum. Japanese rates are now falling and would be below the Consensus if any increase was agreed. They have stated they would not be prepared to apply the rules as in the past and would want to be able to offer ExIm Bank finance at lower than Consensus rates.

10. We are not convinced that the participation of the Japanese ExIm Bank has no effect on export interest rates or that UK exporters will be allowed access to yen financing to enable them to match Japanese credit offers. For this reason, the recent US proposals, whilst acceptable in part, do not appear to answer all the problems, particularly on the question of access to yen in sufficient quantities and at comparable interest rates.

11. Most countries (including ourselves) agree with the Commission's view that while the Japanese cannot reasonably be expected to change their system, they should be asked to pay some price for being allowed to offer officially supported finance at sub-Consensus rates, and also pressed to give satisfactory assurances on foreign access to yen finance. The price might take various forms: one possibility suggested by the Commission is that Japanese ExIm should agree to charge a margin or premium above long term prime rate; an alternative approach, which we have floated, is that Consensus rates should be charged on

the proportion of lending directly funded by ExIm Bank, while the balance provided by commercial banks could be at market rates (as noted above, at present the overall rate charged respects the Consensus minimum). In both cases, the effect would be to limit the size of the Japanese competitive advantage at increased Consensus rates.

12. The Germans are known to be unhappy about the imposition of any penalty on the Japanese which might have implications for their own financing arrangements should they again become a low interest rate country, while the French have suggested that if access to yen cannot be achieved, it should be open to other countries to match yen interest rates in other currencies. This would prejudice the intended reduction in subsidy costs, and could well throw Consensus disciplines into disarray.

13. At this stage the aim should be to get general agreement that some compromise arrangement should be sought; and to leave the Commission maximum flexibility in exploring how best this might be achieved.

Mixed Credits

14. Commission proposals for prior notification of mixed credits with grant elements in the 15-25% range, and prompt notification for cases over the official aid threshold of 25% already have the support of all member states except France. There is strong pressure within the OECD Consensus group for greater transparency in this field, and it is particularly important that the Community should adopt a more positive line now that the practice of offering mixed credits is growing. There have, for example, been reports that the Japanese are beginning to use their new powers to provide such credits, and we need to know what they are doing.

15. We believe that, if pressed on this at Ministerial level, the French may be prepared to come into line. It would obviously be helpful if this issue could be cleared before September.

CONSENSUS ON EXPORT CREDITS

Summary of Guidelines

(Possible changes shown in brackets, assuming increases of 2½% in minimum rates for category I and II countries, and 2% for category III).

Country Classification	Terms of Payment		Minimum Interest Rates	
	Minimum cash Payments %	Maximum Credit Period (Years)	Credits 2-5 years	Credits over 5 years
I Relatively rich:	15 (20)	8½* (5)	8.5% (11.0%)	8.75% (11.25%)
II Intermediate:	15	8½	8.0% (10.5%)	8.5% (11. 0%)
III Relatively poor:	15	10	7.5% (9.5%)	7.75% (9.75%)

*Note At present credits of over 5 years for sales to rich countries are subject to prior notification (except for goods - eg. aircraft, ships - covered by sector agreements allowing longer terms).

Other changes carried forward from the December 1980 Mandate

a. Cash payments for trade with "rich" countries to be increased from 15 to 20% (except where otherwise provided for goods the subject of specific Sector Agreements).

b. A strict maximum of 5 years credit for sales to "rich" countries should be applied, (except for goods covered by Sector Agreements).

c. The maximum terms for agricultural commodities should be 2 years' credit.

d. The maximum terms for conventional/nuclear power stations should be 10 years' credit.

e. Official finance for local costs in intermediate countries should be withdrawn (pure credit insurance cover may still be given).

EUROPEAN COMMUNITIES
THE COUNCIL

Brussels, 26 June 1981 (29.06)

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dual back time for 1.7.

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CCG 30

REPORT

from: Policy Co-ordination Group for Credit Insurance, Credit Guarantees and Financial Credits
to : Permanent Representatives Committee
on : 1 July 1981

Subject: Export credits
- Changes to the Arrangement on Guidelines

1. At its meeting on 15 June 1981 the ECO/FIN Council asked the Permanent Representatives Committee to continue working actively on the abovementioned question so that the Council might adopt a new negotiating brief at its September 1981 meeting at the latest.

2. At its meeting on 25 June 1981 the Policy Co-ordination Group for Credit Insurance, Credit Guarantees and Financial Credits held a further discussion on the main problems posed by changes to the Arrangement on Guidelines.

3. The Group stressed that there was a real danger of the Arrangement being permanently compromised if the Community did not have a negotiating brief of adequate substance at the plenary meeting of the Participants in the Arrangement, planned for 5 to 7 October 1981.

.../...

4. With this in mind, the Group thought it necessary to draw the Permanent Representative Committee's attention to the fact that it was desirable that the ECO/FIN Council at its meeting on 6 July 1981 should hold a policy debate on the three questions below, which seemed to be the most important in the context of changes to the Arrangement:

A. Substantial increase in the levels of the minimum interest rates in the Arrangement

In this connection, it was pointed out that the increases put forward by the Community in accordance with the negotiating brief annexed to the Council Decision of 16 December 1980 (1), were considered quite inadequate by the other Participants.

B. Countries with low interest rates which are participants in the Arrangement

It was emphasized that whilst these countries could not actually be asked to abandon their national financing systems, it was desirable for a balance to be kept between Participants in the Arrangement.

C. Improved transparency for tied aid credits

It was pointed out that the question of a possible amendment to the procedures of the Arrangement arose in this context.

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(1) 1% for categories I and II
0.8% for category III.

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MONETARY RELATIONS BETWEEN THE COMMUNITY AND THIRD COUNTRIES
(ie US interest rates etc)

Purpose of the discussion

The Council will receive reports from the Committee of Central Bank Governors and the Monetary Committee. The first is on the coordination of interest and exchange rate policies vis-a-vis third countries. The second, on the effects of high interest rates in member countries, was commissioned for this Council largely to prevent lengthy discussion of the issue at the European Council on 29/30 June.

Aim of the discussion

4. US INTEREST RATES, ETC.

2. In the past, discussion of interest rates and exchange rates has tended to consist mainly of complaints about US policies, with little clear notion of what the solution might be. Two potentially important questions have not received enough attention

a) the extent to which Community interest rates reflect domestic rather than purely international factors

See below

b) the effects of exchange rate changes on Community output and inflation

In his telex of 1 July to members of the Coordinating Group, Sir Douglas Wass said that you intended to focus discussion on these two questions, together with a third question (c) on the approach to the US at Ottawa. In discussing (a) and (b) you might be able to draw out those factors in the current situation which cannot be laid entirely at the door of the US. Under (c) your objective would be to ensure that the Americans are approached as allies in a way which does not invite a rebuff. The approach should not be formalised or take place in advance of Ottawa.

Points that might be included in Presidency summing up

(A) Interest rates

3. All agree that international transmission of monetary policy an important issue. Points to the need for close consultation between policy makers. Legitimate concern about balance between fiscal and monetary policy and unnecessary volatility of interest rates.

4. High interest rates result from domestic as well as international

pressures. These include:

a) the need to finance continuing high current account deficits in many EC countries.

b) rising trend of public sector deficits. No ~~firm~~ PRECISE correlation between size of budget deficit and level of interest rates. But in several countries the financing of large deficits has put upward pressure on short and long term interest rates

SCALE

c) stubborness of inflation and inflationary expectations. In several member countries inflation has accelerated in recent months. Average EC rate likely to remain in double figures this year. Divergence between countries high [Ireland, Italy, Greece inflation rates over 20 per cent: Germany, Belgium, Netherlands 5½-7 per cent]

(B) Exchange rates

5. The danger to the Community economies of the strong dollar is that it will give a new boost to inflation. This underlines the need to control costs. If they can be controlled and the feed - through from a lower exchange rate to higher inflation curbed, the gain in competitiveness will have a beneficial effect on output.

(C) Ottawa

6. Ottawa an important opportunity for discussing these issues with the US. Believe we are agreed that Community representatives should adopt a moderate tone as befits exchanges between allies. Formalised or strident approach to the US would invite a rebuff. We need to reassure the US of our support for basic thrust of its counter-inflation policy: but to point out that care is needed to ensure that implementation of the policy does not impose excessive burdens on allies. We should ask them to continue their efforts to control their budget deficit: but [as the Governors' report says] draw attention to the possibility that developments during the course of this year may run counter to the Administration's fiscal strategy. If this happened we would hope that any budget over-run is corrected by fiscal action and is not allowed to put further pressure on financial markets.

7. We would also call attention to the effects on our economies of

volatility of US rates /which Monetary Committee report usefully sets out/. We cannot presume to suggest alternative monetary control techniques. But would be right to ask the US whether they have to put so much stress on weekly money supply figures which may be a doubtful guide to the underlying situation.

UK points to make

8. i) Welcome reports by Central Bank Governors and Monetary Committee

ii) Monetary Committee rightly stresses that high interest rates are a consequence of high inflation rates. And it makes the important point that interest rates can be reduced, without relaxing the fight against inflation, by cutting budget deficits.

iii) UK has recognised this. Tough fiscal measure in March budget to permit lower interest rates.

iv) If we show that, domestically, we are aware of the danger of putting too much weight on interest rates and not enough on fiscal policy, we will be well placed to convey the same message to the US

v) We should assure the Americans of our support for the basic thrust of their counter-inflations policies. But point out that, in implementing them, they should be careful not to create problems for others. Particularly important that if US budget deficit comes under control more slowly than Administration expects, any over-run should not be allowed to put further pressure on interest rates

vi) Recent currency movements reflect relative current account developments as well as interest rates. Depreciation of European currencies should improve competitiveness, provided effects of imported inflation are contained.

BRIEF 4 (cont.)

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BACKGROUND

a) The reports

9. The Central Bank Governors' report does not really live up to its title. There is very little in it about "co-ordination" of interest and exchange rate policies. This is perhaps no bad thing. Instead, the report is a fairly conventional description of the "choice of evils" facing monetary authorities in most EC countries - either to raise interest rates to stabilise their currencies or to allow their exchange rates to depreciate, with inflationary consequences. The report does not seek to attribute this dilemma solely to US policies. It recognises that tensions within the EMS have reflected "inadequate performance within and divergences of performance between the member States". It recommends a cautious approach to the Americans. Suggestions that they should radically alter their policy mix "would risk a rebuff". And, the report concludes, it would be unwise to invite the US authorities to change their monetary control techniques when there is no agreement about what alternative techniques might be adopted.

10. The Monetary Committee report adopts a broadly similar tone, though it is more specifically concerned with the impact on member States of US interest rates and the strength of the dollar. Its main conclusions are:

(a) volatility of US interest rates - US techniques should pay more attention to trend movements in target aggregates rather than short term deviations

(b) Level of US interest rates - high interest rates are an essential part of the fight against inflation. Interest rates can be reduced, without relaxing anti-inflation policy, by substantially reducing Government deficits. This is not only valid for the US but for EC members as well.

(c) Exchange rates - interest rate movements may have contributed to overshooting. Need for some degree of intervention to deal with erratic fluctuations. US policy /of minimal intervention/ seems to go too far.

11. The report finally stresses that the difficulties of member countries are "to a large degree domestically generated and that, as

a general principle, responsibility for combating inflation by all appropriate means begins at home".

(b) Recent interest rate developments

12. US money market rates eased slightly in June taking some of the pressure off European rates, which, except in France, remained relatively stable. French interest rates (3 month) soared from 13 per cent in May to around 20 per cent in mid-June but have since fallen back slightly. The following table gives recent interest ratio for the EC countries, the US and Japan.

3 month money market rates at 30 June

US	16.12
Japan	7.25
Germany	12.98
France	18.75
Italy	20.88
Netherlands	11.75
Belgium	15.00
Denmark	16.40
Ireland	15.80
UK	12.59

(c) Domestic pressure on interest rates

13. The suggested points for the Presidency summing up mention three domestic factors which are reflected in high interest rate - the size of current deficits, the draft of budget deficits and the level of inflation. The following tables provide background (a table showing budget deficits in member states is included in the background to the brief on the economic situation).

Current account balances as a % of GDP

	1980	1981 (Commission forecast)
Germany	- 1.7	- 1.9
France	- 1.4	- 1.6
Italy	- 2.5	- 2.3
Netherlands	- 1.5	+ 0.7

	1980	1981 (commission forecast)
Belgium	- 5.7	- 7.3
Denmark	- 3.8	- 3.8
Luxembourg	+ 22.8	+ 20.8
Ireland	- 2.5	- 2.3
Greece	- 2.4	- 2.6
UK	+ 1.2	+ 0.6
EC Average	- 1.4	- 1.7

Year-on-year inflation rates (consumer prices)

	12 months to October 1980	Latest 12 months
Germany	5.3	5.6 (May)
France	13.5	12.7 "
Italy	20.5	20.4
Netherlands	6.7	6.2 (April)
Belgium	7.0	7.4 "
Denmark	11.2	11.8 "
Luxembourg	6.0	7.4 "
Greece	24.3	24.3 "
Ireland	18.2	21.0 (Feb)
UK	15.4	11.7 (April)

14. In 5 of the 10 member states the year on year inflation rate has accelerated since October 1980. Only in the UK has it declined significantly.

d) Effects of exchange rate depreciation on Community economies

15. The Commission has recently done some work on this subject for the Economic Policy Committee. The conclusions might be referred to by Commission representatives at the Council. In summary they are that:

(a) By May 1980 the ECU was just over 20 per cent lower against the dollar than its average value in 1980

(b) The consequent gain in the Community's export price competitiveness is likely to be more than 10 per cent, of which more than a third is reflected in export volume within one and a half years

(c) the effect is to increase the volume of Community exports by $2\frac{1}{2}$ per cent in 1980 and 4 per cent in 1981 (equivalent to 1.1 per cent and 1.9 per cent of GNP respectively)

(d) the impact on Community activity will be offset by the effect of higher inflation on domestic demand. A 20 per cent ECU depreciation might raise the average Community inflation rate by 1 per cent in 1981 and $2\frac{1}{2}$ per cent in 1982.

(e) But for the remainder of this year and in 1982 the depreciation has a net positive effect on GNP

16. This last conclusion contrasts sharply with the OECD's view that EC output will be lower than otherwise for at least the the first two years after the fall in the ECU. We think that the Commission's view is more plausible.

(e) <u>Ottawa Summit</u>

17. The UK's position is set out in the Chancellor's letter to the Prime Minister of 20 June (attached).

18. The conclusions of the European Council on the line to be taken with the US at Ottawa is quoted in the brief for the Presidency provided by the Council Secretariat.

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FINANCE COUNCIL: 6 JULY 1981 BRIEF 6

NEW COMMUNITY INSTRUMENT

Purpose of Discussion

Everything turns on whether the Germans lift their reserve.

2. If they do, the aim is to reach substantial agreement, so that the matter can come back to a subsequent council for final agreement as an A point. If they do not, the aim is to put pressure on the Germans with a view to final agreement at the September council.

Presidency Summing Up

3. If the German reserve remains, the Italian and others will no doubt put pressure on them, referring to the European Council etc. We suggest that your summing up is simply:

- invite the Permanent Representatives Committee to continue its work and report to the Council at its meeting on 17 September.

4. If the Germans lift their reserve, you should aim to secure substantial agreement. The main outstanding point is the ceiling. It should not be difficult to secure agreement that there should be a ceiling. The question is its size. The Italians will probably suggest 2 billion ECU, whilst the Germans are likely to prefer 1 billion ECU. You could suggest 1½ billion ECU as a Presidency compromise. The other outstanding point is whether simultaneous tranches should be allowed. You could press the Germans to lift their reserve on this point. If all goes well, you could then sum up as follows:

6. NEW COMMUNITY INSTRUMENT

- invite the Permanent Representatives Committee to
  - (1) resolve any minor outstanding matters;
  - (2) To put the draft decision into appropriate legal form in all languages of the Community;

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(3) To arrange as an "A" point the transmission of the draft decision to the European Parliament as a "common position of the Council".

UK Points to make

5. [If necessary] Ceiling. Essential to have overall ceiling as in original decision. Matter of normal financial prudence. Will also allow us to review the operation of the facility in the light of experience. Note that the European Investment Bank has ceiling based on amount of capital. (No need to accept allegation that ceiling prevents permanence or continuity).

6. Size of ceiling can accept $1\frac{1}{2}$ billion ECU.

Background

6. The NIC (or "Ortoli facility") was set up in 1978 to allow the Commission to borrow in the markets for on lending to investment projects in member states. The original Council decision was subject to an overall ceiling of 1,000 million ECU's which has now been almost reached.

7. There is no particular interest to the UK since the loans we could obtain under it are not subsidized. Indeed we are restricting our foreign currency borrowing from the Community in line with our objective of reducing the net total of official external debt.

8. It is doubtful if the NIC is necessary, because it overlaps with the EIB. In the past all NIC lending has been to projects already supported by the EIB. The reason for the Commissions enthusiasm is that they are excluded from the running of the EIB's ordinary operations and would like to expand their empire.

9. On the other hand, the NIC does not impose any significant cost on the UK or conflict with any important UK interest, whereas it is strongly favoured by the Italians and the Irish, partly for balance of payments reasons and partly because it helps them to take up the benefit of the "EMS interest rate subsidies" (with which they were induced to join the EMS).

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FINANCE COUNCIL: 6 JULY 1981 BRIEF 7A

5TH MEDIUM TERM PROGRAMME

Purpose of Discussion

This item is not on the agenda, but M Ortoli may wish to raise it under 'other business'.

Presidency Objectives

2. We wish to minimise discussion (which should be straightforward since the convention is that items under 'other business' are not discussed) and to ensure that we are left free to handle the item in future as we think fit.

3. We suggest you aim to sum up on the following lines:-

- grateful to M Ortoli for introducing the programme;
- will arrange for it to be sent to the European Parliament and Economic and Social Committee;
- will bring it back to the Council at the appropriate time;

UK Points to make

4. N/A

Background

5. An extract from the 1974 Convergence Decision, which lays down the procedure, is attached.

6. The ritual is of no use to the UK. Our national objective is to ensure that the final version is anodyne.

7A
5TH
MEDIUM
TERM
PROGRAMME

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FINANCE COUNCIL: 6 JULY 1981 ITEM 7B

ITALIAN IMPORT DEPOSIT MEASURES

We understand that Mr Van der Stee may wish to ask M Ortoli under 'other business', what action the Commission have taken. This is no doubt prompted by M Ortoli statement at the European Council that the Commission was considering a recommendation under Article 108 of the Rome Treaty (attached).

3/7/81.

FINANCE COUNCIL: 6 JULY 1981 ITEM 7B

ITALIAN IMPORT DEPOSIT MEASURES

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7B.
ITALIAN
IMPORT
DEPOSIT
MEASURES

ARTICLE 108 OF THE TREATY OF ROME

Article 108

1. Where a Member State is in difficulties or is seriously threatened with difficulties as regards its balance of payments either as a result of an overall disequilibrium in its balance of payments, or as a result of the type of currency at its disposal, and where such difficulties are liable in particular to jeopardise the functioning of the common market or the progressive implementation of the common commercial policy, the Commission shall immediately investigate the position of the State in question and the action which, making use of all the means at its disposal, that State has taken or may take in accordance with the provisions of Article 104. The Commission shall state what measures it recommends the State concerned to take.

If the action taken by a Member State and the measures suggested by the Commission do not prove sufficient to overcome the difficulties which have arisen or which threaten, the Commission shall, after consulting the Monetary Committee, recommend to the Council the granting of mutual assistance and appropriate methods therefor.

The Commission shall keep the Council regularly informed of the situation and of how it is developing.

2. The Council, acting by a qualified majority, shall grant such mutual assistance; it shall adopt directives or decisions laying down the conditions and details of such assistance, which may take such forms as:

(a) a concerted approach to or within any other international organisations to which Member States may have recourse;

(b) measures needed to avoid deflection of trade where the State which is in difficulties maintains or reintroduces quantitative restrictions against third countries;

(c) the granting of limited credits by other Member States, subject to their agreement.

During the transitional period, mutual assistance may also take the form of special reductions in customs duties or enlargements of quotas in order to facilitate an increase in imports from the State which is in difficulties, subject to the agreement of the States by which such measures would have to be taken.

3. If the mutual assistance recommended by the Commission is not granted by the Council or if the mutual assistance granted and the measures taken are insufficient, the Commission shall authorise the State which is in difficulties to take protective measures, the conditions and details of which the Commission shall determine.

Such authorisation may be revoked and such conditions and details may be changed by the Council acting by a qualified majority.

Trudeau Visit.

Only if obliged to say something.

Mr. Trudeau visited London on 26th June after his visits to Bonn and Paris but before the European Council. He had talks with Prime Minister, Sec of State for Trade and Lord Privy Seal.

The discussion was chiefly about the Ottawa summit. Mr. Trudeau expressed the hope that Ottawa would agree positions on the global negotiations and the energy affiliate. He thought the Community representatives would be sympathetic but was not sure about the position of President Reagan whom he is to visit in Washington on 10th July.

Mrs. Thatcher took the opportunity to explain the United Kingdom's approach to aid to Mr. Trudeau.

Both Prime Ministers agreed on the desirability of a short communique at Ottawa, but recognised that it might (not) in practice be all that easy to achieve.

Delors: DR. BOHME PARL'Y STATE SEC
MR BRUTON MIN N FINCE

Endorse monet cttee

Not wish interfere with US policy
Hope success v inflation
But worry re impact on
(1) Europe — We cd. ask US to
(2) LDCs — intervene to lower $?
Cd. monet cttee measure impact on
- Cttee countries
- LDCs
- World

Australia: Market functions badly: dollar overshoots?

Germany: Not all U.S fault.
Consider influence of our own deficits.
Mon. Cttee useful forum
But U.S. vulnerability high
Avoid too much burden on monet policy

Belgium:

U.K.: Don't overlook our shortcomings
If to mobilize address U.S.A.
∴ consider own policies
Adjust own budget: cf. U.K.
Avoid — cd. grow — must not wish reflect
Stress need for all to adjust

President

Item 3: Second Quarterly Review of economic situation

The way of dealing with the Danish Minister's problem on <u>his</u> budgetary guidelines could be:–

"The Council noted that the Danish Delegation had placed a reserve on the budgetary guidelines in respect of Denmark. This will be noted in the Minutes"

DELORS:

- Endorse text of monet. cttee report
- No intention of criticising US monet. ~~[illegible]~~ policy
- Hope for success in fight agst inflation
- Need for sustained progress on all fronts.

Worried by volatility of int. rates

" " " of ex. rates

∴ We cd. ask US to ~~[illegible]~~ intervene to lower $

Qns.

1. How far does rise of $ add to burdens of Euro?
2.
3. How far do US policies [illegible] from the LDCs? $ 9 Bn an [illegible]

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COMMISSION OF THE EUROPEAN COMMUNITIES

C(81) 1020 final

Brussels, 1 July 1981

COMMISSION RECOMMENDATION

of 1 July 1981

to the Government of Italy under

Article 108, para. 1

C(81) 1020 final

(only the Italian text is authentic)

COMMISSION RECOMMENDATION TO THE GOVERNMENT OF ITALY
UNDER ARTICLE 108, § 1

1. In compliance with the provisions of article 108, § 1 of the Treaty, and following the decision taken on 27 May by the Italian Government, to introduce a compulsory deposit on purchases of currencies, the Commission has carried out an in depth examination of the economic and financial situation in Italy.

2. The Commission found that the current account of the balance of payments after having recorded a substantial deficit - in the region of 2,5 % of expenditure GDP - in 1980, continued to deteriorate during the first few months of 1981. The Commission also established that during the opening months of 1981 the Italian monetary authorities were required to cover the deficit mainly through use of the official reserves.

The Commission considered that the increase in the value of the dollar accounts partly for the difficulties observed. It considers nevertheless that the difficulties stem primarily from insufficient control over the domestic economy during the opening months of this year. After picking up in the closing months of 1980, domestic demand then remained at a relatively high level instead of falling back as was necessary in order to strengthen the trend towards improvement in the real balance on foreign transactions.

It appeared that these difficulties were made appreciably worse by the evolution of a large Treasury budgetary deficit particularly from the final months of 1980 onwards and the strong injection of liquidity to which it gave rise due especially to the transfer to the banking system by several public bodies of credits held at the treasury. Under these conditions, the measures to restrict credit introduced on 31 January and 22 March, were unable to prevent liquidity in the economy from increasing excessively and from reviving inflationary expectations. The raising of the liquidity situation, already rather unrestrictive, enabled companies to act on their expectations, inevitably to the detriment of the external balance.

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3. The Commission observed that these difficulties would have been less acute, if the accompanying budgetary measures, envisaged at the time of the adjustment of the central rate of the lire on 22 March, had been applied quickly, and if interest rates on public securities, together with the discount rate, had been set at a level, sufficient to maintain market interest in such investment, and thus reduce the impact on liquidity of the widening of the public sector deficit.

The Commission has noted that the Italian government considered that, in the situation thus created, it was of the utmost importance to act so as to reduce the liquidity of companies which avoids, or at least reduces, the risk of additional losses of official reserves. It has noted furthermore that the device adopted by the Italian government is considered to have been the only possibility open to it - technically and judicially - of rapidly attaining the desired objective.

The Commission regrets however that there was no prior consultation.

4. With regard to fundamentals, the Commission considered that it is essential to set the Italian balance of payments difficulties and the action undertaken to meet them, in the context of the present situation in the Community and in the world. The Community economy finds itself in perhaps its most difficult position since 1958 : never has the deficit on the current account of the balance of payments been so high nor has so large a percentage of its workforce been out of work. The majority of member states are showing balance of payments positions comparable to that of Italy and in certain cases the situation is even more serious. All this has taken place in a world in which competition in manufactured goods markets is intensifying incessantly, where the weight of economic and political instability in international relations is unprecendented and where the world exchange and payments system lacks a sound and agreed monetary framework.

In these circumstances, and in the absence of suitable action to overcome the crisis through an improved joint effort and international and community cooperation, there is an increasing danger that countries will look for a

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solution to their economic problems through unilateral action, contrary to the principals on which, since the end of the war, expansion of international trade and world economic growth have been founded. The Commission expressed its serious concern over the risk of protectionist chain reactions in other countries which could be provoked by measures leading to restriction of trade.

Italy, among the member countries of the Community, was one of those which had known best how to respond to the challenge of the opening of its borders. Italian industry had been able to make its participation in the Common Market the starting point of a remarkable process of growth and modernisation. The Commission is convinced that the Italian economy has the dynamism, and can regain the flexibility, necessary to successfully overcome the present difficulties and resume the path of balanced growth, fully benefitting from its participation in all aspects of the building of the Community.

5. It is the opinion of the Commission that beyond the immediate causes and present conditions which have led, for the third time in seven years, to the taking of measures likely to hinder trade, the problems of the Italian economy are determined by underlying factors which it has become urgent to tackle resolutely. These factors manifest themselves in the lack of control in the process of determining public and company sector spending.

In the public sector, the size of the deficit and the orientation of spending are the prime source of economic and financial instability and an obstacle to the changing of economic structures. Public sector deficits exert excessive pressure on the money supply.

Too large a proportion of current expenditure in public spending stimulates consumption and impedes the growth which would be necessary to improve the economic structure. Despite reforms introduced during recent years, budgetary procedures have proved to be incapable of assuring a budgetary evolution compatible with economic and monetary stability. Certain parts of the Treasury are insufficiently controlled, as witness for example the recent evolution of the treasury borrowing requirement. In addition funds appropriate to new expenditure of a continuing kind is not assured at the start of the first year of such expenditure.

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In the company sector, the cumulative effect of indexation, and the outcome of wage negotiations have, for several years, been incompatible with a return to a level of inflation in line with the community average. Rigidities in conditions of employment obstruct gains in productivity which are the necessary condition for a non-inflationary and consequently lasting improvement in real wages and employment. Distortions in tha wage structure, caused by the present indexation, are both a source of inflation and an inefficient allocation of resources.

It is the opinion of the Commission that no measure of a protectionist nature can lead to a correction of these fundamental factors. On the contrary, such measures could give rise to the illusion of being able to put off urgent and fundamental adjustments which are unavoidable if internal stability and at the same time external competitivity are to be regained.

6. The Commission is aware that certain corrective measures depend upon the behaviour of the company sector and other economic agents, rather than on the actions of the authorities or the government. It is therefore even more necessary that the authorities make full use of legislative and administrative instruments at their disposal and that they use all their influence to guide the decisions of other economic agents towards the objective of stability.

The recovery process cannot be completed quickly. Continuous and prolonged action is needed to obtain lasting results. Immediate action is therefore even more necessary.

7. The Commission recommends that the Italian government urgently takes the necessary measures in order that public finances cease to burden the administration of short-term economic policy with a constant and disturbing threat. To this end, it recommends :

- every effort be made to keep net domestic borrowing by the public sector in 1981 within the limit set (LIT 37 500 mrds);
- by way of a first step towards the desirable establishment of the unity of the public sector treasury, to apply strictly the arrangements which limit the ability of local and regional authorities to hold liquid assets in the banking system;

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- to end the practice of the Bank of Italy of buying at the time of issue, Treasury bonds and certificates not taken up by the banks or by the public. This implies, firstly, that the level of interest rates applicable will henceforth be determined by the market and secondly, that the Treasury endeavours to avoid too great an instability in these rates, regularising as far as possible its calls on the market and consequently the development of its deficit through the year.

Further to these urgent measures, the Commission recommends that arrangements be made as quickly as possible to bring about, through time, an improvement of public finances. Arrangements on which attention should be focussed are those required to guarantee the respect of essential arrangements forbidding approval of new uncovered expenditure, the possible extension of the ability of local authorites to raise taxes, the reduction of the upward pressure on certain charges brought about through automatic mechanisms, the improvement of administration and knowledge of budgetary flows, and the establishment of a single treasury service.

The Commission recommends furthermore that the Italian government be made especially aware of the risk that inflationay impulses resulting from the public deficit, may set in motion a new intensification of the price and cost spiral, through the mecanism of variable pay scales and the renewal of a number of important collective agreements. The Commission notes that the present framing of credit policy is in principal sufficiently strict. But it is a matter of some urgence that the efforts undertaken by the Italian government, in accord with the social partners, to define and implement a policy of voluntary reduction of the pace of the rise in nominal incomes reach a satisfactory outturn. The Commission considers in fact that such a policy is necessary to ensuring the competitivity of the economy and in consequence to the stability of the exchange rate and the disappearance of the underlying propensity of exchange markets to anticipate its depreciation.

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8. The Commission will follow closely the development of the economic situation in Italy, and carefully monitor the application of the measures taken on 27 May 1981. It considers that in any case, 1 October, the date on which these holding measures must come to an end, fixes a maximum duration for their application and that efforts should be made to shorten this period. It reserves the right to intervene at any time under the arrangements foreseen in the Treaty, in order that any modifications that may be judged necessary may be brought to bear with regard to the field of application and duration of the measures.

Done at Brussels, 1 July 1981

For the Commission

CONFIDENTIAL

BRIEF 10 92

3/7/81

PERSONALITY NOTES

Belgium

1. Mr Robert Vandeputte	Minister for Finance
2. Mr Willy Claes	Minister for Economic Affairs

Denmark

3. Mr Ivar Nørgaard	Minister for Economic Affairs
4. Mr Svend Jakobsen	Minister for Finance

France

5. Mr Jacques Delors	Minister for Finance

Germany

6. Mr Hans Matthöfer	Minister for Finance
7. Mr Otto Graf Lambsdorff	Minister of Economics
8. Dr. Otto Schlecht	State Secretary Federal Minister of Economics
9. Dr. Horst Schulmann	State Secretary Federal Ministry of Finance
*10. Dr. Rolf Böhme	Parliamentary State Secretary Federal Ministry of Finance (German representative on this occasion)

Greece

11. Mr Miltiades Evert	Minister for Finance
12. Mr Ioannis Palaiokrassas	Minister of Coordination

Ireland

*13. Mr John Gerard Bruton	Minister for Finance

Italy

14. Mr Nino Andreatta	Minister for the Treasury

Luxembourg

15. Mr Jacques Santer	Minister of Finance
16. Mr Ernest Mühlen	State Secretary for Finance

Netherlands

17. Mr van der Stee	Minister for Finance

18. Professor Rutten — Secretary-General, Ministry of Economic Affairs

19. Dr Wellinck — Treasurer-General, Ministry of Finance

Secretariat

20. Mr Ersbøll — Secretary General of the Council Secretariat

21. Mr Christofas — Director-General of the Council Secretariat responsible for economic and monetary questions and relations with the European Parliament.

European Commission

22. Mr Gaston Thorn	President
23. Mr Francois-Xavier Ortoli	Member
24. Mr Christopher Tugendhat	Member
25. Mr Poul Dalsager	Member

* changed since last Finance Council

RESTRICTED

BRIEF 9

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9.
GUIDANCE
MATERIAL

EUROPEAN COMMUNITY: COUNCIL MEETINGS

NOTES FOR THE GUIDANCE OF MINISTERS

MAY 1981

RESTRICTED

EUROPEAN COMMUNITY: COUNCIL MEETINGS

NOTES FOR THE GUIDANCE OF MINISTERS

PART I. GUIDANCE ON THE PRACTICAL ASPECTS OF COUNCIL MEETINGS

1. **Place**

Council meetings are held in Brussels and, during the months of April, June and October, in Luxembourg. In Brussels, meetings are held in the conference rooms on the 15th floor of the Council building, known as the Charlemagne. In Luxembourg, the Council meets in the European Centre at Kirchberg on the outskirts of the city.

2. **Time**

The timing of Council meetings is entirely flexible. Meetings may begin and end at any hour though one-day meetings usually begin at 10.00 am and two-day meetings at 3.00 pm on the first day. The time for the opening of a session is generally known well in advance. Meetings end when the business is done or when other engagements take too many Ministers away; they occasionally last until the early hours of the morning.

Firm chairmanship is necessary if Council meetings are to start reasonably on time. Most Ministers arrive in the chamber a few minutes late and Press photographers are usually allowed to be in the chamber until the meeting begins, which adds to the delay.

3. **Seating**

The Member State holding the Presidency for the half-year provides the Chairman, as well as a national representative. The Chairman is flanked by staff of the Council Secretariat who support him and take the official record of the discussion, and by his own Permanent Representative, Deputy PR or Minister (Agriculture). They sit at the head of a rectangular ring of tables. Opposite them sit the members of the Commission and their staff. The member countries sit behind name cards on the other sides of the table. The seating order is alphabetical (by reference to the name of the country in its own language) from the Chairman's right starting with the delegation next in line for the Presidency.

If for any reason the Minister chairing the Council wishes to leave the room during the Council meeting, he must hand over the chairmanship either to another Minister from his own country or to a Minister from the country next in line for the Presidency (in the case of the UK, to the Belgian); he <u>cannot</u> hand over to an official from his own country.

4. **Quorum**

Council meetings cannot start without a quorum of 5 Ministers from different Member States, including the Presidency (some States may be represented by senior officials). If in doubt the Presidency may take soundings before convoking a Council to ensure that at least 5 Ministers will be present. This quorum requirement has very occasionally been waived once the meeting is under way.

5. **Access to the Chamber**

Access to the Council chamber is controlled and a limited number of passes (usually nine) are issued to delegations before each meeting of the Council. The United Kingdom Permanent Representative and/or Deputy Permanent Representative will normally be with the Minister(s) and a member of the Staff of the Permanent Representation will usually be in the Chamber to take the record (see 19 below). The other United Kingdom places will be taken by those immediately interested in the discussion in question. It may not be possible for places to be made available for all visiting officials from London, though they may be able to follow the proceedings by closed-circuit television in a second meeting room (the salle d'écoute) if one is provided.

6. **Language**

Spoken: Each Minister usually speaks his own language. There is simultaneous interpretation from and into all the seven languages of the Community (English, French, German, Italian, Dutch, Danish and Greek).

Written: All documents should exist in all seven Community languages. In practice, this is not always the case but English versions are almost always available quickly. If a delegation asks for discussion to be postponed because of the non-availability of a document in their language, the request must be respected.

7. **Earphones**

A set of earphones is available at each place. It is useful to bear in mind that when using the earphones one is inclined to speak more loudly than normal; one may therefore need to make a conscious effort to keep one's voice down when exchanging private remarks with other members of the delegation.

8. **Microphones**

These are switched on from a central control room. A red light comes on when the microphone is live. There is no switch to press. When speaking, it is advisable to remove the earphones and to turn the volume right down since they may otherwise interfere with the microphone. One should be careful not to make remarks aside to members of the delegation until the microphone has been switched off.

9. **Taking the Floor**

If a Minister wishes to speak, he should catch the Chairman's eye and wait to be called. The console operator will then switch on the microphone. The normal way to catch the Chairman's eye is to raise a hand or a pencil. Ministers sometimes need to attract attention when the control room has switched on the wrong microphone.

10. **Speaking for the Interpreters**

It is worth remembering the constant difficulties the interpreters have in interpreting accurately over a long day. Seconds, and even fractions of seconds, are important to the interpreters. The interpreter of English speakers starts with the handicap that, because of its very rich vocabulary and flexible syntax, English is capable of expressing thoughts with exceptional brevity. He needs time to keep up in another, perhaps more cumbersome, language and it is prudent therefore to speak slowly, avoid being over-concise and to include frequent pauses of a few seconds. Colourful imagery or quotations from English authors are also best avoided. If possible, copies of Ministerial statements should be made available to the interpreters in advance. Above all, the speaker should try to remember that he is being interpreted. Some speakers are much easier to interpret and to that extent are more effective than others.

PART II. PREPARATION FOR COUNCIL SESSIONS

11. The Agenda

This will have been settled in advance in the Committee of Permanent Representatives. Not only the list of items but the substance too will, in most cases, have been thoroughly discussed by officials in Council working groups, the Committee of Permanent Representatives, in the case of agricultural meetings, the Special Committee (Agriculture), and certain other committees concerned with the preparation of Finance Ministers Councils. The specific points requiring Ministerial decisions will therefore have been identified in respect of most items. Ministers may be called upon to decide on precise forms of drafting in legislative texts or they may be asked to solve problems of principle which will later be enshrined in the appropriate form of words by officials. In a small number of cases, Ministerial discussion will precede discussion at the official level. The objective in these circumstances is to establish broad political guidelines within which officials may pursue the work. Foreign Ministers Councils are now preceded by a restricted session (Ministers and Permanent Representatives only) at which the arrangements for handling the agenda are discussed in a political context.

12. Briefing

Written briefs are prepared in London on the basis of the working documents provided by the Council Secretariat and of reports on the latest state of play received from the United Kingdom Permanent Representative. If the timetable permits, oral briefing meetings may be arranged in Brussels (or Luxembourg) which will allow the Permanent Representative and his staff to bring the visiting party from London up to date with any last minute developments. It is desirable for Ministers' Private Secretaries to have time before the Council meeting to go through the briefs and papers with the appropriate members of the Staff of the Permanent Representation to confirm agenda order, check on last minute changes to documents, etc. (For administrative arrangements, see Part VI). The Council Secretariat provides separate written and oral briefing to the Presidency.

PART III. THE PROCEEDINGS

13. Approval of the Agenda

This will be the first item. It will have been largely settled in advance (see paragraph 11) but there may be last minute changes and this item is not always a formality. Ministers wishing to add points to the agenda will normally be asked to raise them under Other Business. The Other Business item is a device which allows Ministers to refer to subjects which are of particular importance to them but which other Ministers will not be expected to discuss.

If a Minister wishes to ask for a change in the agenda or for a last minute addition to the point to be raised under Other Business, it is best to let the Presidency know in advance. It will probably still be necessary to intervene under Approval of the Agenda but the Chairman's reaction is likely to be more helpful if last minute surprises can be avoided.

14. **Approval of A points**

A points are items which have been agreed in advance at a lower level but which require the formal approval ("rubber-stamp") of the Council Ministers will occasionally make a statement drawing attention to the importance of an A point relating to a particular decision. Officials will know whether there is any need to react.

15. **Major Items**

There are no general rules about how these are handled. A great deal depends on the efficiency – and indeed the whims – of the Chairman. The following are the standard procedural devices which the Chairman of other delegations may propose or which United Kingdom Ministers may wish to suggest:

(a) *Brief adjournment.* It is not unusual for the Council to interrupt its work for a short period to allow one or more delegations to give a moment's quiet thought to some new proposal for an agreement or to allow time for bilateral discussions between delegations who find themselves in disagreement. A variant of this procedure is for the Council to interrupt its discussion of a particular item, to allow time for thought or negotiation in the corridors, but to continue at the same time its work on other agenda items.

(b) *Working Groups.* It is sometimes useful to suspend the Council's discussion and to put a working group of officials to work on the problem. This allows the Council to return to the item later and, if the working group has been sucessful, to set its final seal of approval on the agreement reached without getting involved in detailed and technical discussions.

(c) *Commission proposal.* When a compromise formula is sought, the Commission may be invited or may offer to make a proposal. It is their right to do so under the Treaties. The Commission's unique position and the considerable technical support at their disposal make them well qualified for this role of mediator. It should be remembered that the Commission is an independent institution, not at the beck and call of the Council and cannot therefore be instructed by the latter.

(d) *Presidency compromise.* Sometimes the Presidency assumes the role of mediator, even in cases where the Presidency's own delegation is party to the dispute, and may, like the Commission, circulate at the meeting proposals for compromise texts, sometimes at very short notice. But the Presidency must choose its moment carefully. The Chairman must be confident that there are the elements of a solution which will have enough in it for him to achieve unanimity. He must also avoid provoking ill feeling on the part of the Commission, who legally have sole right of proposal. The Council Secretariat will advise the Presidency in these circumstances.

(e) *Waiting reserves.* If the Council is close to reaching an agreement which does not strictly fall within the terms of the United Kingdom brief and if Ministers do not wish to be responsible for holding up a decision until the next Council meeting, it is possible to place a waiting reserve (often referred to in all languages as a *réserve d'attente*). This tells the other members of the Council that the agreement goes a little further than the national brief allows but that the Minister is reasonably confident of being able to persuade his Ministerial colleagues at home that it is acceptable. It can always be converted into a more substantive reserve if confidence has been misplaced or it can be lifted immediately if the Minister finds that he has been over cautious.

(f) *Restricted sessions.* The Council often adopts the practice of conducting at least part of its proceedings in restricted session. This usually means that each delegation is restricted to the Minister plus four advisers, but Chairmen vary in their views of how restricted attendance should be at such sessions. Although meetings attended by Ministers alone are of course not excluded, the most restricted (sometimes known as 'super restricted') composition is normally the Minister plus one (usually the Permanent Representative) from each delegation. Restricted sessions may be used for particularly sensitive items on which a greater degree of confidentiality must be ensured or simply for items which are proving difficult to settle and on which Ministers wish to take a political decision untrammelled by too many technical considerations. The danger of such sessions is that few people know precisely what has happened. It is therefore particularly important for Ministers to be aware of the danger of misunderstanding, to make their points clearly and to insist that the Chairman makes a clear summing up of what has been decided.

This last point is in fact a general one. In order to avoid misunderstandings, Ministers should never be afraid to repeat themselves, more than once if necessary, nor to ask the Chairman to sum up at the end of an item (not all Chairmen do this unless pressed) or to repeat his summing up on a particular point. Too frequently the Council ends with the appearance but not the substance of agreement and the precise terms then have to be settled by the Permanent Representatives or, as sometimes happens when they cannot agree, need to be referred back again to Ministers.

16. **Voting**

Normal practice is to take decisions by consensus. Voting usually only takes place when the Member State(s) in a minority is prepared (or sometimes finds it politically convenient) to be out-voted. Under the 'Luxembourg Compromise' which dates back to 1966, a Member State which feels that its very important interests are at stake may object to a vote being taken and ask for discussions to continue until agreement is reached. In these circumstances HMG's policy is to argue against a vote being taken and to support the need for further discussion. In the unlikely event of the Presidency insisting on a vote, we should say that we will not take part, even to abstain.

17. **Confidentiality**

Council meetings are confidential, but not on the whole in such a strict sense as national Cabinet meetings. The Press is always briefed by the Presidency after a Council meeting and heads of national delegations are free to give their own briefings (see paragraph 18 below). Ministers also can and do report to their national Parliaments on the outcome of a Council meeting and may feel free to ensure that Parliament and the media are aware of the line the UK Minister took on a certain agenda item. It would be wrong, however, for the representative of one member state in speaking to the Press or to Parliament to attribute a remark to his colleague from another one. There are also occasions when the Council itself agrees that a certain matter they have discussed should be treated as particularly sensitive.

PART IV. PRESS

18. *(a)* A large, assiduous Press corps is accredited to the Communities, and its leading members, both British and Foreign, are able journalists. Since the Council meets behind closed doors, the Press depend for information on what is given them in periodical briefings during the course of the meeting by the Press officers of the national delegations, by senior Commission officials, and – less frequently – by Commissioners and Ministers (see paragraph *(d)* below). On the British side the routine briefing is usually shared between the Press Officer accompanying a visiting Minister and the UKREP Press Office. There is a very full exchange of information between all journalists, not only those of the same nationality. It is usually possible for them to piece together a full account of what is going on in a Council meeting from hour to hour, or even minute to minute. For this reason, particularly when a subject is under discussion on which Britain may appear in an unfavourable light, it is necessary to get our view to the Press lobby quickly.

(b) Immediately after a Council meeting the President of the Council gives a Press conference at which he runs through the Press communiqué prepared by the Council staff and answers questions. Apart from the fact that, for the reasons given above, what he says will be stale, it is incumbent upon the President to be so tactful that he is hardly news-worthy. There is therefore rarely much life in these occasions.

(c) The Press are much more interested in what Ministers from national delegations have to say. It is possible to gain access to both the Charlemagne building and the Kirchberg in Luxembourg by back doors, but in the normal course of events Ministers arriving and departing will pass through the lobbies where they will be way-laid for their comments. Despite the undignified mêlée, these occasions can be used to advantage.

(d) It is desirable to be ready on arrival with one or two "quotable quotes" about our intentions/hopes for the meeting. After a meeting a fuller informal Press conference by a Minister provides a good way of giving a direct steer to correspondents reporting the meeting (who will not of course themselves have heard what the speaker said in the chamber). When a major item of public interest has been disposed of, it can also be valuable for a Minister to come out to talk to the Press in the course of the meeting, which may enable what he says to get into first editions. Such sessions are open to all-comers. Apart from the French, it is very rare for Ministers or Delegations to attempt to give briefings exclusive to their national Press representatives during Council meetings. It is difficult to arrange them without giving offence and the international freemasonary is such that what is said will in any case be passed on.

(e) The visitor can usually avoid the hurly-burly in the corridors by using a briefing room where he can talk to the Press in a more-or-less civilised atmosphere. However, if a Minister does not wish to speak in detail, or time is pressing, a few sentences on the way to the door are always effective. This may be the only direct quote from a British Minister that correspondents have had all day and they will do their best to see that it is used.

PART V. RECORDS OF MEETINGS

19. The Minutes

The formal Summary record of the decisions taken at the meeting is prepared by the Council Secretariat. It is usually cleared at official level in Brussels and goes to the next Council as an A point. It is very brief (though longer texts may be annexed as appropriate). It is in no way a verbatim record. Very occasionally, where a particularly important or controversial discussion has taken place, the Secretariat may be asked to prepare a "third person verbatim" (*i.e.* Lord Carrington stressed that . . . and went on to say that . . .) on the basis of the tape recording of the session. Only the Presidency has the right to have access to the Secretariat's tapes.

20. United Kingdom Reporting

The Office of the United Kingdom Permanent Representative usually provides the reporting officer to take note of the proceedings of the Council and to report by telegram or letter so that the Whitehall Departments are speedily informed.

PART VI. NUTS AND BOLTS

21. Office Accommodation

The United Kingdom delegation has four offices on the 14th floor of the Council's Charlemagne building (tel. 736.79.00) which it uses as a base during Council meetings. It is most important to remember at all times that all conversations, telephonic or otherwise, in these offices are insecure. There are also spare offices for the use of Ministers and their advisers in the Permanent Representative's Office at 6 Rond-Point Robert Schuman (tel. 736.99.20), five minutes' walk from the Council's Charlemagne building.

In Luxembourg, the delegation has at its disposal the facilities of the British Embassy at 28 Boulevard Royal (tel. 298.64) but this is some distance from the Kirchberg building where the meetings take place. Most of the work is done from the delegation offices in the Kirchberg (tel. 4302 2105/2106).

22. **Subsistence**

Conference rates are usually paid i.e. cost of the hotel room, breakfast, taxes and service charges, plus BF 1,288 (if accommodation is arranged in certain hotels a special rate of BF 1,030 applies), FL 1,390 (Luxembourg). Alternatively the normal full rate of subsistence may be paid; at present it is BF2,575 per day in Brussels and FL 2,779 per day in Luxembourg to cover all accommodation charges and meals.

23. **Entertainment**

At some meetings of the Council an official lunch or dinner is arranged, with the Chairman or a member of the Commission as host. Exceptionally these affairs are for Ministers only: more frequently each Minister is accompanied by a number of officials. The meal may be purely a social occasion, or an extension of the "restricted session" technique, with discussion of sensitive or confidential business in informal surroundings. If no official entertainment is arranged, Ministers will wish to consider how their meal-times may best be employed, *e.g.* informal bilateral entertainment of their own. Private Offices will normally discuss these arrangements with Private Secretary and/or those directly concerned with the Council.

24. **Programme Arrangements**

Private Offices should keep in close touch with the relevant officers in the United Kingdom Permanent Representative's Office, including as far as possible the Private Secretary. The Conference Officer (ext. 296) arranges hotel accommodation and transport for Ministers and senior officials. (More detailed guidance on administrative matters is to be found in the companion booklet containing guidance for officials.)

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BRIEF 8

PRESS CONFERENCE

1. At the end of the Council you will be expected to hold a press conference, lasting about half an hour, in which your primary role, as President, will be to inform the press of the content and outcome of the meeting.

2. The basic procedure will be for you to open with a run through the agenda, giving a brief summary of the discussions and of the conclusions reached. This need last no longer than five minutes. A question and answer session will follow which you should aim to keep to about twentyfive minutes.

<u>Line to take</u>

3. What you are able to say about the individual items on the agenda will of course depend largely on the way discussions have gone and what conclusions are reached. But you could take the following general line:

(i) The meeting considered a number of difficult economic and social problems affecting the Community to which there are no easy, or short term solutions. We nevertheless continued progress made at the European Summit and paved the way for the forthcoming conference in Ottawa.

(ii) The Council discussed 3 major papers. The first 2 of these, produced by the Committee of Governors of the Central Banks of the Member States and the Monetary Committee, considered the problems posed by high interest rates for the international community and enabled us to talk about the Community's approach to these problems before the Ottawa Summit. The third paper, by the Commission, reviewed the general economic and social situations in the Community and allowed us to discuss the policies we have adopted at national and Community level.

(iii) Believe there was general agreement that may of our problems are home-grown and that the solutions to these problems must vary according to differing national circumstances. Nevertheless also agreed that in setting domestic policies we must have regard for their consequences for the rest of the international community.

(iv) We also discussed a number of other topics. On export credits we prepared the way for establishing a joint Community position before resumption of the Consesus negotiations in October. We also discussed the Commission's proposal for setting up a New Community Instrument which would enable the Commission to borrow in the markets for on-lending to investment projects in Member States. [I am pleased to report that...*]

*if agreement on the NIC is reached.

BACKGROUND

1. Presidency press conferences are conducted with more decorum than national press conferences. A podium will be provided for yourself, UK officials and Mr Christofas.

2. There will be no separate press conference by the FST, as UK representative. Nor will the FST be required to attend the Presidential press conference.

3. Journalists will be seated in front of the podium in a semi-circle. The UK press will be particularly well-represented, and the journalists are likely to be well-informed. Therefore it will be important to give honest, straightforward answers.

4. Questions may be of a European or specifically UK nature. It will be important to distinguish clearly between those occasions when you are speaking with your "Presidency hat on", and those when you are not.

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