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Begins: 27/5/81
Ends: 12/6/81


 PO -CH /GH/0086

 PART B

PO -CH /GH/0086
 PART B

Chancellor's (Howe) Papers:

FINANCE COUNCIL 1981

Disposal Directions: 25 years

D. Howe
26/7/95

U

Bruxelles, le 27 mai 1981

Cher Geoffrey,

Je reviens sur notre conversation du 14 mai et particulièrement sur la question des taux d'intérêts.

Certes, les Etats-Unis ne peuvent se passer, au point incertain où se trouvent leur situation économique et leurs perspectives budgétaires, d'une politique monétaire stricte. En outre leurs conceptions générales comme leur sentiment d'un impérieux devoir de redressement, rendraient au mieux inutiles des pressions rageuses, doctes, et trop visibles. Enfin, les faits sont là : je veux dire une inflation forte, appelant des taux d'intérêts élevés.

Il reste - et c'est à mes yeux essentiel - que ces taux sont, par périodes, beaucoup trop élevés (même au regard des données objectives que je viens de rappeler) et, continuellement trop instables. Peut-être y gagnerons-nous, à l'exportation, par un dollar trop fort, mais nous payons plus cher le pétrole et les matières premières. Nous y perdons économiquement et financièrement, par des mouvements financiers mal justifiés, par un découragement de l'investissement, par un sentiment diffus d'inquiétude, pour tout dire par une récession et un chômage inutilement accentués.

Le risque d'un échec ne doit donc pas nous détourner d'une action, pourvu que cette dernière tienne compte à la fois des données et des convictions qui sous-entendent la politique américaine. Nous avons à presser les Etats-Unis de mieux comprendre les problèmes que leurs politiques posent à d'autres, et d'adapter leurs techniques de façon à prendre en compte des exigences plus larges que celles qui s'imposent à eux seuls.

./.

The Rt. Hon. Sir Geoffrey Howe
Q C ; MP
Chancellor of the Exchequer
The Treasury
Parliament Str.
London S.W. 1 P 3.H.E.

Je suis donc convaincu que nous devrions mettre détermination et constance :

- à analyser puis à expliquer les conséquences sur nos économies de taux d'intérêts trop élevés et erratiques et ceci en termes politiques, et au niveau politique ;
- à rappeler que les mêmes objectifs peuvent être poursuivis en usant de techniques, fussent-elles proches de celles retenues jusqu'ici, qui tiennent moins compte du très court terme et reposent moins exclusivement sur les taux d'intérêts.

Il est impératif que, après une préparation adéquate, ces problèmes fassent l'objet d'un débat sérieux et conclusif sur le fond et sur la tactique au sein du Conseil des Ministres. Ni la discrétion nécessaire, ni la reconnaissance des préoccupations légitimes de notre grand partenaire, n'interdisent une action vigoureuse et éclairante. La difficulté d'un résultat rapide ne peut nous dispenser de défendre nos intérêts. Une présentation commune, calme, ferme, argumentée et continuellement soutenue, doit être faite. A terme, une évolution s'imposera. Nous y aurons aidé, et nous aurons fait notre devoir à l'égard de nos économies, déjà suffisamment perturbées pour qu'il soit absurde d'amplifier encore nos difficultés.

*Je vous demande de croire, cher George,
à mes sentiments fidèlement américains.*



François-Xavier ORTOLI

cc. MR MANCOCK
MRS HEDLEY-MILLER
E.I.B.

for 15/6 mty pps

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EUROPEAN INVESTMENT BANK

BOARD OF GOVERNORS
SECRETARIAT

Luxembourg, 1st June 1981
AG/No. 6226

The Rt.Hon. Sir Geoffrey HOWE
Q.C., M.P.,
Chancellor of the Exchequer
Governor
of the European Investment Bank

LONDON

Dear Chancellor,

/. On behalf of the Chairman, Mr. Gene FITZGERALD, I enclose the draft agenda for the meeting of the Board of Governors to be held at the Bank's headquarters in Luxembourg, on Monday, 15 June 1981. The meeting is scheduled to start at 2.30 p.m.

The restricted working lunch normally taken by Ministers on the occasion of Eco/Fin meetings will be held at the Bank at 12.30 p.m.

/. I am enclosing the preparatory documents for the meeting. The 1980 Annual Report was despatched to you on 22 May 1981.

The chairman would like the Board of Governors' meeting to remain as restricted as possible and asks each Governor to limit the number of people accompanying him (the members of the Board of Directors will attend the Annual Meeting in accordance with Article 2, sub-paragraph 3 of the Rules of Procedure).

In the evening the Bank will be giving a reception at its headquarters at 7 p.m.

Yours faithfully,

E. Greppi
Secretary General

Encs.

A N N U A L M E E T I N G O F T H E
B O A R D O F G O V E R N O R S

Programme for 15 June 1981,
at the Bank's headquarters

- 10.30 a.m., meeting of the Board of Directors,
followed by the usual lunch.
In addition, from 12.30 p.m., restricted
working lunch for the Eco/Fin Council (Ministers
+ 1 adviser each + Mr. Ortoli) (1)
- 2.30 meeting of the Board of Governors, (2)
to (Members of the Board of Directors are
3.30 p.m. invited to attend the Annual Meeting)
- 7.00 p.m., reception (lounge suit) given by the Management
Committee on the occasion of the Annual Meeting

Note

- (1) At the same time, at the European Centre, Kirchberg,
lunch for other persons attending the Eco/Fin Council
meeting.
- (2) Followed by the meeting of the Eco/Fin
Council at the European Centre, Kirchberg.

2.3. As to the length of time for which additional commitment authority should be envisaged, it will be recalled that the Working Party of the Board of Directors on the medium-term outlook for Bank activity was asked to look ahead to 1986. That was considered necessary in order to take the measure of the effects on the Bank of the prospective enlargement of the Community and of the likely trend of activity outside the Community under a further generation of financial protocols. For the same reasons, the mid-1980's would appear to be the appropriate time horizon for considering the size of a new capital increase.

/ 2.4. For purposes of illustration, the tables in Annex 1, line 1, are based on the lower hypothesis adopted by the Working Party, namely an increase in new commitments within the Community averaging 15 % a year. New loans outside the Community are maintained within the 1 600 m.u.a. ceiling decided by the Board of Governors on 8 June 1980, and amortization patterns continue as in 1980. On these assumptions, outstanding loans and guarantees would reach about 36 000 m.u.a., that is, five times the present subscribed capital, by the end of 1986 : to accommodate lending on that scale would require that the subscribed capital be doubled.

2.5. The Working Party did not attempt, for good reason, to distinguish what an average nominal growth rate of 15 % might represent in terms of inflation rates and real growth. Nor was any explicit assumption made about the extent to which lending in Greece, Portugal and Spain might go along with adjustments in the pattern of lending in existing Member States. Departures in practice from the hypothetical trend illustrated in Annex 1 would be reflected in a larger or shorter interval before any given new statutory limit was reached. The Management Committee considers that, for the reasons adduced in para 2.3. above, 1982 to 1985/86 is an appropriate period for which new commitment authority should be provided and, accordingly, recommends that the Board of Directors proposes to the Board of Governors that the subscribed capital be doubled.

3. The proportion to be paid in

3.1. The continued ability to present a healthy financial profile depends on the Bank's continued ability to generate an adequate income to be appropriated to reserves whether adequacy be judged in terms of what is required to protect the capital from erosion or in terms of acceptable balance sheet and interest coverage ratios. So far as the notion of erosion is concerned, the accumulation of net income in the past has clearly been inadequate : in fact, as emerges from the estimates summarised in Annex 3, the level of reserves plus the balance of the profit and loss account as of the end of 1980 fell short by some 524 m.u.a. of what would have been required to offset the decline in the real value of the Bank's paid-in capital up to that date.

3.2. One of the consequences of Article 18.5 in permitting outstanding loans and guarantees to rise to 250% of subscribed capital is also to permit a progressive deterioration in the most commonly regarded financial ratios of the Bank between one capital increase and another. The rate of deterioration however, is influenced by net income which, since the EIB operates with a minimal spread between the effective cost of borrowed funds and interest on loans, arises essentially from the employment of own funds, i.e., capital paid in and reserves. The need for periodic injections of capital is thus, in principle, directly related to the desired rate of increase in own funds as a whole in face of a prospective continued substantial increase in the Bank's debt and loan portfolio.

3.3. On the occasion of each of the three previous general capital increases since the Bank was established, 10 % of the increase subscribed was paid in, the initial proportion of 25 % of total subscribed capital paid in falling to 12.9 % :

Year	Increase in capital		Percentages
	Increase	Proportion paid in or to be paid in	Total capital Proportion paid in or to be paid in
1971	50	10	20
1975	75	10	15.7
1978	100	10	12.9

3.4. Capital markets have no doubt come to think of 10 % as something of a benchmark for EIB subscriptions and, from the point of view of the Management Committee, a proposal to double the capital with 10 % paid in, as in 1978, would be most satisfactory. However, one cannot ignore the fact that new ground was been broken by the 1978 decision on an increase in the capital of the Inter-American Development Bank, which provided for 7.5 % to be paid in, and the 1980 decision by the World Bank which also adopted 7.5 % as the proportion to be paid in. After the implementation of these increases the paid-in capital of the IADB will represent 10.2 % of subscribed capital and that of the World Bank 8.7 %.

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3.5 The tables in Annex 1 illustrate the prospective evolution of the most commonly considered ratios that would result from the lending growth hypothesis referred to in para 2.4. above. (The projections in the tables, stemming from the assumptions adopted for the whole period and set out in detail in Annex 2, will not necessarily correspond with annual presentations to the Board of Directors of the outlook for individual years which take current circumstances into account). Each table assumes a doubling in subscribed capital. It will be seen that, at least through 1986, the difference between the evolution of the ratios in Annex 1.1., based on 10% paid in, and those in Annex 1.2., based on 7.5% paid in, cannot be considered significant (see Annex 1.3.).

3.6 The prime reason why there is little difference between the two cases is the delay, discussed further below, in the receipt of paid in capital under the increase decided in 1978 : the last instalment is not due until October 1983 and the tables assume that payments in respect of the increase to be decided will not start until 1984.

3.7 Since the prospective ratios are not in themselves particularly instructive, a judgement about the scale of paid-in capital required has rather to be based on the rôle that the Member States have come to expect that the Bank will be able to play and hence its need to raise increasingly large amounts from capital markets on the best terms available. The Bank is required not simply to finance individual projects within the Member States but, more broadly, to provide the financial backing for policies decided by the Community. Thus, in recent years, the Bank has been able to respond to calls for an increased effort in financing investment to help counteract declining growth and rising unemployment within the Community, for assistance in promoting economic convergence within the EMS and, in the last few months, for special aid to areas stricken by the earthquake in Italy. Outside the Member States, the E.I.B. has not only provided the long-term finance envisaged in various protocols signed by the Community but has also responded to calls for emergency or additional aid. The E.I.B.'s intervention in these several fields was certainly not without cost to the Member States, but its amount, as measured by their contributions to the paid in capital, was only a fraction of the result achieved.

3.8 The generally unpromising economic outlook within the Community and recent signatures of new protocols with countries outside the Community as well as the conclusions of the Working Party of the Board of Directors may be taken as an

indication that the Member States' requirements of the E.I.B. are likely to be of the same nature as in the past and that the Bank will have to be seen by potential investors to be an equally satisfactory borrower. The willingness of the Member States to pay in, over and above their subscribing to a substantial increase, will be seen as confirmation of a readiness to engage their own resources and a particularly significant indication of their attitude if ever faced with a call on the guarantee capital. The arrival of Greece and potential membership of Portugal and Spain during the period to be covered by the next increase would, moreover, argue strongly against a radical and immediate departure from previous practice as regards the proportion of capital paid in. However, provided that the subscribed capital is doubled as recommended, it is likely that markets would be less suspicious of some reduction in the proportion paid in. The Management Committee accordingly recommends that the Board of Directors propose that the paid in portion be 7.5%. When payment was completed the proportion of total paid-in capital to total subscribed capital would then have been brought down to 10.2%.

3.9 In its discussion of the prospective need for a capital increase, the Working Party of the Board of Directors suggested, inter alia, that it would be appropriate to reflect on the possibility of a partial incorporation of reserves. This matter has been examined carefully within the Bank. Technically such an incorporation would not satisfy the requirement described in 3.2 above of assuring by means of periodic injections of paid-in capital that net income from own funds, consisting of paid-in capital and reserves, is sufficient to protect the ratios of the Bank: an incorporation of reserves in paid-in capital would be a redesignation of resources within own funds, leaving the total amount unchanged. At the same time, because the incorporation would be accompanied by an increase in subscribed capital, the proportion of own funds within the balance sheet would decline, which might be viewed by capital markets as a deterioration.

3.10 Independently of these technical considerations and on the basis of the legal advice which it has received, the Management Committee has come to the conclusion that the incorporation of reserves would be contrary to the spirit and letter of Article 130 of the Treaty of Rome, declaring the Bank a non-profit-making institution, and of these provisions in

the Statute that define the obligations of the individual Member States with respect to the capital and the purposes for which reserves must or may be constituted. That is to say, Article 130 and the Statute taken together are more restrictive than the charters of the Inter-American Development Bank, the Nordic Investment Bank and, notably, the World Bank, which for instance is free to make on behalf of shareholders annual subscriptions to the IDA in the form of a partial distribution of net profits.

3.11 In making its recommendation that the paid-in portion of the proposed capital increase be reduced to 7.5% instead of the 10% practised on each previous occasion, the Management Committee has taken into account the impossibility for the EIB of otherwise reducing the financial burden on the Member States through a partial incorporation of reserves.

4. The timetable for paying in capital

4.1 The last two general capital increases were decided at intervals of three years, but in each case the instalments by which payment was to be made were spread over four years, without overlapping. As noted above, the last instalment in respect of the 1978 increase is not due until October 1983, two years into the period to be covered by the increase to be decided in 1981. Unless some corrective step is taken on this occasion, the problem will become still more acute and markets could question the readiness of the Member States to provide the Bank with the support it needs. Accordingly the Management Committee recommends that the Board of Directors propose to the Board of Governors that payment of the 7.5% portion of the increase in subscribed capital be completed in 1986. The corresponding payments in each of the three years 1984-86 are shown in Annex 4.

5. Recommendation

5.1 The Management Committee recommends to the Board of Directors that it submit the following proposals for a general capital increase to the Board of Governors at its annual meeting in June 1981 :

- 5.1.1 - that the subscribed capital be doubled;
- 5.1.2 - that 7.5% of the increase in subscribed capital be paid in starting in April 30, 1984, to avoid overlapping with payments in respect of the increase in capital decided in 1978;
- 5.1.3 - that payment be completed in six equal instalments in the three year 1984-86.

PROJECTIONS OF E.I.B. FINANCIAL STRUCTURE 1980-1986

Annex no. 1.1. 10% paid in by means of 6 semi-annual instalments
in the years 1984-1986.

Annex no. 1.2. 7.5% paid in by means of 6 semi-annual instalments
in the years 1984-1986.

Annex no. 1.3. Comparison of projection of EIB ratios.

PROJECTIONS OF E.I.B. FINANCIAL STRUCTURE 1980-1986

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
1. Total annual lending	3 125	3 693	4 181	4 727	5 355	6 077	6 908
2. Loans & guarantees o/s*	13 173	16 236	19 679	23 472	27 793	32 538	37 725
3. Annual disbursements	2 855	3 491	4 065	4 646	5 288	6 005	6 825
4. Disbursed loans o/s*	11 413	14 274	17 601	21 313	25 567	30 240	35 344
5. Interest on loans	933	1 188	9 513	1 858	2 228	2 626	3 065
6. Annual borrowing	2 467	3 254	3 918	4 194	4 594	5 060	5 822
7. Borrowings o/s*	10 604	13 327	16 449	19 924	23 629	27 696	32 183
8. Interest paid	880	1 096	1 408	1 723	2 052	2 386	2 758
9. Net interest on loans	53	92	105	135	176	240	307
10. Subscribed capital	7 088	14 400	14 400	14 400	15 690	15 690	15 690
11. Capital paid in	645	740	835	926	1 221	1 515	1 794
12. Reserves	994	1 239	1 465	1 692	2 013	2 397	2 818
13. Own funds	1 639	1 979	2 300	2 618	3 234	3 912	4 612
14. Interest on liquid assets	149	144	133	111	110	114	120
<u>Ratio A</u> Subscribed capital/ loans & guarantees o/s	0.54	0.89	0.73	0.61	0.56	0.48	0.42
<u>Ratio B</u> Subscribed capital/ borrowings o/s	0.67	1.08	0.88	0.72	0.66	0.57	0.49
<u>Ratio C</u> Own funds/loans & guarantees o/s	0.12	0.12	0.12	0.11	0.12	0.12	0.12
<u>Ratio D</u> Own funds/borrowings o/s	0.15	0.15	0.14	0.13	0.14	0.14	0.14
<u>Ratio E</u> Interest coverage	1.24	1.20	1.16	1.13	1.13	1.14	1.14

*Outstanding at end-year

PROJECTIONS OF E.I.B. FINANCIAL STRUCTURE 1980-1986

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
1. Total annual lending	3 125	3 693	4 181	4 727	5 355	6 077	6 908
2. Loans and guarantees o/s*	13 173	16 236	19 679	23 472	27 793	32 538	37 725
3. Annual disbursements	2 855	3 491	4 065	4 646	5 288	6 005	6 825
4. Disbursed loans o/s*	11 413	14 274	17 601	21 313	25 567	30 240	35 344
5. Interest on loans	933	1 188	1 513	1 858	2 228	2 626	3 065
6. Annual borrowing	2 467	3 254	3 918	4 194	4 663	5 134	5 905
7. Borrowings o/s*	10 604	13 327	16 449	19 924	23 698	27 839	32 409
8. Interest paid	880	1 096	1 408	1 723	2 055	2 395	2 775
9. Net interest on loans	53	92	105	135	173	231	290
10. Subscribed capital	7 088	14 400	14 400	14 400	15 690	15 690	15 690
11. Capital paid in	645	740	835	926	1 155	1 384	1 597
12. Reserves	994	1 239	1 465	1 692	2 010	2 385	2 789
13. Own funds	1 639	1 979	2 300	2 618	3 165	3 769	4 386
14. Interest on liquid assets	149	144	133	111	110	114	120
<u>Ratio A</u> Subscribed capital/ loans & guarantees o/s	0.54	0.89	0.73	0.61	0.56	0.48	0.42
<u>Ratio B</u> Subscribed capital/ borrowings o/s	0.67	1.08	0.88	0.72	0.66	0.56	0.48
<u>Ratio C</u> Own funds/loans & guarantees o/s	0.12	0.12	0.12	0.11	0.11	0.12	0.12
<u>Ratio D</u> Own funds/borrowings o/s	0.15	0.15	0.14	0.13	0.13	0.14	0.14
<u>Ratio E</u> Interest coverage	1.24	1.20	1.16	1.13	1.13	1.13	1.13

*Outstanding at end-year

COMPARISON OF PROJECTION OF EIB RATIOS

Capital from 1981 increase paid in 1984-1986

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
<u>Ratio A</u> Subscribed capital/ loans & guarantees o/s							
10% paid in and } 7.5% paid in)	0.54	0.89	0.73	0.61	0.56	0.48	0.42
<u>Ratio B</u> Subscribed capital/ borrowings o/s							
10% paid in	0.67	1.08	0.88	0.72	0.66	0.57	0.49
7.5% paid in	0.67	1.08	0.88	0.72	0.66	0.56	0.48
<u>Ratio C</u> Own funds/ loans & guarantees o/s							
10% paid in	0.12	0.12	0.12	0.11	0.12	0.12	0.12
7.5% paid in	0.12	0.12	0.12	0.11	0.11	0.12	0.12
<u>Ratio D</u> Own funds/ borrowings o/s							
10% paid in	0.15	0.15	0.14	0.13	0.14	0.14	0.14
7.5% paid in	0.15	0.15	0.14	0.13	0.13	0.14	0.14
<u>Ratio E</u> Interest coverage							
10% paid in	1.24	1.20	1.16	1.13	1.13	1.14	1.14
7.5% paid in	1.24	1.20	1.16	1.13	1.13	1.13	1.13

ASSUMPTIONS IN PROJECTIONS OF E.I.B. FINANCIAL STRUCTURE 1980-1986

1. General assumptions in Annexes Nos. 1.1, 1.2 and 1.3.
- 1.1 Annual lending
 - 1.1.1 Within the Community - annual lending is assumed to increase by 15% a year.
 - 1.1.2 Outside the Community - for 1981 the projection takes up 527 million u.a., the figure used in the document 80/140, submitted to the Board of Directors on 21/5/80, with the addition of the extent to which the outturn for 1980 has fallen short of the estimate for the year. From 1982 onwards lending outside the Community is projected at 540 million u.a. per year.
- 1.2 Loans and guarantees outstanding
 - 1.2.1 New lending during each year is added to the total of loans and guarantees outstanding during the year. Repayments of loans now outstanding are expected to conform to the schedule of repayments as up-dated at the end of 1980. Repayments of new lending have been calculated on the assumption that each new loan has a term to final maturity of 13 years and has grace period of 3.5 years. The average interest rate on new loans (compounded annually) declines in steps of 0.5% from 10.4% in 1981 to 8.9% in 1984 where it remains for the rest of the projection.
 - 1.2.2 Guarantees outstanding are assumed to remain constant at the end 1980 figure of 447 million u.a.
- 1.3 Disbursed loans outstanding
 - 1.3.1 It is assumed that on average loans within the Community are disbursed within 37 days of signature. It follows that the total of loans awaiting disbursement should rise each year by about 10% of the increase in annual lending.
 - 1.3.2 On average 10% of the amount of loans outside the Community is assumed to be disbursed in the year in which the loans are signed, 20% the following year, 40% two years and 30% three years after signature.
 - 1.3.3 The schedule of loan repayments is the same as that used in paragraph 1.2.1 above.

1.3 Interest earned on average disbursed loans

1.4.1 A simple average of loans at the beginning and end of the year is used. The interest rates applied are described in paragraph 1.2.1 above.

1.5 Annual borrowing

1.5.1 As a first step annual borrowing is assumed to be determined by the increase in disbursed loans plus repayments during the year of earlier borrowing by the Bank less the increase in the average of own funds (including increases from fresh injections of paid-in capital and contributions to reserves as well as from the operating surpluses earned by the Bank).

1.5.2 Certain adjustments in the Banks' liquidity affecting the amount to be borrowed would be required to cover changes in undisbursed amounts outstanding. As regards lending within the Community, an amount equivalent to 10% of the increase in new lending has been added each year to liquid assets. For lending outside the Community, however, the amount of undisbursed loans calculated according to the hypothesis in paragraph 1.3.2 was deducted from the balance sheet figure and the difference was assumed to be disbursed as to 2/9 in 1981, 4/9 in 1982 and as to 3/9 in 1983. This has reduced the positive adjustment to liquidity in the three years.

1.5.3 It is further assumed that any economies in the liquid cover for undisbursed loans will be fully compensated by additions to the liquid assets held in the Statutory Reserve.

1.6 Borrowings outstanding

1.6.1 Annual borrowing as described in 1.5 has been added to the total of borrowing at the beginning of the year and repayments of existing borrowing in the schedule of repayments as up-dated at the end of 1980 have been subtracted.

1.6.2 Repayments of new borrowing have been calculated on the assumption that on average new borrowing has a 13 year term to final maturity, 3.5 years grace and bears interest at an average of 10.2% in 1981 reducing thereafter by 0.5% a year to 8.7% in 1984 where it remains for the rest of the projection.

1.7 Interest paid

1.7.1 The interest paid on borrowed funds is assumed to be 0.2% less than the rate of interest earned on lending by the Bank. This is equivalent to an upward rounding of the Bank's theoretical interest margin of 0.175%.

1.8 Net income from lending

1.8.1 Net income from lending is derived by deducting interest paid on borrowed funds from interest earned on lending by the Bank.

1.9 Subscribed capital

1.9.1 Subscribed capital, as increased by the accession of Greece to membership on 1 January 1981, is assumed to be doubled during the course of that year. On the assumption that Spain and Portugal become members in 1984, a hypothetical addition to subscribed capital has been made in that year.

1.10 Own funds

1.10.1 Own funds are taken to include capital paid in, the reserves and provisions of the Bank and the balance on the profit and loss account. They are assumed to be increased by amounts paid in under any future increase in capital as well as under arrangements concluded in the context of the 1978 increase and also by contributions of new member countries to the capital, reserves and provisions of the Bank.

1.10.2 Own funds are assumed to be fed also by future operating surpluses of the Bank which have been calculated as the excess of net earnings on borrowed funds plus interest on liquid assets over administrative expenses. Commissions on guarantees have been assumed to be 10 million u.a. per year.

1.10.3 In these calculations administrative expenses for the years 1981 and 1982 have been taken from provisional estimates of 16 September 1980. For the years after 1982 they have been assumed to increase by 12.5% per annum. This consists of an increase in real terms of about 2.5% (in step with lending operations) to which a rate of inflation of 10% has been added.

1.11 Interest on liquid assets

1.11.1 Interest on liquid assets is assumed to average 11% in 1981, equivalent to a rounding down of the 1980 figure. It falls in the model to a more "normal" 7% of the rate on E.I.B. lending in 1983 (7.1%), passing through an intermediate rate of 9.1% in 1982. For the years after 1983 interest on liquid assets is assumed to remain at 7% of the rate on Bank loans.

2. Exclusion from the projections

2.1 The initial additions to liquidity in the form of capitalised interest subsidies and the subsequent reduction as the subsidies are absorbed by the Bank through its profit and loss account have been disregarded in constructing the projections of financial operations and ratios. The effect of such capitalised subsidies is neutral over the life of the subsidised loans.

5/6/81 17

CELEBR - PERMAN

NEW .. - 1.5 - 2 SW. COU

= UNAN. VOTING

NEW COMMUNITY INSTRUMENT (NIC)

Now Jumbo. Ltd.

Objectives

If possible, to delay agreement until our Presidency. If not, to ensure that the Commission proposal is satisfactorily amended to incorporate an overall ceiling and unanimous voting.

2. If, as seems likely, the Germans block this proposal, we can simply lie low. We might then hope to obtain some modest credit for securing agreement during our Presidency. If, on the other hand, other member states including Germany were prepared to accept the proposal after suitable modification, then we could go along.

Points to Make3. 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 at European Investment Bank has ceiling based on amount of capital. (No need to accept allegation that ceiling prevents permanence or continuity).

4. Size of ceiling

Up to Commission to make the proposal, backed up by clear statement of their intentions. What tranches do they envisage? Over what timescale? /If pressed/ suggest a **remit** to COREPER for further consideration when Commission have made this statement. (If further pressed and all other delegations prepared to agree on a particular figure) accept lowest figure acceptable to majority.

5. Unanimous Voting

Support unanimous voting. Lack of Unanimity could lead to loss of confidence in the exchange markets.

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 1000 million acres which has now been almost reached. After a long period of inaction, the Dutch Presidency are now trying hard to secure agreement on a Decision renewing the facility before the end of their Presidency.

7. There is no particular interest to the UK since the loans we could obtain under it are not subsidised. 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. The proposal for renewal needs various financial safeguards - an overall ceiling and unanimous approval of tranches. More radically, it is arguable that the NIC is unnecessary 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 Commission's 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). The note by the Council Secretariat (French original and our unofficial translation attached) suggests that the Council concentrates on the three issues:

(a) whether the NIC should be renewed. (This is because the Germans may well oppose it completely.)

(b) The need for a ceiling.

(c) Whether voting on tranches under the Instrument should be unanimous or by majority vote.

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Translation of
7352/81 Brussels
5 June 1981

NOTE FROM COUNCIL SECRETARIAT TO FINANCIAL COUNCIL

Object: Proposition for a Council decision authorising the Commission to contract loans to promote investment in the Community ("New Community Instrument")

PART 1

1. COREPER suggests that at its meeting on 15 June, the Council should consider:

- a. the general observations made by delegations during their examination of the Commission proposal;
- b. the need for a ceiling on NIC operations;
- c. the voting procedure for tranches under the instrument.

These points are considered below.

2. COREPER suggests that the Council should remit to them for further examination the remaining outstanding points (which are listed in the Annex).

PART 2 : Problems referred to the Council

General observations

Certain delegations (DK, D, F, NL) have expressed a certain reticence about the Commission proposal. They have noted that the decision on the renewal of the NIC should be preceded by a thorough examination of the policy of borrowing and lending carried out by the Community, as required by the 30 May mandate.

RESTRICTED

Voting procedure

The Commission proposed that the Council should act by majority vote when considering tranches under the NIC.

Three delegations (B, I, L) supported this proposition.

Six delegations (DK, D, F, GR, NL, UK) wanted the Council decisions to be unanimous.

The Irish delegation also accept this procedure.

ANNEX

OTHER OUTSTANDING PROBLEMS

1. Procedure for granting the loans

The Commission proposed in Article 5 the same procedure as in the old NIC: that the Commission should decide on the eligibility of projects, but that the European Investment Bank should decide whether to grant the loan.

2. Successive or simultaneous tranches

Although the old NIC required that tranches should be successive, the Commission now proposed that this restriction should be removed so that there would be the possibility of the Council authorising simultaneous tranches.

3. Reference to small and medium-sized enterprises

The Danish delegation asked that in the operation of the instrument particular attention should be given to the needs of small and medium-sized enterprises, and that the loan should not lead to any distortion of competition.

4. Review clause

The United Kingdom delegation suggested a clause providing for a review either at a specific date or when the lending had reached a particular level.

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for briefing folder

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Mr Scholes

Many thanks.

- 1. MR HANCOCK
- 2. CHANCELLOR

- FST
- MST(C)
- cc Sir K Couzens
- Mrs Hedley-Miller o/r
- Mr Kemp
- Mr Ashford
- Mr Bottrill
- Mr Edwards
- Mrs Gilmore
- Mr Hawtin
- Mr Peretz
- Mr Mercer
- Mr Reid - D/Trade
- Mr Bull - B/E
- Mr Butt - UKREP
- Mr Faulkner - FCO
- Mr Rhodes - Cabinet Office

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8/6

5/6/81.

FINANCE COUNCIL AND EIB GOVERNORS MEETING : 15 JUNE

This note is to give you advance warning of these two meetings. Detailed briefing will be submitted in the usual way at the end of next week.

2. The provisional plan is as follows:

- 15 June : 08.20 Depart from Heathrow
- 10.25 Arrive Luxembourg
- 12.30 Lunch in new EIB building
- 14.30 EIB Governors meeting
- 15.30 Finance Council
- 19.00 Reception and dinner in EIB building
- 16 June : 08.25 Depart Luxembourg airport
- 08.35 Arrive Heathrow

In addition we hope to arrange bilateral meetings with Herr Matthöfer and M Delors.

3. The agenda for the EIB Governors meeting is:

- 1. Routine business (approving annual accounts, re-appointing members of Audit Committee etc)
- 2. Capital increase.

4. The provisional agenda for the Finance Council is:

- 1. Renewal of New Community Instrument
- 2. Insurance Services Directive
- 3. Economic situation
- 4. Export credits

EIB Building and Reception

5. The EIB building was designed by Sir Denys Lasdun who also designed the National Theatre. It can be seen as a prestigious British project although much of the construction and other work has been carried out by a wide range of European firms. It has also, sadly, suffered from cost overruns. Nonetheless there may be the opportunity for some discreet flag-waving.

6. I understand that you have agreed to stay for the reception and dinner. The Ambassador would be glad to offer you accommodation overnight.

EIB Capital increase

7. After several discussions in the Board of Directors, we have secured as a compromise proposal for the Governors' approval:

- a. a doubling of the subscribed capital
- b. paying-in 7½ per cent of the increase over four years (beginning in 1984 when the payments under the last increase are complete)
- c. agreement that the Board of Directors should review the Bank's borrowing and lending at regular intervals.

This seems to us a good result (even though the public expenditure cost of (b) is about £15 million a year) and we recommend you to accept it. *(It is fully consistent with the position you approved at an earlier stage in the negotiations.)*

Renewal of New Community Instrument (NIC)

8. 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 1000 million ecus which has now been almost reached. After a long period of inaction, the Dutch Presidency are now trying hard to secure agreement on a Decision renewing the facility before the end of their Presidency.

9. There is no particular interest to the UK since the loans we could obtain under it are not subsidised. 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.

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10. The Commission proposal for renewal needs various financial safeguards (unanimous approval of tranches, overall ceiling etc). More radically, it is arguable that the NIC is unnecessary because it overlaps with the EIB. On the other hand, it 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).

11. It seems likely that at the Council most member states will accept renewal subject to various financial safeguards, but that the Germans will be fundamentally opposed. If they succeed in preventing agreement we could lie fairly low and perhaps hope to attract some credit for securing agreement later on in our Presidency. On the other hand, if they withdraw their objections, we could go along too.

Insurance Services Directive

12. You will recall that this was discussed at the last Finance Council in March. The Directive would give insurers freedom to operate across frontiers within the Community. For example, a UK insurance company can already do business in France by setting up a branch in France, but the directive would allow it to cover French risks direct from the UK. This is particularly important for Lloyds, whose unusual structure makes foreign branches difficult to operate.

13. The March Council confirmed that it attached importance to securing agreement on the directive and identified authorisations as the key issue. ("Authorisation" refers to the question of what information the supervisory authorities in host countries are entitled to receive and what sanctions are available to them.) This question has since been discussed extensively at working level. No agreement has been reached but progress may be possible at the Council by accepting burdensome procedures for "mass risks" (household, holidays etc) in return for relative freedom for the major industrial and commercial risks. This would be a satisfactory compromise since there is little interest in insuring mass risks across frontiers.

Economic situation

14. There is likely to be a discussion of the economic situation. The Chairmen of the Governors' Committee and of the Coordinating Group may make oral statements. In theory the Council is preparing the discussion of economic and financial matters at the European Council, but it is doubtful if it will have much role to play.

15. There may also be some discussion of the import deposits scheme introduced on 28 May by the Italians (depending on the outcome of Monetary Committee discussion on 10 June). From the UK's point of view, the Italian measures are unfortunate in that although they do not greatly harm us in themselves, they do not appear justified and could lead to a snowballing of this sort of measure.

Export credits

16. Little progress was made at the meeting at official level in Paris on 12-13 May. The UK interest is in avoiding a breakdown of the Concensus, securing an increase in the rates and dealing with the Japanese problem. The French, pleading elections, have so far prevented the Community playing a constructive role.

17. The Council on 15 June will have a general discussion of the issues. Further discussions will no doubt be necessary under our Presidency before the next Concensus meeting in October.

Bilateral meetings

18. I understand that you have agreed to withdraw from the Finance Council meeting at an appropriate moment for a short bilateral meeting with Herr Matthöfer. We are still trying to arrange the meeting with M. Delors. He is not staying for the reception in the evening, ^{but} a meeting should be possible immediately after the Council.

J Scholes
J SCHOLES
5 June 1981

D.H.
5/6.

Report by COREPER to the Council on the Services Directive

Following its 696th meeting on 16th March 1981 the Council, having held a discussion on the matters under consideration with the aim of giving guidelines, asked the Committee of Permanent Representatives to review these matters and in particular to seek as a matter of priority a compromise solution on the question of authorisation.

The Committee, having re-examined all the fundamental questions of the draft directive, submits this report to the Council.

a) GENERAL RESERVATION

It is recalled that the Danish, Irish and Luxembourg delegations have entered a general reservation in respect of this directive (see document 5439/81 SURE 12 FISC 13 page 2).

The Greek delegation has also now entered a reservation and has indicated, in the same way as the Irish delegation, that it will request a supplementary period of five years for implementing Title three of the directive.

b) QUESTIONS SUBMITTED TO THE COUNCIL

1. AUTHORISATION

Several delegations take the view that this is the "key" problem of the directive and have said that if a satisfactory solution is adopted for the authorisation procedure, they would be less concerned about the writing of services business by branches and agencies and agreement on this question and also the other unresolved questions could be achieved more easily.

Following very detailed discussions on this problem, a new approach has been outlined which provides for a verification role for the supervisory authority of the country of the service. This new approach is to be found in the texts of Articles 9 and 10 which are attached hereto. Some points relating to the passages in square brackets have yet to be resolved.

The Committee decided however, in order to assist in the continuation of its studies, to ask the Council to what extent it considers that verification procedures on the lines of Articles 9 and 10 are in accordance with the guidelines agreed at its meeting of 16th March 1981. (1)

- (1) It is recalled that the Council asked the Committee of Permanent Representatives to "give priority to seeking a compromise solution for the question of authorisation, while taking into account, on the one hand, the principle of freedom laid down in the Treaty and, on the other hand, the guarantees which should be given to the countries where the service is carried out, within the framework of close cooperation between the supervisory authorities of the member states".

It should be noted the Greek and Irish delegations continue to feel that there should be an actual procedure for authorisation by the authority of the country of the service.

2. BRANCHES AND AGENCIES

Four delegations support the Commission proposal that both Head Offices and agencies and branches of undertakings established within the Community should benefit from the provisions of the Directive.

Six delegations (I, IRL, F, D,L and GR) are opposed to services business by agencies and branches for legal and practical reasons. It has become apparent that the main obstacles as regards the granting of freedom of services to branches and agencies are concern about the respecting of provisions in the host country when services business is written and the difficulties concerned with supervision of services business.

It should be noted that the Legal Services of the Council, in the opinion which they provided (cf document 5343/81 JUR 57 SURE 11), supported the Commission proposal.

The Council is asked to decide on the possibility of agencies and branches benefiting from freedom of services.

3. COMPULSORY INSURANCES

In the event of an overall agreement on the Directive, nine delegations could support the proposal of the Presidency which provides for the inclusion in principle of the compulsory insurances within the scope of application of the Directive but exclusion of motor third party insurance, third party nuclear liability risks, insurance for pharmaceuticals and employer's liability insurance, the Commission representatives having undertaken to present within a very short period a draft Directive on motor third party insurance (1) and to re-examine after a period for consideration, the situation as regards the other exclusions.

The French delegation feels that there should be identical treatment of all the compulsory insurances. It would prefer the inclusion of all these insurances within the scope of application of the Directive but, if exceptions are envisaged, it urges the exclusion of all the compulsory insurances. This last proposal is not acceptable to the other delegations and the Commission representatives given that it would lead to appreciable differences as regards the area of application of the Directive from one member state to another.

The Council is asked to give a decision on the compromise proposal of the Presidency.

- (1) The Italian delegation while recalling that in principle it supports the inclusion of all compulsory insurances within the directive, laid particular stress on the desirability of such a draft directive being prepared quickly, which it felt was an important element of the compromise

4. FISCAL PROBLEM

At present, insurance operations are exempt from VAT under the 6th VAT Directive. However, Member States are able to levy a specific tax on insurance operations.

This situation has led, during the study of the draft directive, to the following questions being posed:

- a) Should the current system as described above be maintained (nine delegations) or should it be provided that insurance operations should be subject only to compulsory VAT in all the Member States (the view supported by the French delegation) ?
- b) Should provision be made
 - for an obligation on insurance companies to have a fiscal representative in the Member State where the risk is situated ?
 - for mutual assistance between the fiscal authorities of the Member States ?

It should be noted that the second set of questions would not arise if the view of the French delegation (compulsory application of VAT) was accepted.

The 6th VAT Directive already provides that Member States may require a fiscal representative and, moreover, the Council has set up a system of mutual assistance between the fiscal authorities of the Member States in the field of VAT.

The Council is asked to decide the question given under a), The Committee of Permanent Representatives can then be asked, if appropriate, to resolve the question set out under b).

Article 9

1. Any undertaking which intends to provide services shall be bound to inform beforehand the competent authorities of the member state of establishment, indicating the member state or the member states within whose territory it contemplates the provision of services and the nature of the risks which it proposes to guarantee.

[These authorities shall issue to the undertaking a certificate stating the classes which it is permitted to write and stating that it has the solvency margin required by Articles 16 and 17 of the First Directive and indicating the risks which it actually covers.]

These authorities may require the following particulars to be communicated:-

- (a) The scale of fees the undertaking proposes to apply;
- (b) forecasts concerning the costs of management;
- (c) forecasts concerning premiums or subscriptions and damages arising out of these new activities;
- (d) the business plan;
- (e) the information which the supervisory authorities of the member states on whose territory the undertaking contemplates the provision of services require from established undertakings (1).

-
- (1) To meet a request by the French delegation it is envisaged that there should be included in the Minutes of the Council a Council declaration according to which the competent authorities of the member state of establishment may oppose the extension outside its territory of the activities of undertakings established on its territory; that any decision to oppose such an extension must be duly reasoned and communicated to the undertaking and that it is subject to judicial control in the country of establishment.

2. All undertakings referred to in Paragraph (1) must submit to the competent authorities of the member state or member states of the provision of services the information referred to in Paragraph 1 , sub-paragraph 1 [and also the certificate referred to in Paragraph 1 sub-paragraph 2].

It shall also [without prejudice to the provisions of Article 7 of this Directive] submit to these authorities for prior examination:

- (a) the general and special conditions of the insurance policy which it intends to use;
- (b) the scale of fees which it proposes to apply [in so far as those scales are governed by the laws of the state concerned];
- (c) the forms and other documents which it proposes to use in its relations with policyholders;
- [(d) the business plan;]
- [(e) the information which the supervisory authorities of the member state on whose territory the undertaking contemplates the provision of services requires from established undertakings]

in so far as those obligations are imposed on undertakings established within the territories of those member states. (1)(2)

-
- (1) The Commission representative proposes the inclusion of a Council declaration in the Minutes saying that Article 9 and in particular paragraph 2 does not change in any way the current situation as regards insurance by correspondence.
 - (2) The Commission representative declares that his organisation attaches great importance, in the case where there is a single contract covering risks situated in several member states, to the general and special conditions applicable being those of the member state whose law is applicable to the contract under Article 5.

[The submission of general and special conditions and rates shall not be required insofar as Article 7 prohibits prior approval, in the context of operating conditions, as regards certain industrial or commercial risks. In this case, the documents and particulars referred to in letters c), [d) and e)] above may not be required.]

3. The competent authorities of the member state of the provision of services shall have a period of [six weeks] [three months] [six months] from the date on which they receive the documents referred to in paragraph 2 to establish the [compliance or] non-compliance of their contents with the provisions in force within their territory [in so far as such provisions are justified by the public interest or by the need to ensure the protection of policyholders and are imposed on all insurance undertakings established within the territory of that member state]. During that period, the undertaking shall abstain from writing services business in the classes in question on the territory of that member state.

4. Any decision establishing non-compliance within the meaning of paragraph 3 must be duly reasoned and communicated to the undertaking. Such decisions, which must specify the branch or the part of the branch concerned and, where appropriate, the specific activity concerned, shall have a suspensive effect. They shall be subject to judicial control in the member state of the provision of services.

Such a decision shall be communicated to the competent authorities of the member state of establishment. The latter may initiate consultations with the competent authorities of the member state of the provision of services. (1)

(1) Some delegations felt that the procedure provided for in this Article should apply each time that an undertaking wishes to change one of the particulars referred to in paragraph 2 (a), (b), and (c).

Article 10

1. If a competent authority of a member state establishes that an undertaking providing services within its territory is not complying with the standards applicable to undertakings established within its territory [and justified by the public interest or by the need to ensure the protection of policyholders], that authority may request the undertaking concerned to take the measures necessary to terminate the situation.

2. If the undertaking fails to take those measures [within a period of ... weeks], the competent authorities of the member state of the provision of services shall inform the competent authorities of the member state of establishment accordingly. The authorities of the member state of establishment shall take any action [required by the member state of the provision of services] [which may go as far as withdrawal of the authorisation referred to in the First Directive] to ensure that the undertaking concerned complies with measures imposed by the authorities of the member state of the provision of services.

3. [If, in spite of the measures thus taken by the member state of establishment or where such measures prove inadequate or no measures have been taken by that state, the undertaking persists in violating the rules referred to in paragraph 1, the member state where the services are being provided may, after having informed the supervisory authority of the member state of establishment, take appropriate measures, which may go as far as a ban on operation, as are strictly necessary to put an end to the situation].

4. Any measure adopted under the provisions of paragraphs 1, 2 [and 3] of this Article, which involves penalties or restrictions on the exercise of provision of services, must be duly reasoned and communicated to the undertaking concerned. All these measures are subject to judicial control in the member state where the authorities have taken these measures.

 5. The competent authorities of the member state of establishment shall be bound to communicate all measures taken in application of Articles 20 and 22 of the First Directive without delay to the competent authorities of the member state or the member states of the provision of services.
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7347/81
RESTREINT

SURE 21

FISC 22

RAPPORT

du Comité des représentants permanents
au Conseil

n° doc. préc.	n° prop. Cion	
8788/2/80 SURE 13 REV 2	R/95/76 (ES 3)	(COM/75 516 final + fin. 2 (f,d,e)
5343/81 JUR 57 SURE 11		
5439/81 SURE 12 FISC 13	R/467/78 (ES 17)	(COM/78 63 final)
5799/81 JUR 78 SURE 13		
6938/81 SURE 18 + COR 1 (f)		
7287/81 SURE 20		

objet : Proposition de deuxième directive du Conseil portant coordination des dispositions législatives, réglementaires et administratives concernant l'assurance directe autre que l'assurance sur la vie et fixant les dispositions destinées à faciliter l'exercice effectif de la libre prestation des services

A la suite de sa 696ème session du 16 mars 1981, le Conseil, ayant procédé à un débat d'orientation sur le dossier en objet, avait demandé au Comité des représentants permanents de le revoir, et notamment de rechercher en priorité une solution de compromis pour la question de l'agrément.

Le Comité, ayant réexaminé l'ensemble des questions fondamentales de la proposition de directive, soumet le présent rapport au Conseil.

.../...

A. RESERVES GENERALES

Il est rappelé que les délégations danoise, irlandaise et luxembourgeoise ont émis une réserve générale à l'égard de cette directive (cf. doc. 5439/81 SURE 12 FISC 13, p. 2).

Depuis lors, la délégation hellénique a également exprimé une réserve générale et a indiqué, comme la délégation irlandaise, qu'elle demanderait un délai supplémentaire de cinq ans pour la mise en oeuvre du titre III de la directive.

B. QUESTIONS SOUMISES AU CONSEIL

1. AGREMENT

Plusieurs délégations sont d'avis que c'est le problème "clé" de la directive et ont indiqué que si une solution satisfaisante était adoptée concernant la procédure d'agrément, les soucis qui existent quant à la prestation de services par les agences et succursales pourraient être apaisés et un accord sur ce dernier problème ainsi que sur les autres questions restant encore ouvertes pourrait plus facilement être atteint.

A la suite des discussions très approfondies sur ce problème, une nouvelle approche qui prévoit un certain rôle de vérification pour l'autorité de contrôle du pays de services a été esquissée. Cette nouvelle approche se trouve concrétisée dans l'ensemble des textes des articles 9 et 10, qui sont repris en annexe. Certains points restent encore ouverts sur les passages entre crochets.

.../...

Le Comité est néanmoins convenu, pour aider à la poursuite de ses travaux, de poser au Conseil la question de savoir dans quelle mesure il estime que les procédures de vérification suivant les grandes lignes des articles 9 et 10 répondent aux orientations dégagées lors de sa session du 16 mars 1981 (1).

Il est à noter que les délégations hellénique et irlandaise insistent toujours sur une véritable procédure d'agrément de l'autorité du pays de services.

2. AGENCES ET SUCCURSALES

Quatre délégations sont en faveur de la proposition de la Commission qui indique en tant que bénéficiaires des dispositions de la directive les sièges et les agences et succursales des entreprises établies dans la Communauté.

Six délégations (I, IRL, F, D, L et GR) sont opposées à la prestation de services par les agences et succursales pour des raisons juridiques et pratiques. Il est apparu que le souci du respect en prestation de services des dispositions du pays d'accueil et les difficultés d'exercice du contrôle à ce sujet constituent les obstacles principaux à ce que l'on accorde la liberté de prestation aux agences et succursales.

(1) Il est rappelé que le Conseil avait demandé au Comité des représentants permanents de "rechercher en priorité une solution de compromis pour la question de l'agrément, en tenant compte, d'une part, du principe de la liberté inscrit au traité et, d'autre part, des garanties qui doivent être données aux pays où s'effectue la prestation, et ceci dans le cadre d'une étroite coopération entre les autorités de contrôle des Etats membres."

Il est à noter que le Service Juridique du Conseil, dans l'avis qu'il a rendu (cf. doc. 5343/81 JUR 57 SURE 11), a soutenu la proposition de la Commission.

Le Conseil est appelé à se prononcer sur la possibilité pour les agences et succursales de bénéficier de la liberté de prestation de services.

3. ASSURANCES OBLIGATOIRES

Dans l'hypothèse d'un accord global sur la directive, neuf délégations ont pu marquer un préjugé favorable sur la proposition de la présidence qui prévoit l'inclusion en principe des assurances obligatoires dans le champ d'application de la directive, mais l'exclusion des assurances à responsabilité civile auto, responsabilité civile risques nucléaires, assurance pour risques concernant les produits médicamenteux et assurance concernant les accidents du travail, les représentants de la Commission s'étant engagés à présenter dans un délai très court une proposition de directive spécifique sur la responsabilité civile auto (1) et à réexaminer, après une période de réflexion, la situation en ce qui concerne les autres exceptions.

(1) La délégation italienne, tout en rappelant sa position de principe en faveur de l'inclusion de toutes les assurances obligatoires dans la directive, a tout particulièrement insisté sur l'opportunité d'une présentation rapide d'un tel projet de directive comme étant un élément important de ce compromis.

La délégation française a insisté sur un traitement identique de toutes les assurances obligatoires. Elle préférerait l'inclusion de toutes ces assurances dans le champ d'application de la directive, mais, au cas où des exceptions devraient être prévues, elle plaiderait pour l'exclusion de toutes les assurances obligatoires. Cette dernière hypothèse n'est pas acceptable pour les autres délégations et les représentants de la Commission, étant donné qu'elle conduirait à une variation sensible du champ d'application de la directive d'un Etat membre à l'autre.

Le Conseil est appelé à se prononcer sur la proposition de compromis de la présidence.

4. PROBLEME FISCAL

Actuellement, les opérations d'assurance sont exonérées de la TVA en vertu de la sixième directive TVA. Toutefois, les Etats membres ont la possibilité de percevoir, sur ces opérations d'assurance, une taxe spécifique.

.../...

Cette situation a amené, lors de l'examen de cette proposition de directive, à deux ordres de questions, à savoir :

- a) Convient-il de maintenir le système actuel décrit ci-dessus (9 délégations) ou convient-il de prévoir que les opérations d'assurance en question seront soumises, à l'avenir, obligatoirement à la seule TVA dans tous les Etats membres (position défendue par la délégation française) ?
- b) Est-ce-qu'il y a lieu de prévoir
- l'obligation pour les compagnies d'assurance de se faire représenter dans l'Etat membre où le risque est situé par un représentant fiscal ?
 - une assistance mutuelle entre les autorités fiscales des Etats membres ?

Il convient de faire remarquer que ces dernières questions ne se posent pas dans le cas où la thèse défendue par la délégation française (application obligatoire de la TVA) serait acceptée.

En effet, la sixième directive TVA prévoit déjà la possibilité pour les Etats membres d'exiger un représentant fiscal et, par ailleurs, le Conseil a établi un système d'assistance mutuelle entre les autorités fiscales des Etats membres dans le domaine de la TVA.

Le Conseil est appelé à se prononcer sur la question reprise sous a), le Comité des représentants permanents pouvant être chargé, le cas échéant, de résoudre ensuite les questions exposées sous b).

Article 9

1. Toute entreprise qui entend effectuer des prestations de services est tenue à'en informer au préalable les autorités compétentes de l'Etat membre d'établissement en indiquant l'Etat membre ou les Etats membres sur le territoire desquels elle envisage d'effectuer ces prestations de services, ainsi que la nature des risques qu'elle se propose de garantir.

⌈Ces mêmes autorités délivrent à l'entreprise un certificat attestant les branches qu'elle est habilitée à pratiquer et attestant qu'elle dispose du minimum de la marge de solvabilité conformément aux articles 16 et 17 de la première directive et indiquant les risques qu'elle garantit effectivement.⌋

Ces autorités peuvent exiger la communication des éléments suivants :

- a) les tarifs que l'entreprise se propose d'appliquer ;
- b) les prévisions relatives aux frais de gestion ;
- c) les prévisions relatives aux primes et cotisations et aux sinistres, en raison des activités nouvelles ;
- d) le programme d'activité ;

.../...

e) les informations que les autorités de contrôle de l'Etat membre sur le territoire duquel l'entreprise entend effectuer des prestations de services demandent aux entreprises établies. (1)

2. Toute entreprise visée au paragraphe 1 est tenue de transmettre aux autorités compétentes de l'Etat membre ou des Etats membres de la prestation les informations visées au paragraphe 1 alinéa 1 [ainsi que le certificat visé au paragraphe 1 alinéa 2].

Elle est en outre tenue [sans préjudice des dispositions de l'article 7 de la présente directive,] de soumettre à ces autorités pour examen préalable :

a) les conditions générales et spéciales de police d'assurance qu'elle se propose d'utiliser ;

(1) Pour venir à la rencontre d'une demande de la délégation française, il a été envisagé d'inscrire au procès-verbal du Conseil une déclaration du Conseil suivant laquelle les autorités compétentes de l'Etat membre d'établissement peuvent s'opposer à l'extension en dehors de son territoire des activités des entreprises établies sur ce territoire ; que toute décision d'opposition doit être motivée et notifiée à l'entreprise et qu'elle est assujettie à un recours juridictionnel du pays d'établissement.

.../...

- b) les tarifs qu'elle se propose d'appliquer [dans la mesure où ces tarifs sont réglementés par la législation de l'Etat concerné] ;
- c) les formulaires et autres documents qu'elle se propose d'utiliser dans ses relations avec les preneurs d'assurance ;

[d) le programme d'activité ;]

[e) les informations que les autorités de contrôle de l'Etat membre sur le territoire duquel l'entreprise entend effectuer des prestations de services demandent aux entreprises établies]

pour autant que ces mêmes obligations sont imposées aux entreprises établies sur le territoire desdits Etats membres. (1)(2)

[La soumission des conditions générales et spéciales et des tarifs n'est pas exigée dans la mesure où l'article 7 interdit une approbation préalable, dans le cadre des conditions d'exercice, en ce qui concerne certains risques industriels ou commerciaux. Dans ce cas, les documents et informations visés au(x) littéra(s) c) [d) et e)] ci-dessus ne peuvent être exigés.]

(1) Le représentant de la Commission entend proposer une déclaration du Conseil à inscrire au procès-verbal qui indique que l'article 9 et notamment son paragraphe 2 ne change en rien la situation actuelle concernant l'assurance par correspondance.

(2) Le représentant de la Commission déclare que son institution attache une grande importance à ce que, au cas où un seul contrat couvre des risques situés dans plusieurs Etats membres, sont d'application les conditions générales et spéciales de l'Etat membre dont la loi est applicable au contrat selon les dispositions de l'article 5.

.../...

3. Les autorités compétentes de l'Etat membre de la prestation disposent d'un délai de [six semaines]/[trois mois]/[six mois] à partir de la date de réception des documents mentionnés au paragraphe 2 pour constater l'éventuelle [conformité ou] non-conformité de leur contenu avec les dispositions en vigueur sur leur territoire [dans la mesure où celles-ci sont justifiées par l'intérêt général ou par la nécessité d'assurer la protection du preneur d'assurance et incombent à toute entreprise d'assurance établie sur le territoire de cet Etat membre]. Pendant cette période, l'entreprise s'abstient d'effectuer des prestations de services dans les branches concernées sur le territoire de cet Etat membre.

4. Toute décision portant constat de non-conformité au sens du paragraphe 3 doit être dûment motivée et notifiée à l'entreprise. Cette décision, qui doit préciser la branche ou la partie de la branche ainsi que, le cas échéant, l'activité spécifique concernées, a un effet suspensif. Elle est assujettie à recours juridictionnel dans l'Etat membre de la prestation.

La décision est notifiée aux autorités compétentes de l'Etat membre d'établissement. Celles-ci peuvent entamer des consultations avec les autorités compétentes de l'Etat membre de la prestation. (1)

(1) Quelques délégations ont estimé que la procédure mise sur pied dans cet article devrait s'appliquer chaque fois que l'entreprise entend modifier un des éléments visés au paragraphe 2 sous a), b) et c).

.../...

Article 10

1. Si une autorité compétente d'un Etat membre constate qu'une entreprise agissant en prestation de services sur son territoire ne respecte pas les normes applicables aux entreprises établies sur son territoire [et qui sont justifiées par l'intérêt général ou par la nécessité d'assurer la protection du preneur d'assurance], cette autorité peut demander à l'entreprise concernée de prendre les mesures appropriées pour mettre fin à cette situation.

2. Si l'entreprise ne respecte pas ces mesures [dans un délai de ... semaines], les autorités compétentes de l'Etat membre de prestation en informent les autorités compétentes de l'Etat membre d'établissement. Les autorités de l'Etat membre de l'établissement prennent toutes dispositions [requis par l'Etat membre de la prestation] [pouvant aller jusqu'au retrait de l'agrément cité dans la première directive] pour que l'entreprise concernée se conforme aux mesures requises par les autorités de l'Etat membre de la prestation.

3. [Si, en dépit des mesures ainsi arrêtées par l'Etat membre d'établissement ou si ces mesures s'avèrent insuffisantes ou si, à défaut de mesures prises par cet Etat, l'entreprise persiste à violer les dispositions visées au paragraphe 1, l'Etat membre où est effectuée la prestation de services, après en avoir informé l'autorité de contrôle de l'Etat d'établissement, peut prendre les mesures appropriées, pouvant aller jusqu'à l'interdiction de l'activité, limitées à ce qui est nécessaire pour mettre fin à cette situation.]

4. Toute mesure adoptée dans le cadre des dispositions des paragraphes 1, 2 [et 3] du présent article, comportant des sanctions ou des restrictions à l'exercice de la prestation de services, doit être dûment motivée et notifiée à l'entreprise concernée. Chacune de ces mesures est assujettie à recours juridictionnel dans l'Etat membre où les autorités les ont prises.

5. Les autorités compétentes de l'Etat membre d'établissement sont tenues de communiquer, sans délai, aux autorités compétentes de l'Etat membre ou des Etats membres de la prestation concernés toutes mesures prises en application des articles 20 et 22 de la première directive.

RESTRICTED

EXPORT CREDITS

OBJECTIVES

1. To gain general agreement that the Community should press ahead with the preparation of a constructive package of proposals which might provide the basis for agreement with the US and Japan when negotiations on changes in the Consensus are resumed in the Autumn.
2. To encourage the new French Minister of Finance to take a more flexible line, particularly as regards increases in minimum interest rates and improved notification procedures for "credits mixtes".

LINE TO TAKE

3. 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. A substantial increase in interest rates in October is of critical importance so as to bring Consensus minimum rates nearer to market levels.
- c. It is also essential to find a way to overcome the Japanese problem and to improve transparency on "credits mixtes".

4. 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.

5. Japanese Problem

We could not accept that the Japanese be accorded a privileged position under the Consensus, but some compromise should be offered. If the Japanese want to offer officially supported export finance at lower than

RESTRICTED

Consensus rates then they must pay some penalty for being allowed to do so. Various ideas on this are being studied by the Policy Co-ordination Group on Export Credits and these should be pursued.

6. 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.

BACKGROUNDCurrent State of Negotiations

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 full meeting of the OECD Consensus group in early October, at which the Community will be expected to make a constructive response. A meeting was also tentatively arranged for mid-July, depending on the progress of EC discussions. This may take the form of exploratory talks between the Commission, the US and Japan to prepare the way for substantive negotiations in October.

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. The purpose of the ECOFIN discussion, which is expected to take place over lunch, is not to attempt to agree detailed solutions, but to consider the basic problems and the general direction that the Community should take, and to encourage the momentum which is now starting to develop. It will provide an opportunity to sound out the position of the new French Administration. (There have been some indications that the French may now be prepared to

show some movement on the size of the increase in minimum interest rates and credits mixtes.) If reasonable progress is made in Community discussions this month, it will then be for the Commission to work up in consultation with member states a possible package which can be considered at the meeting of ECOFIN on 17 September.

5. Two main problems are likely to be discussed:-
- i. What increase in the interest rate guidelines should be offered?
 - ii. the problem of low interest rate countries, notably Japan.

The opportunity should also be taken to press the French to accept the Commission's proposals for improved notification procedures on "credits mixtes".

Interest Rates

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 increases 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. A 2-2½% increase would not be unrealistic, given that - because of prior commitments - there is now no effective possibility of full implementation of any increase this year. 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%.

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Japanese Problem

8. 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 respect the Consensus minimum. Japanese rates are now dropping 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.

9. 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. But various compromise ideas (including some which we have floated) are under consideration in the Policy Co-ordination Group (the official level EC Group on export credits on which ECGD and ourselves are represented) and it is intended that these should be actively pursued when the Group meets again later this month.

AEF3 Divison
11 June 1981

CONSENSUS ON EXPORT CREDITS

(1) Summary of Guidelines

(Possible changes that may be proposed by EC in October 1981 shown in brackets)

<u>Country Classification</u>	<u>Terms of Payment</u>		<u>Minimum Interest Rates</u>	
	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).

BRIEFING FOR THE FINANCE COUNCIL
ETC

1. steering brief + attachments omitted from folder
2. Briefing on insurance
3. Two copies of the Hague speech. (one for Matthöfer)

I'm sorry this isn't properly side flagged: the material you already have arrived one minute before the departure of the box; the remainder not until 8.30 pm.

JW

12/6

12/6/81.

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ECO/FIN COUNCIL 15 JUNE 1981

DRAFT INSURANCE SERVICES DIRECTIVE

EICHOFF

Brief by the Department of Trade

References

- A Report from Coreper doc 7347/81
- B Text of draft directive doc 8788/2/80 REV 2
- C Council Legal Services' Opinion doc 5343/81
- D Letter from UNICE

OBJECTIVES

1. To agree that there should be a liberal regime for industrial, commercial and professional (ICP) risks.
2. To agree that VAT on insurance is neither necessary nor desirable - and certainly not in the timescale of this directive.
3. To dispose of the questions of agencies and branches, and of compulsory insurance.

To set a timetable to Coreper for:-

- (a) dealing with anything unresolved at this meeting and
- (b) resolving, or submitting to Ministers, all other outstanding matters.

POINTS TO MAKEGeneral

1. Welcome the work done by Coreper and attachés. Grateful especially to Commission for efforts to put forward imaginative and constructive solutions. Hope that these will meet with a spirit of compromise on all sides.

2. Coreper have put few, clear, straightforward questions to us. We should answer them now, and open the way for adoption of the directive very soon. It is essential that, after so many years, a fundamental Treaty right be implemented without delay. If that means intensive work by the Council in the coming months, so be it.

"Authorisation"

1. Welcome proposed distinction between mass risks and industrial, commercial and professional (ICP) risks. This would indeed meet the preoccupations of the March Council.

2. Freedom exists under the Treaty for all insurance to be done across frontiers; the proposed Article 9 respects that. Only where the general interest or the need to protect policyholders justify it should that freedom be in any way inhibited by national controls.

3. In spirit of compromise, we are prepared to accept that, for mass risks, items listed in Article 9.2 may be checked by receiving state's authorities, within reasonable time-limit. But last indent of 9.2 essential since ICP insurance does not need, and must not be hampered by, such controls. UNICE have made it clear that industry wants freedom of choice.

4. This freedom must exist not only at the outset under Article 9 but also once insurers are operating. We must be sure that Article 10 does not re-impose control of terms and conditions, premium rates etc on ICP business.

5. Cross-frontier sanctions in Article 10 present insuperable difficulties. Member States cannot undertake to do more than co-operate fully in preventing abuse of each other's rules and laws. Exercise of extra-territorial jurisdiction is objectionable as well as, in effect, unworkable. Member States must surely trust each other to exercise their own jurisdiction responsibly.

6. [If Germans raise thresholds]. The distinction between arrangements for mass risks and for ICP risks is clear and justifiable under the Treaty. Thresholds are inevitably an arbitrary barrier to free trade. Past discussion of the directive has shown that it is time-consuming and almost impossible to agree on threshold figures.

7. [If others allege discrimination]. If Member States are worried about discrimination, they should realise that it is self-imposed. They have only to accord ^{establishments} their/the same freedom in relation to industrial and commercial risks as the directive gives to those doing services.

8. Officials should now tidy up the Articles as a key to agreement on the directive as a whole,

Branches and Agencies

1. Opinion of Council Legal Services settles the matter. Any exclusion of agencies and branches from the provisions of the directive would constitute a restriction on freedom of services and would be invalid under the Treaty. This confirms our view and that of the Commission. There is nothing for us to decide; branches and agencies are included.

Compulsory Insurances

1. We see no need to exclude compulsory insurances because they are such. If any are to be excluded, it must be for other reasons. Equally, no logical reason why exclusion of one should entail exclusion of all.

2. We can consider the Presidency formula, but only in the context of overall agreement; set this aside until then.

Taxation

1. Officials have identified a host of objections to VAT on insurance, and in particular to its existence in some Member States and not in others. Further discussion of that is a waste of time.
2. Article 15 is accepted by vast majority as a workable basis for ensuring collection and remission of taxes due. We see no reason to change matters for sake of one Member State when a workable alternative is already available and more generally acceptable.
3. [If necessary]. We can agree to exploring the establishment of some mechanism to meet problems of evasion, though this must not be such as to vitiate effective freedom of services.

ESSENTIAL FACTSGeneral

1. The EEC Treaty gives freedom to providers of services, including insurers, to operate throughout the Community, and the direct effect of the relevant Articles (59 & 60) has been confirmed by the European Court. But nearly 25 years after the Treaty was signed, this freedom is still not fully effective; contrary national laws and non-discriminatory national controls eg over insurance prevent it. The services directive is designed to remove these obstacles for insurance of large industrial, commercial and professional non-life risks. Our insurers estimate that they would gain over £55 million net in a first year, and more thereafter, from the directive.
2. Since 1962, the Community has had a programme for establishing a common market in services, including insurance. It has not got far. For insurance, effective right of establishment (ie the right of, say, a UK company to set up a subsidiary, branch

or agency in, say, France) is well towards completion on the basis of a harmonised regulatory system; but freedom of services (ie the right of the UK insurer to cover a French risk direct from the UK) is a long way from completion.

3. The present draft directive was proposed by the Commission in 1975, but has made very slow progress, mainly because certain Member States (mainly France, Italy, Belgium and Germany in descending order of obstructiveness) do not want to open up their markets to competition and see business - and money - go abroad. Only the Dutch and the Commission have reasonably consistently fought with us for a liberal directive. Between 1978 and 1980, it was considered at 33 two-day meetings at expert level but came no nearer agreement. In June 1980 the Commission finally prompted Coreper into calling for a report on the outstanding issues; despite heavy pressure from the UK and the Commission, and a co-operative Presidency, those issues remain the same a year later. It is clear that they will only be resolved at a political level. The ECO/FIN Council had a first look at some of the main questions in March and agreed that freedom of services was an important Treaty right and that more rapid progress should be made on the directive. Ministers also instructed Coreper to study the questions further, concentrating on the question of whether insurers should need any special authorisation to do services business.

4. There has been little discussion in any depth since then of two of the questions (branches and agencies; compulsory insurance). On taxation, discussion has concentrated on collection methods rather than on the merits and otherwise of VAT. But on the rules for starting up services business, and their enforcement a lot of work has been done and the Commission in particular have worked hard to produce imaginative and constructive solutions. These have not gone down well with the more restrictive Member States, but it is very much in our interests to try to ensure that their main elements survive, while seeking improvements (some of them major) and some clarifications.

Authorisation

5. This title is shorthand for two related but distinct issues: first, what rules insurers must comply with when starting services business (Article 9) and secondly, what rules, and sanctions for their breach, should govern the conduct of such business thereafter. ^(Article 10) Hitherto the argument has centred round whether or not services business should require a separate authorisation and, if so, whether from the home (ie country of establishment) or host (ie country receiving the service) supervisor. We have always said that it should not - from either source. We argue, in the light of European Court judgments, that an insurer authorised under the now harmonised Community regulatory system should automatically be equally acceptable to all Member States. Others argue that, without special authorisation, they cannot exercise any control over who does what sort of business into their territory from outside.

6. The Commission agree with us, though at one time they did concede, for the sake of making progress, that there might be special authorisation, by the home supervisor only. In the last few weeks however, the Commission have attempted to retrieve that by a new formulation of Article 9 which avoids requiring authorisation while nevertheless giving the host supervisor a chance to object to any proposed business methods which might be against the general interest or the need to protect policyholders (Article 9.2). More recently still, at the end of Article 9.2, they have introduced a provision which would exempt those insuring only ICP risks from even that initial procedure. This is the essential freedom; formalities relating to mass risks do not matter in practice. It is not yet clear whether the exemption extends to Article 10, ie whether insurers of such business risks would be immune from proceedings under that article over matters which they had not even had to submit when they started; it certainly does not do so explicitly at present.

7. The distinction between ICP and mass risks is a welcome one. Mass, ie consumer, risks are most unlikely to be covered on any significant scale across frontiers in the foreseeable future; and greater protection is in any case probably justified in their case. It is business insurance which will bring in the invisible earnings and where UK insurers are successful because they are flexible in response to individual policyholders' needs. Freedom from control over policy terms, premium rates etc, both at the outset and thereafter, is therefore essential.

8. The distinction does also meet the preoccupation expressed at the last Council. It avoids an explicit authorisation while providing for legitimate objections. Therefore freedom exists ab initio, bestowed by the Treaty and not by any Member State; but, where there is a justification for some watch over the insurer's methods, ie in the case of mass risks, the host country may intervene to have these corrected, under a procedure ultimately providing for judicial control. Where such protection is not justified, at the business end of the market, the insurer's freedom would be unfettered. It is not clear that the present texts of Articles 9 and, especially, 10 preserve freedom in the ICP field sufficiently, but Ministers are at present asked to agree only the broad thrust of these Articles.

9. Two main objections to the proposed distinction may be raised. The first is that it would "discriminate" against establishments which were required to submit terms and conditions etc to their own supervisors. On the other hand it is open to those supervisors to extend the liberalisation to their own establishments; we cannot have a harmonisation designed to allow the practices of the most restrictive Member States. The second objection, which the Germans may raise, is that it would be unfair on small and medium-sized firms, which do not have insurance expertise and need protection. They claim that such firms in Germany dissent from the views of UNICE

(Reference D) recently sent to the Council; and reject any ability to choose between tightly regulated German insurance and less regulated Community competition. They would like thresholds established for the size of client firm below which liberalisation would not apply. Thresholds were, however, removed from the draft two years ago, in favour of the present mass versus business distinction, precisely because it had taken years to fail to agree on any arbitrary level. Thresholds are also more difficult to square with free trade under the Treaty.

10. Where the provisions go badly wrong is in the sanctions provided by Article 10, which would purport to provide Member States with jurisdiction on each other's territory either by binding the home supervisor to do the host's bidding (10.2) or by giving the host supervisor power to ban the operations of an establishment in another Member State (10.3). The latter is in any case unworkable, but would be objectionable even if it weren't. The last Council asked for a compromise "in the context of close co-operation between Member States' supervisory authorities". In our view that means that Member States must trust each other's authorities to exercise their jurisdiction responsibly and with due regard to other supervisors' preoccupations and arguments; it cannot, however reasonably be expected to require automatic obedience by one to another's demands.

Branches and Agencies

11. The issue is whether freedom of services applies not only to insurers' head offices but also to their agencies and branches in other Member States. We, and the Commission, have always said that it does; Article 59 of the Treaty bestows the freedom on "nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended". That is precisely what, say, a UK insurer's branch established in France would be when insuring, say, a

German - or even an Englishman. The Council Legal Services have now conclusively confirmed that and Germany (who asked for the Opinion), France, Italy and Luxembourg ought now to accept it, though they have not so far done so. They may claim that the need for a restrictive authorisation procedure is greater if branches and agencies are included. We do not accept that: the existing supervisory regime already makes special provision for controlling the activities of branches and agencies and there is no reason why a branch or agency should be any more or less easy to control when providing services than a head office.

Compulsory Insurance

12. There is no logical reason why compulsory insurance should not be liberalised by the directive. The fact that a given state makes a particular insurance compulsory and even prescribes its essential terms does not necessarily prevent an insurer from another state from being capable of providing a policy which fulfils those prescriptions. Nevertheless, we ourselves require some compulsory insurances to be covered by UK insurers only, and subject the terms of others to Government scrutiny in accordance with international obligations. We would therefore not be unhappy to see the four insurances listed in section 3 of the report excluded; but we have no reason to give them away except as part of a package. We would certainly not subscribe to the French idea of excluding all compulsories, which would soon lead to a rash of such insurances in the more restrictive countries. At this stage, therefore, our objective is to remove the question from current discussion by indicating a readiness to accept the Presidency compromise, but only on the assumption of a satisfactory overall package, as the opening words of section 3 of the report indeed suggest.

Taxation

13. All Member States except the UK and Ireland tax insurance contracts. The incidence varies widely but is highest in France (up to 30% of premiums) where it brings in some 8 billion Francs

(1.6% of total tax revenue). So the desire to prevent evasion is understandable. But 8 out of 10 Member States accept that Article 15 of the draft directive would achieve that (the Greeks are at present reserved). Only the French insist on VAT, if necessary for themselves alone pending further harmonisation.

14. Eight delegations and the Commission are opposed, and a formidable battery of objections has been put together. On the one hand it would reopen the 6th VAT Directive - itself a frail compromise - which specifically excludes insurance, and would need a fresh Commission proposal and consultation with the Parliament; all that would take many months and would hold up the Directive in the meantime. On the other it would have adverse implications in the area of distortion of competition, deflection of trade, double taxation, mutual assistance arrangements and possibly own resources. The 6th VAT Directive's requirements for accountable fiscal representatives could also seriously undermine the principle of freedom of services without need for establishment. So, while the difficulties may not be insuperable nor the disadvantages insufferable, there is no good reason for the majority to put themselves out for one country, especially when a more generally acceptable alternative can be found on the basis of Article 15.

15. The report from Coreper asks Ministers to settle the question of whether a harmonisation on the basis of VAT is needed, so that officials can have a clear context in which to work out the details. It is far from sure that, at this stage in the negotiations, the French will allow that to be settled. Nevertheless, it should be possible to establish that, since the pros and cons of VAT have now been exhaustively discussed and nine delegations are opposed, Coreper should work on the status quo hypothesis. The French may claim that VAT needs further discussion, but they have had months in which to ask for it and have not done so; a request now would be blatant stalling.

16. The advantages of the Article 15 approach are that it would leave those Member States who now levy premium taxes - or even those who do not - free to do so and that it could be agreed and operated straight away. We would, if necessary, be prepared to look at the possibility of some sort of mechanism to meet the worries of some Member States about evasion; though we have strong reservations - shared by the Council and Commission Legal Services - as to whether the appointment of a fiscal representative is compatible with the Treaty right to do services without need for an establishment.

Department of Trade
12 June 1981

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PERSONALITY NOTES

12/6/81.

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 Ministry of Economics
- 9. Dr. Horst Schulmann State Secretary
Federal Ministry of Finance

Greece

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

Ireland

- 12. Mr Gene Fitzgerald Minister for Finance

Italy

- 13. Mr Nino Andreatta Minister for the Treasury

Luxembourg

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

Netherlands

- 16. Mr van der Stee Minister for Finance

17. Professor Rutten

Secretary-General, Ministry
of Economic Affairs

18. Dr Wellinck

Treasurer-General, Ministry
of Finance

Secretariat

19. Mr Ersbøll

Secretary General of the Council
Secretariat

20. Mr Christofas

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

European Commission

21. Mr Gaston Thorn

President

22. Mr Francois-Xavier Ortoli

Member

23. Mr Christopher Tugendhat

Member

24. Mr Poul Dalsager

Member

* changed since last Finance Council

12/6/81.

NEW COMMUNITY INSTRUMENT (NIC)

Objectives

If possible, to delay agreement until our Presidency. If not, to ensure that the Commission proposal is satisfactorily amended to incorporate an overall ceiling and unanimous voting.

2. If, as seems likely, the Germans block this proposal, we can simply lie low. We might then hope to obtain some modest credit for securing agreement during our Presidency. If, on the other hand, other member states including Germany were prepared to accept the proposal after suitable modification, then we could go along.

Points to Make3. 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} at European Investment Bank has ceiling based on amount of capital. (No need to accept allegation that ceiling prevents permanence or continuity).

4. Size of ceiling

Up to Commission to make the proposal, backed up by clear statement of their intentions. What tranches do they envisage? Over what timescale? /If pressed/ suggest a **remit** to COREPER for further consideration when Commission have made this statement. (If further pressed and all other delegations prepared to agree on a particular figure) accept lowest figure acceptable to majority.

5. Unanimous Voting

Support unanimous voting. Lack of Unanimity could lead to loss of confidence in the exchange markets.

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 1000 million acres which has now been almost reached. After a long period of inaction, the Dutch Presidency are now trying hard to secure agreement on a Decision renewing the facility before the end of their Presidency.

7. There is no particular interest to the UK since the loans we could obtain under it are not subsidised. 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. The proposal for renewal needs various financial safeguards - an overall ceiling and unanimous approval of tranches. More radically, it is arguable that the NIC is unnecessary 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 Commission's 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). The note by the Council Secretariat (French original and our unofficial translation attached) suggests that the Council concentrates on the three issues:
 - (a) whether the NIC should be renewed. (This is because the Germans may well oppose it completely.)
 - (b) The need for a ceiling.
 - (c) Whether voting on tranches under the Instrument should be unanimous or by majority vote.

Full dossier
on Insurance

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ECO/FIN COUNCIL 15 JUNE 1981

DRAFT INSURANCE SERVICES DIRECTIVE

12/6/81.

Brief by the Department of Trade

References

- A Report from Coreper doc 7347/81
- B Text of draft directive doc 8788/2/80 REV 2
- C Council Legal Services' Opinion doc 5343/81
- D Letter from UNICE

OBJECTIVES

1. To agree that there should be a liberal regime for industrial, commercial and professional (ICP) risks.
2. To agree that VAT on insurance is neither necessary nor desirable - and certainly not in the timescale of this directive.
3. To dispose of the questions of agencies and branches, and of compulsory insurance.

To set a timetable to Coreper for:-

- (a) dealing with anything unresolved at this meeting and
- (b) resolving, or submitting to Ministers, all other outstanding matters.

POINTS TO MAKE

General

1. Welcome the work done by Coreper and attachés. Grateful especially to Commission for efforts to put forward imaginative and constructive solutions. Hope that these will meet with a spirit of compromise on all sides.

2. Coreper have put few, clear, straightforward questions to us. We should answer them now, and open the way for adoption of the directive very soon. It is essential that, after so many years, a fundamental Treaty right be implemented without delay. If that means intensive work by the Council in the coming months, so be it.

"Authorisation"

1. Welcome proposed distinction between mass risks and industrial, commercial and professional (ICP) risks. This would indeed meet the preoccupations of the March Council.

2. Freedom exists under the Treaty for all insurance to be done across frontiers; the proposed Article 9 respects that. Only where the general interest or the need to protect policyholders justify it should that freedom be in any way inhibited by national controls.

3. In spirit of compromise, we are prepared to accept that, for mass risks, items listed in Article 9.2 may be checked by receiving state's authorities, within reasonable time-limit. But last indent of 9.2 essential since ICP insurance does not need, and must not be hampered by, such controls. UNICE have made it clear that industry wants freedom of choice.

4. This freedom must exist not only at the outset under Article 9 but also once insurers are operating. We must be sure that Article 10 does not re-impose control of terms and conditions, premium rates etc on ICP business.

5. Cross-frontier sanctions in Article 10 present insuperable difficulties. Member States cannot undertake to do more than co-operate fully in presenting abuse of each other's rules and laws. Exercise of extra-territorial jurisdiction is objectionable as well as, in effect, unworkable. Member States must surely trust each other to exercise their own jurisdiction responsibly.

6. [If Germans raise thresholds]. The distinction between arrangements for mass risks and for ICP risks is clear and justifiable under the Treaty. Thresholds are inevitably an arbitrary barrier to free trade. Past discussion of the directive has shown that it is time-consuming and almost impossible to agree on threshold figures.

7. [If others allege discrimination]. If Member States are worried about discrimination, they should realise that it is self-imposed. They have only to accord ^{establishments} their/the same freedom in relation to industrial and commercial risks as the directive gives to those doing services.

8. Officials should now tidy up the Articles as a key to agreement on the directive as a whole,

Branches and Agencies

1. Opinion of Council Legal Services settles the matter. Any exclusion of agencies and branches from the provisions of the directive would constitute a restriction on freedom of services and would be invalid under the Treaty. This confirms our view and that of the Commission. There is nothing for us to decide; branches and agencies are included.

Compulsory Insurances

1. We see no need to exclude compulsory insurances because they are such. If any are to be excluded, it must be for other reasons. Equally, no logical reason why exclusion of one should entail exclusion of all.

2. We can consider the Presidency formula, but only in the context of overall agreement; set this aside until then.

Taxation

1. Officials have identified a host of objections to VAT on insurance, and in particular to its existence in some Member States and not in others. Further discussion of that is a waste of time.
2. Article 15 is accepted by vast majority as a workable basis for ensuring collection and remission of taxes due. We see no reason to change matters for sake of one Member State when a workable alternative is already available and more generally acceptable.
3. [If necessary]. We can agree to exploring the establishment of some mechanism to meet problems of evasion, though this must not be such as to vitiate effective freedom of services.

ESSENTIAL FACTSGeneral

1. The EEC Treaty gives freedom to providers of services, including insurers, to operate throughout the Community, and the direct effect of the relevant Articles (59 & 60) has been confirmed by the European Court. But nearly 25 years after the Treaty was signed, this freedom is still not fully effective; contrary national laws and non-discriminatory national controls eg over insurance prevent it. The services directive is designed to remove these obstacles for insurance of large industrial, commercial and professional non-life risks. Our insurers estimate that they would gain over £55 million net in a first year, and more thereafter, from the directive.
2. Since 1962, the Community has had a programme for establishing a common market in services, including insurance. It has not got far. For insurance, effective right of establishment (ie the right of, say, a UK company to set up a subsidiary, branch

or agency in, say, France) is well towards completion on the basis of a harmonised regulatory system; but freedom of services (ie the right of the UK insurer to cover a French risk direct from the UK) is a long way from completion.

3. The present draft directive was proposed by the Commission in 1975, but has made very slow progress, mainly because certain Member States (mainly France, Italy, Belgium and Germany in descending order of obstructiveness) do not want to open up their markets to competition and see business - and money - go abroad. Only the Dutch and the Commission have reasonably consistently fought with us for a liberal directive. Between 1978 and 1980, it was considered at 33 two-day meetings at expert level but came no nearer agreement. In June 1980 the Commission finally prompted Coreper into calling for a report on the outstanding issues; despite heavy pressure from the UK and the Commission, and a co-operative Presidency, those issues remain the same a year later. It is clear that they will only be resolved at a political level. The ECO/FIN Council had a first look at some of the main questions in March and agreed that freedom of services was an important Treaty right and that more rapid progress should be made on the directive. Ministers also instructed Coreper to study the questions further, concentrating on the question of whether insurers should need any special authorisation to do services business.

4. There has been little discussion in any depth since then of two of the questions (branches and agencies; compulsory insurance). On taxation, discussion has concentrated on collection methods rather than on the merits and otherwise of VAT. But on the rules for starting up services business, and their enforcement a lot of work has been done and the Commission in particular have worked hard to produce imaginative and constructive solutions. These have not gone down well with the more restrictive Member States, but it is very much in our interests to try to ensure that their main elements survive, while seeking improvements (some of them major) and some clarifications.

Authorisation

5. This title is shorthand for two related but distinct issues: first, what rules insurers must comply with when starting services business (Article 9) and secondly, what rules, and sanctions for their breach, should govern the conduct of such business thereafter. ^(Article 10) Hitherto the argument has centred round whether or not services business should require a separate authorisation and, if so, whether from the home (ie country of establishment) or host (ie country receiving the service) supervisor. We have always said that it should not - from either source. We argue, in the light of European Court judgments, that an insurer authorised under the now harmonised Community regulatory system should automatically be equally acceptable to all Member States. Others argue that, without special authorisation, they cannot exercise any control over who does what sort of business into their territory from outside.

6. The Commission agree with us, though at one time they did concede, for the sake of making progress, that there might be special authorisation, by the home supervisor only. In the last few weeks however, the Commission have attempted to retrieve that by a new formulation of Article 9 which avoids requiring authorisation while nevertheless giving the host supervisor a chance to object to any proposed business methods which might be against the general interest or the need to protect policyholders (Article 9.2). More recently still, at the end of Article 9.2, they have introduced a provision which would exempt those insuring only ICP risks from even that initial procedure. This is the essential freedom; formalities relating to mass risks do not matter in practice. It is not yet clear whether the exemption extends to Article 10, ie whether insurers of such business risks would be immune from proceedings under that article over matters which they had not even had to submit when they started; it certainly does not do so explicitly at present.

7. The distinction between ICP and mass risks is a welcome one. Mass, ie consumer, risks are most unlikely to be covered on any significant scale across frontiers in the foreseeable future; and greater protection is in any case probably justified in their case. It is business insurance which will bring in the invisible earnings and where UK insurers are successful because they are flexible in response to individual policyholders' needs. Freedom from control over policy terms, premium rates etc, both at the outset and thereafter, is therefore essential.

8. The distinction does also meet the preoccupation expressed at the last Council. It avoids an explicit authorisation while providing for legitimate objections. Therefore freedom exists ab initio, bestowed by the Treaty and not by any Member State; but, where there is a justification for some watch over the insurer's methods, ie in the case of mass risks, the host country may intervene to have these corrected, under a procedure ultimately providing for judicial control. Where such protection is not justified, at the business end of the market, the insurer's freedom would be unfettered. It is not clear that the present texts of Articles 9 and, especially, 10 preserve freedom in the ICP field sufficiently, but Ministers are at present asked to agree only the broad thrust of these Articles.

9. Two main objections to the proposed distinction may be raised. The first is that it would "discriminate" against establishments which were required to submit terms and conditions etc to their own supervisors. On the other hand it is open to those supervisors to extend the liberalisation to their own establishments; we cannot have a harmonisation designed to allow the practices of the most restrictive Member States. The second objection, which the Germans may raise, is that it would be unfair on small and medium-sized firms, which do not have insurance expertise and need protection. They claim that such firms in Germany dissent from the views of UNICE

(Reference D) recently sent to the Council; and reject any ability to choose between tightly regulated German insurance and less regulated Community competition. They would like thresholds established for the size of client firm below which liberalisation would not apply. Thresholds were, however, removed from the draft two years ago, in favour of the present mass versus business distinction, precisely because it had taken years to fail to agree on any arbitrary level. Thresholds are also more difficult to square with free trade under the Treaty.

10. Where the provisions go badly wrong is in the sanctions provided by Article 10, which would purport to provide Member States with jurisdiction on each other's territory either by binding the home supervisor to do the host's bidding (10.2) or by giving the host supervisor power to ban the operations of an establishment in another Member State (10.3). The latter is in any case unworkable, but would be objectionable even if it weren't. The last Council asked for a compromise "in the context of close co-operation between Member States' supervisory authorities". In our view that means that Member States must trust each other's authorities to exercise their jurisdiction responsibly and with due regard to other supervisors' preoccupations and arguments; it cannot, however reasonably be expected to require automatic obedience by one to another's demands.

Branches and Agencies

11. The issue is whether freedom of services applies not only to insurers' head offices but also to their agencies and branches in other Member States. We, and the Commission, have always said that it does; Article 59 of the Treaty bestows the freedom on "nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended". That is precisely what, say, a UK insurer's branch established in France would be when insuring, say, a

German - or even an Englishman. The Council Legal Services have now conclusively confirmed that and Germany (who asked for the Opinion), France, Italy and Luxembourg ought now to accept it, though they have not so far done so. They may claim that the need for a restrictive authorisation procedure is greater if branches and agencies are included. We do not accept that: the existing supervisory regime already makes special provision for controlling the activities of branches and agencies and there is no reason why a branch or agency should be any more or less easy to control when providing services than a head office.

Compulsory Insurance

12. There is no logical reason why compulsory insurance should not be liberalised by the directive. The fact that a given state makes a particular insurance compulsory and even prescribes its essential terms does not necessarily prevent an insurer from another state from being capable of providing a policy which fulfils those prescriptions. Nevertheless, we ourselves require some compulsory insurances to be covered by UK insurers only, and subject the terms of others to Government scrutiny in accordance with international obligations. We would therefore not be unhappy to see the four insurances listed in section 3 of the report excluded; but we have no reason to give them away except as part of a package. We would certainly not subscribe to the French idea of excluding all compulsories, which would soon lead to a rash of such insurances in the more restrictive countries. At this stage, therefore, our objective is to remove the question from current discussion by indicating a readiness to accept the Presidency compromise, but only on the assumption of a satisfactory overall package, as the opening words of section 3 of the report indeed suggest.

Taxation

13. All Member States except the UK and Ireland tax insurance contracts. The incidence varies widely but is highest in France (up to 30% of premiums) where it brings in some 8 billion Francs

(1.6% of total tax revenue). So the desire to prevent evasion is understandable. But 8 out of 10 Member States accept that Article 15 of the draft directive would achieve that (the Greeks are at present reserved). Only the French insist on VAT, if necessary for themselves alone pending further harmonisation.

14. Eight delegations and the Commission are opposed, and a formidable battery of objections has been put together. On the one hand it would reopen the 6th VAT Directive - itself a frail compromise - which specifically excludes insurance, and would need a fresh Commission proposal and consultation with the Parliament; all that would take many months and would hold up the Directive in the meantime. On the other it would have adverse implications in the area of distortion of competition, deflection of trade, double taxation, mutual assistance arrangements and possibly own resources. The 6th VAT Directive's requirements for accountable fiscal representatives could also seriously undermine the principle of freedom of services without need for establishment. So, while the difficulties may not be insuperable nor the disadvantages insufferable, there is no good reason for the majority to put themselves out for one country, especially when a more generally acceptable alternative can be found on the basis of Article 15.

15. The report from Coreper asks Ministers to settle the question of whether a harmonisation on the basis of VAT is needed, so that officials can have a clear context in which to work out the details. It is far from sure that, at this stage in the negotiations, the French will allow that to be settled. Nevertheless, it should be possible to establish that, since the pros and cons of VAT have now been exhaustively discussed and nine delegations are opposed, Coreper should work on the status quo hypothesis. The French may claim that VAT needs further discussion, but they have had months in which to ask for it and have not done so; a request now would be blatant stalling.

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16. The advantages of the Article 15 approach are that it would leave those Member States who now levy premium taxes - or even those who do not - free to do so and that it could be agreed and operated straight away. We would, if necessary, be prepared to look at the possibility of some sort of mechanism to meet the worries of some Member States about evasion; though we have strong reservations - shared by the Council and Commission Legal Services - as to whether the appointment of a fiscal representative is compatible with the Treaty right to do services without need for an establishment.

Department of Trade
12 June 1981

12/6/81.

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ECO/FIN COUNCIL, 15 JUNE 1981

ITEM . ITALY. IMPORT DEPOSIT SCHEME

General

Item of the agenda refers to the decision of the Italian authorities, on 27 May last, to set up an import deposit scheme for a period (initially) of 4 months. It is important as a matter of principle that this first opportunity should be taken for Finance Ministers to discuss the Italian action. It has generally been ill-received.

2. A note on the scheme is attached to this brief. The effect on UK exports to Italy will probably not be very great.

3. The objections to what the Italians did lie elsewhere. They were discussed in the Monetary Committee (Sir Kenneth Couzens in the chair, in the absence of the French Chairman M. Haberer) on Wednesday 10 June. A statement (copy also attached) on behalf of the Committee will be made by M. Haberer to ECO/FIN on Monday. This statement is quite hostile, as these things go, and was unanimously endorsed.

Line to Take

4. The Chancellor need not take a prominent part in any discussion. There may be a disposition among Ministers to rest on the Monetary Committee statement and let the Italians off on this occasion without further criticism. But the Germans and Dutch might wish to speak quite sternly (see below). The Chancellor could :-

- endorse the views expressed by the Monetary Committee
- add his voice to those who express sympathy for the Italian authorities, who do face great difficulties in restoring better balance to the Italian economy
- but add his voice also to those who regret the decision, which lies awkwardly with Community objectives, and who believe that the measures must, at worst, last no longer than the 4 months originally specified.

Discussion to Avoid on 15 June

5. There is an issue which the Commission must wrangle with, about whether the Italian measures are to be "justified" under Articles 108 or 109 of the Treaty (copies attached). The Italians say 109 - "sudden crisis in the balance of payments". ECO/FIN will have to look at this, probably in July, but all being well only in order to rubber stamp an agreed procedural solution. It would be a great mistake to bother with any of this on Monday. The point about Monday is that Ministers must not let the Italian measures go by on this first occasion after they were adopted without taking some notice of them. But the legalities at this moment are a side-issue.

Background

6. Procedurally, the Italians have been behaving badly. There was no proper consultation about their recent devaluation : it was absurd to seek to do this by telephone. Now insult is added to injury because there was no consultation at all about this import deposit scheme. This has gained them bad marks and added to the general displeasure.

7. In substance, whether designed (as the Italians say) primarily as a device to mop up domestic liquidity or (as the Germans say) also to have some of the effects of an exchange rate change, the scheme conflicts with the principle of intra-Community free trade;

is doubtfully consistent with the good behaviour in the EMS; is protectionist; and sets a bad precedent.

8. To say nothing of the fact that it is hopelessly inadequate to deal with Italy's deep-seated ills : a public sector deficit which is virtually out of control, with monetary consequences; and a highly indexed wages system (the scala mobile).

9. The Italian defence for their action is likely to be that:-

a. the balance of payments has deteriorated sharply this year;

b. speculation against the lira intensified in the second half of March, requiring heavy intervention (\$1 billion), and with the fall of the Government, threatened to become a fully fledged foreign exchange crisis.

c. further devaluation of the lira would have been inappropriate;

d. domestic liquidity creation is admittedly too rapid. Measures have been taken to restrain this (by decree, pending Parliamentary approval). These will take time to bear fruit;

e. expectations of continuing inflation threatened enhanced spending, including spending on imports;

f. so the import deposit scheme, which mops up liquidity, is a bridging operation until the other measures bite.

10. It is possible that Germany, Holland, and possibly Denmark, will speak quite severely - though in sorrow more than anger and with understanding that the Italians have severe problems. Some or all of the following points are likely to be heard :-

- i. The Italians should have consulted.
- ii. The Italian balance of payments deficit is not worse than about average for the Community.
- iii. Their action is not within the spirit of Community co-operation, or consistent with Community principles and policies.
- iv. All Community countries are having considerable difficulties with their economies, but are not using measures which are bad for the Community.
- v. The effects of the measures are in some ways like those of a lira devaluation. This should have triggered consultation in the light of the EMS obligations.
- vi. Mopping up liquidity is certainly necessary. But the measures are no substitute for the more drastic measures the Italian economy needs to counter excessive domestic liquidity, monetary financing of public sector deficits, and the effects of wages indexation.
- vii. The prime purpose may be to mop up some domestic liquidity, but the measure must affect intra-Community trade, is protectionist, and sets a bad precedent.
- viii. Not only does this cure not match the disease, but it will be counter productive in its effects on domestic liquidity when the measures end and the deposits are unwound.
- ix. The Italians are always asking for time. This is the third time in 7 years that the Italians have tried an import deposit scheme "as a purely temporary mechanism" bridging the gap towards more permanent restructuring to bring more stability to the economy.

x. The Italians could have used up more of their 6% margin in the EMS.

11. The Belgians are as concerned as everyone else but may be more muted. The Irish and Greeks may express rather more sympathy with the Italians, and the French may not want to sound too severe.

12. But there is unlikely to be any desire to quarrel with the Monetary Committee's statement, reflecting displeasure at the lack of consultation, doubts about the justification for the measures, the relevance and their efficacy, or with the proposition that they must end after 4 months.

MEH-M
12 June 1981

AT THE REQUEST OF MR. DINI, AND IN PREPARATION OF THE DISCUSSION TO BE HELD AT THE ECOFIN COUNCIL OF 15 JUNE, PLEASE FIND BELOW THE TEXT OF HIS INTERVENTION AT THE MONETARY COMMITTEE MEETING OF 10 JUNE ON THE BACKGROUND TO THE INTRODUCTION BY THE ITALIAN GOVERNMENT OF A COMPULSORY DEPOSIT ON FOREIGN EXCHANGE PURCHASES.

TEXT BEGINS

1. SINCE THE BEGINNING OF 1981 THERE HAVE BEEN MASSIVE INTERVENTIONS IN THE EXCHANGE MARKET WHICH HAVE RESULTED IN A WORRISOME REDUCTION OF OFFICIAL RESERVES. RESERVES IN CONVERTIBLE CURRENCIES, WHICH STOOD AT ABOUT 11 BILLION DOLLARS AT THE END OF 1980 DECLINED TO 5.4 BILLION DOLLARS AT THE END OF MAY 1981. OVER THE SAME PERIOD, THE CURRENT ACCOUNT BALANCE HAS DETERIORATED AND SPECULATIVE MOVEMENTS HAVE BECOME INCREASINGLY FREQUENT, ESPECIALLY IN REGARD OF SHORT-TERM COMMERCIAL CREDITS.

DURING JANUARY-APRIL 1981 THE BALANCE OF PAYMENTS RECORDED AN OVERALL DEFICIT OF LIT 3 500 BILLION, DESPITE A NET INFLOW OF MEDIUM- AND LONG-TERM CAPITAL ESTIMATED AT ABOUT LIT 2 500 BILLION. THEREFORE, ON A CASH BASIS, THE CURRENT ACCOUNT SHOWED A DEFICIT OF LIT 6 000 BILLION, OR ABOUT TWICE THAT RECORDED IN THE CORRESPONDING PERIOD OF 1980. THESE DEVELOPMENTS ARE NOT IN LINE WITH THE 1981 TARGET FOR THE CURRENT ACCOUNT DEFICIT, WHICH HAD BEEN SET AT NO MORE THAN LIT 9 800 BILLION FOR THE YEAR AS A WHOLE.

IN MAY, SUPPORT INTERVENTIONS EXCEEDED LIT 1 300 BILLION, WHILE MEDIUM- AND LONG-TERM LOANS RESULTED IN A NET INFLOW OF FUNDS OF ABOUT LIT 400 BILLION. IN PARTICULAR, IN THE PERIOD MAY 15-27, TOTAL INTERVENTIONS HAD AMOUNTED TO 1 BILLION DOLLARS, OR ABOUT 20 PER CENT OF LIQUID RESERVES. IN THE FIRST NINE DAYS FOLLOWING THE INTRODUCTION OF THE DEPOSIT SCHEME ON MAY 28, INTERVENTIONS HAVE CONSIDERABLY SLOWED : FROM A DAILY AVERAGE OF SOME 120 MILLION DOLLARS IN THE SECOND HALF OF MAY TO AN AVERAGE OF 20 MILLION DOLLARS. THE DEPOSIT SCHEME HAD IN TURN RESULTED IN AN AVERAGE DAILY ABSORPTION OF LIQUIDITY OF ABOUT 70 BILLION LIRE.

2. THE STRENGTHENING OF THE DOLLAR, IN A SITUATION OF UNSETTLED INTERNATIONAL FINANCIAL MARKETS, NOT ONLY HAS HAD AN IMMEDIATE IMPACT ON THE BALANCE OF PAYMENTS THROUGH THE DETERIORATION OF THE TERMS OF TRADE. IT HAS ALSO INCREASED UNCERTAINTY AND FOSTERED THE EXPECTATION OF RISES IN IMPORT COSTS, THEREBY ENCOURAGING FOREIGN EXCHANGE PURCHASES AND ADVANCE PAYMENTS OF A PRECAUTIONARY AND SPECULATIVE NATURE. THE GROWING VOLUME OF MARKET INTERVENTIONS IN THE SECOND HALF OF MAY REFLECTS ALSO SUCH TENSIONS.

BEYOND THESE DEVELOPMENTS, THE SUDDEN RESIGNATION OF THE ITALIAN GOVERNMENT HAS BROUGHT ABOUT A CRISIS WHICH, IN THE ABSENCE OF PROMPT AND EFFECTIVE MEASURES, COULD HAVE RESULTED IN AN ACCELERATION OF SPECULATIVE MOVEMENTS AND HENCE IN A FULLY FLEDGED FOREIGN EXCHANGE CRISIS. THIS WAS AN UNACCEPTABLE RISK FOR THE ITALIAN AUTHORITIES.

3. SPECULATIVE ATTACKS AGAINST THE LIRA HAVE BEEN POSSIBLE, DESPITE A SUCCESSIVE TIGHTENING OF CREDIT POLICIES AND RISING INTEREST RATES, BECAUSE OF THE LIQUIDITY CREATION RESULTING FROM A GROWING PUBLIC SECTOR DEFICIT. IN THE FIRST FIVE MONTHS OF 1981 THE MONTHLY TREASURY FINANCING REQUIREMENT HAS BEEN OF THE ORDER OF LIT 4 200 BILLION, COMPARED WITH ABOUT LIT 2 100 BILLION DURING THE SAME PERIOD OF 1980.

3.1 THE NEW CEILINGS ON DOMESTIC SHORT-TERM LENDING BY BANKS ANNOUNCED IN JANUARY 1981, SET FOR THE PERIOD MARCH-DECEMBER 1981, BESIDES REDUCING SHARPLY CREDIT OPERATIONS EXEMPTED FROM THE CEILING, PROVIDED FOR AN EXPANSION OF SUCH LENDING OF ABOUT 13 PER CENT FOR THE ENTIRE 1981.

INTEREST RATES HAVE RISEN CONSIDERABLY DURING 1981 : THE YIELD ON 6-MONTHS TREASURY BILLS HAS MOVED FROM 16.9 PER CENT TO 19.8 PER CENT AND THAT ON BONDS ISSUES BY SPECIAL CREDIT INSTITUTIONS FROM 16.3 PER CENT TO 20.3 PER CENT. ON MARCH 22, TOGETHER WITH THE REALIGNMENT OF THE CENTRAL RATES FOR THE LIRA, THE DISCOUNT RATE WAS RAISED FROM 16.5 TO 19 PER CENT AND THE MARGINAL RESERVE REQUIREMENT FOR BANKS FROM 15.75 TO 20 PER CENT. INTEREST RATES ON BANK LENDING HAVE RISEN TO ABOUT 25 PER CENT.

ALTHOUGH AVAILABLE INFORMATION SHOWS THAT IN APRIL DEMAND FOR CREDIT WAS STILL BUOYANT AND THAT THE ANNUAL RATE OF INCREASE OF BANK LENDING DURING THE FIRST 4 MONTHS OF THE YEAR WAS AROUND 18.5 PER CENT, THE MONETARY POLICY MEASURES SO FAR INTRODUCED WILL IN ALL LIKELIHOOD PRODUCE CONSIDERABLE RESTRICTION ON CREDIT AVAILABILITY FOR ENTERPRISES DURING THE COMING MONTHS., THEIR INITIAL IMPACT WAS NECESSARILY LIMITED, ALL THE MORE SO AS THEIR EFFECT HAD BEEN PARTLY OFFSET BY THE EXPANDING TREASURY DEFICIT.

3. ON MAY 28, THE OUTGOING GOVERNMENT INTRODUCED BY DECREE LAW A SET OF MEASURES DESIGNED TO CURTAIL THE PUBLIC SECTOR DEFICIT, MEASURED

REACHED. THESE MEASURES INCLUDE THE FOLLOWING : AN INCREASE IN SOCIAL SECURITY AND HEALTH CONTRIBUTIONS, AND IN SCHOOL AND UNIVERSITY FEES., THE CONTAINMENT OF THE EXPENDITURE FOR PURCHASES OF GOODS AND SERVICES BY THE GOVERNMENT, AND FOR CURRENT TRANSFERS TO OTHER PUBLIC ENTITIES, PARTICULARLY TO REGIONAL GOVERNMENTS. IT IS STILL DIFFICULT TO QUANTIFY THE OVERALL EFFECT OF THESE MEASURES, BUT THE EXPENDITURE CUTS WILL UNDOUBTEDLY CONTRIBUTE TO RESTRAIN THE FINANCING REQUIREMENT OF THE TREASURY, AND THE RESULTING LIQUIDITY CREATION MAINLY FROM THE LAST QUARTER OF THE YEAR.

4. THEREFORE, TO PREVENT THE SITUATION FROM DEGENERATING IN A MAJOR CRISIS, EFFECTIVE MAY 28, 1981, THE AUTHORITIES INTRODUCED AN EMERGENCY MEASURE : ALL PURCHASES OF FOREIGN EXCHANGE WERE MADE SUBJECT, FOR A PERIOD OF FOUR MONTHS, TO THE REQUIREMENT OF A 90-DAY NON-INTEREST BEARING DEPOSIT AT THE BANK OF ITALY EQUIVALENT TO 30 PER CENT OF THE AMOUNT IN LIRE OF THE TRANSACTION. THE DEPOSIT REQUIREMENT DOES NOT APPLY TO PAYMENTS RELATING TO IMPORTS OF GRAIN AND CRUDE OIL AND TO CERTAIN INVISIBLES SPECIFIED IN THE DECREE.

THE AMOUNT OF LIQUIDITY ABSORBED BY THE DEPOSIT CAN BE ESTIMATED AT ABOUT LIT 1 800 BILLION A MONTH DURING THE FIRST THREE MONTHS OF OPERATION. THIS WILL HAVE THE EFFECT OF BRINGING FORWARD THE LIQUIDITY ABSORPTION THAT WILL RESULT FROM THE FISCAL MEASURES RECENTLY INTRODUCED.

THE ADDITIONAL COST OF IMPORTS DUE TO THE DEPOSIT REQUIREMENT IS ESTIMATED AT AROUND 1.8 PER CENT.

5. THE AUTHORITIES COULD HAVE ENVISAGED A DEPRECIATION OF THE EXCHANGE RATE WITHIN THE PRESENT EMS MARGINS. HOWEVER, UNDER SPECULATIVE PRESSURE, EXCHANGE RATE OVERSHOOTING COULD HAVE RESULTED CREATING DIFFICULTIES FOR THE DEFENCE OF THE CENTRAL RATES.

THEREFORE, IN THE VIEW OF THE ITALIAN AUTHORITIES THERE WAS NO VIABLE ALTERNATIVE TO THE INTRODUCTION OF THE DEPOSIT SCHEME, A TEMPORARY MEASURE WHICH WAS TAKEN NOT WITHOUT REALISATION OF ITS DRAWBACKS AND ADVERSE IMPLICATIONS FOR THE EEC. IT IS THE FIRM RESOLVE OF THE AUTHORITIES TO DO AWAY WITH THIS MEASURE AT AN EARLY DATE AND AS SOON AS THE DOMESTIC CIRCUMSTANCES PERMIT.

A. KEES COMEU B
NNNN

262405 TRSY GINCUPPH COMEU B

12/6/81. 86

FINANCIAL SECRETARY

cc Principal Private Secretary —
 PS/Minister of State (C)
 Sir D Wass
 Sir K Couzens
 Mr Hancock
 Mr Kemp
 Mrs Hedley-Miller
 Mr Lovell
 Mr Fitchew
 Mr Edwards
 Mr Donovan
 Mr Scholes
 Mr Butt (UKREP)
 Mrs Hubbard (UKREP)
 Mrs Algar

*I should like a
 Estimate
 track in on
 all this at
 some point.*

EUROPEAN COMMUNITY 1981 RECTIFYING BUDGET
 AND 1982 PRELIMINARY DRAFT BUDGET

I. The Main Policy Issues

I attach a note on the main policy issues raised by the proposals that the Commission outlined on 26 May. It is more tentative than I would have wished, but the Commission have not yet produced their requested justification for the Rectifying Budget; nor has there so far been any significant COREPER discussion, except, briefly, on the problem of nomenclature. The Budget volumes, containing the Commission's explanations, are promised next week, after which we will make a further report as necessary (NB. activity in Brussels, both in Councils and in general operations, is currently significantly reduced as a result of industrial action by the staff of the Institutions. There are major interruptions in the interpretation and translation services, and in the provision of documents. The interruptions could well last into our Presidency and may have adverse effects on the approach to the 23 July Budget Council).

2. Our examination so far suggests that, while there may well be a number of tricky issues for the Council, and European Parliament, to sort out, there should, with one important exception, be no great difficulty about the line that the UK should adopt in its national interest. Our Presidency role may in some cases require us to try to seek compromises between the attitudes of the various Member States, but it is as yet too early to consider this.

3. The exception is our attitude to the Commission's proposals for 1981 and 1982 budgetary provision for FEOGA Guarantee expenditure; at official level, the MAFF have so far taken a different stance from ourselves and the Foreign Office. Mr Fitchew has provided paragraphs 20-23 in our note commenting on this and emphasising the importance of knowing the German position. In the meantime we will in Budget Committee discussions emphasise the relevance of the very important declaration made at the April Agricultural Council.

4. For the rest, our present conclusions about our national aims, agreed with other Departments, are as follows. (it is too early to know to what extent there may be differences of view between Member States). Subject to your endorsement they will guide UKREP in initial discussions, commencing next week, in the Budget Committee.

(a) 1981 Rectifying Budget

(i) FEOGA Guarantee: We should support the proposed reduction.

(ii) UK Advances: We should seek an additional 50 million ecus on top of the 50 proposed, i.e. a net increase in commitments and payments of 28 million ecus instead of a net reduction of 22.

(iii) Regional Fund: Subject to Commission justification, we should support the proposed inclusion of 250 million ecus additional Regional Fund payments and 50 million ecus in payments for aid to Non-Associates, in order to meet outstanding commitments.

(iv) FEOGA Guidance and Food Aid: We need to await Commission explanations before reaching any views.

(v) Maximum Rate: We should be prepared to agree to a new maximum rate for non-obligatory payments to accommodate the increased provision.

(b) 1982 Preliminary Draft Budget

(i) Commitments: We should seek a significant overall reduction in commitments so as to keep well below the equivalent of the 1% ceiling. A major cut, if obtainable, in FEOGA Guarantee commitments would contribute to this.

(ii) UK Supplementary Measures: We should press for at least a token entry for 1982 advances.

(iii) Non-Obligatory Expenditure: We should aim up to, and at, the July Budget Council to restrain the growth in non-obligatory expenditure, both commitments and payments, to within half the maximum rate - i.e. 7.25% - in order to restrain the amount of additional provision that the European Parliament will be able to add.

(iv) Regional and Social Fund: Commensurate with i) and iii), and allowing for increases by the European Parliament in the later stages of the Budget exercise, and consistent with our aims on Budget Restructuring, we should in the UK's interest seek significant increases in Regional and Social Fund payments provision, and a modest increase in commitments.

(v) Aid to Non-Associates, Food Aid and FEOGA Guidance: We need to await Commission explanations.

(vi) Staff Posts: We should insist on a very firm line on additional posts for Community Institutions outside of the language regime. We have already been taking this line in preliminary discussions on the Budgets of the other Institutions.

(vii) Budget Nomenclature: We should be prepared to accept the proposed changes, generally, but should continue to oppose the transfer of food aid restitutions from the FEOGA section to the aid section of the Budget.

II. The Overall Approach to both Budgets

5. The Council's Budget Committee will commence detailed examination of the Commission's proposals as soon as the documentation is available but we also hope that there will be some discussion in COREPER (Deputies) on the overall approach. Some Member States may argue that one cannot even consider proposals for the 1982 PDB until there is finality on the 1981 Budget,

including a final decision of the Budgetary Authority on the 1981 Rectifying Budget. But the Parliament could very well refuse to deal with the Rectifying Budget in isolation from the 1982 Budget. So there would be a circular situation. Mr Tugendhat has already said that the two Budgets should be considered together and we will support this in COREPER discussion.

III. Relevance to Budget Dispute

6. When outlining their proposals for the Rectifying Budget Mr Tugendhat said that the Commission saw this as constituting a political solution to the 1980/81 Budget dispute. Mr Christofas told us that he thought that for the Parliament the Rectifying Budget could constitute a basis for forward movement on the dispute. On the other hand we at present have some difficulty in seeing how much it is likely to contribute to a solution of the dispute. The Germans will be looking for a significant reduction in the 1981 Budget, but the Rectifying Budget provides for only a very small net reduction; the Commission have not proposed to make any adjustment to the provision for the Social Fund; such a reduction might have tempted the Germans. On the other hand it would appear strange for the Community to cut the Social Fund in the present unemployment situation in Member States, and the Parliament would almost certainly refuse to accept it.

7. Discussion in COREPER may give us further information about likely attitudes of those directly involved in the Budget dispute; so far there has not been a word from the French. There may, therefore, be further developments on the Budget dispute before the Dutch hand over the Presidency to ourselves.

Contingency Planning

8. At your request we have been trying to do some contingency planning on what we might do if there had been no progress at all by 30 June on resolving the dispute. If any initiative appears to be called for, at the outset of our Presidency, rather than simply leaving the matter in the hands of the European Court, we shall in any case now have to build on whatever has been said in the context of the Rectifying Budget.

9. We have considered the possibility of seeking at that time some kind of composite approach involving:-

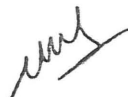
(i) Trying to persuade the French and Germans to adopt the position in public that their opposition last December to the Commission's Supplementary Budget proposals was due to their being unconvinced of the need for the level of provision that was proposed and that, if they had been so convinced, they would not have objected to higher provision in the 1981 Budget. If the Commission now produce additional explanations on the need for the higher levels of payment appropriations we might be able to seek to persuade the French and Germans to state that they were now convinced of the need, and in consequence pay their arrears of contributions as the Commission have requested. They might couple this with complaints about the Commission's failure to provide the necessary information earlier and a general complaint about the procedures adopted by the European Parliament.

(ii) Additional to this, and perhaps as a condition of it, we might aim to secure some kind of public concensus between the Council, Commission and Parliament that the events of December 1980 were unfortunate in the context of the functioning and image of the Community, certainly involved unusual procedures, and that all were agreed on the need to avoid a repetition. The statement might then say that since the main troubles had arisen in the context of handling proposals through a Supplementary Budget late in the year, all parties considered that there was a need for a thorough review of the rules relating to the presentation, consideration and implementation of Supplementary Budgets. The opportunity for such a review is provided within the context of consideration of Commission proposals - on which not very much progress has yet been made - on revision of the Financial Regulation.

10. Such a composite approach would have the aim of persuading the French, Germans and Belgians, that, having made their point and sustained it for a long period, and in the interests of Community progress and harmony, they should now make their full contributions to the 1980 Supplementary Budget and 1981 Budget;

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this would remove any difficulties that uncertainty about the 1981 base would create for 1982 non-obligatory expenditure. Such an approach would only have prospects of success if the French and Germans in particular now seemed ready to contemplate steps to regularise the situation without too much loss of face. But at present we have no indication that this is likely and they may well be content simply to let things lie and to await a Court ruling which could be a long way off.



G R ASHFORD
IG2 Division
12 June 1981

1981 RECTIFYING BUDGET AND 1982

PRELIMINARY DRAFT BUDGET

POLICY ISSUES

On 26 May the Commission announced that they will present their proposals for these budgets to the Council on 15 June; they released some advance details of their contents, but full details of the PDB proposals, in the Budget Volumes, will not be available in London until 16/17 June. It is however possible to identify the main policy issues likely to arise on these two sets of proposals. The issues, and our conclusions on them, which with one major exception have been agreed with the Departments principally concerned, are summarised below. The conclusions are necessarily tentative at this stage and will need to be reconsidered as consideration of the proposals continues.

I. 1981 RECTIFYING BUDGET

2. This will provide for a reduction in total of 27 million ecus. Since the Commission are proposing to incorporate 1980 surplus revenue of 82.4 million ecus, the VAT own resource requirement will be reduced by 109 million ecus.

3. The main changes proposed by the Commission are:-

	<u>Million ecus commitments</u>	<u>Payments</u>
EAGGF Guarantee	-520	-520
Regional Development Fund	-	+250
Food Aid	+127	+127
EAGGF Guidance	+ 55	+ 55
Aid to Non-Associates	-	+ 60
UK Supplementary Measures	- 22	- 22

The change in the provision for UK supplementary measures is made up of a reduction of 72 million ecus to take account of the advances financed by the Open Transfer last year, and an increase of 50 million ecus in the provision for advances in respect of 1981.

4. The Commission have said that the reduction in estimated Guarantee Section expenditure is due to changes in world prices, etc; the increased provision for food aid is due to the price fixing; the proposed increases for the RDF and aid to non-associates are justified on the grounds that these payments are needed to meet prior commitments.

5. We have no problem of principle about having such a Rectifying Budget, although the French and Germans may have because they do not consider the existing 1981 budget to have been legally adopted. The following are the main issues likely to arise for the UK on individual proposals.

The Reduction in FEOGA Guarantee Provision

6. Departments are agreed that we should support this. If accepted by the Council and Parliament, there will be an important consequence for the FEOGA provision in the 1982 budget - see paragraphs 20-23 below.

UK supplementary measures

7. We cannot oppose the reduction in the provision for refunds in respect of 1980; we agreed last year to accept such a reduction in return for the advance payments made to us in December.

The increase in the provision for advance payments in respect of 1981 is welcome but we consider that, in accordance with the Council undertaking of October last year to consider the scope for advances in 1981 of at least 200 million ecus, the increase should be 100 rather than 50 million ecus. (The 1981 Budget as adopted includes 100 million ecus for advances).

Increased Payments Provision for the Regional Development Fund

8. We have consistently, in previous rounds, maintained the need to make adequate payments provision to meet obligations created by commitment appropriations in earlier Budgets (it was the refusal of the French and Germans to adopt a similar view that led to the budgetary dispute at the end of

1980). We have impressed on the Commission the need to justify on this basis the extra 250 million ecus proposed; if they can do so, we should support this increase (the Germans and French may well oppose it, using their strength to block a qualified majority in favour of 250 million ecus).

Increased Provision for FEOGA Guidance, Aid to Non-Associates and Food Aid

9. We await the Commission's justifications. For Aid to Non-Associates it may, as for the RDF, be to meet accruing obligations on which it would be wrong for the Community to default. We have no information on the Commission's reasons for seeking an increase in the FEOGA Guidance provision.

Implications for the Maximum Rate

10. The Rectifying Budget proposes increases in non-obligatory expenditure of between 23 and 27 million ecus for commitments and 337 million ecus for payments. The size of margin for increasing non-obligatory expenditure which was left unused when the 1981 Budget was adopted depends on the maximum rate used. The original maximum rate declared by the Commission for 1981 was 12.2%. The Budget Council, on 24 November 1980, agreed to increase the maximum rate for payments to 19.9%. When the Draft Supplementary Budget No. 2 for 1980 was established the Council said, in sending it to the European Parliament, that the maximum rate was "automatically" reduced to 14.7%. This was not in accordance with the Treaty but was the only way in which the French and Germans would agree to the Supplementary. The European Parliament never reacted to either of these Council proposals.

11. The increases in commitments proposed by the Commission would be within the margin available with a maximum rate of either 14.7% or 19.9%. However, the increase in payments would be greater than the margin available with a maximum rate of 14.7% (though within the available margin using a rate of 19.9%); a new rate would therefore have to be agreed to accommodate the actual levels of provision on which the two Institutions can agree.

II. 1982 PRELIMINARY DRAFT BUDGET

12. The Commission's proposals for the various sectors of the 1982 Budget are shown in the attached table, together with the corresponding figures for 1981 both as in the Budget as adopted and as they would become if the Rectifying Budget were adopted with the Commission's proposals unchanged.

13. Subject to the detailed explanations that will be included in the Budget Volumes, and to attitudes adopted by other Member States, the main issues that appear likely to arise on the PDB are the overall size of the Budget, both for commitments and payments, in relation to the limitation imposed by the 1% VAT own resource limit; the implications in the non-obligatory area for the maximum rate arrangements; and the provision for FEOGA Guarantee and Guidance, for refunds to the UK, for the Regional and Social Funds, and Aid to Non-Associates and for Staff Numbers; there will also be difficulties over the Budget structure; some of these issues are inter-connected. The only significant area where there are differences of view between officials in the UK is on the level of provision for FEOGA Guarantee. The main area of difference between the Council and the European Parliament appears likely to be the overall level of commitment in relation to the 1% limit.

The Overall Size of the Budget in relation to the 1% Ceiling

14. The Commission proposals amount to 23,921.7 million ecus for commitments and 22,381.5 million ecus for payments. Total own resources within the 1% limit are estimated at 22,998 million ecus; this total has been considered by Member States and virtually all the components agreed.

15. The payments figure proposed by the Commission is therefore 616 million ecus below the limit, and the VAT own resource rate would be 0.9533% if the Commission's proposals were adopted in full. The total at the end of the Budget exercise will no doubt be reduced, leaving a correspondingly greater margin, but still not far from the 1% limit.

16. But the figure for commitments for obligatory and non-obligatory expenditure is 923 million ecus above the limit. This is legally compatible with the Own Resources Decision since commitments are not "expenditure". But commitments result in later payments, and the higher the level of commitments in the 1982 Budget, the greater the risk that, when the resulting payments falling due in 1983 are added to the non-differentiated appropriations in that year, the total of payments in the 1983 Budget could exceed what would be covered by the then available total level of own resources, including the product of a 1% VAT rate. Moreover to agree to commitments exceeding the 1% limit would be bad from a presentational point of view.

17. To minimise this risk, the level of commitments in the 1982 Budget will need to be kept not only within the limit (ie. 924 million ecus less than the Commission has proposed), but as much further below the limit as possible. It will also be necessary to ensure that the draft budget leaves available a margin, on non-obligatory expenditure, for the European Parliament. They have a right to their margin. Half the maximum rate applied to the 1981 total for non-obligatory commitments amounts to 300 million ecus. This has implications for our attitude to the Commission's proposals for the Regional and Social Funds, as well as for other areas of the Budget.

UK Supplementary Measures

18. The Commission have included 1658 million ecus for refunds in respect of our 1981 contribution. They have not, despite repeated attempts to persuade them to do so, included any provision for advances in respect of our 1982 contribution. We consider that we should press for at least a token entry for 1982 advances.

Non-Obligatory Expenditure and the Maximum Rate

19. The total increase in the 1982 PDB over the 1981 Budget as modified by the Rectifying Budget, is 15.1% for commitments and 15.96% for payments. On non-obligatory expenditure, the increases proposed, using the Commission classification, are 26.3% for commitments and 31.9% for payments. The maximum

rate for 1982 is 14.5%. The Council classification differs significantly from that of the Commission; it will not be possible to calculate the increase in non-obligatory expenditure on the Council's classification until full details of the PDB are available; but it is safe to assume that it will be above the maximum rate. The aim of many Member States will certainly be to contain the increase in the 1982 Budget, as finally adopted, within the maximum rate; this will necessitate keeping the increase in non-obligatory expenditure in the Draft Budget as established on 23 July to what will be permitted by half the maximum rate, i.e. 7.25%, thus restricting the further sum that the European Parliament may add to a similar amount. This aim has been agreed by the Financial Secretary. (At Annex is a more detailed note on what may be practicable within this constraint).

FEOGA Guarantee Expenditure 1981 and 1982

20. The Commission's proposals for Guarantee Section expenditure for 1981 and 1982 present us with a problem. The Commission envisage a figure for FEOGA Guarantee expenditure in the 1982 budget of 13,965 million ecus. The original 1981 budget provided a figure of 12.897 million ecus. But the Commission are now also proposing a cutback of 520 million ecus to 12,377 million ecus. Compared with the provision in the original 1981 budget the 13,965 million ecus represents an increase of 8.3%. But if the Commission's proposed cutback for 1981 is accepted - and neither MAFF nor ourselves see any reason to challenge it - then the increase between the two years will rise to 12.8%. These figures compare with an estimated increase in the Own Resources base between the two years of 11.67%.

21. The Government's policy is that we want to see the rate of growth of FEOGA Guarantee expenditure held down "markedly below" the rate of growth of Own Resources. This is regarded as one of the main planks of CAP reform. The objective was endorsed by OD (5th meeting) on 12 March before the price fixing negotiations and was then explicitly set out by the Minister of Agriculture and entered in the minutes at the Agriculture Council on 1 April, at which the price-fixing was concluded. The entry in the minutes (which the German and Dutch Governments also supported) is as follows:

"The UK declared that in accepting the price increases and economy measures it had in no way changed its view that, beginning with the 1982 budget, the rate of increase in agricultural Guarantee expenditure, compared with the level provided for in the previous year should be markedly lower than the rate of increase in the own resources base between the two years: and that agricultural expenditure should be so managed as to remain within this limit".

22. The Government's commitment to this formula was reaffirmed in April by OD(E) in preparation for the recent Anglo/German Summit. A note on CAP reform which contained the formula has been handed over to both the French and German Governments. At the Anglo-German summit Herr Schulman likewise reaffirmed the German commitment to the objective. The Chancellor in his speech in the Hague also said that one of the main guidelines for CAP reform was that CAP expenditure should be submitted to a comparable financial discipline to that imposed on other parts of the public sector. Our view, which is strongly supported by the FCO and Cabinet Office, is that it would seem difficult to reconcile the policy outlined above, and in particular the declaration made at the 1 April Council, with acceptance of an increase in agricultural expenditure between 1981 and 1982 as high as 12.8%. Indeed, to do so might cast doubt on the Government's commitment to CAP reform in general and financial discipline in particular. More positively, to seek a reduction in the Commission's figure would demonstrate Anglo/German determination to achieve genuine and permanent savings in CAP expenditure during the budget restructuring exercise, and could indeed be a useful bargaining card in the restructuring negotiations later in the autumn. Moreover the Tugendhat Cabinet have told us they believe that the 13,965 million ecus figure has been padded by DG VI to contain the safety margin. Finally, the FCO strongly take the view (which we support) that it would be a mistake for us to accept the Commission's proposal, if the Germans seek substantial reductions in it. We must at the same time recognise that the imposition by the UK and Germany of the lower figure in the budget at the 23 July Council could create

acrimony with most other Member States and is unlikely to be supported by the Commission. The Commission could also embarrass us at a later stage by making proposals for savings which would be unacceptable to HMG, eg. another increase in the linear coresponsibility levy or cuts in the UK butter subsidy.

23. In an initial interdepartmental discussion this week both Cabinet Office and FCO supported our view that we should be looking for cuts, perhaps of the order of 500 million ecus to bring the rate of increase back down to about 8%. MAFF contested this on the unconvincing grounds that the right comparison was that between the original 1981 budget and the 1982 PDB. However, they accepted that it would be reasonable to seek reductions of up to 200 million ecus. A final decision on what reductions we should seek cannot be made until we know the views of the Germans. With the agreement of the other departments concerned we will be briefing the Chancellor to broach the subject with Herr Matthoefer in the margins of the Finance Council in Luxembourg on Monday 15 June. We would then aim to follow this up with further discussion with German Finance Ministry officials before the end of June. If, after that, the differences between ourselves and the MAFF cannot be resolved at official level, it may be necessary for the Chancellor to write to his colleagues early in July before the final COREPER discussions and the Council itself. In the meantime other departments have agreed that in the initial round of discussions in the Budget Committee the UK representatives can reasonably refer to the declaration made at the April Council as indicating the bench-mark against which we will consider the appropriate level of FEOGA Guarantee provision.

FEOGA Guidance

24. We await the Commission's explanations for the large increase proposed.

Aid to Non-Associates

25. We will need to know the extent of outstanding commitments and the payments likely to be needed in 1982.

Staff Numbers

26. The Commission are requesting some 160 extra posts. No doubt many of these will be for the language regime, and may be acceptable to us. But, outside of this area, the aim of Treasury Ministers is to restrain additional posts. The UK position will have to be that other necessary additional posts should be met by switching staff from low to high priority areas.

Budget Nomenclature

27. As expected, the Commission will use a new layout for the PDB. Under this the Commission's budget would be split into two sections; one covering pay and administration, the other covering operating expenditure. To do this requires an amendment to the Financial Regulation; the Commission are presenting a proposal for this. The European Parliament will probably support the proposed changes. Since the budget nomenclature is settled as part of the budget procedure the Parliament has the final word. But, unless the Financial Regulation is amended, adopting the Budget in the new form would be illegal.

28. The changes in the order of the Budget are likely to cause confusion and all Member States had requested the Commission to maintain the existing nomenclature. The new nomenclature does not however itself raise serious policy issues. In some respects it would be an improvement to the present layout. Discussion in COREPER on how to deal with this situation was inconclusive; some Member States were willing to accept a "pragmatic solution" (as yet unidentified).

29. On balance we consider that the UK should be prepared to accept the proposed changes, particularly since Council opposition to them would be likely to create a further, unnecessary, difference with the European Parliament.

30. The Commission will also propose one other change, separate from those mentioned above. This is to transfer food aid restitutions (export subsidies) from the FEOGA section of the Budget to the aid section. The change would reduce the

apparent size of agricultural expenditure. We have consistently opposed this proposal since it was first put forward in 1975 and should continue to do so.

NON-OBLIGATORY EXPENDITURE AND THE MAXIMUM RATE

The total provision for non-obligatory expenditure in the 1981 Budget as adopted amounts to 4140.1 million ecus for commitments and 2645.6 million ecus for payments. The Commission proposals in the rectifying budget, if adopted unchanged, would increase this to 4155.2 million ecus for commitments and 2969.8 million ecus for payments. These figures are then the base for calculating the 1982 position.

2. Applying the maximum rate of 14.5 per cent gives a margin for increases of

	Budget as adopted million ecus	Budget including rectifying budget million ecus
Commitments	600.3	602.5
Payments	383.6	430.6

Had the maximum rate gives a margin of

	Budget as adopted million ecus	Budget including rectifying budget million ecus
Commitments	300.2	301.3
Payments	191.8	215.3

3. The Council will wish to keep the increase in the draft budget within half the maximum rate both to contain the overall Budget size and to limit the European Parliament's freedom to increase total non-obligatory expenditure. The UK shares this objective.

4. In determining the provision for non-obligatory payment appropriations there are two main constraints:-

- (i) the level of payments likely to result in the year from new commitments;
- (ii) the payments due in respect of prior year's commitments.

Last year the UK made a major issue of the second point. Other countries' refusal to attach the same importance to this led to the 1981 Budget dispute. We will have to maintain the same line

this year, both because we regard it as an important principle and for consistency.

5. On commitments the Budget Authority is free to decide the level of new commitments. There are some exceptions, e.g. the financial protocols, but the amounts involved are small in relation to the total.

6. The major elements of non-obligatory expenditure are the Regional Development Fund and the Social Fund which together account for 60 per cent of the total in commitments and 50 per cent in payments. Our approach to the commitments provision for these Funds will need to be consistent with our general approach to restructuring. On payments the main determinant of our approach will be the need to make adequate provision for the payments falling due in 1982.

7. There is a further item of non-obligatory expenditure where we will have to pay particular attention to the level of payment appropriations; aid to non-associates. There is a considerable overhang of commitments from earlier years which have not yet led to payments.

8. For commitments half the maximum rate amounts to 300 million ecus. This would allow for an increase of between 8 and 9 per cent for the RDF and Social Fund with an increase for other non-obligatory expenditure of 5 per cent. The margin of half the maximum rate on payments amounts to about 200 million ecus. This would again allow for increases of 9 per cent for the RDF and Social Fund and 5 per cent for other non-obligatory expenditure. This would mean that, if we achieve our objective on Guarantee Section provision, the draft budget would provide a higher rate of growth for these Funds than for agriculture - a respectable and defensible position at this stage of the budget procedure. The need to provide for outstanding commitments may, however, make it difficult to restrict the provision for payments in this way. This will only become clear when we have the full PDB.

1981 COMMUNITY BUDGET AND 1982
PRELIMINARY DRAFT BUDGET

Amounts-million ecus

	COMMITMENTS			PAYMENTS		
	1981 Adopted Budget	1981 incl Rectifying Budget	1982 PDB	1981 Adopted Budget	1981 incl Rectifying Budget	1982 PDB
EAGGF Guarantee	12870	12350	13930	12870	12350	13930
EAGGF Guidance	624	697	770	468	523	760
UK Supplementary Measures	955	933	1658	955	933	1658
Financial Mechanism	469	469	-	469	469	-
Regional Development Fund	1540	1540	1940	619	869	1120
Social Fund	963	963	1350	620	620	960
EMS interest rate subsidy	245	245	200	245	245	200
Own resources refund	875	875	962	875	875	962
Refunds to Greece	125	125	174	125	125	174
Research, Energy, Industry	396	396	621	297	297	456
Food Aid	369	493	483	369	493	483
Aid to Non-Associates	150	150	210	23	23	130
Financial Protocols	234	234	221	157	147	142
Pay and Administration	675	677	758	675	677	758
Other		287	263			267
COMMISSION TOTAL	20772	20434	23540	18975	18948	22000
Other institutions	353	353	381	353	353	381
TOTAL	21124	20787	23921.7	19327	19301	22381.5
Vat own resource rate						
1981 Adopted	0.8906%					
1981 incl						
Rectifying Budget	0.8813%					
1982 PDB	0.9533%					



V. C. Borstel

12/6/81 105

- Comm
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Draft Tribute to Van der Stee

Good opportunity
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The Netherlands Presidency has been distinguished by its objectivity, fairness and masterly of the subjects discussed. These are, I believe, Dutch characteristics. They have been especially apparent in your supervision of our discussions. Your Presidency ^{embodied} began ^{with} ~~with~~ the tricky problems [presented by my own proposal to establish a financial guideline for the 1981 price fixing. I admired the way you dealt with that. I hope you do not plan some form of revenge in July. But, if you are unable to resist the temptation,] I hope that I shall be as successful in retaining your goodwill as you were in retaining mine and as successful in keeping the confidence of our colleagues.

Last week you were presented with a special challenge at the Junco Council. I thought it brave of you to take it on but am the first to acknowledge that



it could not have been better handled.

We were all, I am sure, especially appreciative of the way you summed up the discussion with a text we could all accept without inflicting on a Council of twenty or more Ministers the unwelcome task of a collective drafting session. ~~Once again, I hope I shall live up to your example.~~

Do not imagine that from July you will be able to go to sleep at Council meetings. My aim will be to stimulate spontaneous debate - perhaps in restricted session - whenever the subject permits. But ~~I have~~

~~no doubt that, on occasion, I shall be forced to adopt that classic device of Presidents in trouble - the tour de table starting ^{with} the Minister to the President's left.~~

no need for reminder - this idea

Bruxelles, le 12 juin 1981

7403/81

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OJ/CONS 26
ECOFIN 32

ORDRE DU JOUR PROVISOIRE

de la 710^{ème} session du CONSEIL DES COMMUNAUTÉS EUROPÉENNES
(Questions économiques et financières)

Luxembourg, lundi 15 (15 h.30) juin 1981

1. Approbation de l'ordre du jour provisoire
2. Proposition de décision du Conseil habilitant la Commission à contracter des emprunts en vue de promouvoir les investissements dans la Communauté NIC
doc. 7352/81 ECOFIN 30
+ Corr. 1
3. Proposition de deuxième directive du Conseil portant coordination des dispositions législatives, réglementaires et administratives concernant l'assurance directe autre que sur la vie et fixant les dispositions destinées à faciliter l'exercice effectif de la libre prestation des services
docs 7347/81 SURE 21
FISC 22
8788/2/80 SURE 13 rév. 2
5343/81 JUR 57
SURE 11
5799/81 JUR 78
SURE 13 Insurance
4. Préparation des points de caractère économique, financier et monétaire susceptibles d'être évoqués lors de la prochaine réunion du Conseil Européen Ecos

5. Crédits à l'exportation : Aménagement de l'arrangement sur les lignes directrices

Export credits

6. Subventions du prix de pétrole

Energy subsidies

7. Mesures de sauvegarde prises par le Gouvernement italien

Italian scheme

8. Divers

~~7. Récapitulatif~~
 NEW PROPOSAL DISTRIBUTION OF
 BUT - OBJECTIVE, FINANCIAL & MARKET
 A DEMAND FOR QUANTITIES MORE APPROPRIATE
 TO SUPPORT OF OUR DISCUSSION

CAN WE HAVE QUANTITIES

- COMPROMISE WITH JUMBO

- COURAGE

- CLARITY

~~EMPHASIS ON THE POINTS MADE~~

ARE WE ASKING? NO IS ANSWER.

...

1. MR HANCOCK
2. CHANCELLOR

cc. As attached list

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12/6/81.

FINANCE COUNCIL AND EIB GOVERNORS MEETING: 15 JUNE

1. The Council and the Governors Meeting will be held in Luxembourg on Monday, 15 June. You will also be having bilateral meetings with M. Delors and Herr Matthofer, touring the new EIB building, and attending a reception and dinner in the evening. The time-table is attached at Annex 1. You will be accompanied by Mr Hancock, Mrs Gilmore, Mr Wiggins and Mr Reid (the Under Secretary in the Department of Trade dealing with the Insurance Services Directive.) Mrs Hedley-Miller and Mr Rupert Raw (the retiring UK Director of the EIB) will also be around for the EIB Directors meeting. The Governor, accompanied by Mr Balfour, will be attending the Finance Council in his capacity as Chairman of the Committee of Central Bank Governors. Annex 2 lists the topics that will be discussed at the various meetings.

Meeting with M. Delors

2. The objective here is to build on your earlier meeting with M. Delors and establish good personal relations with a view to future cooperation; to emphasise our desire to improve UK/French relations, both bilaterally and within the Community; and to sound out the thinking of the new French Government on a range of economic issues, particularly those of immediate interest to the UK.

Lunch

3. Although export credits is on the Council agenda, we understand that it will be discussed over lunch. Our objectives are to encourage M. Delors to take a more flexible line than his predecessor, particularly as regards increases in minimum interest rates and improved notification procedures for "credits mixts"; and to gain general agreement that the Community should press ahead with the preparation of a constructive package of proposals which might provide the basis for agreement with the US and Japan when negotiations on changes in the Consensus are resumed in the autumn.

4. We understand that France may raise the question of further economic assistance to Poland over lunch. Whilst we would be prepared to join in any ^{relevant} discussions that were arranged on this topic, we would not be optimistic about their outcome.

5. You could take the opportunity to explain to colleagues our increasing concern about the level of Japanese imports. This concern reflects the fact that, although some of our Community partners could take administrative action to discourage imports from Japan, the UK would be frustrated in such a course by legal action.

6. You have agreed to have a word with M. Ortoli at lunch about the handling of the US interest rate issue. His letter of 27 May 1981 and Mr Bottrill's draft reply are attached.

7. You intend to ask Herr Matthofer and the Greek Minister if they agree with Mr van der Stee and Mr Norgaard that it would be better to have genuine informal discussions at the regular Council meetings by going into restricted session on sensitive items, than to have informal meetings. If they do agree, you will be able to announce your intentions at the first lunch over which you will preside on Monday, 6 July.

EIB Governors Meeting

B. After several discussions in the Board of Directors we have secured as a compromise proposal for the Governors approval:

- (a) a doubling of the subscribed capital:
- (b) paying in 7½% of the increase over four years (beginning in 1984 when repayments under the last increase are complete):
- (c) agreement that the Board of Directors should review the Bank's borrowing and lending at regular intervals.

This seems to us a good result (even though the Public Expenditure cost of (b) is about £50 million a year). We recommend you to accept it.

9. Under the economic situation it is likely that discussion will concentrate on the US interest rate issue. At last week's Coordinating Group it was generally agreed that the European Council should consider the effect which US domestic policy was having on the Community. As you know, M. Delors and S. Colombo have joined Chancellor Schmidt in attacking US interest rate policy. And M. Ortoli wrote to you on 27 May to express his concern as well, suggesting that Community countries should make a common approach to the US. You will want to stress the importance of the US succeeding in its fight against inflation and to suggest that careful consideration should be given to any approach to the US. A quiet dialogue is much better than a public demarche. We assume the Presidency will report the conclusions of the discussion to the European Council at the end of the month.

10. The most important item on the agenda for the UK is the Insurance Services Directive. You will recall that this was discussed at the last Finance Council in March. The Directive would give insurers freedom to operate across frontiers within the Community. For example, a UK insurance company can already do business in France by setting up a branch in France, but the directive would allow it to cover French risks direct from the UK. This is particularly important for Lloyds, whose unusual structure makes foreign branches difficult to operate.

11. The March Council confirmed that it attached importance to securing agreement on the directive. The directive has since been discussed extensively at working level and a report from Coreper is before the Council. A brief by the Department of Trade is included in the attached briefing. Our objectives are to agree as much as possible and to set a time-table to Coreper for dealing with any unresolved issues and reporting back to the Council.

12. Our objective on the renewal ^{of the} New Community instrument is: if possible to delay agreement until our Presidency; if not, to ensure that the Commission proposal is satisfactorily amended to incorporate an overall ceiling and unanimous voting. It seems likely that the Germans will block this proposal, in which case we can simply lie low. We might then hope to obtain some modest credit for securing agreement during our Presidency. If, on the other hand, some member states - including Germany - were prepared to accept the proposal after suitable modification, then we could go along.

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14. There was a discussion in the Monetary Committee on Wednesday, 10 June, about the recently introduced Italian import deposit scheme. Ministers will wish to discuss the Italian action; it has generally been ill-received. However, the effect on UK exports to Italy is probably not very great.

15. As we agreed at the meeting with Mr Christofas last Monday, you will wish to tell your colleagues that you intend to return to afternoon sessions for the Finance Councils under the UK Presidency.

16. It is the custom for the President ^{- to be} to say a few words about the retiring President.

17. Herr Matthofer has requested a short bilateral meeting. The only time that it has been possible to arrange is something during the Finance Council itself. You will have to withdraw at an appropriate moment. It is important, however, that you

- should be present in the Council for the whole of the Insurance item and that you should be there at the end in order to say your piece about Mr van der Stee. It is likely that Herr Matthofer will wish to assure you of his good wishes after he was ~~unable~~ to attend the earlier bilateral meeting. You can take the opportunity to discuss budget restructuring and CAP reform.
- 18 21. UKREP suggest that it would be desirable for you to have a few minutes alone with Mr Tugendhat after the Council, so that he can explain his tactical difficulties within the Commission on Budget restructuring, and you can confirm that a net contribution of over a billion ecu a year after 1981 is out of the question.
- 19 22. We have arranged for you to be taken on a short tour of the building before the Reception in the evening.

J. Scholes
J. SCHOLES
12 June 1981

TIMETABLE

<u>15 June</u>	08.20	Depart Heathrow	- <u>Flight LG 402</u>
	10.25	Arrive Luxembourg	
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I Meeting with M Delors - current relations

II Lunch

1. Export credits

2. Poland's debt

3. [Chancellor to raise] Japanese trade

4. [Chancellor to raise] informal meetings

5. [Chancellor to raise with markets] handling of interest rate issue

III EIB Governors meeting

1. Routine business (approving annual accounts, appointing members of Audit Committee, etc).

2. Capital increase

IV Finance Council

1. Economic situation (especially US interest rates)

2. Insurance Services Directive

3. Renewal of New Community Instrument (NIC)

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5. Italian import deposits

6. [Chancellor to raise] Returning to afternoon sessions under UK Presidency

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V Meeting with Herr Matthofer - budget restructuring

CAP reform.

VI Brief meeting with M Tugendat

VII Tour of new EIB building - British architects

12/6/81.

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awp 12/6

1. MR PERETZ
2. MR HANCOCK
3. CHANCELLOR OF THE EXCHEQUER

copies attached for :
Financial Secretary
Sir K Couzens
Mrs Hedley-Miller
Mr Lavelle
Mr Scholes

INSURANCE SERVICES DIRECTIVE

On Tuesday 9 June I accompanied Mr Reid (D/Trade) to Bonn to discuss in the Insurance Services Directive with the Germans. You might like a short report of my impressions to supplement the briefing the Department of Trade will be providing for Monday's Finance Council, at which Mr Reid will support you.

2. The German attitude was disappointing. If anything they were less helpful than they have recently been in official negotiations in Brussels. They showed no appreciation of the wider arguments in favour of early liberalisation of services as an objective of the Community. To the extent that they were prepared to shift their position it was by no means clear that they were trying to be constructive but rather they seemed to be looking for proposals that would slow down negotiations (and jocularly referred to discussions lasting to the year 2,000).

3. On the details:

(a) In official discussions in Brussels it had appeared that progress might be made if the directive liberalized insurance services for industrial and commercial risks only (ie not consumer business). This is the profitable bit of the market and might at some stage be an acceptable compromise to us as a first step. In Bonn the Germans suggested that there should be a threshold and only risks of large firms should be liberalized. Thresholds have been discussed unsuccessfully in earlier years and this was a retrograde step. We impressed on them that freedom of services was a right and should not be subject to thresholds. We find it easier to distinguish between different types of risk, as the draft directive does at present, than between different sizes of client firms.

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(b) On authorisation the Germans suggest that business be subject to prior notification with no business done for a specified period of time. We object to the amount of information that must be notified under the present draft. In particular we object to the idea that UK insurers trading in Germany should give the German authorities all the information they require from their domestic insurers. UK firms are already supervised in the UK and should not also be supervised by the German authorities. German consumers should be free to choose whether they wish to do business with companies supervised by the German authorities or whether they prefer the flexibility and competitive premiums offered by other European insurers. Brokers are always available to advise small firms which policies suit their needs the best. The Germans proposed, for the first time, that cross-border business should be done in accordance with three or four principles. They had not worked these principles out but have promised to show them to us as soon as possible. This idea could well be no more than a negotiating tactic designed as a distraction from the existing draft text.

Conclusion

4. Overall, it seems that the German attitude remains disappointing. Their main concern is undoubtedly to protect their own insurance companies. However their own employers federation (BDI) and the European Federation of Employers (UNICE) support liberalization. At the Finance Council on Monday 15 June other Ministers will probably wish to return the subject to officials as quickly as possible and may suggest time wasting red herrings. It will be helpful if we can take the opportunity to impress on the Germans* and others that we attach great importance to reaching an agreement on this directive that reflects the principle of freedom of services. Free trade is a basic principle of the Community and for the UK free trade in services is of particular importance.

* I ~~will~~ will lobby Ministry of Finance officials in Luxembourg on 15 June. It would be helpful if you could make this point to Matthaefer. D.H. 12/6.

R.M. Perfect
R M PERFECT
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CONFIDENTIAL

13. Mr Christofas did not have any fixed ideas on the second Budget Council. Informal contacts would be needed and much would depend on the mandate given to the Presidency. An extra Council in Strasbourg might prove necessary.

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VII Tour of new EIB building - British architects

CIRCULATION

With Attachments:

- Principal Private Secretary
- Financial Secretary
- Minister of State (C)
- Sir K Couzens
- Mr Byatt
- Mr Hancock
- Mrs Hedley-Miller
- Mr Mountfield
- Mr Ashford
- Mr Bottrill
- Mr Edwards
- Mr Fitchew
- Mrs Gilmore
- Mr Hawtin
- Mr Peretz
- Mr Culpin
- Mr Mercer
- Mr Seebohm
- Mr Thornton

- PS/Governor B/E
- Mr Balfour B/E
- Mr Wentworth Cabinet Office
- Mr Spreckley FCO
- Mr Reid D/Trade
- Mr Butt UKREP (3 copies)
- Mr Appleyard Paris
- Mr Boyd Bonn
- Mr Anson Washington
- Mr Adams Rome

Steering Brief only:

- Chief Secretary
- Minister of State (L)
- Sir D Wass
- Mr Kemp
- Mr Ridley

