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PART D

Part D.

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Begins: 13/11/87.
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PART D

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PART D

Chancellor's (Lawson) Papers:

ECONOMIC FINANCE COUNCIL
MEETINGS 1987

Disposal Directions: 25 Years

D Anderson

25/8/95

BRIEF A

13/11/87.

BRIEF A

CREATION OF A EUROPEAN FINANCIAL AREA: CAPITAL LIBERALISATION

Relevant documents: Communication from the Commission; two draft Directives; and a draft regulation. (attached)

UK Objectives

The discussion is expected to be largely procedural. Your objectives are to limit substantive discussion at this stage and to ensure that the work is carried forward under the German Presidency with the advice of the Monetary Committee - chaired by the UK. It may not be possible entirely to avoid discussion of the issues, particularly on tax on which separate brief is attached. In any discussion there are a number of markers you may wish to put down on the key points.

Points to Make

(i) Agree with Commission that rapid progress on this needed. But need advice of Monetary Committee. Suggest that it be remitted to Monetary Committee and at the same time that Coreper set up a Council Working Party to be ready to start work as soon as comments from the Monetary Committee are available [likely to be in January, when ECOFIN itself does not usually meet].

(ii) Agree with Commission that harmonising supervisory structures, changes in tax, and membership of ERM "must not be regarded as pre-conditions" for capital liberalisation [Page 2 of Commission paper].

(iii) [If points of substance are raised]. Should await comments of Monetary Committee and Central Bank Governors on details. But:

X - disappointed with proposal to retain and extend 1972 directive. Thought it had been agreed at Nyborg that this directive was obsolete and should be abrogated.

Y - doubtful about need for additional safeguard clause.

- [will want to examine proposals to merge medium term credit facilities, and conditions for access, very carefully.]

Why Y shd make any less for X

Background

The Commission are presenting to ECOFIN a paper on the creation of a European financial area, two draft Directives (one covering the liberalisation of capital movements and the second amending the 1972 Directive), and a draft regulation (on medium term credit facilities). The paper largely follows the version discussed by officials in the Monetary Committee on 30 October and by Governors in Basle last week.

The paper outlines the basis of the proposals, and looks at the "complementary questions" of:

(a) harmonising supervisory structures to facilitate freedom of financial services while ensuring adequate protection;

(b) the problems of fiscal evasion and fiscal differences leading to distortions in capital markets; and

(c) any linkage between financial integration and participation of all EC currencies in the ERM.

Fortunately, the Commission paper states, clearly, that solutions to these issues are not pre-conditions for capital liberalisation (though Delors has said that he, personally, does see sterling's membership of the ERM as a pre-condition).

The proposals are:-

(a) a Directive for the full liberalisation of capital movements;

(b) amendments to the 1972 Directive which allows restrictions to be imposed for monetary policy reasons, to include also a statement of intent that flows should be liberalised vis-a-vis third countries, as well as within the Community;

(c) changes to the Community instruments for medium term balance of payments assistance.

Draft Directives and Regulations

On the new Directive the Commission sensibly argue that liberalisation cannot be phased according to the nature of capital movements; should be completed in one step; and that dual exchange markets (as run by Belgians) should not be maintained. The current drafts do not make it clear to what extent it is intended that liberalisation should cover indirect obstacles (for example, capital market queuing arrangements).

The Commission propose an additional safeguard clause allowing temporary derogation from the capital liberalisation obligation to deal with financial disturbance for monetary and exchange rate policy reasons. Member states could either impose controls before or after consultation and these measures could apply for six months. Up to now opposition to this has come from the UK, German, Danes, Dutch, Belgians and Luxembourg; and support from the Italians, French and Greeks.

Transitional arrangements are proposed for Spain, Portugal, Greece and Ireland. These will allow additional periods for the implementation of both existing and new community liberalisation obligations. It is unrealistic to think that we can proceed without some such arrangements.

The Commission are now proposing to amend instead of abolish the 1972 Directive. They are proposing to include a declaration of intent that liberalisation should also be vis a vis third countries - the so called "erga omnes" principle. They are also proposing to extend the range of instruments covered. And it is proposed that the Commission should be able to recommend activation of the provisions since we are already technically in breach of the 1972 Directive, its retention could mean that the UK would have to take domestic legislation to meet the requirements. This is all disappointing since (according to the offical report to the Monetary Committee) it was agreed at Nyborg that the 1972 Directive is "obsolete and should be abrogated". This is still the UK and German view: though others - including the French, Dutch and Danes - appear to be wavering. There seems no reason why the "erga omnes" principle should not be included in the new directive, instead.

The Commission propose <u>combining the two existing medium term finance mechanisms</u> (community loan mechanism for balance of payments assistance and medium term financial assistance). Loans will be made subject to a Council decision taken by a <u>qualified</u> majority for a country implementing a programme of capital market liberalisation. The loans would be primarily financed by Community borrowing, but in some circumstances by credits from member states. The Commission are also proposing an increase in the mechanism from the present ECU 8 billion to ECU 13 billion and that any higher assistance would be financed by member states (which for the UK would score as public expenditure). There are no provisions to trigger early repayment if economic conditions improve. There are obviously several points we will need to watch very closely. Nor is it clear that this proposal is <u>necessarily</u> linked with progress on capital market liberalisation.

Complementary Questions

(a) Prudential Supervision

The Commission are seeking rapid progress on the adoption of harmonised prudential and supervisory rules for the protection of savers and depositors, but rightly acknowledge this should not be regarded as a precondition of capital liberalisation. The overriding objective should be of all countries to get the right balance between regulation, market freedom and supervision in an EC context at the speed which is necessary to keep up with market developments. The Commission argue that differences in supervision could create competition which could in turn distort the movement of capital and or reduce investor protection. There is no evidence that this is happening.

[illegible]

(b) Taxation

See attached note.

(c) ERM

The Commission argue that capital liberalisation makes the question of sterling's participation in the ERM more urgent. As far as the UK is concerned they believe it would add credibility to our use of the exchange rate as a monetary indicator, reduce problems the Irish have because of the large potential capital flows between the two countries and facilitate the creation of an integrated capital market.

There seems little to be said for any of these arguments. As far as the Irish are concerned capital flows between the two countries would arguably rise rather than fall if sterling was a member of ERM. Non-membership of the ERM has not been a barrier to our having liberalised capital markets far earlier than the other EMS members; and we have been able to cooperate with others on our economic and monetary policy without formally belonging to the ERM. The more convincing argument works the other way round. Abolition of exchange controls in European would remove the concern sometimes expressed in the UK that were we to join we would have to reintroduce exchange controls.

TAXATION QUESTIONS

The Commission paper addresses four tax issues: harmonisation of company taxation; tax evasion; discriminatory provisions in national tax schemes that provide incentives for private individuals to invest in national securities and restrictions on investments by pension funds in Member States.

Harmonisation of Company Taxation

The Commission argue that a genuine internal market will not be attained if the tax conditions influencing company investment and production decisions differ. They argue that tax distortions can be removed by a closer approximation of company taxation in Member States. The Commission are to issue a White Paper on this topic before the end of the year. They will take as their starting point the draft Directive for the harmonisation of company tax systems put forward in August 1975

COMMENT

Much depends on the detailed proposals on the Commission's White Paper which is promised before the end of the year. Glad that Commission recognise that any scheme of harmonisation of company taxation must involve lower tax rates than the 45-55 per cent bracket proposed in 1975. But must record now that UK would have no sympathy with any proposals which obliged it substantially to alter its present system of company taxation. This is particularly true of proposals which would narrow the tax base or increase tax rates. The reform of the UK system of company taxation in 1984 has been widely recognised as the first major example of a low rate/wide base approach to taxation which is now being widely emulated elsewhere, notably in the USA.

Tax evasion

The Commission recognise that their proposals on liberalisation of capital markets carry serious risks of tax evasion for some Member States. When investors are allowed to have investment income paid into bank account held outside their country of residence, it may not be declared in the country of residence, and so lead to substantial tax evasion. Their paper makes a number of proposals to counter this. One possibility is for dividends and interest to have harmonised deduction of tax at source, along the lines of composite rate tax. Another, which would also be applied to bonds, would be to impose an obligation on the banks to disclose information to the tax authorities. Agreement with third countries on withholding tax and stronger exchange of information procedures are also options. The Commission's paper now recognises the danger that effective measures to combat tax evasion limited to EC states risk encouraging capital movements to third countries.

COMMENT

Glad that Commission paper now recognises that tax evasion already exists in parallel with exchange controls; and that where such controls have been removed, as in the UK, substantial additional tax evasion has not been found to be a problem. Also glad that paper acknowledges that effective measures against evasion limited to EC countries will tend to drive capital to third countries where such measures do not exist. In these circumstances, a broad measure of international agreement providing for greater co-operation between national tax authorities is the most promising approach.

Discrimination provisions

The Commission criticise provisions in national tax systems that provide an incentive to private individuals to invest in national securities as distortionary. They propose discussion aimed at gradually removing tis distortion. Member States could either discontinue the tax concession or extend it to securities in other Member States.

COMMENT

[If France opens up Loi 'Monory' we cd apply to Euro PEPs]

[This looks like a straight allusion to Loi Monory and PEPs.] Willing to discuss the Commission's proposal, but note that it involves a number of issues, both of policy and practicality, for all Member States. These would need to be fully considered.

Restrictions on investments by pension funds in Member States

Which?

The Commission point up the fact that some Member States do not allow pension funds established there to invest freely abroad. They propose to discuss the gradual removal of such restrictions.

COMMENT

The UK welcomes the Commission's approach.

SEC (87) 1667

COMM PAPER SEC(87) 1667

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

(Creation of an European Financial Area)

Creation of a European Financial Area

Introduction

In April 1983, the Commission sent the Council a Communication on Financial Integration[1]. This gave new impetus to Community discussions and was followed in May 1986 by a programme for the liberalistion of capital movements[2], which is a vital element in the cration of an integrated financial area. The first stage of that programme was put into effect by the Council in November 1986 when it adopted a Directive which entered into force on 1 March 1987 extending the list of liberalised transactions.

Several Member States have taken measures which go beyond their Community obligations; and the relaxation of exchange controls in France and Italy has made it possible to terminate the protective clauses under Article 108 of the Treaty from which they previously benefited.

The programme adopted in May 1986 stipulates that the Commission will study with the Monetary Committee and the Committee of Central Bank Governors the implications of financial integration for monetary cooperation and on the liberalisation of financial services. It also stated that proposals for a Directive establishing the full liberalisation of capital movements will be submitted to the Council in 1987.

A link was established between the strengthening of the EMS and the liberalisation of capital movements during the discussions which followed the realignment of January 1987. At their informal meeting in Knokke in April 1987, the Ministers of Finance agreed that the measures under examination for strengthening the EMS should be adopted in September and that the Commission would present as soon as possible afterwards its proposals on the liberalisation of capital movements.

The informal meeting of Ministers in Nyborg in September approved a package on the strenghtening of the EMS and welcomed the Commission's intention to send its proposals for the implementation of the final stage of the liberalisation of capital movements to the Council meeting of November.

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[1] COM(83)207 final

[2] COM(86)292 final

The first part of this document outlines the main options on which those proposals are based.

The second part considers the following three complementary questions, which have been posed during the Commission's considerations on the implications of the full liberalisation of capital movements and in the notes sent by the President of the Commission to the President of the Council for the informal meetings of the Finance Ministers.

- How should the programme to liberalise capital movements fit in with the programme to harmonise national supervisory structures, whose purpose is to facilitate the full freedom of financial services while ensuring the protection of savings and the conditions for fair competition between financial intermediaries?

- With no restrictions, capital movements will be determined to a greater extent by fiscal considerations. What measures may be necessary to ensure that there is no misallocation of capital; and to combat a possible increase in fiscal evasion?

- Maintaining stable exchange rates is necessary both for achieving and preserving the large internal market. What relationship is there between financial integration and participation in the exchange rate mechanism of the EMS?

The Commission's view is that solutions to these questions must not be regarded as pre-conditions for the programme of liberalisation of capital movements. An integrated financial market will not be achieved by simultaneously implementing all the necessary measures. On the contrary it will be achieved by creating a dynamic movement towards integration and accepting some disequilibrium within an overall programme which is both coherent and binding. The liberalisation of capital movements will itself provide the momentum for this process.

I. Legislative Proposals for the Final State of the Liberalisation of Capital Movements

The Commission's proposals are based on three texts:-

- A proposal for a Directive for the full liberalisation of capital movements

- A proposal for the amendment of the 1972 Directive on regulating international capital flows

- A proposal for a Regulation amending and combining the existing two Community instruments which are available to provide medium-term balance of payments assistance.

1. The Directive to Implement the Full Liberalisation of Capital Movements

The purpose of this Directive, which will be based on Article 69 of the Treaty is to extend liberalisation to all capital movements. This extention will cover mainly the following operations:-

- investments in short-term securities;
- current and deposit account operations;
- financial loans and credits;

As the Directive will also stipulate that transfers made for the purposes of capital movements must be effected on the same exchange rate conditions as those for current payments, a dual exchange market could not be maintained or introduced except under a safeguard clause, provided for in the Treaty or in this Directive.

Belgium

The obligation to liberalise will be worded in a general way. This will remove any ambiguities over its scope, which may remain even after the decisions of the Court of Justice on this subject. The obligation must be interpreted to imply:-

- not only the elimination of restrictions on capital transfers but also on the underlying transactions;
- the possibility for a resident in one Member State to have access to the financial system of another Member State and all the financial products that are available there; this resident therefore puts himself in the regulatory framework of the market in which he deals;
- the elimination in domestic rules of discriminatory measures, for example fiscal discrimination, and restrictions imposed on certain types of investor, in so far as they are not strictly necessary for prudential reasons.

The new Directive will contain a safeguard clause which would permit the re-introduction of controls, on short-term capital movements if they were seriously endangering a Member State's monetary or exchange rate policy.

Exercise of the safeguard clause would be subject to Community procedures. Either the Commission, after consulting the Monetary Committee and the Committee of Central Bank Governors, would authorise the implementation of protective measures; or in an emergency the Member State would do so itself, in which case it would inform the Commission and the Member States. The Commission may then decide whether the measures taken should be amended or suspended. In all cases the measures would be limited in time to a maximum of six months and could only affect transactions newly liberalised by the Directive.

A safeguard clause in the Directive itself is necessary, despite the fact that the Treaty provides safeguard clauses through Articles 73, 108 and 109, for the following reasons:

- Articles 108 and 109 require that the Member State has balance of payments difficulties, but there can be disruptive short-term capital movements without a balance of payments crisis. Article 73 refers to "disturbances in the functioning of capital market". There are risks in encouraging a wide interpretation of this to cover monetary and exchange rate difficulties connected with short-term transactions.

what risks?

- As the measures would affect short-term and monetary transaction, the Committee of Central Bank Governors should be consulted; but the safeguard clauses of the Treaty do not provide for this.

- It is desirable to have a short fixed time limit.

Four Member States - Spain, Portugal, Greece and Ireland - are not in a position to proceed to the final stage of the liberalisation of capital movements at the same pace for a variety of reasons such as : precarious balance of payments positions, high external indebtedness, less developed domestic financial systems, etc.

The new Directive will provide for a longer time-table over which these countries would remove controls on the transactions covered. This would not affect the special provisions which already apply in these countries on other transactions covered by previous legislation.

For Spain and Ireland it is proposed that the transitional period would terminate at the end of 1990; and for Portugal and Greece at the end of 1992.

2. **Amendment of the 1972 Directive on regulating international capital flows**

The purpose of amending this Directive is the following:-

- To include a declaration of intent that the degree of liberalisation of capital movements to and from third countries should be equivalent to those within the Community. This solution is preferable to the introduction into Community law of an obligation to liberalise "erga omnes". Although this would probably be done in practice, such a legal commitment, which would be more difficult to reverse than to make, could compromise the Community as a whole or individual Member States in negotiations with third countries.

why not put this in new directive?

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- To give operational content to the notion that there should be a Community dimension, which is contained in the preamble to the existing text but not in the Articles. The proposal is that Member States would keep the Commission informed of measures taken vis-à-vis third countries, and that the Commission, after consulting with the Monetary Committee would be able to make recommendations to the Member States.

and thus?

- To extend the range of instruments covered by the Directive, to make them the same as the instruments which would be necessary for the implementation of the safeguard clause in the new Directive implementing Article 67 of the Treaty.

It is desirable to include these aims in an amended version of the 1972 Directive rather than in the new Directive because they have to be based on different Articles of the Treaty. why?

3. **Mechanisms providing medium-term balance of payments assistance**

The purpose of the proposal, which takes the form of a Regulation based on Articles 108 and 235, is to:

- establish a single instrument to provide medium-term financial support (MTFS) by combining the existing Community loan and medium-term financial assistance mechanisms;
- make the Community loan the primary instrument for medium-term assistance;
- extend the conditions under which medium-term assistance can be granted to cover needs associated with the liberalisation of capital movements as well as general balance of payments difficulties.

It is desireble to fuse the two instruments for the following reasons:

- it will unify the conditions under which they can be granted, while preserving their different financing methods;
- it reflects the current reality that the MTFA is not used;

The granting of the loan, or the opening of a credit line, would be made by a Council decision taken by a qualified majority on a proposal from the Commission after the Monetary Comittee had been consulted. The decision would cover : the amount of the loan, its length, procedures (e.g. single or phased payment) and the economic policy conditions to be attached. The nature of the conditionality would depend on whether the loan was activated for purely balance of payments reasons or whether it was granted to assist the process of liberalisation of capital movements.

The broadening of the mechanisms' scope and the order of precedence introduced between the two financing methods will mean that the upper limit on the outstanding amount of financing in the form of market borrowing should have to be raised to /ECU X 000 million/, instead of the present ECU 8 000 million). ?

II. Complementary Questions

1. The Protection of savers and depositors: the Harmonisation of Supervisory and Prudential Rules

The liberalisation of capital movements, combined with the full liberalisation of financial services, will not only allow capital to move freely throughout the Community, but will also make it possible for banks, the many different categories of savings institutions and other financial intermediaries to offer and advertise their services to savers and depositors throughout the Community either through establishments in the Member States or across frontiers without establishments.

It is important that this liberalisation should take place in a framework which ensures: a satisfactory level of protection for savers and depositors; high standards of disclosure and information for investors and shareholders; equal conditions of competition in financial markets; and the solvency and stability of banks and other financial institutions.

The Commission's approach to the question of investor and depositor protection distinguishes between two different situations. The first case is where a resident in one Member State addresses himself on his own initiative to a supplier of financial services in another Member State. The second case is where a supplier from one Member State wishes to market his services and solicit business from the residents of another Member State, either from an establishment in that other Member State or across frontiers under the freedom of services provisions of the Treaty.

In the first case the residents of any one Member State should be free to address themselves to the suppliers of financial services and products in any other Member State on the same terms and conditions as residents in that Member State. In doing so, the client or purchaser of financial services is deemed to place himself under the regulatory framework of the Member State of the supplier and accordingly he cannot invoke the rules of his country of residence to protect himself. Banking and other savings institutions in all Member States of the Community are in general subject to strict regulation by the national authorities both as regards their solvency and liquidity and as regards the protection of investors and depositors.

To deal with the second case, the Commission has initiated a substantial programme of legislation to harmonise national rules for the prudential supervision of financial institutions and for the protection and information of investors. Many of these measures have already been adopted or are under discussion by the Council; the remaining proposals will be put forward by the Commission before end of 1988. The objectives of the measures proposed are:

(a) the removal of the remaining obstacles (i.e. other than exchange controls) to the freedom of establishment and freedom of services;

(b) harmonising prudential rules to ensure the solvency and financial stability of financial institutions;

(c) ensuring equivalent standards of investor, depositor and consumer information and protection.

The method of approach in the legislation as set out in the White Paper comprises three main elements:

(i) the harmonisation of the essential elements of prudential rules and standards;

(ii) the mutual recognition of the way in which these standards are applied in the different Member States;

(iii) based on (i) and (ii), the principle of "home country control", i.e the principle that all the activities of banks (and other financial institutions) throughout the Community, whether carried out through a branch or by cross-frontier provision of services, will be supervised by the authorities of the Member States of the head office.

Although it is important that rapid progress should be made in the adoption of the harmonising measures described above, their adoption should not be regarded as a precondition for the final phase of liberalisation of capital movements. Many of the measures in question indeed relate to transactions which have already been liberalised. In the view of the Commission this programme provides a sufficient level of protection for savers and depositors; no further specific prudential measures are required for the completion of the liberalisation of capital movements.

2. Taxation questions

The liberalisation of capital movements highlights the following four issues in the field of direct taxation:

- harmonisation of company taxation;
- tax evasion;
- discriminatory provisions in national tax systems that provide an incentive for private individuals to invest in national securities.
- restrictions on investments by pension funds in Member States.

2.1 Harmonisation of company taxation

The full benefits of the liberalisation of capital movements will not be obtained if investment decisions are distorted by significant differences in company taxation between Member States. Such decisions include not only decisions by companies as to where to set up their head office and where to do business, but also decisions by shareholders and individual investors as to where to place their funds.

The Commission takes the view that these distortions should be substantially reduced by a closer approximation of the systems, the taxable base and, tax rates of company taxation in the different Member States. Its approach to this issue will be set out fully in a White Paper on the taxation of enterprises to be issued before the end of this year. The Commission will take as the starting point the Directive for the harmonization of company taxation systems which it put forward in August 1975. This proposal will be complemented by a proposal to harmonise the tax base and some aspects of the 1975 proposals will be amended. In particular, the bracket of tax rates then proposed (45%-55%) is now too high in view of recent and prospective developments in Member States.

2.2 Tax Evasion

The final stage of liberalisation of capital movements carries with it a risk of increased tax evasion. This is because investors in all Member States will be able to have investment income paid into bank accounts held by them outside their country of residence and this will heighten the risk that this income will not be declared in their country of residence. The Commission takes the view that an increase in tax evasion would be a matter of serious concern both because of the loss of budgetary revenue and because of the damage to fiscal equity, and that practical measures should be taken to minimise this risk.

Already true for UK

This risk is less in the case of income arising from dividends than from interest from bonds or bank deposits. In the former case, in a large majority of Member States a substantial part of the tax due from the shareholder is deducted at source (usually through a withholding tax) by the company. The proposals in the Commission's 1975 Directive for the harmonisation of corporate taxation would ensure a common Community system for ensuring such a deduction.

The risk is greater in the case of interest income, because most industrial countries either impose no withholding tax at all on such income or exempt non-residents from its application.

Tax evasion already takes place, even where exchange controls have not been removed, and the extent of any increase in evasion, when these controls are removed, must be uncertain. If, as capital movements become completely liberalised throughout the Community, the threat of increased evasion proves substantial two main types of remedy (which are not mutually exclusive) could be considered:

- a generalised withholding tax applied either to all residents and non-residents alike or at least to all Community residents;

- an obligation on banks to disclose information about interest income, received by Community residents, to their tax authorities.

Either of these solutions would ensure that any interest income paid into a bank account within the Community would be taxed. The withholding tax would be administratively more simple. But it would probably have to be levied at a relatively low rate and the revenue would accrue to the country where the income arises. The obligation on banks to declare income would ensure that the taxpayers concerned paid the full tax due to their country of residence. But it could only be operated if banking secrecy requirements, applying in several Member States, were removed.

The problem of fiscal evasion presents Member States with a dilemma. The more effective are any measures taken within the Community to combat such evasion, the greater the risk of capital movements to third countries. A fully effective solution can therefore only be achieved through international agreements either for the more general extension of a withholding tax on interest or for stronger cooperation between fiscal administrations. So far as a generalized withholding tax is concerned, the prospects for such an agreement seem remote at present. As regards stronger cooperation between tax authorities, prospects seem somewhat brighter, since a Convention has now been negotiated in the Council of Europe and in OECD and will soon be open for signature.

Ok ?

Conclusions

The final phase of liberalisation of capital movements entails a risk of increased fiscal evasion. There is no watertight solution to this problem, but everything possible must be done to minimise the risks.

Ok ?

Action to strengthen cooperation between fiscal administrations, e.g. in cases of suspected fraud, would be helpful and should in any case be set in hand. The other two main options are a withholding tax on all forms of interest payment to be paid at least by all Community residents and/or a general obligation on all banks to declare interest income to Community fiscal authorities.

The Council is invited to give its views on these solutions and on any other solutions which may be considered feasible.

2.3 Discriminatory provisions in national tax systems that provide an incentive for private individuals to invest in national securities

PEls?

There has been an increasing tendency in Member States in recent years to introduce tax incentives for the purchase of domestic securities (shares and bonds). These measures could be regarded as discriminatory and might lead to distortions in capital movements and to a misallocation of capital investment. Such measures may take the form of a deduction from taxable income of sums invested in such securities, generally up to a specific ceiling, and/or of an exemption, likewise normally subject to a specific ceiling, for income arising from such securities. They are normally limited over time.

The Commision takes the view that such distortions should be eliminated. It is proposing to open discussions with the Member States concerned with the view to imposing a standstill and gradually removing any distortion or discrimination. In the latter case Member States would have the choice of discontinuing the tax concession or extending it to securities issued in other Member States.

2.4 Restrictions on investments by pension funds in Member States

Dahl

Some Member States do not allow pension funds to invest in foreign securities, or restrict their scope for doing so, thereby impeding the free movement of capital.

The Commission is aware that some form of prudential supervision might be justified in the case of pension funds. However, the restrictions are, in its view, excessive. It is planning to start discussions with the Member States concerned with a view to their gradual removal.

Good?

3. The Relationship between liberalisation of capital movements and the EMS

Full participation in the exchange rate mechanism of the EMS and liberalisation of capital movements are complementary. On the one hand liberalisation can be undertaken because of the support given by the System to the stabilisation of exchange rates. On the other hand, liberalisation increases the need to fully co-ordinate policies and hence requires a strengthened System. Those countries which do not fully participate and which have not liberalised capital movements should complete the two processes in parallel.

Sterling present a different case. The UK has fully liberalised capital movements but does not participate in the exchange rate mechanism. This has a number of disadvantages both for the UK, its closest partners, and for the Community as a whole.

- For the UK it has been recognised that the exchange rate is a valuable policy target and the authorities maintain a degree of stability vis-à-vis the Community currencies. The credibility of this policy would however be enhanced if it were formalised.

- For its closest partners, Ireland especially, which has very close commercial and financial links with the UK, sterling's non-participation causes problems. The very large potential for capital flows between the two countries has made it more difficult for Ireland to move fully towards liberalisation of capital movements.

Made worse if £ joined the ERM

- For the Community as a whole, the overall purpose is to complete a large internal market. This goes beyond the establishment of a free trade area and a zone of unimpeded capital mobility and requires exchange rate stability throughout the European financial area. The creation of an integrated financial area implies a degree of joint management through a reasonably homogeneous regulatory and supervisory framework and close and structured co-ordination between monetary authorities.

SEC (87) 1660

PROPOSAL FOR A COUNCIL DIRECTIVE FOR THE IMPLEMENTATION OF ARTICLE 67 OF THE EEC TREATY

(Liberalization of capital movements)

(presented by the Commission to the Council)

PROPOSAL FOR A COUNCIL DIRECTIVE

for the implementation of Article 67 of the Treaty.
Liberalization of capital movements

EXPLANATORY MEMORANDUM

I. General aims

1. This proposal for a Directive is the main element implementing the second phase of the programme for the liberalization of capital movements, which the Commission set out in its communication to the Council of 21 May 1986 (1).

Its aim is to lay down arrangements for the complete liberalization of capital movements in accordance with the objective of completing the internal market set by the Single Act.

A further two proposals which the Commission regards as closely complementing the present one are being presented to the Council at the same time. They concern :

- revision of the provisions governing the Community instruments for providing medium-term support for Member States' balances of payments and the widening of their scope (2);

- amendment of the Directive of 21 March 1972 on regulating international capital flows and neutralizing their undesirable effects on domestic liquidity (3).

2. The present proposal forms part of a broader approach involving the implementation at Community level of two other types of measure :

a) Full convertibility of the Community currencies as between themselves represents a vital step towards monetary integration in the Community. In that context, maintenance of exchange rate stability, which is also necessary for the completion and viability of the large internal market, calls for closer coordination and convergence of Member States' economic policies. The package of measures to strengthen the EMS agreed by the Central Bank Governors and the Ministers for Economic and Financial Affairs in September will contribute to greater cohesion of the system in a financial environment which has become much more fluid.

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(1) Doc. COM(86) 292 final
(2) Doc. COM(..) ...
(3) Doc. COM(..) ...

../..

b) Free movement of capital is a necessary but not a sufficient condition for setting up an efficient, stable and attractive Community financial system. Though not a prerequisite, it is important that a framework of harmonized rules - proposals for which have, incidentally, been put forward by the Commission - should be established by 1992 in the prudential and tax fields. The aim in these fields is to bring about effective freedom to provide financial services while at the same time guaranteeing an adequate level of protection for savers, satisfactory competitive conditions and tax systems which are sufficiently close as to rule out the danger that the functioning of the capital market will be unduly distorted.

3. Free movement of capital will impose a more pronounced external constraint on the conduct of Member States' monetary policies. The effect of this will be attenuated by cooperation within the EMS. Some room for manoeuvre must be retained, however, to allow Member States to maintain adequate control of monetary regulation when faced with major financial disburbances. The safeguard clauses in the Treaty are not enough.

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In the financial integration process, not all States are starting from the same position. This might be because they have only recently joined the Community, because of difficulties with their balance of payments, because of a high level of external debt, or because their domestic financial system is less developed. Transitional arrangements must be made for those with the greatest leeway to make up.

4. In accordance with Article 69 of the Treaty, the Commission has consulted the Monetary Commitee on this proposal for a Directive, the content and scope of which are explained below.

II. Extension of the requirement to liberalize capital movements

1. The proposal aims to extend the liberalization requirement to all capital movements.

The unconditional liberalization requirement, which currently applies to the capital movements contained in List A of Annex I to the Directive in force (as last amended by Directive 86/566/EEC of 17 November 1987), would therefore be extended to :

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- the capital movements contained in Annex I, List B, which are currently subject to conditional liberalization in the sense that Member States may, if the liberalization of those operations is such as to form an obstacle to the achievement of their economic policy objective, continue to apply or reintroduce exchange restrictions on such capital movements, provided that they were operative on the date of entry into force of the Directive or on the date of accession;

- the capital movements which are contained in Annex I List C, and which Member States are not required to liberalize.

2. The possible approach of breaking down the last stage of the liberalization of capital movements into a number of phases, depending on the nature of the operations in question, did not seem justified in terms of exchange-rate policy.

a) The present border line between liberalized and non-liberalized operations corresponds to threshold beyond which it is difficult to differentiate between groups of operations which are both significant and coherent enough to permit gradual liberalization.

b) Some Member States have admittedly gone beyond current Community obligations, taking measures which partially and selectively liberalize short-term capital movements. But those measures are essentially a relaxation of the supervisory procedures applying to such operations when they are directly linked to current transactions or to liberalized capital movements. Although such measures relaxation may have considerable practical significance, it would be difficult to consolidate their use at Community level without establishing rules which were very detailed and hence very rigid in their application.

3. Imposition of the same liberalization requirement in respect of all capital movements obviates the need for different lists. The Commission considers, however, that it would be useful to retain a general nomenclature of capital movements, together with explanatory notes, in order to define the various categories of capital movement and to have available a convenient source of references for the possible application of derogations from the liberalization arrangements (1). This annex is referred to in Article I of the proposed Directive.

III. Formulation and general scope of the liberalization requirement

1. The Commission proposes that Article 1 of the Directive contains a general, composite formulation of the liberalization requirement based directly on Article 67 (1) of the Treaty.

Article 1 also stipulates that transfers in respect of movements of capital must be effected on the same exchange-rate conditions as those ruling for current payments. A two-tier exchange-market system could therefore be introduced or maintained only under the conditions and according to the procedures relating to the use of a safeguard clause, laid down in the provisions of the Treaty or in those of the present proposal for a Directive (see point IV-3 below).

2. Notwithstanding the extension of the scope of the liberalization requirement to all capital movements, the proposed change in wording does not, in the Commission's view, alter its nature. It should, however, provide the opportunity of removing any ambiguity which might remain despite the decisions of the Court of Justice on this subject.

a) The liberalization requirement implies not only the abolition of restrictions on transfers in respect of movements of capital (actual exchange restrictions) but also the abolition of any measure which limits the possibility of the underlying transaction being concluded or performed between residents of different Member States.

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b) Without prejudice to the measures for coordinating national provisions at Community level to facilitate the effective exercise of the free movement of capital, each Member State applies its own domestic rules and regulations to the operations in question in a non-discriminatory fashion.

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(1) The proposed technical amendments to this Nomenclature are set out at point VI below.

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The liberalization of capital movements therefore gives a resident of one Member State the right to access to the financial system of another Member State in order to conclude investment, placement, lending or borrowing operations there. It must be accepted that, in so doing, he agrees to comply with the regulatory framework of the financial market or financial institutions with which he is dealing and that the rules of his country of residence cannot be invoked in order to protect him (1).

c) Financial institutions should be able to benefit from the free movement of capital in the same way as other residents of the Community. As they manage funds entrusted to them and draw on the savings of the public, however, there may be some justification for imposing certain rules on their investments or borrowings in order to protect those savings. Such rules will cover, for example, the composition of the assets that a collective investment undertaking or an institutional investor may hold in its portfolio, the various ratios imposed on credit institutions or the amount and nature of insurance company reserves.

The Commission's position is that these rules should not as a matter of principle, discriminate between operations according to whether they take place between residents of the same Member States or with residents of other Member States. Restrictions on capital movements to and from other countries would be permissible only in exceptional circumstances and if they are essential for the attainment of the objective in view. Each case must be assessed individually in the light of the activity engaged in by each type of financial institution, although two general criteria can be adopted to begin with :

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(1) A resident's right of access, under the rules governing the free movement of capital, to the financial system of another Member State should be distinguished from the conditions under which a financial institution established in one Member State may provide services in another Member State. Those conditions are governed by the provisions of the Treaty and of secondary Community legislation relating to freedom of establishment and freedom to provide services, as interpreted by the decisions of the Court of Justice in that field.

- The exchange risk : for example, the setting of rules concerning the exchange position of credit institutions seems justified, since institutions which incur exchange risks in connection with the funds which they raise find themselves in such a position for reasons which are not directly connected with the nature of their activities.

- The guarantee offered by the various investments : here the assessment should depend on the nature of the investment (shares or bonds; public or private securities; the question of whether or not securities are dealt in on a stock exchange) rather than on the place where the investment is made.

While such measures have an impact on capital movements, they essentially fall within the scope of work to harmonize the prudential rules undertaken with a view to facilitating effective freedom to provide financial services.

d) In accordance with Article 67 § 1 of the Treaty, the free movement of capital implies the abolition of all restrictions on the movement of capital and hence, in particular, the elimination of any discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested.

In a recent decision (1), the Court of Justice adopted in this connection the interpretation that Article 67 §1 applied in full to capital operations unconditionally liberalized by the Directive in force. Afterall, it is certain that the objective of fully liberalizing capital movements could not be attained if the administrative and tax authorities were to continue to apply discriminatory measures which reintroduce the segmentation of national markets by indirect means.

However, most Member States have put into effect tax schemes to promote savings and to develop certain forms of investment. Such measures have usually been adopted in pursuit of legitimate economic objectives; they may nevertheless have discriminatory effects.

In the Commission's opinion, a pragmatic approach should be adopted with a view to adapting national tax schemes to the requirements of Community law; this would involve closer monitoring of the tax measures having a bearing on the formation of, and income from, savings and a case-by-case examination of the nature and extent of their discriminatory effects.

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(1) Judgment of 24.6.1987 in Case 157/85 (Brugnoni-Ruffinengo)

3. Article 4 of the proposal for a Directive confirms the right of Member States to take all requisite measures to prevent infringements of their laws and regulations. They will be free to establish declaration procedures to enable them to keep track of capital movements to or from other countries, e.g. for tax reasons or simply for statistical purposes. It is stipulated, however, that such measures must not have the effect of impeding the capital movements in question.

IV. Provisions governing the regulation of capital movements on grounds of domestic monetary policy

1. All the Member States will have to adapt their conduct of monetary policy, albeit to differing degrees, to the new requirements created by the complete liberalization of capital movements. In order to facilitate that adaptation while complying with exchange-rate disipline, the Commission feels that Member States need to be allowed some room for manoeuvre and, to this end, has included two types of provision in the proposal for a Directive.

2. In order to regulate bank liquidity, Member States may be obliged to take measures affecting capital movements to and from other countries carried out by credit institutions : rules governing their net external position or the setting of specific reserve ratios for their assets or liabilities.

Article 2 of the proposal empowers Member States to deploy such monetary policy instruments subject to a posteriori Community monitoring : any measures taken are to be notified to the Commission, the Monetary Committee and the Committee of Central Bank Governors; possibility open to the Commission to ascertain whether such measures go beyond what is necessary for purposes of domestic monetary regulation and, if so, to institute any procedure for removing or amending them that is provided for in the Treaty.

3. Article 3 of the proposal constitutes a specific safeguard clause permitting Member States to take limited and temporary protective measures where short-term capital movements on an exceptional scale seriously disrupt the conduct of monetary and exchange-rate policies. The safeguard clause may not be applied or continue to be applied if the disruption in question stems from a marked divergence in economic fundamentals necessitating a shift in economic policy on the part of the Member State concerned and/or more extensive exchange-control measures.

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The case for authorizing measures to regulate short-term capital movements will have to be assessed in the light of the possibilities offered by other means, in particular monetary cooperation, of dealing with the disturbances observed : coordinated changes in interest rates, intervention on foreign exchange markets, and realignment of central rates if necessary.

a) The Commission considers it necessary to incorporate into the Directive itself a special safeguard clause, since the safeguard provisions of the Treaty (Articles 108 - 109 and Article 73) do not provide the appropriate procedures for a precise response to the situation in question without there being a danger of circumvention.

   - The safeguard clauses in the Treaty cover :

     . situations where a Member State is in difficulties or is seriously threatened with difficulties as regards its balance of payments (Articles 108 and 109); the conduct of a Member State's monetary and exchange-rate policy may, however, be disrupted by short-term capital movements without the overall balance-of payments situation being affected;

     . situations in which the functioning of the capital market is disturbed (Article 73); this concept of the "functioning of capital market" cannot, without taking risks with the law, be interpreted widely to include monetary or exchange rate difficulties connected with short-term operations.

   - The safeguard clauses in the Treaty are not a priori limited as to scope or length of application. In the Commission's view, it is necessary, in the situation under consideration, to impose such limitations in order to guarantee the credibility and convergence of Member States' monetary policies.

   - The procedure for implementing Articles 108 and 109 is relatively cumbersome, whereas rapid measures are required to deal with the strains on monetary and exchange rate policy resulting from short-term capital movements. These measures must fit in closely with all the coordinating procedures existing between monetary authorities, and in the Commission's view, this means that the Committee of Central Bank Governors must also be consulted (there is no provision for this in Article 73).

b) Annex II to the proposal for a Directive lists the operations to which the specific safeguard clause may apply. For the reasons given above and in order that its introduction does not constitute a step backwards in relation to existing Community provisions, it is proposed that the scope of the specific safeguard clause be confined to short-term operations for which liberalization is not at present required :

- short-term financial loans and credits;

- current or deposit account operations;

- operations in units of undertakings for collective investment, investing in securities or other short-term instruments;

- short-term operations in securities (1) or in other instruments normally dealt in on the money market;

- personal loan operations;

- the physical import and export of financial assets (securities referred to above, means of payments).

The measures taken to control these operations may comprise rules on procedures for payment for current operations (forward cover for imports and exports, periods laid down for the acquisition of the foreign currency required to pay for imports or for the surrender of foreign currency derived from exports). This type of rule should not, however, infringe the provisions of Articles 30, 34 and 106 §2 of the Treaty by impeding the smooth functioning of intra-Community trade.

c) With regard to procedure, it is proposed that, at the request of the Member State concerned, the Commission should, after consulting the Monetary Committee and the Committee of Central Bank Governors, authorize, under the circumstances and for the operations indicated above, the application of protective measures the conditions and details of which it would determine.

In urgent cases, the Member State may itself take the measures after informing the Commission and the other Member States, with the Commission having to decide, after consulting the two Committees concerned, whether the Member State in question should amend or discontinue them.

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(1) Unlike bonds, these would normally be securities issued for a period of under two years.

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d) Whatever the method of activating the safeguard clause, the proposal is that it should be applied for not more than a maximum of six months. The Commission considers that, if the disruption to the Member State's monetary and exchange rate policies were to continue beyond that point, this would indicate the existence of more fundamental economic divergences and hence the need for other corrective measures or more extensive controls.

Furthermore, the limited scope of this safeguard clause is likely to mean that the measures taken will become less effective in time because of the induced effects of disintermediation, the migration of such operations or their spillover into longer-term operations.

V. Transitional arrangements for certain Member States

1. It is proposed that the Directive should come into force three months after its adoption by the Council.

2. Not all the Member States, however, are starting from the same position when it comes to embarking upon this last phase in the complete liberalization of capital movements. Four of them - Spain, Portugal, Greece and Ireland - are currently lagging behind in the process of financial integration in the Community for a variety of reasons such as their recent accession to the Community, a precarious current account position, very high external indebtedness or a less-developed domestic financial system.

Under the terms of the 1985 Act of Accession, Spain and Portugal are to benefit from the transitional arrangements for the liberalization of capital movements until the end of 1990 and 1992 respectively. When Directive 86/566/CEE of 17 November 1986 was adopted, it was agreed to extend those transitional arrangements to the newly liberalized operations.

On expiry of the transitional arrangements that were also introduced for them on their accession to the Community, Ireland and Greece were obliged, in response to balance-of-payments difficulties, to invoke the safeguard clause in Article 108 of the Treaty in order to defer liberalization of a number of categories of capital movements. Protective measures are still in force on the date of this proposal's transmission to the Council.

3. In order that those Member States may continue their efforts to adapt to the constraints imposed by the complete liberalization of capital movements, and in accordance with

Article 8 C of the Treaty, it is proposed that the Directive should grant them more time to implement the new liberalization requirements arising from it (Article 6).

By analogy with the duration of the transitional arrangements provided for in the Act of Accession and in view of the economic situation in each of those countries, it is proposed that the following deadlines be set :
- end of 1990 for Spain and Ireland;
- end of 1992 for Portugal and Greece.

These deadlines are still compatible with the timetable laid down by the Single Act for completing the internal market.

The transitional arrangements provided for in Directive 86/566/CEE in respect of Spain and Portugal have been incorporated unchanged into the new proposal. Those benefiting Ireland and Greece should apply without prejudice to decisions adopted by the Commission under Article 108 §3 of the EEC Treaty. The resulting arrangements for the four Member States concerned are set out in Annex IV.

4. The references to the 1960 Directive in the 1985 Act of Accession will have to be interpreted as relating to the provisions of the new directive in view of the proposed amendments to the nomenclature of capital movements and the abolition of the breakdown by list.

<u>In the interests of transparency</u>, it is proposed to indicate in the Directive (Annex II, referred to in Article 5) <u>the scope for Spain and Portugal of the provisions of the 1985 Act of Accession</u> in the new Nomenclature of capital movements.

VI. <u>Technical amendments to the Nomenclature of capital movements and the Explanatory Notes (Annex I to the proposal for a Directive</u>)

1. The application of uniform liberalization arrangements to all capital movements reduces the need for a detailed nomenclature and a precise definition of the various categories of operation. The Commission considers, however, that such a nomenclature should be retained in the Directive, since it would enable its scope to be clarified - the concept of capital movement not being defined by the Treaty - and the exceptional arrangements that may be made for certain Member States to be administered more easily.

The proposed amendments are intended to simplify or supplement the existing nomenclature in the light of experience.

2. The nomenclature of capital movements would be preceded by an introduction setting out common rules governing the scope of the various categories of operations.

3. It is proposed that operations in securities should be grouped, according to their nature, under three headings:

a) Operations in securities normally dealt in on the capital market : shares and other securities of a participating nature and bonds, whether or not dealt in on a stock exchange. The present definition of bonds would be retained, i.e. the one based on the criterion of a life on issue of two years or more;

b) Operations in units of collective investment undertakings : it would seem appropriate to take the opportunity presented by the revision of the nomenclature to introduce, along the lines of the OECD Code of liberalization of capital movements, a special heading for this category of security. This heading would be further subdivided into :

- undertakings for investment in capital-market securities (shares and bonds);
- undertakings for investment in money-market securities and instruments;
- undertakings for investment in other assets (real estate, commodities, etc.);

c) Operations in securities normally dealt in on the money market, together with other non-securitized money-market instruments. This heading covers in particular Treasury bills, certificates of deposit, commercial paper and bank acceptances. The other non-securitized instruments consist mainly of interbank operations or operations with the central bank.

Each of these headings would be broken down into subheadings so as to distinguish between operations involving admission to the market in question, on the one hand, and operations involving the acquisition (or liquidation) of such securities, on the other.

4. In the Commission's view, there is no need to include new headings or items in the nomenclature to take account of the wide variety of new financial products which have appeared since the first Directive was drafted. The purpose of the nomenclature is to ensure transparency of national arrangements applicable to capital movements and not to draw up a complete list of the financial products in

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use, which would, in any case, rapidly be overtaken by events. Exchange-control systems are based more on a classification of capital movements according to their economic nature and their impact on the balance of payments than on technical operational details. Consequently, the new financial products can, generally speaking, be included under existing nomenclature headings or may be a combination of various basic capital movements.

Thus, "issue facilities" (of the NIF or RUF type) rank as operations in money-market securities or loan operations, as the case may be. More generally, commitments, whether conditional or not, to grant loans should be regarded as falling within the heading corresponding to the type of loan concerned; the heading "sureties, other guarantees", relates to commitments to cover the risk of default by a debtor.

The various techniques nowadays available for trading in different financial instruments (subscription rights, warrants, options, forward contracts, swaps) should be regarded as coming under the heading corresponding to the underlying financial instrument.

Cash purchases and sales of foreign currency do not constitute a specific form of capital movement and cannot be divorced from the underlying (current or capital) operation of which they represent the settlement. The other methods of dealing in currencies - forward operations, options, forward contracts, swaps - can also be treated as special techniques for constituting monetary assets.

The introduction to the nomenclature would make it clear that the various categories of capital movement listed also cover all the financial techniques available for a particular operation on the market used by the borrower or lender.

5. It is proposed that the following amendments be made to the heading "Personal capital movements" :

a) Subheadings F and G, which are difficult to distinguish from each other, would be combined under the title : "Transfers of assets constituted by residents, in the event of emigration, at the time of their installation or during their period of stay abroad".

b) Subheading H would be supplemented as follows : "Transfers, during their period of stay, of immigrants' savings to their previous country of residence".

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c) Subheading M "Transfers of minor amounts abroad" would be deleted. Such transfers do not constitute a specific capital operation but are simply a facility available under a restrictive exchange-control system.

d) For the same reason, subheadings I and L relating to transfers of blocked funds would also be deleted. It would be made clear in the introduction to the nomenclature, however, that the immediate use on the spot or the repatriation of the proceeds of the liquidation of assets belonging to non-residents is unrestricted, since the constitution of such assets is liberalized under the present proposal for a Directive. The opening of blocked accounts for exchange-control reasons should no longer normally occur in operations between Community residents, although the transfer of funds could be suspended temporarily pending the outcome of legal proceedings, particularly in cases in which Article 4 of the proposal for a Directive is applied (infringements of national laws and regulations).

COUNCIL DIRECTIVE

of ....

for the implementation of Article 67 of the Treaty

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 69 thereof,

Having regard to the proposal from the Commission, which consulted the Monetary Committee for this purpose (1),

Having regard to the Opinion of the European Parliament (2),

Whereas Article 8A of the Treaty stipulates that the internal market shall comprise an area without internal frontiers in which the free movement of capital is ensured;

Whereas Member States should be able to take, within the framework of appropriate Community procedures, the requisite measures to regulate bank liquidity and, if necessary, to restrict temporarily short-term capital movements which, even where there is no appreciable divergence in economic fundamentals, seriously disrupt the conduct of their monetary and exchange-rate policies;

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Whereas, in the interests of transparency, it is adbvisable to indicate the scope, in accordance with the Nomenclature laid down in this Directive, of the transitional measures adopted for the benefit of the Kingdom of Spain and the Portuguese Republic by the 1985 Act of Accession in the field of capital movements;

Whereas the Kingdom of Spain and the Portuguese Republic may, under the terms of Articles 61 to 66 and 222 to 232 respectively of the 1985 Act of Accession, postpone the liberalization of certain capital movements in derogation from the obligations of the Directive of 11 May 1960; whereas Council Directive 86/566/EEC of 17 November 1986 also provides for transitional arrangements to be applied for the benefit of those two Member States in respect of their obligations to liberalize capital movements; whereas it is appropriate for those two Member States to be able to postpone the application of the new liberalization obligations resulting from this Directive for the same periods and for the same conomic reasons;

Whereas the Hellenic Republic and Ireland are faced, albeit to differing degrees, with difficult balance-of-payments situations and high levels of external indebtedness; whereas the immediate and complete liberalization of capital movements by those two Member States would make it more difficult for them to continue to apply the measures they have taken to improve their external positions and to reinforce the capacity of their financial systems to adapt to the requirements of an integrated financial market in the Community; whereas it is appropriate, in accordance with Article 8C of the Treaty, to grant to those two Member States, in the light of their specific circumstances, further time in which to comply with the obligations arising from this Directive,

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HAS ADOPTED THIS DIRECTIVE :

Article 1

1. Without prejudice to the following provisions, Member States shall abolish restrictions on the movement of capital taking place between persons resident in Member States. The different categories of capital movement are set out in Annex I to this Directive.

2. Transfers in respect of capital movements shall be made on the same exchange-rate conditions as those ruling for payments relating to current transactions.

Article 2

Member States shall notify the Commission, the Monetary Committee and the Committee of Governors of Central Banks, by the date of the entry into force at the latest, of measures to regulate bank liquidity which have a specific impact on capital operations carried out by credit institutions with non-residents and which involve regulation of the net external positions of such institutions or of the setting of compulsory reserve ratios on their external assets or liabilities.

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Such measures shall be confined to what is necessary for the purposes of domestic monetary regulation.

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Article 3

1. Where short-term capital movements of exceptional magnitude impose severe strains on foreign-exchange markets and lead to serious disturbances in the conduct of a Member State's monetary and exchange-rate policies, being reflected in particular in substantial variations in domestic liquidity, the Commission may, after consulting the Monetary Committee and the Committee of Governors of Central Banks, authorize that Member State to take in respect of the capital movements listed in Annex II to this Directive, protective measures the conditions and details of which the Commission shall determine.

2. The Member State concerned may itself take the protective measures referred to above, on grounds of urgency, should these measures be necessary. The Commission and the other Member States shall be informed of such measures by the date of their entry into force at the latest. The Commission may, after consulting the Monetary Committee and the Committee of Governors of Central Banks, decide that the Member State concerned shall amend or abolish the measures.

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3. The period of application of protective measures taken pursuant to this Article shall not exceed six months.

Article 4

The provisions of this Directive shall not prejudice the right of Member States to take all requisite measures to prevent infringements of their laws and regulations or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information.

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Application of those measures and procedures may not have the effect of impeding the capital movements in question.

Article 5

For the Kingdom of Spain and the Portuguese Republic, the scope, in accordance with the Nomenclature of capital movements contained in Annex I to this Directive, of the provisions of the 1985 Act of Accession in the field of capital movements shall be as indicated in Annex III.

Article 6

1. The Member States shall take the measures necessary for them to comply with this Directive no later than .... They shall forthwith inform the Commission thereof. They shall also make known, by the date of their entry into force at the latest, any new measure or any amendment made to the provisions governing the capital movements listed in Annex I to this Directive.

2. The Kingdom of Spain and the Portuguese Republic, without prejudice for these two Member States to Articles 61 to 66 and 222 to 232 of the 1985 Act of Accession, and the Hellenic Republic and Ireland may temporarily continue to apply restrictions on the capital movements listed in Annex IV to this Directive, subject to the conditions and time limits laid down in that Annex.

Article 7

The Nomenclature of capital movements and the Explanatory Notes in Annex I, together with Annexes II, III and IV, form an integral part of this Directive.

Article 8

The Council Directive of 11 Mai 1960, as last amended by Council Directive 86/566/CEE of 17 November 1986, is hereby repealed.

Article 9

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President

ANNEX I

NOMENCLATURE OF THE CAPITAL MOVEMENTS REFERRED TO IN ARTICLE I OF THE DIRECTIVE

In this Nomenclature, capital movements are classified according to the economic nature of the assets and liabilities they concern, denominated either in national currency or in foreign exchange.

The capital movements listed in this Nomenclature are taken to cover:

- all the operations necessary for the purposes of capital movements: conclusion and performance of the transaction and related transfers. The transaction is generally between residents of different Member States although some capital movements are carried out by a single person for his own account (e.g. transfers of assets belonging to emigrants);

- operations carried out by any natural or legal person*, including operations in respect of the assets or liabilities of Member States or of other public administrations and agencies, subject to the provisions of Article 68 (3) of the Treaty;

- access for the economic operator to all the financial techniques available on the market approached for the purpose of carrying out the operation in question. For example, the concept of acquisition of securities and other financial instruments covers not only spot transactions but also all the dealing techniques available: forward transactions, transactions carrying an option or warrant, swaps against other assets, etc. Similarly, the concept of operations in current and deposit accounts with financial institutions, includes not only the opening and placing of

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* See Explanatory Notes below.

funds on accounts but also forward foreign exchange transactions, irrespective of whether these are intended to cover an exchange risk or to take an open foreign exchange position;

- operations to liquidate or assign assets built up, repatriation of the proceeds of liquidation thereof* or immediate use of such proceeds within the limits of Community obligations;

- operations to repay credits or loans.

I - DIRECT INVESTMENTS *

1. Establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings.

2. Participation in new or existing undertakings with a view to establishing or maintaining lasting economic links.

3. Long-term loans with a view to establishing or maintaining lasting economic links.

4. Reinvestment of profits with a view to maintaining lasting economic links.

A - Direct investments on national territory by non-residents *

B - Direct investments abroad by residents *

II - INVESTMENTS IN REAL ESTATE (not included under I) *

A - Investments in real estate on national territory by non-residents

B - Investments in real estate abroad by residents

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* See Explanatory Notes below.

III - OPERATIONS IN SECURITIES NORMALLY DEALT IN ON THE CAPITAL MARKET (not included under I, IV et V)

(a) Shares and other securities of a participating nature*.

(b) Bonds*.

A - Transactions in securities on the capital market

1. Acquisition by non-residents of domesic securities dealt in on a stock exchange*.

2. Acquisition by residents of foreign securities dealt in on a stock exchange.

3. Acquisition by non-residents of domestic securities not dealt in on a stock exchange*.

4. Acquisition by residents of foreign securities not dealt in on a stock exchange.

B - Admission of securities to the capital market *

(i) Introduction on a stock exchange*.

(ii) Issue and placing on a capital market*.

1. Admission of domestic securities to a foreign capital market.

2. Admission of foreign securities to the domestic capital market.

IV - OPERATIONS IN UNITS OF COLLECTIVE INVESTMENT UNDERTAKINGS *

(a) Units of undertakings for collective investment in securities normally dealt in on the capital market (shares, other equities and bonds).

(b) Units of undertakings for collective investment in securities or instruments normally dealt in on the money market.

(c) Units of undertakings for collective investment in other assets.

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* See Explanatory Notes below.

A - Transactions in units of collective investment undertakings

1. Acquisition by non-residents of units of national undertakings dealt in on a stock exchange.

2. Acquisition by residents of units of foreign undertakings dealt in on a stock exchange.

3. Acquisition by non-residents of units of national undertakings not dealt in on a stock exchange.

4. Acquisition by residents of units of foreign undertakings not dealt in on a stock exchange.

B - Admission of units of collective investment undertakings to the capial market

(i) Introduction on a stock exchange.

(ii) Issue and placing on a capital market.

1. Admission of units of national collective investment undertakings to a foreign capital market.

2. Admission of units of foreign collective investment undertakings to the domestic capital market.

V - OPERATIONS IN SECURITIES AND OTHER INSTRUMENTS NORMALLY DEALT IN ON THE MONEY MARKET *

A - Transactions in securities and other instruments on the money market

1. Acquisition by non-residents of domestic money market securities and instruments.

2. Acquisition by residents of foreign money market securities and instruments.

B - Admission of securities and other instruments to the money market

(i) Introduction on a recognized money market*.

(ii) Issue and placing on a recognized money market.

1. Admission of domestic securities and instruments to a foreign money market.

2. Admission of foreign securities and instruments to the domestic money market.

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* See Explanatory Notes below.

VI - OPERATIONS IN CURRENT AND DEPOSIT ACCOUNTS WITH FINANCIAL INSTITUTIONS *

A - Operations carried out by non-residents with domestic financial institutions

B - Operations carried out by residents with foreign financial institutions

VII - CREDITS RELATED TO COMMERCIAL TRANSACTIONS OR TO THE PROVISION OF SERVICES IN WHICH A RESIDENT IS PARTICIPATING *

1. Short-term (less than one year).
2. Medium-term (from one to five years).
3. Long-term (five years or more).

A - Credits granted by non-residents to residents

B - Credits granted by residents to non-residents

VIII - FINANCIAL LOANS AND CREDITS (not included under I, VII and XI) *

1. Short-term (less than one year).
2. Medium-term (from one to five years).
3. Long-term (five years or more).

A - Loans and credits granted by non-residents to residents

B - Loans and credits granted by residents to non-residents

IX - SURETIES, OTHER GUARANTEES AND RIGHTS OF PLEDGE

A - Granted by non-residents to residents

B - Granted by residents to non-residents

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* See Explanatory Notes below.

X - TRANSFERS IN PERFORMANCE OF INSURANCE CONTRACTS

A - Premiums and payments in respect of life assurance

1. Contracts concluded between domestic life assurance companies and non-residents.

2 Contracts concluded between foreign life assurance companies and residents.

B - Premiums and payments in respect of credit insurance

1. Contracts concluded between domestic credit insurance companies and non-residents.

2. Contracts concluded between foreign credit insurance companies and residents.

C - Other transfers of capital in respect of insurance contracts

XI - PERSONAL CAPITAL MOVEMENTS

A - Loans

B - Gifts and endowments

C - Dowries

D - Inheritances and legacies

E - Settlement of debts by immigrants in their previous country of residence

F - Transfers of assets constituted by residents, in the event of emigration, at the time of their installation or during their period of stay abroad

G - Transfers, during their period of stay, of immigrants' savings to their previous country of residence

XII - PHYSICAL IMPORT AND EXPORT OF FINANCIAL ASSETS

A - Securities

B - Means of payment of every kind

XIII - OTHER CAPITAL MOVEMENTS

A - Death duties

B - Damages (where these can be considered as capital)

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C - Refunds in the case of cancellation of contracts and refunds of uncalled-for payments (where these can be considered as capital)

D - Authors' royalties: patents, designs, trade marks and inventions (assignments and transfers arising out of such assignments)

E - Transfers of the moneys required for the provision of services (not included under VI)

F - Miscellaneous

EXPLANATORY NOTES

For the purposes of this Nomenclature, the following expressions have the meanings assigned to them respectively:

Direct investments

Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity. This concept must therefore be understood in its widest sense.

The undertakings mentioned under I-1 of the Nomenclature include legally independent undertakings (wholly-owned subsidiaries) and branches.

As regards those undertakings mentioned under I-2 of the Nomenclature which have the status of companies limited by shares, there is participation in the nature of direct investment where the block of shares held by a natural person or another undertaking or any other holder enables the shareholder, either pursuant to the provisions of national laws relating to companies limited by shares or otherwise, to participate effectively in the management of the company or in its control.

Long-term loans of a participating nature, mentioned under I-3 of the Nomenclature, means loans for a period of more than five years which are made for the purpose of establishing or maintaining lasting economic links. The main examples which may be cited are loans granted by a company to its

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subsidiaries or to companies in which it has a share, and loans linked with a profit-sharing arrangement. Loans granted by financial institutions with a view to establishing or maintaining lasting economic links are also included under this heading.

Investments in real estate

Purchases of buildings and land and the construction of buildings by private persons for gain or personal use. This category also includes rights of usufruct, easements and building rights.

Introduction on a stock exchange or on a recognized money market

Access - in accordance with a specified procedure - for securities and other negotiable instruments to dealings, whether controlled officially or unofficially, on an officially recognized stock exchange or in an officially recognized segment of the money market.

Securities dealt in on a stock exchange (quoted or unquoted)

Securities the dealings in which are controlled by regulations, the prices for which are regularly published, either by official stock exchanges (quoted securities) or by other bodies attached to a stock exchange - e.g. committees of banks (unquoted securities).

Issue of securities and other negotiable instruments

Sale by way of an offer to the public.

Placing of securities and other negotiable instruments

The direct sale of securities by the issuer or by the consortium which the issuer has instructed to sell them, with no offer being made to the public.

Domestic or foreign securities and other instruments

Securities according to the country in which the issuer has his principal place of business. Acquisition by residents of domestic securities and other instruments issued on a foreign market ranks as the acquisition of foreign securities.

Shares and other securities of a participating nature

Including rights to subscribe to new issues of shares.

Bonds

Negotiable securities with a maturity of two years or more from issue for which the interest rate and the terms for the repayment of the principal and the payment of interest are determined at the time of issue.

Collective investment undertakings

Undertakings:

- the object of which is the collective investment in transferable securities or other assets of the capital they raise and which operate on the principle of risk-spreading, and

- the units of which are, at the request of holders, under the legal, contractual or statutory conditions governing them, repurchased or redeemed, directly or indirectly, out of those undertakings' assets. Action taken by a collective investment undertaking to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such repurchase or redemption.

Such undertakings may be constituted according to law either under the law of contract (as common funds managed by management companies) or trust law (as unit trusts) or under statute (as investment companies).

For the purposes of this Directive, "common funds" shall also include unit trusts.

Securities and other instruments normally dealt in on the money market

Treasury bills and other negotiable bills, certificates of deposit, bankers' acceptances, commercial paper and other like instruments.

Credits related to commercial transactions or to the provision of services

Contractual trade credits (advances or payments by instalment in respect of work in progress or on order and extended payment terms, whether or not involving subscription to a commercial bill) and their financing by credits provided by credit institutions. This category also includes factoring operations.

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Financial loans and credits

Financing of every kind granted by financial institutions, including financing related to commercial transactions or to the provision of services in which no resident is participating.

This category also includes mortgage loans, consumer credit and financial leasing, as well as back-up facilities and other note-issuance facilities.

Residents or non-residents

Natural and legal persons according to the definitions laid down in the exchange control regulations in force in each Member State.

Proceeds of liquidation (of investments, securities, etc.)

Proceeds of sale including any capital appreciation, amount of repayments, proceeds of execution of judgements, etc.

Natural or legal persons

As defined by the national rules.

Financial institutions

Banks, savings banks and institutions specializing in the provision of short-term, medium-term and long-term credit, and insurance companies, building societies, investment companies and other institutions of like character.

Credit institutions

Banks, savings banks and institutions specializing in the provision of short-term, medium-term and long-term credit.

ANNEX II

LIST OF OPERATIONS REFERRED TO IN ARTICLE 3 OF THE DIRECTIVE

Nature of operation	Heading
Operations in securities and other instruments normally dealt in on the money market	V
Operations in current and deposit accounts with financial institutions	VI
Operations in units of collective investment undertakings	IV-A and B(c)
- underakings for investment in securities or instruments normally dealt in on the money market	
Financial loans and credits	VIII-A and B-1
- short-term	
Personal capital movements	XI-A
- loans	
Physical import and export of financial assets	XII
- securities normally dealt in on the money market	
- means of payment	

ANNEX III

REFERRED TO IN ARTICLE 5 OF THE DIRECTIVE

Scope of the provisions of the 1985 Act of Accession relating to capital movements, in accordance with the nomenclature of capital movements set out in Annex I to the Directive

Articles of the Act of Accession (dates of expiry of transitional provisions)	Nature of operation	Heading
	(a) Provisions concerning the Kingdom of Spain	
Art. 62 (31.12.1990)	Direct investments abroad by residents	I-B
Art. 63 (31.12.1990)	Investments in real estate abroad by residents	II-B
Art. 64 (31.12.1988)	Operations in securities normally dealt in on the capital market	
	- Acquisition by residents of foreign securities dealt in on a stock exchange	III-A-2
	. excluding bonds issued on a foreign market and denominated in national currency	
	Operations in units of collective investment undertakings	
	- Acquisition by residents of units of collective investment undertakings dealt in on a stock exchange	IV-A-2
	. excluding units of undertakings taking the form of common funds	

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Articles of the Act of Accession (dates of expiry of transitional provisions)	Nature of operation	Heading
	(b) Provisions concerning the Portuguese Republic	
Art. 222 (31.12.1989)	Direct investments on national territory by non-residents	I-A
Art. 224 (31.12.1992)	Direct investments abroad by residents	I-B
Art. 225 & 226 (31.12.1990)	Investments in real estate on national territory by non-residents	II-A
Art. 227 (31.12.1992)	Investments in real estate abroad by residents	II-B
Art. 228 (31.12.1990)	Personal capital movements	
	(i) for the purpose of applying the higher amounts specified in Article 228 (2):	
	- Dowries	XI-C
	- Inheritances and legacies	XI-D
	- Transfers of assets built up by residents in case of emigration at the time of their installation or during their period of stay abroad	XI-F
	(ii) for the purpose of applying the lower amounts specified in Article 228 (2):	
	- Gifts and endowments	XI-B
	- Settlement of debts by immigrants in their previous country of residence	XI-E
	- Transfers of immigrants' savings to their previous country of residence during their period of stay	XI-G

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Articles of the Act of Accession (dates of expiry of transitional provisions)	Nature of operation	Heading
(cont'd)	**(b) Provisions concerning the Portuguese Republic**	
Art. 229 (31.12.1990)	Operations in securities normally dealt in on the capital market	
	- Acquisition by residents of foreign securities dealt in on a stock exchange	III-A-2
	. excluding bonds issued on a foreign market and denominated in national currency	
	Operations in units of collective investment undertakings	
	- Acquisition by residents of units of foreign collective investment undertakings dealt in on a stock exchange	IV-A-2
	. excluding units of undertakings taking the form of common funds	

ANNEX IV

REFERRED TO IN ARTICLE 6 (2) OF THE DIRECTIVE

I. The Kingdom of Spain and the Portuguese Republic may continue to apply or reintroduce, until 1 October 1989 and 31 December 1990 respectively, restrictions existing on the date of entry into force of this Directive on capital movements given in List I below:

LIST I

Nature of operation	Heading
Operations in units of collective investment undertakings	
- Acquisition by residents of units of foreign collective investment undertakings dealt in on a stock exchange	IV-A-2(a)
. undertakings subject to Directive 85/611/EEC [1] and taking the form of common funds	
- Acquisition by residents of units of foreign collective investment undertakings not dealt in on a stock exchange	IV-A-4(a)
. undertakings subject to Directive 85/611/EEC [1]	

[1] Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ No L 375, 31.12.1985)

II. The Kingdom of Spain and the Portuguese Republic may continue to apply or reintroduce, until 31 December 1990 and 31 December 1992 respectively, restrictions existing on the date of entry into force of this Directive on capital movements given in List II below:

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LIST II

Nature of operation	Heading
Operations in securities normally dealt in on the capital market	
- Acquisition by residents of foreign securities dealt in on a stock exchange	III-A-2(b)
• bonds issued on a foreign market and denominated in national currency	
- Acquisition by residents (non-residents) of foreign (domestic) securities not dealt in on a stock exchange	III-A-3 and 4
- Admission of securities to the capital market	III-B-1 and 2
• where they are dealt in on or in the process of introduction to a stock exchange in a Member State	
Operations in units of collective investment undertakings	
- Acquisition by residents of units of foreign collective investment undertakings dealt in on a stock exchange	IV-A-2
• undertakings not subject to Directive 85/611/EEC [1] and taking the form of common funds	
- Acquisition by residents (non-residents) of units of foreign (domestic) collective investment undertakings not dealt in on a stock exchange	IV-A-3 and 4
• undertakings not subject to Directive 85/611/EEC [1] and the sole object of which is the acquisition of assets that have been liberalized	
- Admission to the capital market of units of collective investment undertakings	IV-B-1 and 2(a)
• undertakings subject to Directive 85/611/EEC [1]	
Credits related to commercial transactions or to the provision of services in which a resident is participating	VII-A and B-3
- Long-term credits	

1 See footnote to List I

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III. The Kingdom of Spain and Ireland, until 31 December 1990, and the Hellenic Republic and the Portuguese Republic, until 31 December 1992, may continue to apply or reintroduce restrictions existing at the date of entry into force of this Directive on capital movements given in List III below:

LIST III

Nature of operation	Heading
Operations in securities dealt in on the capital market	
- Admission of securities to the capital market	III-B-1 and 2
. where they are not dealt in on or in the process of introduction to a stock exchange in a Member State	
Operations in units of collective investment undertakings	
- Admission to the capital market of units of collective investment undertakings	IV-B-1 and 2
. undertakings not subject to Directive 85/611/EEC [1] and the sole object of which is the acquisition of assets that have been liberalized	
Financial loans and credits	VIII-A, B-2 et 3
- medium-term and long-term	

1 See footnote to List I

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IV. The Kingdom of Spain and Ireland, until 31 December 1990, and the Hellenic Republic and the Portuguese Republic, until 31 December 1992, may defer liberalization of the capital movements given in List IV below:

LIST IV

Nature of operation	Heading
Operations in securities and other instruments normally dealt in on the money market	V
Operations in current and deposit accounts with financial institutions	VI
Operations in units of collective investment undertakings	IV-A and B(c)
- undertakings for investment in securities or instruments normally dealt in on the money market	
Financial loans and credits	VIII-A and B-1
- short-term	
Personal capital movements	XI-A
- loans	
Physical import and export of financial assets	XII
- securities normally dealt in on the money market	
- means of payment	

SEC (87) 1659

PROPOSAL FOR A DIRECTIVE AMENDING DIRECTIVE 72/156/EEC ON REGULATING INTERNATIONAL CAPITAL FLOWS AND NEUTRALIZING THEIR UNDESIRABLE EFFECTS ON DOMESTIC LIQUIDITY

(Presented by the Commission to the Council)

PROPOSAL FOR A DIRECTIVE AMENDING DIRECTIVE 72/156/ECC ON REGULATING INTERNATIONAL CAPITAL FLOWS AND NEUTRALIZING THEIR UNDESIRABLE EFFECTS ON DOMESTIC LIQUIDITY

EXPLANATORY MEMORANDUM

I - General objectives

1. The recitals of Directive 72/156/EEC on regulating international capital flows and neutralizing their undesirable effects on domestic liquidity are based on two fundamental concerns :

- the Member States must have available a set of protective instruments for the purpose of discouraging, if they consider it appropriate, untimely flows of short-term capital (in particular to and from third countries) and a set of monetary policy instruments to neutralize their undesirable effects on domestic liquidity;

- they must be able to put these regulatory instruments into operation immediately, without further enabling measures, either individually or within the framework of concerted action by the Member States.

2. These concerns will remain relevant in a situation in which the freedom of capital movements becomes the rule for the Community, the stability of exchange rates between the Community currencies becomes an important aspect for the completion of the internal market and the scale of international capital flows continues to grow. The Community and its Member States must retain the means of taking coordinated action vis-à-vis third countries, in particular in the event of the EMS being subject to violent external monetary shocks. Even though the stability of monetary relationships must first be based on the convergence of monetary policies and the integration of national financial systems, the Member States must still have the technical possibility, if need be, and within the framework of a Community safeguard procedure, of rapid recourse to measures regulating short term capital movements.

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3. With this in view, the amendments to the 1972 Directive are proposed with two objectives in view :

- to ensure that its provisions are consistent with the safeguard provisions of the Directive relating to the liberalization of capital movements (1);
- to specify the conditions for the concerted implementation of the regulatory instruments provided for therein in response to external monetary shocks.

4. The content and the scope of the proposed amendments are presented below.

II - Degree of liberalization vis-à-vis third countries

1. It is proposed that the text of the Directive (the new Article 1) shall include a declaration of intent, which would state that in the arrangements they apply to the conclusion or perfomance of transactions and to transfers in respect of capital movements with third countries, the Member States will endeavour to attain the same degree of liberalization as for operations taking place with residents of the other Member States of the Community.

2. Even though it does not contain a strict legal obligation, such a provision would confirm the wish expressed at Community level for the European financial area to be wide open to the outside world and the practice already very widely followed in this respect by the Member States.

The statement of this principle would mean, in concrete terms, that the Commission would have to be informed of any specific arrangements which the Member States might apply to capital movements to or from third countries and that, as far as necessary, it would use, in this area, the right which it possesses in general to make recommendations to the Member States (Article 1 (2) and (3)).

3. From the Commission's point of view, this solution is preferable to the introduction into Community law, for the Member States to liberalize "erga omnes". Such a commitment - which afterall would be tantamount to granting the Community sole power over capital movements to or from third countries - would have two major disadvantages :

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(1) Proposal for a Council Directive for the implementation of Article 67 (EEC). Doc. COM (87)

a) This commitment entered into unilaterally would be difficult to reverse (unanimity would be required in order to amend the Directive accordingly) and would considerably reduce the room for manoeuvre and negotiation of the Community as a whole, or of the Member States taken separately, in their relations in this area with third countries.

b) The liberalization of capital movements forms part of a larger process of creating an integrated finanial area in the Community. The obligation for Member States to liberalize capital movements vis-à-vis one another can and must be more extensive and more exacting, from certain points of view, than is the case for capital movements to or from third countries (e.g. with respect to the non-discriminatory application of domestic rules on taxation or prudential surveillance).

III - Modification, in terms of their scope, of the instruments regulating international capital flows referred to in the Directive

1. It is proposed (Article 2 (a) of the amended Directive) to supplement the set of instruments regulating short-term financial flows which the Member States must have available, so that the coverage of these instruments is the same as that of the specific safeguard clause laid down in the proposal for a Directive liberalizing capital movements.

2. The regulatory instruments referred to in the 1972 Directive, in its original exacting terms, concern inflows capital almost exclusively. This can be explained by the situation which prevailed at the time, characterized by an inflow of funds into certain European currencies and by the fact that most of the Member States maintained permanent restrictions on outflows of capital of the same nature. In a situation in which the complete freedom of capital movements is the rule , provision must be made for the symmetrical use of regulatory instruments so that, in all cases, a response can be made to short-term capital movements of great magnitude which might lead to serious disturbances in the conduct of the monetary and exchange rate policies of the Member States or threaten the cohesion of the EMS.

3. This adjustment of the scope of the instruments referred to in the Directive would make it possible to guarantee that all the Member States are technically able, if they feel the need or if coordinated action proves necessary, to take the requisite temporary protective measures rapidly.

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The monetary authorities must be able to react immediately if they are to be effective in combating the onset of a bout of speculation.

IV - <u>Amendment of the procedures for implementing the instruments regulating international capital flows</u>

1. The operations to which the regulatory instruments referred to in the Directive can apply will be subject to an unconditional Community obligation for liberalization. It therefore becomes necessary to stipulate (Article 3 (2) of the amended Directive) that these instruments may be put into operation in the case of capital movements between residents of the Member States, only on the conditions and according to the procedures of Community law permitting the restriction of the free movement of capital, the relevant provisions on this matter being :

- in general, the safeguard clauses laid down in the Treaty;
- more specifically,
  - . Article 2 of the Directive for the liberalization of capital movements with respect to the instruments neutralizing the undesirable effect on domestic liquidity of international capital flows (rules covering the net external position of the credit institutions, the fixing of compulsory reserve ratios),
  - . Article 3 of the same Directive with respect to the instruments regulating the short term assets or liabilities of residents placed with non-residents.

2. According to the present exacting terms of the 1972 Directive, the regulatory instruments to which it refers are put into operation chiefly on the individual initiative of the Member States. The latter must nevertheless take account of the interests of their partners and the Commission, in cooperation with the Monetary Committee and the Committee of Governors, must ensure the necessary coordination.

It is proposed introducing into the amended Directive (Article 2 (a)) the possibility of the regulatory instruments being activated on a recommendation from the Commission to the Member States and or to some of them, in the event of short-term capital movements to or from third countries leading to serious disturbances to the stability of exchange rate relationships in the European Monetary System.

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If this recommendation cannot be implemented without also affecting movements of capital between the residents of the Member States, the above mentioned provisions of the liberalization Directive would apply, in particular the maximum length of time for which such measures can be maintained.

V - For the sake of clarity, it has been considered preferable to consolidate into a single text the original exacting terms of Directive 72/156/EEC and the amendments which are made to it by this proposal.

PROPOSAL FOR A COUNCIL DIRECTIVE

amending Directive 72/156/EEC on regulating international capital flows and neutralizing their undesirable effects on domestic liquidity

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

having regard to the Treaty establishing the European Community, and in particular Article 70 (1) therof,

having regard to the proposal from the Commission, which consulted the Monetary Committee for this purpose,

having regard to the Opinion of the European Parliament (1),

whereas by Directive / /EEC (2) for the implementation of Article 67 of the Treaty, the Council established the free movement of capital between the residents of the Member States;

whereas the Member States shall endeavour to attain the highest possible degree of liberalization in respect of movement of capital between the residents of the Community and those of third countries;

whereas by Directive 72/156/EEC (3), the Council established a set of instruments for regulating international capital flows and neutralizing their undesirable effects on domestic liquidity; whereas in view of the fact that the free movement of capital within the Community has been established,

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(1) OJ N° of

(2) OJ N° of

(3) OJ N° L 91 of 18.4.1972, p.13

these instruments may be put into operation in order to regulate short-term capital movements between residents of the Member States of the Community only on the conditions and according to the safeguard procedures laid down in the Treaty and in Directive / /EEC; whereas Directive 72/156/EEC must be amended accordingly;

whereas it must be possible for these instruments to be used on a recommendation from the Commission, in order to ensure coordinated action by the Member States, in the event of short-term capital flows to or from third countries leading to serious disturbances in their domestic monetary situation and in the stability of exchange rate relationships in the European Monetary System;

whereas for the sake of clarity, it is advisable to present in a single text all the exacting terms of Directive 72/156/EEC, as amended by this Directive,

HAS ADOPTED THIS DIRECTIVE :

ARTICLE 1

?? The exacting terms of Directive 72/156/EEC shall be replaced by the following :

"Article 1

1. In the arrangements which they apply to the conclusion or performance of transactions and to transfers in respect of capital movements with third countries, the Member States shall endeavour to attain the same degree of liberalization as in the case of operations taking place with residents of the other Member States of the Community.

2. The Member States shall inform the Commission of the restrictions which they impose on movements of capital to or from third countries at the date of entry into force of this Directive, and of any subsequent change to these provisions.

3. The Commission may make recommendations to Member States on this subject.

Article 2

The Member States shall take all necessary measures to ensure that the monetary authorities have available the following instruments and are able, where necessary, to put them into operation immediately without further enabling measures :

a) for effective regulation of international capital flows :

- rules governing the constitution of short-term assets or liabilities placed with non-residents and payment of interest on the short-term holdings of non-residents;

- regulation of short-term financial loans and credits granted to or contracted with non-residents;

b) for the neutralization of those effects produced by international capital flows on domestic liquidity which are considered undesirable :

- regulation of the net external position of credit institutions,

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- fixing minimum reserve ratios, in particular for the holdings of non-residents.

Article 3

1. The Member States shall forthwith adopt the necessary measures to comply with this Directive. They shall forthwith inform the Commission thereof.

2. Each Member State shall, where necessary, and taking account of the interests of the other Member States, apply all or some of the instruments mentioned in Article 2.

When these instruments apply to movements of capital occurring between residents of the Member States of the Community, they may be put into operation only on the conditions and according to the procedures laid down in the provisions of the Treaty relating to the use of a safeguard clause or in the provisions of Article 2 and 3 of Directive / /EEC for the implementation of Article 67 of the Treaty.

Without prejudice to these provisions, the Commission may recommend to the Member States that all or some of the instruments mentioned in Article 2 be put into operation, in the event of short-term capital flows to or from third countries leading to serious disturbances in the domestic monetary situation and in the stability of exchange rate relationships in the European Monetary System.

3. When the instruments mentioned in Article 2 are applied, the Commission shall ensure close coordination between the authorities of the Member States.

Article 4

In exercising the powers which are conferred upon it by this Directive, the Commission shall act in consultation with the Monetary Committee and the Committee of Governors of Central Banks.

Article 5

This Directive is addressed to the Member States."

ARTICLE 2

This Directive is addressed to the Member States.

Done at Brussels,

For the Council,

The President

SEC (87)1661

PROPOSAL FOR A COUNCIL REGULATION

establishing a single facility providing
medium-term financial support for
Member States' balances of payments

(Presented by the Commission to the Council)

PROPOSAL FOR A COUNCIL REGULATION

establishing a single facility providing
medium-term financial support for
Member States' balances of payments

EXPLANATORY MEMORANDUM

In December 1984, when extending for a further two years the machinery for medium-term financial assistance (MTFA), the Council, in a statement, expressed the opinion that opportunities for the combined use of that machinery with the other instrument for medium-term balance-of-payments support, the Community loan mechanism, should be exploited.

On adoption of Regulation (EEC) No 1131/85 of 30 April 1985, which raised the ceiling on Community loans, the Commission followed up Parliament's opinion by issuing a statement announcing to the Council its intention of examining the two Community facilities for medium-term balance-of-payments support with a view to:

(i) assessing their purposes and the arrangements for applying them;

(ii) exploring possibilities for improving the links between them or even for merging them into a single facility;

(iii) complying with the Council's desire, expressed in its statement of December 1984, for a reduction of 2 000 million ECU in the amount available under the MTFA machinery in view of the corresponding increase in the ceiling on Community loans.

In December 1986, on the occasion of the last two-year extension of the MTFA machinery, the Council adopted a Commission proposal putting into effect the aforementioned reduction (see Decision 86/656/EEC of 22 December 1986) and took the opportunity to reaffirm the desirability of establishing a link between the MTFA machinery and Community loans.

Furthermore, in its programme for the liberalization of capital movements in the Community (see the Commission's communication to the Council: COM (86) 292 Final of 23 May 1986), the Commission stated that the Community, through its instruments for supporting balances of payments, must be able to offer Member States which are faced with special constraints the means of overcoming these difficulties so as to enable them to take part in the full process of capital liberalization.

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For the past two years, Commission departments, along with the Monetary Committee, have been able to examine the operation of those two Community facilities, the conditions and the financing arrangements attaching to each of them, and the reasons for the relatively infrequent use of the MTFA machinery. Their work, together with experience in granting balance-of-payments loans and the prospect of embarking on the final stage in the liberalization of capital movements, has enabled the Commission to identify the conditions and arrangements that should govern the facilities in future.

The Commission has decided to propose to the Council the establishment of a single medium-term financial support (MTFS) facility that will serve a wider purpose, combining the two existing mechanisms while retaining their specific financing arrangements.

The main features of the proposed facility are described below.

1. <u>The MTFS facility as a means of supporting balances of payments</u>

Medium-term financial support would still be basically a conditional financing facility to be deployed if a Member State were experiencing or seriously threatened with balance-of-payments difficulties. It would to that extent constitute the main form of the mutual assistance provided for in Article 108 of the EEC Treaty and could thus be activated by a Commission recommendation. That is the procedure in the case of the present MTFA machinery.

Nevertheless, a Member State experiencing or foreseeing serious balance-of-payments problems could take the initiative in seeking Community assistance, as long as it submitted a recovery programme in support of its application. That is the present procedure for Community loans.

Pursuant to Article 108, the facility itself could be activated only by a decision of the Council, acting by qualified majority on a Commission proposal adopted after consultation with the Monetary Committee and specifying the amount, duration and techniques for disbursing the loan (single payment or by instalments) and the economic policy conditions attaching to it.

2. <u>The MTFS facility as a means of providing back-up for the liberalization of capital movements</u>

The Commission proposes that it should also be possible to activate the MTFS facility for the benefit of a Member State committing itself to implementing a programme of capital liberalization despite a fragile external situation.

The facility would be activated on the basis of this commitment and provided that the Member State put forward a coherent back-up programme focussing primarily on the main thrust of monetary and budgetary policy and on whatever measures might be required to adapt the national financial system. If the Member State does not participate in the EMS exchange-rate mechanism, support may be made subject to its accepting some degree of exchange-rate discipline.

The purpose of granting financial support would be to discourage speculation and to guarantee the beneficiary Member State access to Community financing, if need be.

To this end, it is proposed that appropriate changes be made to the techniques for disbursing financial support. Assistance would take the form either of a credit line or of an undertaking to grant a loan, both valid for a fixed period (specified in the grant decision but not normally exceeding one year), with the resources being made available at the request of the beneficiary Member State when they were actually needed. Loan maturities would be fairly short: one year, with the possibility of a further one year renewal.

If exchange controls were introduced (or reintroduced) during the term of the loan, consolidation would be possible only within the framework of a longer-term conditional balance-of-payments loan granted under the mutual assistance procedure of Article 108, i.e. examination of the situation by the Commission, economic policy recommendations for the Member State concerned, and the introduction of a recovery programme.

3. <u>Sources of finance for the facility</u>

As a general rule, loans granted under the renovated facility would be financed as a priority, from Community borrowings on capital markets. This method of financing, at present used for Community loans, is extremely flexible and provides scope for exploiting all the financial innovations available on international markets.

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However, for the Community, the transaction would be financially neutral: there would be no transaction cost, no exchange-rate or interest-rate risk, and no cash management.

In view of the Community's borrowing capacity and its credit rating, the market should generally prove to be a satisfactory source of financing for all Community lending fulfilling MTFS criteria. If, however, circumstances are such that recourse to the market is not deemed appropriate, the arrangements for the new facility include provision for Community loans granted in case of balance-of-payments difficulties to be financed from credits specifically advanced for that purpose by Member States. This is the financing method used at present for the MTFA machinery, which represents the consolidation of the credit mechanisms associated with the EMS and must, therefore, be retained.

If financing from the Member States were required, the arrangements for the MTFS facility provide for the Council to lay down in its decision granting the loan the amount of the Member States' contributions as well as the financial conditions relating to the loan.

4. Ceilings for the facility

The outstanding amount of borrowing on capital markets for the purposes of the MTFS facility would be limited to ... 000 million ECU in principal. This is considerably higher than the present ceiling of 8 000 million ECU on Community loans; the increase is justified because:

(i) under the new facility, market borrowing takes precedence as the method of financing Community support, with Member States' contributions acting only as a safety net; the financing available under the present MTFA machinery (13 925 million ECU) is considered to be interchangeable with the financing available under the Community loan mechanism;

(ii) the recent enlargement of the Community has increased the potential need for balance-of-payments support for Member States;

(iii) the facility needs to be endowed with sufficient resources for it to fulfil its wider purpose; insofar as the measure accompanies the liberalization of capital movements, it must be able to play fully its role in discouraging potential speculation.

The new facility also sets a commitment ceiling for each Member State, the aim being to limit a priori their contributions, if any, to one or more MTFS loans. The sum of the individual quotas and their apportionment between the Member States is the same as under the present MTFA machinery.

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Finally, as under the existing instruments, there will be a rule limiting each individual Member State's recourse to the MTFS facility: in principle, no Member State may borrow more than 50% of the ceiling on market borrowings authorized for the facility.

5. Arrangements for economic monitoring

The Commission proposes that the arrangements for economic monitoring associated with the present Community loan mechanism should be generalized. The Commission, in collaboration with the Monetary Committee, would verify at regular intervals that the recipient Member State was complying with the economic policy conditions attaching to loans under the MTFS facility. Successive instalments would be released by the Commission - or, where appropriate, the Member States - on the basis of the findings of such verification. The Council could decide on any adjustments to be made to the initial economic policy conditions.

6. Duration, financial techniques and loan management

The Commission proposes that the duration of the loans should be laid down in the relevant Council decisions. As a rule, it could not be less than one year, so that the new facility would, without giving rise to any duplication, guarantee a measure of continuity with the other credit facilities available under the EMS. Specific mention would be made of the possibility that MTFS could be made available to consolidate short-term monetary support. Moreover, loans could be granted with the option of early repayment.

Where the loan was financed by market borrowing, it is further proposed that the recipient Member State should be able, in appropriate circumstances, to apply for restructuring of the financial conditions imposed or even refinancing (i.e. a change in lenders). The Commission, after consulting the Monetary Committee, would take all the appropriate steps to oblige, although the original amount and the average duration of the borrowing could not be changed.

There is nothing in the basic Regulation governing the Community loan mechanism to prevent such operations, and experience has shown how useful they can be. The Commission feels that it is worth taking the opportunity afforded by this revision of the rules to introduce explicit arrangements for them.

Under the new facility, the Commission proposes simplifying the present MTFA procedures, according to which a Member State can be exempted from contributing to the financing of Community support or can mobilize its claim.

A Member State which maintains that difficulties exist or can be foreseen as regards its balance of payments could be exempted from contributing to the financing of the MTFS facility by a Council decision taken on the basis of a proposal from the Commission which, to that end, would consult the Monetary Committee. Similarly, a Member State experiencing balance-of-payment difficulties or a sudden contraction in its foreign currency reserves could request mobilization of its claim. On a proposal from the Commission, which would have consulted the Monetary Committee, the Council would decide on the principle of mobilization; mobilization would be effected by refinancing from Community borrowings on the financial markets or, failing that, by a transfer of claims to other creditor Member States or by early repayment by the debtor Member State. However, the procedures under the existing MTFA machinery which explicitly provide and arrange for the possibility of concerted action with other international organizations for the purpose of mobilization would appear to be superfluous in the present situation.

PROPOSAL FOR A COUNCIL REGULATION

PROPOSAL FOR A COUNCIL REGULATION

establishing a single facility providing medium-term financial support for Member States' balances of payments

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THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Articles 108 and 235 thereof,

Having regard to the proposal from the Commission, which consulted the Monetary Committee for this purpose,

Having regard to the Opinion of the European Parliament,[1]

Whereas Article 108 of the Treaty provides for the granting of mutual assistance, to be decided by the Council on a proposal from the Commission, to a Member State in difficulties or seriously threatened with difficulties as regards its balance of payments; whereas the Resolution of the European Council of 5 December 1978 on the establishment of the European Monetary System (EMS) and related matters confirmed the need for a Community facility for medium-term financial assistance of balances of payments;

Whereas it should be possible for the operation of lending to a Member State to take place soon enough in order to encourage that Member State to adopt, in good time, measures likely to prevent the occurence of an acute balance-of-payments crisis;

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1 O.J. No...... of ....

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Whereas a financing facility, in the form of a credit line or a loan commitment to a Member State undertaking to implement a capital liberalization programme despite a fragile balance-of-payments situation, should provide back-up for such a programme in orderly exchange-rate conditions;

Whereas each loan to a Member State must be linked to the adoption by that Member State of economic policy measures designed to re-establish or to ensure a sustainable balance-of-payments situation and adapted to the gravity of the balance-of-payments situation in that State and to the way in which it develops;

Whereas appropriate procedures and instruments should be provided for in advance to enable the Community and Member States to ensure that, if required, medium-term financial support is provided quickly, especially where circumstances call for immediate action;

Whereas, in order to finance the support granted, the Community needs to be able to use its creditworthiness to borrow resources that will be placed at the disposal of the Member States concerned in the form of loans; whereas operations of this kind are necessary to the achievement of the objectives of the Community as defined in the Treaty, especially the harmonious development of economic activities in the Community as a whole; whereas the Treaty makes no provision for the specific powers of action required for this purpose;

Whereas by Decision 71/143/EEC [1], as amended by Decision 86/656/EEC [2], the Council set up machinery for providing medium-term financial assistance that was initially valid for

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[1] O.J. No L 73 of 27.3.1971, p. 15.

[2] O.J. No L 382 of 31.12.1986, p. 28.

a period of four years from 1 January 1972; whereas this machinery has since been renewed and extended, on the last occasion for two years until 31 December 1988 by Decision 86/656/EEC; whereas this machinery provides for the Member States to grant medium-term loans, within certain limits, to one or more Member States experiencing balance-of-payments difficulties;

Whereas by Regulation (EEC) No 682/81 [1], as amended by Regulation (EEC) No 1131/85 [2], the Council set up a Community loan mechanism designed to support the balances of payments of the Member States; whereas this mechanism provides for the Community to contract loans, according to needs and within the limits set on outstanding borrowing, in order to on-lend the proceeds to one or more Member States experiencing balance-of-payments difficulties;

Whereas the Community loan mechanism has demonstrated its effectiveness; whereas its general design and the arrangements for implementing it still meet the needs of the Community; whereas, in view of the Community's borrowing capacity and of the conditions available to it for borrowing from financial institutions or on capital markets, the mechanism could constitute the main form of mutual assistance provided for under Article 108 of the Treaty; whereas it could also constitute, under certain conditions and in an appropriate form, an instrument to provide back-up for a programme of capital liberalization; whereas the ceiling on amounts outstanding under the mechanism should be adjusted accordingly;

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1 O.J. No L 73 du 19.3.1981, p. 1
2 O.J. No L 118 du 1.5.1985, p. 59

Whereas, however, it is appropriate that the obligation on Member States to finance mutual assistance under the machinery for medium-term financial assistance stay in force until the final stage of the European Monetary System so as to ensure that System's cohesion and stability, irrespective of the conditions prevailing on international capital markets; whereas the present procedures for exempting a Member State from contributing or for mobilizing Member States' claims should, nevertheless, be simplified;

Whereas it is appropriate to merge medium-term financial assistance and the Community loan mechanism into a single facility for medium-term financial support, while retaining their specific methods of financing;

HAS ADOPTED THIS REGULATION:

Article 1

1. In accordance with the decision adopted by the Council pursuant to Articles 3 or 4 and after consulting the Monetary Committee, the Commission shall be empowered to contract loans on the capital markets on behalf of the European Economic Community, with the aim of lending the proceeds to one or more Member States which are experiencing or seriously threatened with balance-of-payments difficulties or which have undertaken to implement a programme of capital liberalization despite a fragile balance-of-payments situation.

2. The outstanding amount of loans to be granted to Member States pursuant to paragraph 1 shall be limited to ... 000 million ECU in principal.

Article 2

Where a Member State proposes to call upon sources of conditional financing outside the Community, it shall first consult the Commission and the other Member States in order to examine, among other things, the possibilities available under the Community facility for medium-term financial support. Such consultations shall be held within the Monetary Committee.

Article 3

1. On the initiative of the Commission acting pursuant to Article 108 of the Treaty or of the Member State experiencing balance-of-payments difficulties and seeking a Community loan, the Council, after examining the situation in that Member State and the adjustment programme that it has undertaken to implement, shall decide, as a rule during the same meeting:

   - whether to grant the loan, and the amount of the loan;

   - the average duration of, and the techniques for disbursing the loan, which may be paid in one amount or in several instalments;

   - the economic policy conditions attaching to the loan, with a view to re-establishing a sustainable balance-of-payments situation.

2. If the amount available under the ceiling referred to in Article 1 (2) is insufficient, or if the conditions available on international capital markets are unsatisfactory, Community loans to Member States experiencing balance-of-payments difficulties shall be financed in full or in part by the other Member States, whose contributions in principal may not exeed the ceilings specified in the Annex.

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In such cases, the Council, in addition to taking the decisions referred to in paragraph 1, shall decide on the size of the Member States' contributions to the financing of the loan and on the financial conditions attaching to the credits they make available in that connection. The Council may exempt from contributing any Member State which maintains that difficulties exist or can be foreseen as regards its balance of payments.

Article 4

1. On the initiative of a Member State undertaking to implement a capital liberalization programme despite a fragile balance-of-payments situation, the Council, after examining the situation in that Member State and the back-up programme presented in support of its application, shall decide, as a rule during the same meeting:

   - whether to grant a financing facility, in the form of a credit line or an undertaking to grant a loan, which may be activated at the request of the beneficiary Member State as and when the need arises and for a period that may not normally exceed one year;

   - the overall amount of resources allocated;

   - the back-up measures accompanying the liberalization of capital movements with a view to ensuring a sustainable balance-of-payments situation.

2. Loans drawn under the financing facility and granted pursuant to paragraph 1 shall, as a rule, have a term of one year renewable for a further one-year period.

3. In cases where restrictions on capital movements are introduced or re-introduced during the term of the loan, the latter may be consolidated only within the framework of a longer-term loan granted as mutual assistance pursuant to Article 108 of the Treaty.

Article 5

The Commission shall take the necessary measures to verify at regular intervals, in collaboration with the Monetary Committee, that the economic policy of the Member State in receipt of a Community loan accords with the adjustment or back-up programme and with any other conditions laid down by the Council pursuant to Articles 3 or 4. To this end, the Member State shall place all the necessary information at the disposal of the Commission. On the basis of the findings of such verification, the Commission and, where appropriate, the Member States holding claims under the facility shall release further instalments. The Council shall decide on any adjustment to be made to the initial economic policy conditions.

Article 6

1. Loans granted as medium-term financial support shall have a term of one year or more. They may be granted as consolidation of short-term monetary support made available by the central banks of the Member States.

2. At the request of the beneficiary Member State, such loans may carry the option of early repayment.

3. Normally, no Member State may draw on this facility to the extent of more than 50% of the ceiling referred to in Article 1 (2).

Article 7

1. The borrowing and lending operations referred to in Article 1 shall be carried out using the same value date and shall not involve the Community in the transformation of maturities or in any exchange or interest-rate risk.

   When the borrowings are expressed, payable or repayable in the currency of a Member State, they may be concluded only after consultation with the competent authorities of that Member State.

   Where a Member State receives a loan carrying an early repayment clause and decides to invoke this option, the Commission shall take the necessary steps after consulting the Monetary Committee.

2. At the request of the debtor Member State and where circumstances permit an improvement in the interest rate on the loans, the Commission may, after consulting the Monetary Committee, refinance all or part of its initial borrowings or restructure the corresponding financial conditions.

   Refinancing or restructuring shall not have the effect of extending the average duration of the borrowings concerned or increasing the amount, expressed at the current exchange rate, of capital outstanding at the date of the refinancing or restructuring.

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3. The costs incurred by the Community in concluding and carrying out each operation shall be borne by the beneficiary Member State.

Article 8

1. If one or more Member States that are creditors under this facility experience difficulties as regards their balance-of-payments and/or a sudden decline in their foreign currency reserves, they may request mobilization of their claims. The Council, having due regard to the circumstances, shall decide to mobilize such claims, in particular in accordance with one of the following procedures, or a combination thereof:

   - by refinancing from Community borrowings from financial institutions or on capital markets;

   - by a transfer of the claim to other creditor Member States;

   - by early repayment in full or in part by the debtor Member State or States.

2. Where refinancing takes place in accordance with paragraph 1, the debtor Member State shall agree that its debt, originally denominated in one currency, shall be replaced by a debt denominated in the currency used for the refinancing. Where applicable, the debtor Member State shall bear any additional cost resulting from an alteration in the interest rate and the costs incurred by the Community in concluding and carrying out the operation.

3. Any creditor Member State may arrange with one or more other Member States for the partial or total transfer of its claims. The Member States concerned shall notify the Commission and the other Member States of the transfer.

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4. Any Member State that is a creditor in respect of a loan carrying an early repayment clause shall take the requisite steps where the debtor Member State decides to invoke this option. The Member States concerned shall notify the Commission and the other Member States of the operation.

Article 9

For the application of the ceilings referred to in Articles 1 (2) and 3 (2), the loan operations shall be recorded at the exchange rate of the day on which they are concluded. The repayment operations shall be recorded at the exchange rate of the day on which the corresponding loan was concluded.

Article 10

The Council shall adopt the decisions referred to in Articles 3, 4, 5 and 8, acting by qualified majority on a proposal from the Commission, made after consulting the Monetary Committee on the matter.

Article 11

The European Monetary Cooperation Fund shall make the necessary arrangements for the administration of the loans.

The funds shall be paid only to central banks and shall be used only for the purposes indicated in Article 1.

Article 12

No later than five years after the adoption of this Regulation, the Council shall examine, on the basis of a report from the Commission, after delivery of an opinion by the Monetary Committee and following consultation with the European Parliament, whether the facility established still meets, in its principle, its arrangements and its ceiling, the needs which led to its creation.

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Article 13

1. Regulation (EEC) No 682/81 and Decision 71/143/EEC are hereby repealed.

2. Amounts not yet repaid under outstanding Community loan operations concluded pursuant to Regulation (EEC) No 682/81 before the date of entry into force of this Regulation shall count against the ceiling referred to in Article 1 (2) at their initial value in ECUs.

3. References to the instruments repealed by virtue of paragraph 1 shall be deemed to be references to this Regulation.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Council

The President

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ANNEX

The ceilings for credits provided for in Article 3 (2) shall be as follows:

Member State	Million ECU	% of total
Belgium	875	6.28
Denmark	407	2.92
Germany	2 715	19.50
Greece	235	1.69
Spain	1 132	8.13
France	2 715	19.50
Ireland	158	1.13
Italy	1 810	13.00
Luxembourg	31	0.22
Netherlands	905	6.50
Portugal	227	1.63
United Kingdom	2 715	19.50
Total	13 925	100.00

BRIEF B

20.22

OBJECTIVES

BRIEF B

ECOFIN, 16 NOVEMBER 1987

FUTURE FINANCING

Objectives

This item is on the lunch-time agenda at the UK's request. The Chancellor may therefore be invited to speak first. He will wish in any event to take a leading part in the dicussion.

2. Although Finance Ministers are not the major actors in the future financing negotiation, the ECOFIN Council cannot responsibly neglect the dossier. There are also important messages for the Chancellor to get across in this forum. The main objectives should be:

(i) to signal clearly that we mean business when we say that detailed agreement on effective and binding budget discipline will be a prerequisite for any overall agreement at Copenhagen;

(ii) to underline our conviction that the Community must take this opportunity to make progress in dealing with the major problems which continue to confront us, notably in the areas of agricultural reform, financial control and budgetary imbalances; and

(iii) to encourage Finance Ministers to convey these messages to their ministerial colleagues.

OPENING REMARKS FULL VERSION

NOTES FOR OPENING REMARKS
(fuller version)

1. Most grateful to Presidency for arranging this discussion. Finance Ministers have strong interest in outcome of future financing negotiations. Must therefore be right to exchange views which can then be passed on to colleagues more directly involved.

2. UK Government hopes very much that we shall reach agreement at Copenhagen. We believe that, given the will, this should be possible.

3. Clear, however, that there will be no agreement at Copenhagen without substantive and specific agreement on effective and binding control of expenditure. Important message for us to give our colleagues at home. We need to be sure that any new own resources ceiling which may be set will be maintained and respected. Community must prove that it has the will, and the policy instruments, to achieve this.

4. In key area of agriculture, we now have general recognition that all is not well. As agreed at Fontainebleau, we set guideline limits for 1986 and 1987. We then exceeded the 1986 limit by about 1 billion ecus. In an underlying sense, we shall be exceeding the 1987 limit by some 4 billion ecus. We have not had adequate policy instruments to ensure that the limits could be respected.

5. We cannot go on like this. Four aspects which we must tackle at Copenhagen or before.

- First, the guideline must in future be an absolute and binding constraint on the Community's expenditure. The limit must be a limit. It should be tough but realistic and should rise only modestly over time.

- Second, we must have agreement on stabiliser mechanisms, regime by regime. We need agreement on substance and stringent numbers, not just on general principles.

- Third, we shall need agreement on a foolproof system for monitoring and control of agricultural expenditure, which will ensure that the overall limit and the budgetary provisions for particular product regimes are not exceeded. Have to recognise that budget variations arise not only from production excesses but from other factors. Production stabilisers may well not suffice on their own to keep expenditure within budget provisions. Council and Commission will need to agree on more flexible management powers to ensure that proper control can be exercised.

- Fourth, we must have a proper system for management of stocks. We must have a programme for reducing stocks to appropriate levels and keeping them there. New stocks taken into intervention should be strictly controlled and depreciated in line with market values.

6. All these are matters in which we as Finance Ministers clearly have a special interest. Nor must we lose sight of the continuing need to make the common agricultural policy more responsive to market conditions through decisions taken at the annual price fixing. The OECD's work suggests that our subsidies remain on average well above US levels, though well below Japanese levels.* Our support prices are about three times world price levels for wheat, barley, butter, sugar and oilseeds, and two and a half times world price levels for skimmed milk.

7. In field of non-obligatory expenditure, we likewise have serious problems. These programmes have an important part to play in the Community's development. But they cannot be increased on an arbitary basis bearing no relation to the real

[* See background table 1 below]

needs of member states or to the resources available. Will be important to ensure that the budget discipline for this expenditure which we agreed so laboriously in 1984 is reaffirmed and strengthened. This will leave room for substantial further growth in these programmes on top of the extremely rapid rate of growth since 1984. Additional elements we shall need are:

- First, a reaffirmation of the procedures agreed in 1979 enabling the Council to take coherent budgetary decisions which respect budget discipline;

- Second, a tightening up of financial procedures: in particular, an overall limit on commitment appropriations and strict control of negative reserves.

8. Finally, we have the continuing problem of budgetary imbalances. *
Will be crucially important to ensure that decisions taken at Copenhagen help to solve this problem rather than making it worse. Unrealistic to look for complete solutions overnight; but we must not make things worse.

9. How do the Commission's proposals measure against this criterion? On our calculations, not well. We have an existing pattern of budgetary imbalances in the Community which is difficult to defend. In the UK's case, our underlying imbalance as measured by the VAT/expenditure gap has more than doubled since Fontainebleau. ‡
The effect of the Commission's proposals would be, not to improve the present pattern, with all its manifest imperfections, but to amplify it. The relativities would remain roughly the same. The scale would almost double by 1992. That is not an acceptable prospect. We must find a better way.

10. To sum up, we are not going to solve the Community's problems simply by throwing more money at them. We need to make a reality of the effective and binding budget discipline on which all Heads of Government were agreed at the June European Council. We need to make solid progress on policies, financial management and the distribution of burdens. That is what we shall need to achieve if Copenhagen is to be the success which we all want it to be.

[* see background tables 3 and 4 below.]

[‡ See background table 5 below.]

DEFENSIVE POINTS

1. What increases in own resources ceiling could UK accept?

Our position remains that this issue can be addressed only when we have agreement on how we are going to make a reality of effective and binding budget discipline.

2. UK's prescriptions for agriculture too severe: must have "exceptional circumstances" provision

All past experience suggests that, if we make provision for exceeding the guideline in exceptional circumstances, then it <u>will be</u> exceeded. Correct solution, as so often, is simplest one: <u>no</u> exceptional circumstances.

[IF NECESSARY] Whole point about guideline is that it defines what Community can afford. If additional expenditure were contemplated, therefore, an accompanying [safety-valve] provision would be needed whereby rate of Community funding of this expenditure would be reduced below 100 per cent (as envisaged by M Delors earlier this year).

3. UK's line on non-obligatory expenditure implies no progress in Community

Not so. The Community has reached agreement on substantial increases in R&D expenditure, and structural fund payment appropriations have already been raised by two-thirds in real terms since 1984. Continuation of existing budget discipline in this area would still enable, on our calculations, substantial further increases in the structural funds, subject to the final right of the European Parliament to distribute non-obligatory expenditure between chapters. This could be of the order of 15-20 per cent in real terms over the period to 1992, with substantially higher rates of increase if concentrated on less prosperous member states.

DEFENSIVE POINTS

4. **UK abatement: UK should agree to Commission proposals.**

The Commission's latest communication essentially repeats their February proposals in COM(87)101. We have made clear that these proposals are totally unacceptable. On our calculations, they would leave the UK some 700-900 mecu a year worse off. Would be great mistake to scrap the existing abatement system agreed after so much sturm und drang at Fontainebleau. No realistic prospect of finding agreement on acceptable alternative mechanism limited to one area of the budget.

5. **UK abatement: Nonsense that UK should be compensated for our contribution to administrative and structural fund expenditure.**

Cannot endorse these criticisms. Although main elements in our imbalance problem are our low share of agricultral guarantee receipts (around 7½ per cent) and our high share of own resources contributions (around 18 per cent), we are net contributors to virtually every individual section of the budget.

6. **Attitude to fourth resource proposal**

First task must be to make a reality of effective and binding budget discipline. In any subsequent discussion on own resources, the important point will be to ensure that any changes which may be made will help to alleviate imbalances problem.

7. **Must be agreement at Copenhagen on 1988 budget**

No problem about this if agreement at Copenhagen. If no agreement, essential that any budget for 1988 must genuinely respect the existing own resources limit.

FUTURE FINANCING

BACKGROUND TABLES

1. Agricultural subsidies, US, EC and Japan

2. Relative prosperity: GDP per head

3. Net balances in relation to GDP and population

4. Net balances, 1983 to 1987

5. UK's VAT /expenditure gap, 1983 to 1987

BACKGND TABLES

TABLE 1

AGRICULTURAL SUBSIDES

Producer subsidy equivalents (PSEs)

The OECD Secretariat estimate that the percentages of total farm incomes which have resulted from Government subsidies and support policies in recent years have been as follows:

	per cent	
	1979-81 average	1982-85 average
US	15	22
EC 10	39	36
Japan	55	60

TABLE 2

GDP PER HEAD OF POPULATION AT CURRENT MARKET PRICES (1986)

Index numbers: EC12 = 100

@ MGR		(1) Purchasing power parities	(2) Market exchange rates
1	Luxembourg	172.0	173.7
3	Germany	115.7	136.9
2	Denmark	112.7	143.7
4	France	110.0	121.4
5	Netherlands	106.5	112.0
8	UK	105.6	91.0
6	Belgium	103.2	108.2
7	Italy	102.4	97.1
10	Spain	71.5	54.3
11	Greece	55.4	36.6
9	Ireland	55.2	56.6
12	Portugal	51.6	27.0
	EC12	100	100

+10.1 (i.e. 10% higher)

+45.9 (i.e. 50% higher)

Source Commission figures circulated to COREPER, 3 November.

Comment

Other member states like to argue that, since the UK is now so prosperous, we do not need a special abatement system any longer. As the above series indicate, it is at best unclear whether our relative prosperity is greater than the Community average (ppps are notoriously arbitrary). In any case, no other member state close to average prosperity is expected to shoulder burdens on anything like our scale.

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TABLE 3

NET BALANCES OF MEMBER STATES (AFTER CORRECTION), 1987

	As a percentage of GNP	Per head of population (ECU)
Ireland	4.48	280
Greece	4.13	160
Luxembourg	3.85	815
Portugal	1.01	30
Denmark	0.48	80
Netherlands	0.38	50
Belgium	0.25	30
Spain	0.17	10
Italy	0.12	10
France	- 0.05	- 5
UK	- 0.21	- 20
Germany	- 0.43	- 70

Sources
i. Net balances: UK estimates (from published sources)
ii. GNP: European Commission (SEC(87)461/2).
iii. Population: OECD (1986 provisional Figures)

Net
Abatements are read back to the year in which they arise.

Comment

This table, which is rough and ready but is based on published data, shows how well or badly individual member states are doing from the Community budget. The high Luxembourg figure mainly reflects the considerable concentration of Community institutions in Luxembourg. As the table indicates, the net balances do not accurately reflect relative prosperity: the Benelux and Denmark do much too well. Ireland and Greece do extraordinarily well already.

TABLE 4

NET BALANCES OF THE MEMBER STATES

(becu)

	1983	1984	1985	1986	1987
1 Unadjusted figures (before UK and German compensation)					
Belgium	0.2	0.3	0.7	0.9	0.4
Denmark	0.3	0.5	0.3	0.5	0.5
Germany	-2.4	-3.0	-3.1	-3.1	-3.7
Greece	1.0	1.0	1.3	1.3	1.6
France	0.1	-0.4	0.4	0.2	0.3
Ireland	0.8	0.9	1.3	1.3	1.0
Italy	1.2	1.7	1.2	0.5	1.2
Luxembourg	0.3	0.3	0.3	0.5	0.3
Netherlands	0.4	0.5	0.5	0.4	0.8
UK	-1.8	-1.9	-2.9	-3.0	-3.4
Portugal	-	-	-	0.3	0.3
Spain	-	-	-	0.4	0.6
2 Adjusted figures (after UK and German compensation)					
Belgium	0.2	0.3	0.6	0.8	0.3
Denmark	0.3	0.5	0.3	0.4	0.4
Germany	-2.6	-3.2	-3.5	-3.5	-4.2
Greece	1.0	1.0	1.3	1.3	1.6
France	-0.2	-0.7	-0.2	-0.4	-0.4
Ireland	0.7	0.9	1.3	1.2	1.0
Italy	1.0	1.5	0.8	0.1	0.7
Luxembourg	0.3	0.3	0.3	0.4	0.3
Netherlands	0.4	0.5	0.3	0.3	0.7
UK	-1.0	-0.9	-1.0	-1.2	-1.1
Portugal	-	-	-	0.2	0.3
Spain	-	-	-0.2	0.2	0.4

Source: 83 and 84: based on Commission data circulated to Budget Committee
85, 86 and 87: UK estimates from published sources.

Note: abatements are read back to the year in which they arise, not the year in which they are paid.

Spain's adjusted net deficit in 1985 is its contribution to the UK's 1985 abatement.

TABLE 5

VAT EXPENDITURE GAP OF THE UK

(becu)

	1983	1984	1985	1986	1987
1. Unadjusted figures (before UK and German compensation)					
UK	- 1.5	- 1.4	- 2.9	- 2.9	- 3.6
2. Adjusted figures (after UK and German compensation)					
UK	- 0.8	- 0.4	- 1.0	- 1.1	- 1.4

Source 83 and 84: based on Commission data circulated to Budget Committee

85, 86 and 87: UK estimates

Abatements and refunds are read back to the year to which they relate.

785/26

FUTURE FINANCING: BACKGROUND NOTE

This note summarises where we have got to in the ex novo review of the Community's financing arrangements, and discusses briefly the timetable for negotiations during the rest of the year.

<u>**The June European Council**</u>

2. The Brussels European Council on 29/30 June considered all the main elements in the future financing dossier. Although there was considerable agreement of principle on the steps to be taken to resolve the main problems, the UK could not agree:

i) that there should be discussion at that stage on the size of any increase in the own resources ceiling. Before that question could be addressed, agreement was needed on effective and binding controls over Community spending, particularly agricultural spending;

ii) that the level from which we start to calculate the agricultural guideline should include <u>all</u> the 1987 overrun.

3. The text of the Council conclusions agreed by the other eleven member states was helpful insofar as it said that:

- the use of the Community's resources should be subject to effective and binding budget discipline;
- additional measures were required to stop surplus agricultural production, and so reduce costs and keep expenditure within the budget framework.

Other significant points are that the conclusions of the Elevan referred to the need

- to express the new own resources ceiling as a fixed percentage of Community GNP;
- for member states' contributions to take greater account of national prosperity (ie an implicit endorsement of the fourth own resource proposal).

BACKGND NOTE

The Commission's recent papers

4. Since the European Council, the Commission have produced five main and a number of subsidiary papers on future financing issues which have been discussed at official and Ministerial level.

5. The draft new own resources decision COM(87)420) incorporates the Commission's proposals on own resources, including a new own resources ceiling of 1.4 per cent of Community GNP, annual sub-ceilings (rising from 1.2 per cent of GNP in 1988 to 1.3 per cent in 1992), the introduction of the new fourth resource ("diff tax"), a 1 per cent ceiling on VAT, the abolition of own resources refunds, and the conversion of customs duties on coal and steel imports into own resources. (The draft ORD does not refer to the UK's future correction mechanism. But the Commission have this week reaffirmed their earlier proposals on this, as in COM(87)101.

6. Our main concerns here are to limit any increases in the own resources ceiling and to ensure that any change to the abatement mechanism leaves us better off than under the Fontainebleau financing arrangements. On the structure of own resources we have said in discussions (but without commitment) that the "diff tax" merits consideration as one possible means of relating contributions to national prosperity (the main opponents are Italy, Denmark and the Netherlands).

7. The Commission's communication on agricultural reform (COM(87)410) reviews past agricultural reforms, proposes new automatic stabilisers for each of the main commodity regimes, and outlines a policy for preserving the structure of Euorpean agriculture. The section on automatic stabilisers is considerably more helpful than it might have been (and represents a welcome response to UK pressure in this area), though we still need to tighten up the proposals in certain areas. The key thing, of course, is to convince other member states that radical reform really is essential, and to obtain agreement on figures as well

as principles.

8. <u>The Commission's communication on budget discipline (COM(87)430)</u> contains little that is new. As far as agricultural spending is concerned, the call for new automatic stabilisers and the pleas for agricultural spending to be kept within the financial guideline are helpful. But the agricultural guideline proposal is objectionable in that it allows in substantial loopholes for exceptional circumstances. The Commission are still wedded to the idea that the guideline should take account of the full amount of the 1987 overrun. The important proposals for ensuring that expenditure respects the guideline limit have run into considerable problems in the Council.

9. The proposals for containing non-obligatory expenditure are no better than those put forward previously. They are, in effect, devices for evading the maximum rate discipline. Far too much reliance is placed on the possibility of restricting expenditure by having an inter-institutional agreement between the Council and the Parliament at the beginning of the budgetary procedure, and on the part to be played by the Commission's multi-annual forecasts. The Commission's proposals in the area envisage that the growth of non-obligatory expenditure should be about 9 times the calculated maximum rate of increase as they forecast it.

10. <u>The Commission's communication on the structural funds (COM(87)386)</u> covers a draft framework regulation incorporating the main elements in the Commission's proposals set out in COM(87)100 and 101. The Commission calls for a doubling of structural fund commitments in real terms by 1992. It argues that the funds should be targeted more effectively, and that up to 80 per cent of the regional fund should be devoted to assisting backward regions. We are aiming to secure agreement to a much lower growth of total structural fund expenditure but with a rather higher proportion of that expenditure devoted to regions suffering industrial decline.

11. <u>The Commission's revised draft financial regulation (COM(87)400)</u> provides for the Commission's main proposals on budget

Covering confidential

BRIEF C

BRIEF C

BACK GROUND

ECOFIN: 16 NOVEMBER 1987

TAX APPROXIMATION

<u>Relevant documents:</u> Package summarised in Global Communication (Council doc: 8199/87); convergence proposal (Council doc: 8203/87).

<u>UK objective:</u> To avoid decisions that would force pace of Council examination of proposals [intervene, as necessary, to counter suggestions by Commission or other Member States].

<u>Points to make:</u>

[Early substantive/political discussion] Cannot expect to have useful discussion of substance before in possession of full analysis of Commission approach. Counter productive to highlight political difficulties at this stage.

[Time limit on EPC study/narrow remit] Right to remit package to EPC for macro-economic evaluation. Council needs EPC advice to make informed decisions. EPC needs freedom to consider all relevant issues, if advice to be of value, and time to do thorough job. Cannot be expected to report back before March 1988 <u>at earliest.</u>

[Deadlines for decisions/progress] Cannot now foresee how discussions will progress. Know that problems likely to be numerous. So unrealistic to set deadlines at this stage.

[Early progress on 'convergence' proposal] Commitment to convergence would be premature and illogical. Draft directive presupposes that VAT and excise rates will be adopted as laid down in proposals. Problems - especially on excises - well known - must be good chance that if approximation adopted by Council, level agreed will differ from proposals.

BACKGROUND

At its informal meeting on 12/13 September, ECOFIN agreed that, in the first instance, the Commission's tax package should be remitted to EPC for study. No remit and no timetable were laid down. The informal decision needs to be confirmed at a formal ECOFIN meeting. The Danish Presidency has not proposed the text of a remit to EPC (Key EPC members - including Ian Byatt - have themselves been discussing their terms of reference, but have not as yet reached conclusions. They meet again on 17 November). It is possible the Germans, as next Presidency, may try to pin the discussion at ECOFIN to firmer conclusions. The UK's interests lie in ensuring that any decisions taken are as unspecific as possible. Other Member States will probably take a similar view, but may not be keen to express it.

Lord Cockfield will formally present the proposals to the Council. He is expected to call for speedy progress in discussions and is likely to press in particular for

i. more frequent meetings of the Council's working group during the rest of the Danish and the German Presidency to allow fiscal experts to examine

   a) the proposal amending the 6th VAT Directive

   b) the VAT clearing mechanism

   c) the excise structural proposals (which the Commission is in the process of updating)

ii. an undertaking that the Council will begin work on the rate proposals once EPC has reported, together with a timetable for EPC's work.

iii. early progress on the convergence proposal.

Attached are copies of telegram 3753 describing Lord Cockfield's desired timetable and telegram 543 noting German and Danish problems with the Cockfield proposals.

5. THE COUNCIL SHOULD AIM TO DECIDE IN PRINCIPLE ON THESE PROPOSALS ON 6 JUNE.

6. THE THIRD STAGE WOULD COMMENCE AFTER 6 JUNE ECOFIN COUNCIL AND WOULD BE GIVEN OVER TO NEW FURTHER COMMISSION PROPOSALS ON, FOR EXAMPLE, PASSENGER TRANSPORT, WORKS OF ART, GOLD AND THE EXCISE-LINKED WAREHOUSE SYSTEM AND TO RESOLVING INDIVIDUAL PROBLEMS AND REQUESTS FOR DEROGATIONS.

7. THE COMMISSION WOULD LOOK TO THE COUNCIL TO ADOPT ALL THE COMMISSION'S FISCAL PROPOSALS BY THE END OF 1988, IN ORDER THAT THE MEMBER STATES MAY HAVE SUFFICIENT TIME AND ROOM FOR MANOEUVRE TO IMPLEMENT THEM AS THEY SEE FIT, BUT IN ANY EVEN TO NO LATER THAN 31 DECEMBER 1992.

8. THIS TIMETABLE CAME WITH MUCH RHETORIC ABOUT THE CRUCIAL IMPORTANCE OF THE ABOLITION OF FISCAL FRONTIERS FOR THE COMPLETION OF THE INTERNAL MARKET AND THE NEED FOR THE COMMISSION TO BE ABLE TO MAKE CLEAR IN ITS REPORT ON THE INTERNAL MARKET DUE IN DECEMBER 1988 THAT IRREVERSIBLE PROGRESS HAD BEEN MADE TOWARDS THE COMMUNITY'S OBJECTIVES FOR 1992.

9. IN DISCUSSION, NIEMAN (NETHERLANDS) WONDERED WHETHER THE COPENHAGEN EUROPEAN COUNCIL SHOULD BE ASKED TO GIVE ITS BLESSING TO RAPID WORK ON FISCAL APPROXIMATION. ESPER LARSEN (PRESIDENCY) RULED THAT THE COPENHAGEN EUROPEAN COUNCIL ALREADY HAD ENOUGH ON ITS PLATE WITH FUTURE FINANCING.

10. THERE WERE NO OTHER COMMENTS APART FROM EXPRESSIONS OF GENTLE GOODWILL AND REMINDERS THAT, FOR SOME MEMBER STATES, THE CHANGES ADVOCATED BY THE COMMISSION WOULD BE VERY DIFFICULT. ALL OF MY COLLEAGUES WERE TOO POLITE TO VOICE THEIR OBVIOUS FEELING THAT LORD COCKFIELD'S TIMETABLE WAS LAUGHABLY UNREALISTIC.

HANNAY

<u>ADVANCE</u> 24

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MR BRAITHWAITE	PS/CHANCELLOR TRSY
HD/ECD(I)	MR J E MORTIMER TRSY
HD/NEWS	MR C D CRABBIE TRSY
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TELE-GRAMS

FRAME ECONOMIC

COREPER LUNCH 12 NOVEMBER: APPROXIMATION OF INDIRECT TAXES

SUMMARY

1. LORD COCKFIELD OUTLINES AMBITIOUS WORK PROGRAMME, WHICH HE WILL PRESENT TO MONDAY'S ECOFIN COUNCIL, AIMING AT ADOPTION OF ALL COMMISSION'S PROPOSALS BY THE END OF 1988.

DETAIL

2. AT TODAY'S COREPER LUNCH LORD COCKFIELD DESCRIBED AND CIRCULATED AN AMBITIOUS THREE STAGE TIMETABLE FOR COUNCIL CONSIDERATION OF THE COMMISSION'S PROPOSALS ON VAT AND EXCISE DUTY APPROXIMATION WHICH HE WILL PRESENT AT MONDAY'S ECOFIN.

3. THE FIRST STAGE WOULD RUN UNTIL ECOFIN ON 18 APRIL NEXT YEAR. DURING THIS PERIOD COREPER AND WORKING GROUPS WOULD EXAMINE:

(A) ON VAT SIDE, THE PROPOSAL TO REMOVE FISCAL FRONTIERS (TECHNICAL AMENDMENTS NEEDED TO 6TH VAT DIRECTIVE), THE CLEARING SYSTEM AND OUTSTANDING PROPOSALS TO COMPLETE THE VAT BASE (12TH, 18TH AND 19TH DIRECTIVES):
(B) ON THE EXCISE SIDE, PROPOSALS ON THE DUTY STRUCTURES FOR MINERAL OILS, ALCOHOLIC BEVERAGES, AND TOBACCO PRODUCTS OTHER THAN CIGARETTES (STRUCTURE OF CIGARETTES IS CLOSELY LINKED TO THE QUESTION OF RATES AND SHOULD BE LEFT TO THE SECOND STAGE:
(C) THE PROPOSAL FOR CONVERGENCE OF VAT RATES.

4. THE SECOND STAGE WOULD RUN FROM 18 APRIL (BY WHICH TIME THE COMMISSION WOULD EXPECT THE EP TO HAVE DELIVERED ITS OPINION AND THE MEMBER STATES TO HAVE COMPLETED THEIR ''MACROECONOMIC STUDIES'') UNTIL THE 6 JUNE ECOFIN. DURING THIS PERIOD WORK SHOULD FOCUS ON:

(A) PROPOSALS ON THE NUMBER, LEVEL AND SCOPE OF VAT RATES:
(B) PROPOSALS ON THE EXCISE DUTY RATES, INCLUDING THOSE ON CIGARETTES.

VAT HARMONISATION IN WHAT WOULD BE A DANISH ELECTION YEAR.)
4. AIR TRANSPORT AND GIBRALTAR: I EXPLAINED BRIEFLY OUR EFFORTS TO REACH AGREEMENT WITH THE SPANIARDS. GENSCHER ASKED IF WE WOULD NOT BE SATISFIED WITH A DISCLAIMER. KERR SAID THE PROBLEM WAS THAT THE SPANIARDS WERE LOOKING FOR MORE: THEY WANTED TO USE THE EC AVIATION NEGOTIATIONS AS A LEVER TO IMPROVE THEIR GRIP OVER THE AIRPORT. I EXPLAINED THAT THE EXISTING BARRIERS OF DISTRUST WERE DIFFICULT TO SURMOUNT. WE HAD TO TRY TO PERSUADE THE SPANIARDS TO WOO GIBRALTAR. TRUMPF DREW ATTENTION TO THE RISK THE EUROPEAN PARLIAMENT WOULD TRY SIGNFICANTLY TO AMEND THE THAT AVIATION PACKAGE.

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MIPT: MY MEETING WITH GENSCHER, 11 NOVEMBER
OTHER EC ISSUES
SUMMARY
1. STAND-OFF ON POST-CHERNOBYL. GERMANS PROMISED NO EXCESSIVE ZEAL ON TAX HARMONISATION DURING THEIR PRESIDENCY. INCONCLUSIVE EXCHANGE ON AIR TRANSPORT/GIBRALTAR.
DETAIL
2. GENSCHER ASKED WHY THE SPECIAL FAC LAST WEEKEND ON POST-CHERNOBYL HAD FAILED. I SAID THAT WE, LIKE THE FRENCH AND SPANISH, HAD MOVED FROM OUR INITIAL POSITION TO ONE OF READINESS TO ACCEPT THE PRESIDENCY COMPROMISE. THERE HAD BEEN NO CORRESPONDING MOVE FROM THE GERMANS. GENSCHER SAID THAT, AGAINST THE BACKGROUND OF A GERMAN POLICY OF SEEKING IMPROVED STANDARDS OF PROTECTION, THEY COULD NOT ACCEPT LOOSER STANDARDS. GERMANY HAD BEEN MORE AFFECTED BY CHERNOBYL RADIATION THAN THE UK, AND ITS PUBLIC OPINION WAS CORRESPONDINGLY MORE SENSITIVE. AT THE VERY LEAST WE SHOULD STICK WITH THE STATUS QUO. I POINTED OUT THAT THE COMMUNITY HAD SOUGHT SCIENTIFIC ADVICE, AND THAT OUR ORIGINAL POSITION HAD BEEN BASED ON THE ARTICLE 31 GROUP'S THE PRESIDENCY HAD NOW PROPOSED MUCH LOWER LEVELS. IN THE INTERESTS OF FINDING A PRACTICAL SOLUTION, WE COULD ACCEPT THESE. BUT IF THE FRG INSISTED ON STILL LOWER FIGURES, AND WERE NOT PREPARED TO MAKE COMPARABLE MOVES, WE DID NOT SEE A BASIS FOR AGREEMENT.
3. TAX APPROXIMATION: I EXPLAINED OUR DIFFICULTIES OVER ANY ATTEMPT TO LIMIT VAT ZERO RATES. OUR IMMEDIATE GOAL SHOULD BE TO REDUCE FRONTIER DELAYS, EG BY PRESSING ON WITH THE FOURTEENTH VAT DIRECTIVE. I HOPED THE GERMAN PRESIDENCY WOULD NOT GIVE UNDUE PRIORITY TO THIS DOSSIER. GENSCHER SAID THAT THEY WOULD NOT AND TRUMPF ADDED THAT GERMANY HAD ITS OWN PROBLEMS WITH THE COCKFIELD PROPOSALS OTHER THAN ON VAT. THEY WOULD KEEP WORK ON TAX HARMONISATION GOING, BUT WOULD NOT BE MAKING A SPECIAL FEATURE OF IT. THEY REGARDED DENMARK, NOT THE UK, AS THE MAIN PROBLEM. (IN THE MARGINS TRUMPF TOLD KERR THAT THE DANES HAD DRAWN FRG ATTENTION TO THE DANISH DOMESTIC IMPACT OF ANY MAJOR CAMPAIGN ON

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(87) 320 final

Brussels, 5 August 1987

COM(87) 320

VERSION PROVISOIRE

Completion of the internal market:
approximation of indirect tax rates
and harmonization of indirect tax structure.
Global Communication from the Commission

COM(87) 320 final

COMPLETION OF THE INTERNAL MARKET: APPROXIMATION OF INDIRECT TAX RATES AND HARMONIZATION OF INDIRECT TAX STRUCTURES

GLOBAL COMMUNICATION FROM THE COMMISSION

1. Introduction: the economic and historical perspective

The Commission's White Paper on completing the internal market of the Community[1] was a response to the need to reverse the relative decline of western Europe. The undertaking is an ambitious one - to some perhaps frighteningly so - but it had to be ambitious if it was to measure up to the scale of what is needed. And the Governments of the Member States have firmly and repeatedly committed themselves to fulfilling those ambitions. They had already been searching for some time for a strategy - a strategy which would revive the entire economy of Europe and reverse the process of the previous decade or more which had caused our performance in terms of output to fall increasingly behind those of our main competitors in America and Japan.

Their recognition that the solution was to be found in the completion of the internal market goes back as far as the Copenhagen European Council in December 1982 and was reaffirmed at Dublin and Fontainebleau in 1984.

The Commission took up the challenge and gave it more concrete expression by declaring in the European Parliament in January 1985 that within 8 years - the life of two Commissions - a programme for the dismantlement of the Community's internal frontiers would be drawn up and implemented.

The population of the European Community is nearly half as large again as that of the United States and well over twice that of Japan. We are the biggest and oldest-established bloc of trading nations in the world. Our scientific knowledge and our capacity for invention are second to none. But for want of a dynamic regenerative impetus these immense resources in considerable measure lie fallow, failing to produce the growth and the rich

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(1) COM(85) 310 final

harvest of prosperity of which they are intrinsically capable. Perhaps the starkest measure of the extent of the waste and of the urgency of the need for action is that, meanwhile, 16 million potential producers of wealth and growth stand unemployed. The simple truth is that we are failing to make use of the immense potential which Europe possesses.

What is the reason for this tragic waste of opportunity and potential? The Community's Heads of State and Government had long sensed that the answer lay in the disunity which still, nearly 30 years after the signing of the Treaty of Rome, marked the European economy itself. The countries of the European Community, for all their common heritage and common interest, remain a fragmented economy, divided into a dozen separate markets; each with its own rules; each manufacturing for its own market; each facing obstacles and difficulties in trying to trade with other Member States. That is why the Community has steadily fallen behind the more integrated markets of the United States and Japan in the growth of its demand, its production and its trade.

The Heads of State and Government, meeting in March 1985 in Brussels, set the target and the objective by identifying as their first priority "action to achieve a single large market by 1992 thereby creating a more favourable environment for stimulating enterprise, competition and trade; it called upon the Commission to draw up a detailed programme with a specific timetable before its next meeting".

The Commission's blueprint in response to this challenge was rapid, bold and radical. It has since been universally accepted as the foundation for a rebirth of European aspirations. The White Paper on completing the internal market did not mince its words:

"Europe stands at the cross-roads. We either go ahead - with resolution and determination - or we drop back into mediocrity. We can now either resolve to complete the integration of the economies of Europe; or through a lack of political will to face the immense problems involved, we can simply allow Europe to develop into no more than a free trade area.

The difference is crucial. A well-developed free trade area offers significant advantages: it is something much better than that which existed before the Treaty of Rome; better even than that which exists today. But it would fail and fail dismally to release the energies of the people of Europe; it would fail to deploy Europe's immense resources to the maximum advantage; and it would fail to satisfy the aspirations of the people of Europe."

The White Paper and its programme were welcomed and largely endorsed by the European Council meeting in Milan in June 1985. Six months later saw the adoption of the Single European Act which establishes as a legal commitment the objective of "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured." A Europe without internal frontiers - not a Europe with fewer or simpler frontier controls, but one with no such divisive frontier controls at all. The programme in the White Paper is for a comprehensive elimination of all the barriers - the physical barriers, the technical barriers and the fiscal barriers - which cause the face of Europe to be scarred by the frontiers which divide it. One of the declarations that accompanied the Single European Act made specific reference to "decisions necessary to implement the Commission's programme described in the White Paper on the Internal Market".

The Commission and the Governments of the Member States are therefore firmly committed to embark on the completion of the programme.

2. Completing the Internal Market: the fiscal aspects

The Commission has taken as its starting point a snapshot of the existing wide spread of indirect tax rates and structures in the Community. It has then confined itself to setting out the minimum changes which must be made to that picture in order to achieve a sufficient degree of fiscal approximation. It must be clearly understood that the present package is not an attempt to design an ideal fiscal system for the Community, but a blueprint for abolition of fiscal frontiers. It is in that spirit that the Commission has tried to find the most practical possible solutions; and it is in that spirit, and taking possible problems of adjustment into account, that they are presented and must be studied. That is the job which the Commission was asked to do.

Already in Milan in June 1985, the European Council launched an intensive programme of activity based on the White Paper proposals. As far as the fiscal chapter (Part III) was concerned, the Milan conclusions stated: "As regards the approximation of VAT and excise duties, the European Council invited the Council of Ministers for Financial Affairs (ECOFIN) to examine on the basis of the White Paper any measures which might be necessary for the achievement of a single market and the possible timetable for the application of those measures."

The ECOFIN Council delegated this mandate in the first instance to a high-level group of fiscal experts who, together with representatives of the Commission, considered the fiscal proposals outlined in the White Paper and the possible alternatives to it. The high-level group reported to the ECOFIN Council in June 1986 that the proposal would achieve the removal of formalities and fiscal controls at borders in the case of intra-Community trade and that the alternatives they had considered would fail to result in the removal of fiscal frontiers and could not, therefore, be recommended. Nevertheless, the report also made it clear that there were still considerable difficulties, uncertainties and hesitations, and concluded that "Member States will not be able to decide whether the measures envisaged by the Commission are ultimately acceptable to them until full details of the measures as a whole are available. Only when Member States can see clearly

- the financial, budgetary, economic and social consequences of the measures for them,

- the practical consequences for both the economy and individuals and the national budget entailed by the clearing mechanism,

will each of them be in a position to weigh up the advantages and disadvantages resulting from the Commission's system and decide whether it is prepared to agree to the system."

The ECOFIN Council in June 1986 discussed the group's conclusions and reserved its position until the Commission had submitted to the Council "detailed proposals on the rates and rate structure of indirect taxation and on the clearing system. On that basis the Member States will be able to state their position on the approach which the Commission envisages in Part III of the White Paper".

This Communication provides the detailed proposals for which ECOFIN have asked. It constitutes the beginning of the next, and probably most

decisive, phase of this dialogue. As is clear from the conclusions of the high-level group and the ECOFIN Council, the process of fiscal integration cannot begin in earnest until the Member States have had an opportunity to assess what fiscal approximation will mean to them in real terms. Only when a clear and coherent set of proposals for fiscal approximation is on the Council table will the Member States be in a position to weigh up the implications for themselves, and to determine what benefits and what costs they offer to each of them in their own particular circumstances, both in the shorter and the longer term.

Neither the Commission nor the Member States have ever had any illusion about the magnitude and the difficulty of the task ahead. But they have not hitherto been in a position to measure it. The present proposals are the basis on which that task of analysis, of evaluation and of eventual adjustment can now take place. Every effort will need to be made to find Community solutions to difficulties that may arise. If that should prove in some cases to be impossible, the Commission is prepared to examine with the Member States concerned what special measures might be applied to them. Such measures would have to be of a temporary nature and must cause the least possible disturbance to the functioning of the Common Market. The Commission could then propose appropriate solutions to the Council, notably as provided for in Article 8C of the Treaty as amended by the Single European Act.

As is discussed in more detail later in this paper, the path to abolition of fiscal frontiers in 1992 will be an easier one to tread for some Member States than for others. Some aspects may cause extreme difficulty in some cases, for example in Member States whose budgetary receipts would be significantly reduced or increased. The Community as a whole - the Member States and the Commission working together - will have to find ways, including the possibility of derogations where these can be justified, of easing the path for those of its members for whom the implementations of the proposals could pose political, social or budgetary problems. The proposals already provide a major element of flexibility; it is proposed that Member States be given freedom to determine their own path to 1992 and the pace at which they travel along it. The Council and the Commission will monitor the pattern of progress and may propose solutions to difficulties which manifest themselves. The Commission will consider the possibility of proposing complementary measures at a later date, which would enable the measures proposed here to be amended on a Community basis if economic developments were to make that desirable. This would enable any limitation which fiscal approximation might impose on Member States' flexibility of response to be compensated for at a Community level.

All this, however, is yet to come. The immediate task for the Community is to study the proposals which accompany this communication and for each of its Members to evaluate their significance.

3. The Proposals

The White Paper demonstrated that if fiscal frontiers are to be abolished and the indirect taxation system of the Community is to serve the single unified market which we are committed to completing, there must be a considerable measure of approximation of indirect taxes. Only then, when indirect tax levels are sufficiently close as between one Member State and another so as not to distort competition and patterns of trade, will it be possible for the European economy to work in a free and unfettered way; only then will goods, services, capital and people be able to move freely to where they enjoy genuine comparative and competitive advantage. If we are to abolish the internal frontiers which at present divide us, it is vital to deal with fiscal frontiers and the underlying reasons for their existence. This is not a new dawning of the truth. It is something which has been accepted ever since the founding of the Community: and it has been re-affirmed on many subsequent occasions, not least in the Single European Act itself.

The abolition of fiscal frontiers will bring with it the abolition for intra-Community trade of the existing system of relieving goods from tax at export and of imposing tax at import, as has indeed been envisaged ever since the First VAT Directive was adopted twenty years ago. Elimination of the distinction made at present between supplies within a Member States and supplies to another Member State should result in significant administrative simplification for traders.

In addition, the removal of fiscal frontiers necessitates approximation of VAT and the main excise duties if unacceptable levels of distortion of competition, diversion of trade, and tax fraud are to be avoided.

The Commission is also proposing a VAT clearing mechanism to ensure that, after frontier controls have been abolished, the Member States continue to receive the revenue to which they are entitled. It will ensure that output tax collected on export sales in one Member State is passed on to the Member States in which the supplies are finally consumed. The mechanism is described in detail in a separate Working Paper but is in essence a central account through which Member States will draw or pay money periodically, depending on the extent to which they are net importers or exporters. Member States will calculate the amount to be drawn from or paid to the central account on the basis of information supplied in traders' VAT returns. No additional records will need to be kept. For excise duties, no such system is needed, since these are not charged until the goods are released from bond, normally in the country in which they are to be sold to the final consumer.

There are, of course, other indirect taxes within the Community, such as taxes on the registration of vehicles, and on the purchase of houses, which vary considerably from Member State to Member State. Those variations can be such as to cause distortions of competition and deflection of trade. But they do not impede the free movement of goods in the sense that the differences between them do not give rise to controls or formalities at frontiers. The Commission actively pursues cases in which such indirect taxes breach the rules of the Treaty, but does not consider their approximation to be a necessary part of the abolition of fiscal frontiers.

In adopting its approach to the elimination of fiscal frontiers, based on the notion of the sufficient approximation of the existing patterns of indirect taxation in the Member States, the Commission is strictly implementing Article 99 of the Treaty as amended by the Single European Act. That Article calls for proposals "for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market within the time limit laid down in Article 8A (ie, 1992)". The Commission has refrained from proposing anything which is not strictly necessary for that purpose. There are pressures from one quarter or another to use the approximation process as a vehicle for achieving other fiscal changes or even non-fiscal policy objectives. The Commission considers, however, that it would not be justified in seeking to place additional strains of adaptation on Member States in this way. Every effort has been made to avoid running counter to other policy objectives, and to bear the wider economic social and regional implications in mind in formulating these proposals. But these are among the implications which can only be evaluated on the basis of a collective consideration of the proposals. In what will be a challenging period of transition, the Commission has concentrated on two overriding priorities: its proposals must result in the best possible fiscal environment for economic operators in the internal market; at the same time they must minimize the adverse effects of the approximation exercise for Member States' revenue flows and budget flexibility. This document sets out in general terms the Commission's proposals for a manageable level of approximation. The specific proposals in question are listed in Annex A.

For ease of analysis, VAT and the excise duties are dealt with separately in the following two sections.

4. Approximation of VAT rates and rate structure

The First and Second VAT Directives, which laid down in 1967 the foundations of the Community VAT system, already clearly envisaged the abolition of tax on imports and the remission of tax on exports in trade between Member States and the approximation of legislation concerning turnover taxes in order to eliminate distortion of competition within the Community. This objective has been repeatedly confirmed over the years. Considerable progress has been made towards the creation of a common VAT base, notably with the adoption of the Sixth VAT Directive. The Sixth Directive lays down, in particular, a clear programme for the staged introduction of the fiscal conditions permitting the internal market to function. That programme is already under way. The Commission has put forward several proposals - notably the Seventh, Twelfth, Eighteenth and Nineteenth Draft Directives - designed to eliminate some of the most significant remaining areas of divergence. The Council should deal with these proposals as a matter of urgency. Certain derogations have not yet been tackled. More is said of these questions later in this Communication. Nonetheless, there now exists an identifiable common VAT base which represents a decisive step along the road towards a common fiscal system and thus towards the elimination of fiscal frontiers.

a) Number of rates

The starting point for any approach to the approximation of both the number and level of VAT rates must be the existing situation in the Member States. This is as follows:

	Reduced Rates	Standard rate	Increased rate
Belgium (1) (2)	1 & 6	19	25 & 25+8
Denmark (1)	-	22	-
France	2.1; 4 5.5 & 7	18.60	33 1/3
Germany	7	14	-
Greece	6	18	36
Ireland (1)	2.4 & 10	25	-
Italy (1)	2 & 9	18	38
Luxembourg	3 & 6	12	-
Netherlands	6	20	-
Portugal (1)	8	16	30
Spain	6	12	33
United Kingdom (1)	-	15	-

Rates applicable as at 1.4.1987

From the above it can be seen that all Member States, with the exception of Denmark and the UK, apply more than one rate. Thus, although the Commission accepts that, in theory, a VAT system with only one rate is the simplest and most efficient structure, it is clear that such an approach would have disruptive consequences for all Member States, other than the two mentioned, and is unlikely to be acceptable to the Community as a whole. It is therefore proposed that a multi-rate system should be adopted.

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(1) Also applies an exemption with a right to refund (ie a zero-rate) to certain domestic transactions (NB all Member States apply the zero rate for exports and like transactions).

(2) Also applies an intermediate rate of 17%

The question of how many rates a Community multi-rate system should have is less clear cut. Whilst a majority of Member States have three or more rates, in practice they fall into two main camps, namely those with a standard and a reduced rate or rates and those with standard, reduced and increased rates. Taking into account the fact that, where Member States have more than three rates the more extreme rates normally apply to only a very limited number of products, the real choice lies between a two-rate and a three-rate system.

There is little doubt that a three-rate system creates more complications for both taxpayers and national administrations and that it would therefore be simpler and more cost-effective to move to a two-rate system than to oblige those Member States who currently do not apply an increased rate to move to a three-rate system. Furthermore, since the existing increased rates are applied to a relatively small proportion of the tax base in each Member State (on average below 10%), their abolition would not create undue budgetary problems. Finally, the coverage of existing increased rates is not particularly homogeneous and it would therefore be difficult objectively to draw up a common list of goods and services which should be subjected to an increased rate. For all these reasons, the Commission has concluded that a two-rate system would be preferable - namely a system with a standard rate and a reduced rate only.

b) Scope of the reduced rate

In most Member States the coverage of the reduced rate or rates is generally restricted to items of basic necessity. The zero-rates in Ireland and the United Kingdom cover much the same ground. Taking this into account, there is a considerable degree of consistency in the different Member States. The Commission proposes therefore that the following basic goods and services should be taxed at a reduced rate under the harmonized Community VAT structure, **but it is important to read this list in conjunction with what is said at 2d) below about zero rates.**

- foodstuffs (with the exception of alcoholic drinks);
- energy products for heating and lighting;

- supplies of water;
- pharmaceutical products;
- books, newspapers and periodicals;
- passenger transport.

Overall, these items represent approximately one third of the common Community tax base.

c) Rate levels

The standard rates currently applied in the Member States vary from 12% (Spain and Luxembourg) to 25% (Ireland). This is clearly too wide a band to permit the abolition of fiscal frontiers without serious economic consequences. The spread of rates therefore has to be narrowed to a point where the difference between the upper and lower limits will itself not create intolerable price differences between the Member States (especially those which are adjacent). On the other hand, the Commission is conscious that the narrower the band becomes, the greater is the number of Member States that will suffer budgetary disruption. In terms of the second of these criteria, the optimum spread of the standard rate band would be 8 points (which would incorporate 10 out of the 12 standard rates currently applied, within a band from 12% to 20%). Unfortunately, however, neighbouring Member States are to be found at either end of this spectrum and the Commission has been forced to conclude that the resulting tax-induced border price differentials would generate trade distortions and fiscal fraud, which Member States would be likely to find unacceptable.

If, however, the standard rate band were narrowed from 8 to 6 points there would still be 8 Member States who would currently fall within this range (if the parameters were set at 14% and 20%) and the resulting price differentials would become that much less distortive and more manageable. The Commission has, therefore, concluded that the optimum norm for the standard rate should be within a permitted range of between 14% and 20%. In fixing their own individual rate within this band, Member States would need to take into account the effect of market forces once fiscal frontiers had been eliminated - and would, of course, be entirely free to do so.

Turning to the reduced rates, these currently vary from 1% to 10% but the lowest rates apply only to a very few products and those with significant coverage vary from 4% to 10%. On the other hand, it also has to be borne in mind that two Member States currently apply a zero rate to most, if not all of the basic goods and services which are included in the list of items to be taxed at the reduced rate. Taking these various factors into account, the Commission has concluded that the permitted range for the reduced rate should be between 4% and 9% though in view of the inclusion in this rate band of certain sensitive sectors, such as the cultural sector, the Commission recommends that Member States fix their rate in the lower half of that band.

The weighted average VAT burden resulting from these calculations (i.e. the total tax yield in proportion to the total harmonized tax base) in the Community is currently around 13%. The proposed rate bands will permit Member States to choose rates which will result in a minimum of disruption for the maximum number of Member States in terms of this existing tax burden. The future weighted average VAT burden will, of course, depend on the actual choices made by the Member States within the permitted bands.

d) Derogations, zero rates and exemptions

The White Paper acknowledged that some countries would face considerable difficulties with fiscal approximation; and it said that derogations might be needed to meet these problems. This is likely to be of particular importance in the case of zero rating.

It has always been an accepted part of Community policy that zero rating, except in the case of exports, was a temporary measure which would disappear with the Completion of the Internal Market. This was clearly stated in the second VAT Directive adopted in 1967 and restated in the Sixth VAT Directive adopted in 1977.

The zero rating of supplies generally acknowledged as basic necessities rests upon considerations of social policy; though it is clearly a less efficient way of achieving such objectives than measures more closely targeted towards those in need. Only two Member States have followed such policies to any significant degree; the other Member States have successfully accommodated themselves to a broadly based concept of VAT without the extensive use of zero rating. This has been achieved by direct compensation of disadvantaged groups through the social security system and welfare payments, thus directly benefiting the groups primarily affected in a more cost-effective way than is achieved by a fiscal price subsidy. It should also be remembered that zero rating, by giving a price advantage to the products of one Member State, distorts competition within the Community; this is particularly true when applied to supplies which feed through into industrial and commercial costs. Finally, it needs to be remembered that, for any given yield of revenue, zero rating in one area must inevitably lead to a higher overall rate of tax elsewhere; if 50% of consumer expenditure is exempted by zero rating, the rate of tax elsewhere necessarily has to be twice what it would have been if there had been comprehensive coverage.

For all of these reasons, the Commission could not recommend that the Community should abandon what has been its considered and settled policy ever since the VAT was first adopted. It is for this reason, that in the rates and coverage proposed above, the Commission has not proposed zero rates, but has proposed that for the most part basic necessities should be charged at the reduced rate, as is the practice in almost all the Member States.

Nevertheless, the Commission accepts that some Member States face difficulties. The Commission recognises that the Member States concerned may well wish to be granted derogations to meet their particular difficulties. Indeed, this point was clearly recognised in the White Paper itself.

The Commission has indeed considered whether it should already at this juncture propose such derogations but has come to the clear view that it would not in any event be practicable to do so until the Member States have had a chance to study its proposals and consider what particular difficulties they may present. Though the proliferation of derogations would present serious problems that could threaten the operation of the internal market and the objective of abolishing fiscal frontiers, the Commission would of course take a constructive part in the discussion of any derogations for which Member States in real difficulty might feel the need. But that dialogue cannot commence until the present proposals have been studied and evaluated by all concerned.

This is not the place to deploy at any length the arguments for and against such derogations. The principle which needs to be respected all the time is the integrity of the Internal Market. Clearly where trade between Member States inevitably involves significant additional costs, it may well be possible for the market to accommodate cost differences resulting from derogations without too much risk of deflection or distortion of trade. But where cross-border shopping is easy and involves of itself no significant additional costs, derogations might well create significant distortions. For this reason also derogations are not simply a matter concerning the Member States asking for the derogation, but concern also the other Member States.

The second point which needs to be made is that derogations always carry a cost - which ultimately is borne primarily by the Member State concerned. The objective of the Completion of the Internal Market is to reduce actual and identifiable costs arising from the present frontier controls, and to give industry a more cost-effective basis on which to conduct its operations by having access to an undivided market of 320 million instead of primarily to its own domestic market only. Derogations may well lead neighbouring Member States to insist on the maintenance of frontier controls directed specifically against the Member State concerned. It would be a tragedy for the Community as a whole and in particular for the Member State concerned if by its own policies it forced itself into a position where effectively it had cut itself off from the overwhelming benefits which will flow from the integrated European market.

A word should also be said here about exemptions. The Sixth VAT Directive, in laying down the basic principles of the tax base, designated certain supplies as in principle exempt but gave Member States the option to continue to tax some of them on a transitional basis. Others were to be in principle taxable, but again as a transitional measure, Member States were allowed to continue to exempt them. The draft Eighteenth VAT Directive, still before the Council, seeks in the interests of fair competition within a single internal market to bring many of these transitional options to an end - either as permanent exemptions or by bringing the supplies concerned definitively into the tax net; others remain to be settled at a later stage, including the treatment of gold (other than for industrial use) and of works of art, where further thought needs to be given to what the definitive régime should be. Further proposals will therefore be needed, as foreseen in White Paper programme.

5. Excise duties

When first putting forward its proposals in 1972 for harmonizing the structures of excise duties, the Commission singled out for retention and harmonization at Community level the excises on manufactured tobacco, mineral oils, spirits, wine and beer. The other excise duties were to be phased out to the extent that they involved tax adjustments at internal frontiers. This programme had as its ultimate objective the creation of conditions permitting the abolition of fiscal frontiers.

This objective can, of course, only be met when common rates of excise duty are charged on harmonized structures throughout the Community. The present proposals, put forward under the White Paper programme, complete the process by laying down the common rates to be applied to those structures. It should be stressed, however, that very little progress has so far been made in the Council towards the adoption of the Commission's structural proposals. Consequently, the considerations in respect of the excise duties are more complicated than those in respect of VAT because not only the rates but also the structures still differ widely between different Member States.

As far as excise duties are concerned, any flexibility in the rates of duty which might be permitted would be compounded with the permitted margin for VAT rates and would therefore result in tax-induced price differentials well in excess of 6%. This is because VAT is imposed on the price of goods inclusive of excise duty. Consequently, the Commission has proposed that, as a general rule, any margin of flexibility in approximating rates should be reserved for the VAT rates because these rates have by far the widest coverage and therefore have an overriding importance for Member States' budgets. For tobacco products, where the Commission is proposing a composite rate for the ad-valorem excise duty and VAT, taken together, a margin of flexibility is proposed which is equivalent in its effect on retail prices to the margin proposed for VAT on other goods. More generally the possibility of providing a margin of flexibility on excise duties in particular cases of difficulty would depend on whether it was compatible with the objective of the abolition of frontier controls.

As regards the level of excise rates, the present divergence between Member States is much greater than in the case of VAT and it is consequently that much more difficult to arrive at an optimal solution which will cause the least amount of disturbance to the greatest number of Member States. Account must also be taken of other Community policies which affect mineral oils, tobacco products and alcoholic beverages.

In determining the rates the Commission's general approach has been to secure equity between Member States and the minimum disruption in each sector. The method for achieving this has varied according to the particular circumstances or characteristics of each sector in question.

Accordingly, in the case of tobacco products the rates have been calculated on the basis of the Community arithmetic average which gives equal weight to the rates applied by each Member State. The resulting rate produces an increase in the overall taxation of manufactured tobacco at Community level, which is consistent with the Commission's policy in health matters, set out in the report to Parliament in 1982 (COM(82)61 final) and in the Action Programme: "Europe Against Cancer" (COM(86)717 final).

The alcoholic drinks sector is broadly composed of two categories - distilled and fermented beverages. For the former (ie spirits) the Commission has taken the Community arithmetic average. However in the case of the fermented beverages (wine and beer) it was found that the effect of the arithmetic average, and also of an average weighted by consumption, would be highly disruptive. The solution proposed for these products, which are in competition, is therefore to tax them equally per litre of product on an overall revenue-neutral basis.

For mineral oils the Commission is proposing, for each main category of product, a rate which minimises disturbance to national tax revenues or industrial cost patterns. Thus for petrol which is by far the most important producer of revenue in this sector, a rate based on the arithmetic average of existing rates has been chosen. For diesel, heating gas oil and heavy fuel oil on the other hand, whose use is predominantly commercial, the Commission considers that an average weighted by consumption would be more appropriate, as it minimizes the effects on industrial costs.

On the basis of these considerations the Commission accordingly proposes the following rates:

Alcoholic drinks	Amounts in ECU
Alcohol for beverages (per hl of pure alcohol)	1271
Intermediate products (per hl)	85
Wine (per hl) average 11% vol)	17
Beer (per hl) (average 12,5° plato)	17
Manufactured tobaccos	
Cigarettes (specific excise per 1000)	19.5
ad val + VAT (in % of retail price)	52%-54%
Cigars and cigarillos ad val + VAT (in % of retail price)	34%-36%
Smoking tobacco ad val + VAT (in % of retail price)	54%-56%
Other manufactured tobacco ad val + VAT (in % of retail price)	41%-43%

Mineral oils

Petrol, leaded, and medium oils used as propellants, per 1000 l	340 ECU
Petrol, unleaded per 1000 l	310 ECU
Liquified petroleum gas (LPG) per 1000 l	85 ECU
Diesel (gas-oil) per 1000 l	177 ECU
Heating gas-oil and medium oils used as fuels other than propellants per 1000 l	50 ECU
Heavy fuel oil per 1000 kg	17 ECU

It should be noted that the excise duties proposed above are based on the situation as at 1 April 1987. Between now and 1992 the amounts of the specific duties will be adapted annually by the Commission in accordance with the general consumer price index in the Community and the revised figures will be communicated to the Member States.

6. Overall budgetary effects

As indicated previously, the Commission has kept in mind in formulating its proposals the need to minimize budgetary disturbance for the maximum number of Member States.

While the eventual adjustments which may be needed in individual Member States' budgetary arrangements are primarily and properly a matter for the Member States concerned, some tentative global qualitative assessment of the likely overall effects of the Commission's proposals can be given at this stage. Any quantitative estimates would have to be based on purely mechanical calculations which could not take account of the effects of changes in demand which tax and price changes may generate (elasticity effects); or of the effects on frontier trade; or of any macroeconomic stabilising mechanisms which may operate in the absence of compensatory measures. Taking such effects into account would in principle reduce the initial budgetary gains or losses shown. The Commission is, however, very conscious that in view of the complexity of the present tax rates and structures, and in view of the freedom given to the Member States to determine how they make the fiscal changes they need between now and 31 December 1992, any quantitative estimate of these moderating effects would be particularly difficult and unreliable. In particular an in-depth study of such effects would require a prior knowledge of the nature and extent of any compensatory policies which the Member States might adopt, depending on their budgetary situation and the use they make of indirect taxation. The Commission asked for such information early on in the process of formulating its proposals but has had only an inadequate response. The task of evaluating the effects of these proposals for individual Member States is, in any case, primarily a task for the Member States themselves. With the publication of the proposals, that is a task on which they can now begin. The Commission has already undertaken a certain amount of exploratory work in collaboration with national administrations. It is ready to pursue these studies and to complete them on the basis of any suggestions which the Member States may submit as to the adjustments they may consider desirable.

Subject to these qualifications, it seems probable that three Member States (Belgium, Italy, the Netherlands) would be able to continue to obtain the same level of total tax revenue from the VAT and excise duty rates proposed as they currently receive. One Member State (France) would suffer a slight budgetary loss, while three Member States (Germany, United Kingdom and Greece) would obtain small or moderate increases in budgetary receipts. Two Member States (Ireland and Denmark) would suffer pronounced budgetary losses, while the other Member States (Luxembourg, Spain and Portugal) would obtain substantial increases in budgetary receipts.

7. Timetable

It is intended that Community rates for VAT and the excise duties should enter into force no later than 31 December 1992. It will be the responsibility of the individual Member States to work towards these rates in the intervening period. The Commission will monitor the progress being made by the Member States and will report periodically to the Council, in accordance with the provisions of Article 8B of the Treaty as amended by the Single European Act. Such reports will consider the need for proposals for any complementary amending measures to take account of economic developments.

Furthermore, the Commission is putting forward a Convergence Proposal which replaces the standstill proposal currently before the Council (1). The convergence proposal, which covers both the VAT rates and the main excise duty rates, aims to ensure that Member States do not diverge from the overall objective in the meantime.

8. Conclusions

The abolition of fiscal frontiers is a vital element in the completion of the internal market. But it will also be an achievement of incalculable value in itself. The most direct and immediate benefit would accrue to industry and commerce as the administrative cost of fiscal frontier formalities virtually disappeared and the time spent in transporting goods was reduced. Relieved of those costs, firms in the Community would become more price-competitive both within the internal market and internationally. That in itself would increase their potential market and lead to economies of scale in production. These, together with the reduction in administrative costs, would be reflected in lower prices for the consumer. Real domestic demand in the Community would rise, with favourable effects on GDP growth. And, of course, the cost of frontier controls to member governments would be reduced. Frontier controls for fiscal reasons constitute the overwhelming majority of such controls. A Community in which it was no longer necessary for the citizen to worry about whether or not he had exceeded his travellers' allowance or whether he could drive his car into one Member State or another; a Community in which traders could do business with customers in other Member States just as they do with customers in the next street or the next town; a Community in which there would no longer be the endless queueing and form-filling and rubber-stamping at frontier posts; a Community in which goods and services no longer bore the extra and unnecessary cost of delay and bureaucracy; such a Community is well worth the effort on all sides that the Commission's proposals will undoubtedly require.

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(1) COM(85) 606 as amended by COM(87) 17

That effort, the Commission acknowledges, will be a considerable one. The Commission has done as much as possible to minimise it, but is nevertheless well aware that for some Member States the measures proposed will create problems, even though they allow a degree of flexibility and a reasonable period for adjustment (i.e., until the end of 1992). The Commission has, therefore, always acknowledged that there may be a need for derogations since these difficulties cannot be allowed to jeopardize the fundamental objective of creating a single European market. Nevertheless, it is in the general interests of the Community that such derogations should be kept to the minimum.

The Commission is nonetheless convinced that the present proposals for the approximation of the VAT and excise rates, taken in conjunction with the proposals already on the table, will serve two major purposes. They will firstly permit the abolition of fiscal frontiers; they will thus contribute towards the attainment of an integrated and expanding European economy. They will also satisfy, so far as possible, the legitimate concern of individual Member States that their existing economic and taxation systems should not be unduly disrupted.

ANNEX A

PROPOSALS TO BE SUBMITTED IN CONNECTION WITH THE APPROXIMATION OF INDIRECT TAX RATES AND HARMONIZATION OF INDIRECT TAX STRUCTURES

A) VAT

1) Proposal for a Council Directive supplementing the Common System of Value Added Tax and amending Directive 77/388/EEC - approximation of VAT rates. COM(87) 321

2) Proposal for a Council Directive supplementing the Common System of Value Added Tax and amending Directive 77/388/EEC - Abolition of Fiscal Frontiers. COM(87) 322

3) Outline Working Paper for a Community VAT clearing mechanism. COM(87) 323

4) Proposal for a Council Directive instituting a process of convergence of rates of value added tax and excise duties. COM(87) 324

B) EXCISES

1) Proposal for a Council Directive concerning the approximation of taxes on cigarettes. COM(87) 325

2) Proposal for a Council Directive concerning the approximation of taxes on manufactured tobacco other than cigarettes. COM(87) 326

3) Proposal for a Council Directive concerning approximation of the rates of excise duty on mineral oils. COM(87) 327

4) Proposal for a Council Directive concerning approximation of the rates of excise duty on alcoholic beverages and on the alcohol contained in other products. COM(87) 328

COMMISSION OF THE EUROPEAN COMMUNITIES

REVISED VERSION

COM(87) 324 final/2

Brussels, 21 August 1987

COM(87) 324

Proposal for a Council Directive instituting a process of convergence of rates of value-added tax and excise duties

(presented by the Commission)

COM(87) 324 final/2

C 011524/2

EXPLANATORY MEMORANDUM

The overall approach towards completing the internal market as far as indirect taxation is concerned is described in the Commission's Global Communication to the Council[1]. That Communication sets out the reasons underlying the proposals which the Commission is making and deploys the arguments in their support. It is particularly important therefore that the present document should be read in conjunction with the Global Communication.

On 21 November 1985, the Commission submitted to the Council a proposal for a Directive[2] which instituted within the framework of the White Paper on the completion of the internal market[3] a standstill on VAT and any new excise duties in order to prevent any further increase in the existing differences between national systems of indirect taxation.

On 22 May 1986, the Economic and Social Committee delivered a favourable opinion on the proposal[4]. The European Parliament was also in principle in favour of the proposal, but in its opinion of 9 October 1986[5] put forward a number of amendments which led the Commission to amend its original proposal[6].

Now that the Commission has presented its detailed proposals in the field of indirect taxation described in the Global Communication, the proposed standstill Directive as at present drafted is no longer appropriate. Instead, the Commission proposes a new draft Directive which would prohibit any divergence in the number and level of VAT rates at present applied by the Member States whilst at the same time allowing, and indeed encouraging, convergence towards the number and level of VAT rates which the Commission proposes should apply by 31 December 1992 at the latest.

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[1] Document COM(87) 320 final
[2] O.J. Nr. C 313 of 4.12.1985
[3] Bulletin CE 6/1985, points 1.3.1 and following
[4] O.J. Nr. C 207 of 18.08.1986
[5] O.J. Nr. C 283 of 10.11.1986
[6] O.J. Nr. C 30 of 07.02.1987

Similarly, for excise duties on alcoholic drinks, tobacco products and mineral oils, only changes which converge towards the rates of duty proposed by the Commission would be allowed. The introduction of new excise duties which give rise to controls at internal frontiers would be prohibited.

Commentary on the Articles

Article 1

Provisions relating to VAT

Paragraph 1 proposes, as a general rule, a prohibition on changes to the number and rates of tax except within the conditions fixed by paragraphs 2 and 3.

Paragraph 2 establishes the provisions which concern the number of rates to be retained.

Paragraph 3 provides that the Member States can alter their normal and reduced tax rates on condition that they do so within the terms provided for in the Directive. The higher tax rates must be abolished, or reduced in such a way as to align themselves on the VAT system of two rates proposed by the Commission.

Article 2

Provisions relating to excise duties

Paragraph 1 provides for a prohibition against the introduction by Member States of new excise duties which give rise in trade within the Community to the system of taxation of imports and refunds on export or to internal frontier controls.

Paragraphs 2 and 3 provide for a standstill for the excise duties which relate to tobacco products, alcoholic drinks and mineral oils as set out in paragraph 4. The standstill includes a prohibition against any increase in the scope of these duties.

Paragraph 4 provides that the Member States can alter their excise duties which apply to alcoholic drinks, tobacco products and mineral oils provided that they move towards the Community rates.

Proposal for a
Council Directive instituting a process of
convergence of rates of value added tax and
excise duties

The Council of the European Communities,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 99 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament[1],

Having regard of the opinion of the Economic and Social Committee[2],

Whereas completing the internal market, which is one of the fundamental objectives of the Community, requires that fiscal frontiers be abolished, that is to say that the system of remission of tax on exportation and the imposition of tax on importation and of frontier controls on taxable persons as well as on private persons be discontinued;

Whereas the measures to be taken to accomplish that objective ought to be spread over a period of time, but it is necessary at present to avoid an increase in the existing divergence between the fiscal systems of the Member States and on the contrary to encourage their convergence;

Whereas, in order to attain this objective, it is necessary for the Member States to refrain from altering the number and the rates of value added tax; whereas it is on the other hand desirable that the Member States should, if they wish, be authorized to alter the number and the rates of tax which they apply in each situation so that the substantial differences that currently exist within the Community may be reduced;

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(1)

(2)

Whereas only the excise duties on tobacco products, alcoholic drinks and mineral oils ought to be maintained at a Community level; whereas the Member States ought therefore to commit themselves not to introduce new excise duties or to increase the rates or the scope of existing excise duties; whereas it is appropriate, however, to allow them to move their main excise duty rates towards the Community rates,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Value-Added Tax provisions

1. Standstill

Pending the adoption of provisions concerning the number and level of the rates which will have to be applied in the Community in order to permit the abolition of the remission of tax on exportation and of the imposition of tax on importation insofar as trade between Member States is concerned, Member States shall refrain from altering the number and level of rates which they apply at the date of adoption of this Directive, subject to the rights provided for in the paragraphs below.

2. Optional convergence of the number of tax rates

Member States which apply:

a) three rates or more, may reduce that number to two rates, to be called a reduced rate and a normal rate,

b) one rate, may increase that number to two rates, to be called a reduced rate and a normal rate.

3. Optional convergence of the tax rates

Member States may:

(a) alter the levels of their reduced and normal tax rates on condition that they move towards or within the following limits:

(aa) for reduced rates: between 4% and 9%

(ab) for normal rates: between 14% and 20 %

(b) reduce or abolish their increased tax rates.

Article 2

Excise Duty provisions

1. Member States shall refrain from introducing new excise duties or indirect taxes which give rise, in trade between Member States, to taxation on importation and remission of tax on exportation or to frontier controls.

2. Member States shall refrain from increasing the rates or enlarging the scope of those excise duties or indirect taxes which give rise to taxation on importation and remission of tax on exportation or to frontier controls.

3. Paragraphs 1 and 2 shall not apply to the excise duties on manufactured tobacco, alcoholic beverages and mineral oils.

4. Pending the adoption of provisions concerning the rates and/or amounts of excise duty which will have to be applied in the Community in order to permit the abolition of import taxation and of export tax remission in trade between Member States, the latter may alter the rates of excise duty applied to the products set out below on condition that they move towards the following levels or amounts:

Alcoholic Beverages

Potable Spirits (per hl of pure alcohol)	1271 ECU
Intermediate products (per hl)	85 ECU
Wines	17 ECU
Beers per ° Plato per hl	1,32 ECU

Manufactured tobacco

Cigarettes: specific excise in (ECU per 1.000)	19,5 ECU +
+ ad valorem duty plus VAT (as a % of the retail price)	between 52% and 54%
Cigars and cigarillos ad valorem duty plus VAT (as a % of the retail price)	between 34% and 36%
Smoking tobacco ad valorem duty plus VAT (as a % of the retail price)	between 54% and 56%
Other manufactured tobacco ad valorem duty plus VAT (as a % of the retail price)	between 41% and 43%

Mineral oils

Leaded petrol and medium oils used as propellant per 1.000 l	340 ECU
Unleaded petrol per 1.000 l	310 ECU
Liquified petroleum gas (LPG) per 1.000 l	85 ECU
Diesel oil per 1.000 l	177 ECU
Heating gas-oil and medium oils used as fuels other than propellants per 1.000 l	50 ECU
Heavy fuel oil per 1.000 kg	17 ECU

Article 3

The Member States shall communicate to the Commission the text of all the provisions of national law which they adopt in the field covered by this Directive.

Article 4

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President

FICHE D'IMPACT

Propositions de directives concernant la suppression
des frontières fiscales en matière de TVA

- Proposition de directive du Conseil instituant un processus de convergence des taux de la taxe sur la valeur ajoutée et les accises

- Proposition de directive du Conseil complétant le système commun de la taxe sur la valeur ajoutée et modifiant la directive 77/388/CEE
  - Rapprochement des taux de TVA

- Proposition de directive du Conseil complétant et modifiant la directive 77/388/CEE
  - Suppression des frontières fiscales

- Communication de la Commission :
  Achèvement du marché intérieur - Mise en place d'un mécanisme de compensation de la TVA pour les ventes intracommunautaires

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1. CONTRAINTES ADMINISTRATIVES DECOULANT DE L'APPLICATION DE LA LEGISLATION POUR LES ENTREPRISES :

   Directives : Néant

   Clearing : Fournir quelques éléments supplémentaires sur la déclaration TVA périodique

2. ALLEGEMENTS POUR LES ENTREPRISES :

   - La plupart des Etats membres, à l'exception du Danemark, utilisant un système de TVA à deux ou plusieurs taux, la proposition entraînera une simplification de la gestion administrative de la TVA. Tous les Etats membres utiliseront en effet un système de TVA à deux taux, ce qui simplifiera la ventilation entre les taux, la structure des taux sera donc identique.

   - De plus,un même produit sera taxé au même type de taux dans tous les Etats membres, la classification des produits par taux sera simplifiée.

   - Les formalités d'exportation et d'importation seront supprimées puisque le système actuel de la détaxation (taux zéro) à l'exportation et de la taxation à l'importation sera aboli. Toutes les opérations intra-communautaires seront traitées de la même façon que les opérations en régime intérieur à l'heure actuelle.

   - Les petites entreprises ayant un chiffre d'affaires annuel inférieur à 35.000 ECUs sont libérées des obligations découlant du clearing et bénéficieront donc d'un traitement plus favorable dans ce domaine. Le chiffre de 35.000 ECUs correspond à la limite pour la franchise facultative prévue dans la proposition de directive en matière d'harmonisation du régime particulier TVA applicable aux PME (Doc. COM(86)444 final).

3. INCONVENIENTS POUR LES ENTREPRISES (coûts supplémentaires) :

   Non

4. EFFETS SUR L'EMPLOI :

Ces directives n'ont pas d'effets directs sur l'emploi. Toutefois, vu les allègements procurés aux entreprises (cf. point 2) on peut raisonnablement espérer un effet positif sur l'emploi.

De plus, la création du marché intérieur contribuera à la relance de l'économie européenne entière et par conséquent entraînera vraisemblablement des effets positifs sur l'emploi.

5. Y A-T-IL EU CONCERTATION PREALABLE AVEC LES PARTENAIRES SOCIAUX ?

Non

6. Y A-T-IL UNE APPROCHE ALTERNATIVE MOINS CONTRAIGNANTE ?

Non

BRIEF D

BRIEF D

ECOFIN COUNCIL, 16 NOVEMBER 1987: BRIEFING

Relevant document: Community document 9588/87 withdrawing proposal (attached).

1. AGENDA ITEM (e) - common system of VAT for works of art, antiques and other used goods

UK OBJECTIVES

The Chancellor will be participating in a general discussion and is not required to intervene. When faced with a Presidency compromise text for a Seventh VAT Directive (secondhand goods schemes), the Commission withdrew its 1986 revised proposal. The Danish Presidency wishes to give delegates the opportunity to react to the withdrawal of the Commission's proposal. While the UK had nothing to gain from the Presidency compromise text, our negotiating objectives would have been met, and the Chancellor could if necessary support the Presidency's initiative. Depending on the nature of the Commission's presentation on this issue, the Chancellor could support requests that the Commission put forward fresh proposals for a Seventh VAT Directive as soon as possible; or welcome their offer so to do.

POINTS TO MAKE

The Danish Presidency compromise suggestion appears to meet the needs of those wishing to introduce schemes for secondhand goods, while providing the requirement for a second phase directive to achieve a fully harmonized scheme.

Without an agreed directive, those member states which were fortunate enough to have secondhand goods schemes when the Sixth VAT Directive was implemented are at an advantage over those which are precluded from introducing schemes until a harmonized scheme is available.

The UK is fortunate to have a pre-existing scheme, but does not wish to deny others the opportunity of having equal facilities, including the availability of an exemption at importation for works of art, antiques and collectors' items.

BACKGROUND

The ECOFIN discussion will take place against the background of the recent withdrawal by the Commission of its 1986 revised proposals for a draft Seventh VAT Directive, which is required under Article 32 of the Sixth VAT Directive to provide a harmonized Community scheme for taxing secondhand goods including works of art, antiques and collectors' items. The Commission's first proposal was made in 1978 and revised in 1986. Very little progress has proved possible in official level discussions in Brussels. Some member states, notably Germany, have been reluctant to suffer the budgetary loss which would follow from the introduction of secondhand schemes; while France and the UK who already operate schemes under the "existing conditions" provisions of Article 32 have been unwilling to change their schemes whereby tax is applied on the basis of the "margin" achieved by the dealer. In addition, the UK and France have been reluctant to surrender their import exemptions for works of art, antiques and collectors' items; and the UK has protected the interests of the fine arts trade, notably auctioneers.

The Presidency's initiative

The Danish Presidency, anxious to progress the draft Directive, has evolved an extremely flexible compromise text, intended as a first-phase directive, which would in effect allow member states with existing schemes to retain them; and those without, to introduce schemes. The first phase directive would cover internal transactions only, and a second phase is envisaged by 1992 which would address import/export problems and sanction a fully harmonized scheme for secondhand goods.

The Presidency's text is broadly satisfactory to a number of member states, including the UK. However, because the text does not further the Internal Market, the Commission is strongly opposed and signified at an October Coreper meeting that it would withdraw its substantive proposal. The Presidency has nonetheless exercised its right to draw the issues involved to the attention of Ministers in ECOFIN. Belgium, because it feels disadvantaged without the possibility of secondhand schemes, and because it would like a UK-type import exemption for works of art, etc may be expected to press the Commission in ECOFIN to produce a new draft Seventh Directive as a matter of priority.

10

EUROPEAN COMMUNITIES
THE COUNCIL

Brussels, 12 November 1987

9588/87	
	RESTREINT

FISC 76

COPY OF LETTER (1)

from : Lord COCKFIELD, Vice-President of the Commission of the European Communities

dated: 11 November 1987

to : Mr. UFFE ELLEMANN-JENSEN, President of the Council of the European Communities

Subject : Withdrawal of the proposal for a 7th VAT Directive

Dear President,

The purpose of this letter is to confirm formally that the Commission has withdrawn its proposal for a Seventh Council Directive on the harmonization of the laws of the Member States relating to the system of value added tax to be applied to works of art, collectors' items, antiques and used goods.

The Commission announced the withdrawal of its proposal and the reasons for doing so at the COREPER meeting of 4 November 1987. However, I am taking the opportunity to restate here the reasons which led to the Commission's decision.

At its previous meeting on 28 October 1987, the Committee of Permanent Representatives discussed a compromise text formulated by the Council working group on fiscal matters as an alternative to the proposal submitted by the Commission. This compromise text is unacceptable to the Commission for three main reasons.

Firstly, the application of the compromise proposal is limited to a transitional period, i.e. until 31 December 1992. The Seventh Directive was submitted to the Council on the basis of Article 32 of the Sixth Directive and had therefore the objective of introducing a definitive Community regime and not a transitional one.

.../...

(1) This letter has been received by the Council in English only.

11

Secondly, the proposed compromise is only partial because it is strictly limited to transactions inside each Member State. The aim of creating the internal market and the recent related proposals of the Commission in the area of indirect taxation mean that a system which does not fix any rules to be applied to intracommunity transactions could not be accepted.

Finally, the compromise gives Member States the freedom to choose the method of taxation they apply and thus allows the coexistence of two very different taxation methods (normal scheme and margin scheme). This is contrary to another basic principle of Article 32 which is the introduction of a Community scheme, i.e. a harmonization of the legislation of Member States.

For these reasons, the Commission was left with no alternative but to withdraw its proposal and will shortly submit a new proposal for a Community taxation system to be applied to used goods, works of art, antiques and collectors' items.

(Complimentary close).

(s.) COCKFIELD

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(s.) COCKFIELD

BRIEF E

BRIEF E

2. **AGENDA ITEM (4) - eighteenth VAT directive** (compiled on the basis that Ministers assent to the line-to-take recommended in Mr Knox's 3 November submission to Paymaster General/Economic Secretary)

Relevant documents: Community documents 9587/87 and 9586/87 (attached)

UK OBJECTIVES

The Chancellor will be required to intervene. He should seek to ensure that requirements attaching to the UK's agreement to abolish derogations contained in the Presidency compromise draft directive are met; and that all other member states agree to make, simultaneously, equally significant sacrifices. This includes Ireland simultaneously surrendering the derogations whereby it exempts from VAT the supply of greyhounds and thoroughbred horses. In any event, the UK's agreement to lift reservations placed on individual items contained in the proposal must be provisional upon Parliamentary scrutiny of the substantive proposal. The Chancellor should also support passively two amendments which will be proposed to the Presidency compromise. These concern the detail of Article 4; and a request by Germany for abolition of an additional derogation (F27: tour operators services for journeys taken in the Community) in the first phase, by 1989.

LINE TO TAKE

The UK appreciates the Presidency's efforts in trying to achieve agreement to an Eighteenth Directive, which would be a further step on the road to harmonizing VAT policy in the Community.

It is particularly important to harmonize VAT policy where the continuation of disparity is distortive to international trade.

The UK Parliament is equally seized with the importance and implications of this draft proposal; and has signified its wish to fully consider the matter. Parliament is expected to do so shortly, and until then the UK must maintain a Reservation on the proposals to abolish derogations which it currently employs. These derogations are not distortive to international trade.

Subject to the UK Parliament's comments, the UK may be able to lift its reservations, providing certain requirements are met.

These requirements are that:

a. all member states make equally significant sacrifices; and simultaneously. Of particular importance in this respect is the derogation permitting the exemption of greyhounds and thoroughbred horses

b. the UK requires a provision in the Directive - a Minutes Statement will not suffice - to enable limitation of the scope of exemptions Annex E4 (certain sporting services) and Annex E5 (certain cultural services), in order that distortion of competition shall not arise.

BACKGROUND

The EC Sixth VAT Directive provides the basis for a common system of VAT throughout the Community. However, to facilitate its adoption in 1977, a number of derogations were incorporated which allow member states to retain, for a transitional period, certain taxation policies which they used at that time. In particular, Annexes E and F of the Sixth Directive list certain supplies which member states may tax where exemption is the Sixth Directive rule (Annex E); and vice versa (Annex F). The draft Eighteenth VAT Directive, first proposed in November 1984 and amended in June 1987, seeks the abolition of most of those derogations.

The Commission's proposals

The Commission has proposed that the Annex E and F derogations be abolished in three phases, beginning with those regarded by it as most easily conceded by member states and ending with those which pose greatest difficulty for them. Although the draft directive has recently been amended, the dates proposed in it for the three phases remain 1 January 1986 (clearly impossible), 1988 and 1990.

The Presidency compromise

The Danish Presidency has now put together a more modest compromise package which proposes the abolition on 1 January 1989 of all but two of the items included in the Commission's first phase - but on 1 January 1991 for the Irish derogation on greyhounds and horses - and calls for a decision on the remainder of the Commission's proposal before 1 January 1990. The Presidency has put the package to the ECOFIN Council in an attempt to give political impetus to the draft directive.

The UK position

Until recently the line taken in official level discussions has been to defend established national policy on the grounds that it is not distortive to Community trade, but at the same time, seek further information on the likely effects of conforming fully with the tax regime envisaged in the Sixth Directive. All member states were equally reluctant initially to abandon use of their own derogations but recently all of them except the UK have shown willingness to forgo derogations as part of a meaningful Community measure and in recognition that the derogations were intended to be transitional, not permanent. The result is that while most member states still maintain one or two reservations, the UK is isolated on six items included in the Presidency compromise package.

However, upon reappraisal of the UK's position, Ministers have given assent to a revised line-to-take in Brussels negotiations. This line is that all the UK reservations to the proposals in the Presidency's compromise solution should now be lifted provided that:

(a) a proviso is included in the text of the Directive to enable member states to take action as necessary to prevent distortion of competition

(b) all member states make equally significant sacrifices

(c) the Irish give up their derogation for bloodstock, and at the same time as other member states surrender theirs, ie 1989.

Likely scenario at ECOFIN

a. For decision:

(i) Amendment to Article 4 of Presidency compromise.

- UK should support.

(ii) Introduction by FRG in the first phase of the directive, ie by 1.1.89 of Annex F, Item 27 (exemption by derogation, of tour operators for journeys within the Community.

- UK agnostic (only Denmark use the derogation) but should, on balance, support.

b. Position of other member states on reservations:

(i) Luxembourg have replaced reservations on Annex F, Items 13 and 15 (exemption, by derogation, of certain financial management services), as a mark of displeasure at revision of Presidency compromise (relegation of Irish point 1.1.91) - may be posturing; but may also assist UK insistence of simultaneous abolition of the Irish derogation.

(ii) Dutch retain reserve on F11 (exemption, by derogation, of insurance claim assessments). This is the only Dutch derogation in the first phase.

(iii) France will lift reservation on F20 (exemption, by derogation, of supplies of scrap) if safeguarded by Minutes Statement 2(ii). UK has a reserve on the potential effect of the Minutes Statement in that Article 27 derogations should always follow 6th Directive rules; but the difficulty could be overcome with a small adjustment to the text.

EUROPEAN COMMUNITES
THE COUNCIL

Brussels, 11 November 1987

9587/87	
	RESTREINT

FISC 75

Pl fax to
Mr M. Parkinson HMT.
14/11

INTRODUCTORY NOTE

from : General Secretariat of the Council
to : ECOFIN Council of 16 November 1987

No prev. doc. 9586/87 FISC 74

Nos Cion props 11176/84 FISC 110
COM(84) 649 final
+ COR 1(d)
7422/87 FISC 36
COM(87) 272 final

Subject : Proposal for an 18th VAT Directive
- Abolition of certain VAT derogations

I.

1. On 4 December 1984 the Commission submitted to the Council a proposal for an 18th VAT Directive abolishing certain derogations provided for in Article 28(3) of the 6th VAT Directive.

The European Parliament and the Economic and Social Committee were consulted and issued their opinions on 6 April 1987 and 3 July 1985 respectively.

The Commission's proposal was amended on 25 June 1987 following the Opinion issued by the European Parliament and pursuant to the second paragraph of Article 149 of the Treaty.

.../...

2. The Working Party on Financial Questions and the Permanent Representatives Committee examined this proposal. In the light of these discussions, the Presidency presented a compromise set out in the Annex to document 9586/87 FISC 74.

The outstanding problems relating to this compromise are set out below in part II of this document.

II.

OUTSTANDING PROBLEMS

A. Deadline for a decision on other derogations (Article 4)

> The compromise proposal only covers a part of the derogations listed for deletion in the Commission's proposal for an 18th VAT Directive. Article 4 of the compromise provides for a decision to be taken before 1 January 1990 on the deletion of the remaining derogations which are the subject of the Commission proposal for an 18th VAT Directive.

The Spanish delegation entered a reservation on this Article. In the view of this delegation, this Article should not limit the future decision by the Council to those derogations which are in the proposal for an 18th VAT Directive, but should also include all the other derogations which are covered by Article 28 of the 6th VAT Directive.

The Luxembourg and Portuguese delegations reserved their position on this Article.

B. List of derogations to be deleted (Articles 1 and 2)

The following points mentioned in Articles 1 and 2 are subject to reservations by delegations :

1. Sport and cultural services (E4 and E5)

Reservation by the UK delegation.

However this delegation stated that its problems could be solved by the addition of a new Paragraph 2 to Article 1, as follows :

> "However, Member States are authorized to apply the conditions of Article 13 A.2(a), final indent, of the 6th VAT Directive to all supplies envisaged in Article 13 A.1(m) and (n) of the Directive, including supplies by bodies governed by public law."

2. Thoroughbred horses and greyhounds (F4)

Reservation by the UK delegation on the additional period of two years envisaged for this derogation. In the view of the UK delegation there should be a single date for the deletion of all derogations covered by this Directive.

3. Services of experts on insurance claims (F11)

Reservation by the Netherlands delegation.

4. Management of credit and credit guarantees ; safekeeping and management of shares, etc. (F13 and F 15)

Reservation by the Luxembourg delegation.

.../...

5. Supplies of recuperable material and fresh industrial waste (F20)

Reservation by the UK delegation on the statement for Council minutes under 2 ii) of the Annex to the ANNEX of document 9586/87 FISC 74.

The UK delegation demanded that the wording of the abovementioned statement be modified to read as follows :

> "The Council and the Commission will, on the basis of Article 27 of the 6th Directive, consider granting special derogations ... (etc.)".

The French delegation confirmed that it could only accept point F 20 if the wording of the statement set out in the Presidency compromise text was agreed without amendment.

6. Transport of goods on the Rhine and the canalised Moselle (F24)

Reservation by the French delegation, pending the outcome of a meeting of the Rhine Commission to be held in the near future.

7. Travel agencies for journies within the Community (F27) (not included in the Presidency compromise)

Request by the German delegation to add to Article 2 a point F 27. This point is worded as follows :

> F 27:"The services of travel agents referred to in Article 26, and those of travel agents acting in the name and on account of the traveller, for journeys within the Community."

The Belgian delegation agreed with this request ; however, this delegation asked for an undertaking by the Commission to examine the economic effects of the full application of the final regime of the 6th Directive to travel agents. Indeed, according to this regime journeys within the Community would be taxed, whereas journeys outside the Community would be exempted.

5

EUROPEAN COMMUNITIES
THE COUNCIL

Brussels, 11 November 1987

9586/87	
	RESTREINT

FISC 74

PRESIDENCY NOTE

to ECOFIN COUNCIL
of 16 November 1987

No. prev. doc. 9471/87 FISC 72

Nos Cion props 11176/84 FISC 110
COM(84) 649 final
+ COR 1 (d)
7422/87 FISC 36
COM(87) 272 final

Subject : Proposal for an 18th VAT Directive
- Amended text of the Presidency's compromise

Following the meeting of the Permanent Representatives Committee on 11 November 1987, the Presidency submits herewith the amended text of its compromise, as set out in the Annex, to the Council.

6

ANNEX

Amended text of the Presidency's compromise
for an 18th VAT Directive

Article 1

With effect from 1 January 1989, the following transactions shall be deleted from Annex E to Directive 77/388/EEC :

E 1. Transactions referred to in Article 13A(1)(a) insofar as they relate to parcel post services;

E 3. Transactions referred to in Article 13A(1)(f) other than those of groups of a medical or paramedical nature;

E 4. Transactions referred to in Article 13A(1)(m);

E 5. Transactions referred to in Article 13A(1)(n);

E 6. Transactions referred to in Article 13A(1)(p);

E 8. Transactions referred to in Article 13B(d)(2) insofar as they relate to the services of intermediaries;

E 9. Transactions referred to in Article 13B(d)(5) insofar as they relate to the services of intermediaries;

E 10. Transactions referred to in Article 13B(d)(6);

E 12. Supplies of goods referred to in Article 15(2);

E 13. Transactions referred to in Article 15(6) and (9);

E 14. Supplies of goods referred to in Article 15(12).

Article 2

1. With effect from 1 January 1989, the following transactions shall be deleted from Annex F to Directive 77/388/EEC:

F 3. Supply of services by means of agricultural machinery for individual or associated agricultural undertakings;

F 11. Services of experts in connection with insurance claim assessments;

F 13. Management of credit and credit guarantees by a person or a body other than the one which granted the credits;

F 14. Debt collection;

F 15. The safekeeping and management of shares, interests in companies and associations, debentures and other securities or negotiable instruments, excluding documents establishing title to goods or securities referred to in Article 5(3);

F 18. The supply, modification, repair, maintenance, chartering and hiring of commercial inland waterway vessels and the supply, hiring, repair and maintenance of equipment incorporated or used therein;

F 19. Supplies of some capital goods after the expiry of the adjustment period for deductions;

F 20. Supplies of recuperable material and fresh industrial waste;

F 21. Goods for the fuelling and provisioning of private boats proceeding outside the national territory;

F 22. Goods for the fuelling and provisioning of aircraft for private use proceeding outside the national territory;

F 24. The transport of goods on the Rhine and the canalized Moselle, and transactions linked thereto.

2. With effect from 1 January 1991, the following transaction shall be deleted from Annex F to Directive 77/388/EEC :

F 4. Supply of greyhounds and thoroughbred horses.

Article 3

Portugal may defer until 1 January 1994 at the latest the date referred to in Article 2 (1) for the deletion of point 3 from Annex F.

Article 4

The Council shall decide, before 1 January 1990, on the deletion of the remaining derogations from the 6th VAT Directive, which are the subject of the Commission proposal for an 18th VAT Directive.

Article 5

In respect of the transactions referred to in the preceding Articles, Member States may take measures concerning deduction of value added tax in order totally or partially to prevent the taxable persons concerned from deriving unwarranted advantages or sustaining unwarranted disadvantages.

Article 6

1. Member States shall bring into force the measures necessary to comply with this Directive not later than the dates laid down in Articles 1, 2 and 3.

2. Member States shall inform the Commission of the provisions which they adopt for the purpose of implementing this Directive.

Article 7

This Directive is addressed to the Member States.

ANNEX to the Annex

9

Draft statements for the Council minutes

1) Re Article 1, point E5

"The Council and the Commission state that transactions not closely linked to the cultural services referred to in Article 13A(1)(n) of the 6th VAT Directive shall be taxed."

2) Re Article 2, points F18 and F20

i) "The Council and the Commission agree that, notwithstanding deletion of these points from Annex F by this Directive, Member States may continue to apply existing special derogations of which they have notified the Commission in accordance with Article 27(5) of Directive 77/388/EEC."

ii) "The Council and the Commission agree that, on the basis of Article 27(1) to (4) of Directive 77/388/EEC, they will grant special derogations at the request of Member States in order to retain the system currently applied by them on the basis of these points of Annex F to the Directive."

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THE COUNCIL

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The Spanish delegation entered a reservation on this Article. In the view of this delegation, this Article should not limit the future decision by the Council to those derogations which are in the proposal for an 18th VAT Directive, but should also include all the other derogations which are covered by Article 28 of the 6th VAT Directive.

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9586/87

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Portugal may defer until 1 January 1994 at the latest the date referred to in Article 2 (1) for the deletion of point 3 from Annex F.

Article 4

The Council shall decide, before 1 January 1990, on the deletion of the remaining derogations from the 6th VAT Directive, which are the subject of the Commission proposal for an 18th VAT Directive.

Article 5

In respect of the transactions referred to in the preceding Articles, Member States may take measures concerning deduction of value added tax in order totally or partially to prevent the taxable persons concerned from deriving unwarranted advantages or sustaining unwarranted disadvantages.

Article 6

1. Member States shall bring into force the measures necessary to comply with this Directive not later than the dates laid down in Articles 1, 2 and 3.

2. Member States shall inform the Commission of the provisions which they adopt for the purpose of implementing this Directive.

Article 7

This Directive is addressed to the Member States.

ANNEX to the Annex

9

Draft statements for the Council minutes

1) Re Article 1, point E5

"The Council and the Commission state that transactions not closely linked to the cultural services referred to in Article 13A(1)(n) of the 6th VAT Directive shall be taxed."

2) Re Article 2, points F18 and F20

i) "The Council and the Commission agree that, notwithstanding deletion of these points from Annex F by this Directive, Member States may continue to apply existing special derogations of which they have notified the Commission in accordance with Article 27(5) of Directive 77/388/EEC."

ii) "The Council and the Commission agree that, on the basis of Article 27(1) to (4) of Directive 77/388/EEC, they will grant special derogations at the request of Member States in order to retain the system currently applied by them on the basis of these points of Annex F to the Directive."

BRIEF F

Confidential

BRIEF F.

BRIEF

ECOFIN, 16 NOVEMBER: OILS AND FATS TAX

This is not on the ECOFIN agenda. But the Chancellor may wish to have the opportunity for a bilateral discussion in the margin, with Mr Balladur. The speaking note has been provided by Sir D Hannay.

SPEAKING NOTE FOR CHANCELLOR OF THE EXCHEQUER/BALLADUR

OILS AND FATS TAX

1. Afraid one point has become very much a bone of contention between us in the future financing negotiation; oils and fats tax. Dominated Brussels European Council and PM/Chirac meetings in July and September. Could shipwreck Copenhagen if we are not careful.

2. Know importance French government have attached to tax. But must say very frankly that, for a whole range of reasons as much domestic (effect on RPI, British dislike of taxes on food) as external (developing country as well as US reactions - and now surely not time to poke up Congress) we cannot agree to it. Hard fact is that no British government could defend oils and fats tax <u>and</u> increase in own resources to House of Commons and we will not do it.

3. Realise that absence of tax somewhat alters the financial equation and account will have to be taken of that. But we have to get to grips with spending on fats and oils anyway (including particularly olive oil); and the tax was never going to do that effectively.

4. So, very much hope we can agree to disagree on the tax and not let it cut across Anglo-French Co-operation on many other parts of the Copenhagen package. Has caused particular difficulty hitherto in PM/Chirac meetings. Another such meeting is now scheduled for 22 November. Do you (Balladur) have any advice on how to handle it?

BRIEF G

8/019

BRIEF G

UCITS (INVESTMENT POLICY) AMENDMENT DIRECTIVE

UK OBJECTIVES

1. Germany - with Netherlands, a dissenting minority - wishes to make an oral statement for the record. There should be no substantive discussion. We support the directive which has been agreed at Coreper, but subject to our Parliamentary scrutiny reserve being lifted.

IF SPEECH IS NEEDED

2. I am content with the solution finally found to this ~~small but money~~ problem. I am obliged to maintain a Parliamentary scrutiny reserve but am confident that this can be lifted in the next few days.

BACKGROUND

3. The UCITS Directive, adopted in 1985, sets minimum standards for authorisation of "UCITS" (unit trusts, and their Continental equivalents) for promotion to the public. Once implemented, a UCITS authorised in its home member State will be able to market units anywhere in the Community, subject only to local marketing rules.

4. This amendment, though expressed in general terms, is intended to meet a Danish problem. It increases the proportion of a UCITs' assets which may be invested in certain bonds (of a kind thought to issued only by 5 Danish mortgage banks). Germany would prefer tighter percentage limits. Netherlands thinks the change insufficiently liberal. The proposal originally included a relaxation for certain UK funds, since withdrawn at our request.

5. The draft directive has been agreed at COREPER by qualified majority. It was originally intended to be taken as an 'A' point, but the Germans wish to make a dissenting oral statement. It may be taken as a B* point, in which case a vote may be needed. If the Presidency does not acknowledge the existence of our Parliamentary scrutiny reserve, the speaking note would be needed.

133/13

BRIEF H

BRIEF H

INTERNATIONAL STATISTICS: EUROPEAN COMMUNITY, US AND JAPAN

List of tables

INTERNATIONAL STATISTICS: EUROPEAN COMMUNITY, US AND JAPAN

1. Gross domestic product (per cent changes)

	1986	1987	1988
Belgium	2 ¼	1 ¼	2
Denmark	3 ½	- ¼	½
France	2 ½	1 ½	2 ½
Germany	2 ½	1 ½	2
Greece	1 ¼	- ¾	½
Ireland	½	1	1 ½
Italy	2 ¾	3 ¼	2 ¾
Luxembourg	2 ¼	2	1 ½
Netherlands	2	1 ¾	1
Portugal	4 ¼	3 ½	3
Spain	3	2 ¾	3
UK	2 ½	3	2 ½
EC	2 ½	2 ¼	2 ¼
USA	2 ½	2 ¼	2 ½
Japan	2 ½	2 ¾	3 ¼

2. Prices- consumers' expenditure deflator (per cent changes)

	1986	1987	1988
Belgium	1 ¼	1 ½	2
Denmark	3 ½	4 ¼	4 ¼
France	2 ¾	2 ¾	2 ¼
Germany	- ½	¾	2
Greece	22	13 ½	9
Ireland	3 ½	3 ¼	3 ½
Italy	6 ¼	4 ¼	3 ¾
Luxembourg	¼	1 ¼	2 ½
Netherlands	-	-1	1 ¼
Portugal	11 ¾	9 ½	8
Spain	9	6	5 ½
UK	3 ¾	4	4 ¼
EC	3 ½	3	3 ¼
USA	2	3 ½	3 ¾
Japan	¾	-	½

Source: EC Commission Forecasts, May 1987

3. **Unemployment rate (per cent of civilian labour force)***

	1986	1987	1988
Belgium	12 ¾	12 ¾	12 ¾
Denmark	7 ½	8	8 ½
France	11 ½	11 ½	12
Germany	8	8	8
Greece	7 ½	8	8 ¾
Ireland	18 ¼	18 ¾	18 ¼
Italy	13	13	12 ½
Luxembourg	1 ½	1 ¼	1 ¼
Netherlands	12	11 ½	11
Portugal	8 ½	8 ½	8 ½
Spain	21 ½	21 ¼	21 ¼
UK	12	11	10¾
EC	12	11 ¾	11 ¾
USA	7	6 ¾	6 ¾
Japan	2 ¾	3 ¼	3 ¼

* Partially standardised

4. **Current account balances (% of GDP)**

	1986	1987	1988
Belgium	2 ½	3½	3 ½
Denmark	-4 ¾	-3 ¼	-2 ½
France	- ¼	- ½	- ½
Germany	4	2 ¾	2
Greece	-5 ½	-4 ¾	-5 ¼
Ireland	-1 ¼	-1 ½	-1 ¼
Italy	¾	½	-
Luxembourg	41 ½	39 ¾	38 ¼
Netherlands	3	1 ½	1 ½
Portugal	4	1	- ¾
Spain	2	¾	¼
UK	- ¼	- ¾	- ¾
EC	1	¾	½
USA	-3 ½	-3 ¼	-3
Japan	4 ¼	3 ¾	3 ¼

Source: EC Commission Forecasts, May 1987

5. **General Government fiscal deficits (per cent of GNP)**

	1986	1987	1988
Belgium	8¾	-6½	-6¼
Denmark	3½	2½	2¾
France	-3	-2¾	-2¾
Germany	-1¼	-1¾	-2
Greece	-10¼	-9½	-10¼
Ireland	-10¾	-9	-7¾
Italy	-11¼	10½	-9¼
Luxembourg	4	2½	2
Netherlands	-6	-6½	-6
Portugal	-8½	-9	-9
Spain	-6	-5½	-5
UK	-3¼	-2½	-2¼
EC	-5	-4½	-4½
US	-3¼	-2¾	-2
Japan	-1½	-1½	-1¼

Source: EC Commission Forecasts, May 1987

6. **Money supply (change over previous period at annual rates)**

	1985	1986	latest growth over base at annual rate	Target range
Germany (CBM)	4.6	6.4	7.4 (Aug)	3 - 6
France (M3)	8.3	5.4	9.7 (Aug)	3 - 5
UK (MO)	4.6	4.0	4.9 (Sep)*	2 - 6
US (M1)	9.2	13.4	8.4 (Sep)	na
Japan (M2+CDs)	8.4	8.6	10.4 (Jul)	10

* Change on level 12 months earlier.

7. **Three-month interest rates (per cent per annum)**

	1986				1987			2 Nov
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	
France	8¾	7½	7¼	7¾	8¼	8	8	8
Germany	4½	4½	4½	4¾	4¼	3¾	4	4
Italy	15¾	12¾	11½	11¼	11½	10½	12	11¾
Netherlands	5¾	5½	5½	5½	5½	5¼	5¼	5¼
UK	12½	10¼	10	11¼	10½	9¼	9¾	9¼
Major EC average	9	7½	7½	8	7¾	7	7½	7½
USA	7¾	6¾	6¼	6¼	6¼	6¼	7	7½
Japan	6	4¾	4¾	4½	4	3¾	3¾	4

8. Long term government bond yields (per cent)

	1985	1986				1987			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	9 Nov
France	10½	9½	8	7¾	8½	8¾	9	9¾	10
Germany	6¾	6½	6	6	6½	6¼	6½	6½	6½
Italy	13¾	13¾	11¾	11	10¼	9¾	10¼	11	11½
Netherlands	7	6¾	6¾	6	6¼	6¼	6¼	6½	6½
UK	10¾	10¾	9½	9¾	11	9¾	9	10	8¾
Major EC average	9½	9¼	8	8¼	8½	8	8½	8¾	8½
USA	9¾	8½	7½	7¼	7¼	7¼	8¼	8¾	8¾
Japan	6	5½	4¾	4¾	5	4¾	3¼	5	4½

9. Effective exchange rates (1975 = 100)

	1986				1987			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	10 Nov
Belgium	93.8	95.2	96.2	97.5	100.4	100.0	99.7	101.6
France	71.0	69.0	69.5	70.8	72.0	71.6	71.4	72.5
Germany	133.1	134.7	138.6	142.6	147.7	146.9	146.4	151.4
Italy	45.9	46.1	47.3	48.2	48.4	47.5	47.1	47.5
Netherlands	122.6	124.4	129.0	130.8	135.1	135.0	134.6	139.5
UK	75.1	76.0	71.9	68.3	69.9	72.8	72.7	75.5
US	121.2	116.0	111.4	110.5	104.2	101.0	102.5	96.0
Japan	186.7	202.8	214.8	208.0	210.1	222.9	218.0	229.0

Source: Bank of England

10. Relative unit labour costs in manufacturing (1980=100)*

	1986				1987	
	Q1	Q2	Q3	Q4	Q1	Q2
Belgium	78.2	77.1	76.3	77.7	80.5	80.8
Denmark	107.1	100.8	106.2	107.5	115.9	117.2
France	96.3	91.7	92.1	93.8	94.3	92.2
Germany	94.9	97.0	101.2	104.5	108.8	107.0
Italy	110.4	110.7	114.1	117.6	118.9	118.5
Netherlands	81.0	83.9	86.1	88.4	88.3	88.0
Portugal						
Spain	74.8	73.4	76.8	75.5	75.7	76.6
UK	83.8	84.9	78.8	74.2	76.2	80.0
US	117.8	112.9	106.5	105.0	96.9	93.1
Japan	122.7	132.5	141.5	136.0	134.5	141.9

* In common currency
Source:IMF

11. **Total Reserves minus gold (SDR billion, end of period)**

	1986 Q1	1986 Q2	1986 Q3	1986 Q4	1987 Q1	1987 Q2	Latest
Belgium	4.3	4.9	4.3	4.5	4.8	6.1	6.4 (July)
Denmark	4.1	3.7	4.3	4.1	5.1	6.9	6.8 (July)
France	23.3	29.4	25.8	25.7	24.8	25.2	25.2 (June)
Germany	40.0	37.9	40.4	42.3	47.0	48.7	48.0 (July)
Greece	1.0	0.9	1.3	1.2	1.4	1.4	1.8 (July)
Ireland	2.7	2.8	2.6	2.6	2.8	2.9	3.2 (July)
Italy	13.1	16.9	15.8	16.3	19.5	17.8	16.9 (July)
Netherlands	9.6	9.3	9.6	9.1	9.5	10.7	10.9 (July)
Portugal	1.0	1.0	1.7	1.2	1.2	1.3	1.8 (July)
Spain	10.7	10.5	12.5	12.1		15.6	15.6 (June)
UK	12.3	12.6	15.3	15.1	16.7	22.5e	22.9e (July)
US	29.7	30.2	30.5	30.6	29.4	26.7	26.2 (July)
Japan	24.7	28.9	34.2	34.5	45.3	54.0	54.9 (July)

Source: IMF

12. **Total reserves including gold (at SDR 35 per Ounce) and IMF items (SDR billion, end of period)**

	1986 Q1	1986 Q2	1986 Q3	1986 Q4	1987 Q1	1987 Q2	Latest
Belgium	7.3	5.5	6.1	5.5	5.7	6.0	7.5 (July)
Denmark	6.9	4.1	3.7	4.3	4.1	5.1	6.9 (July)
France	28.1	26.1	32.2	30.6	28.6	27.6	28.1 (June)
Germany	52.1	43.3	41.2	43.7	45.6	50.3	51.4 (July)
Greece	1.5	1.1	1.0	1.4	1.4	1.5	1.9 (July)
Ireland	3.0	2.7	2.8	2.6	2.7	2.8	3.2 (July)
Italy	20.1	15.4	19.2	18.2	18.7	21.8	19.2 (July)
Netherlands	12.3	11.2	10.9	11.2	10.7	11.0	12.5 (July)
Portugal	2.0	1.7	1.7	2.4	1.9	1.9	2.5 (July)
Spain	16.1	11.2	11.0	13.0	12.6	12.6	16.1 (June)
UK	23.1	12.9	13.3	16.0	15.7	17.4	23.6 (July)
US	35.8	38.9	39.3	39.7	39.8	38.5	35.4 (July)
Japan	54.9	25.5	29.8	35.1	35.4	46.2	55.7 (July)

Source: IMF

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AND TO IMMEDIATE DEPT OF ENERGY LEICESTER, DEPT OF TRADE, MAFF
AND TO IMMEDIATE SCOTTISH OFFICE LONDON, TREASURY, ODA, DOE
AND TO IMMEDIATE INLAND REVENUE, CUSTOMS AND EXCISE, BANK OF ENGLAND
AND TO IMMEDIATE COI, WELSH OFFICE CARDIFF

FRAME FORECAST

SUBJECT : ''A'' ITEM FOR 1199TH MEETING OF COUNCIL OF EUROPEAN COMMUNITIES (ECONOMIC AND FINANCIAL QUESTIONS) ON 16 NOVEMBER 1987

- GATT
  = CONCLUSION OF THE PROTOCOL AMENDING THE GATT AGREEMENT ON GOVERNMENT PROCUREMENT (9622/87 GATT 132, 8107/1/87 GATT 100 MAP 14 REV 1)
(AMENDED BY COREPER PART 2 ON 12.11.87 AND FINALIZED BY LEGAL/ LINGUISTIC EXPERTS WORKING PARTY).

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PERSONALITY NOTES .

20/12

COVERING CONFIDENTIAL

PERSONALITY NOTES

Belgium

1.	Mr Philippe Maystadt	Minister for Economic Affairs
2.	Mr Mark Eyskens	Minister for Finance

Denmark

3.	Mr Knud Enggaard	Minister for Economic Affairs
4.	Mr Palle Simonsen	Minister for Finance

France

5.	Mr Edouard Balladur	Minister for the Economy, Finance

Germany

6.	Dr Gerhard Stoltenberg	Minister for Finance
7.	Dr Martin Bangemann	Minister of the Economy
8.	Dr Otto Schlecht	State Secretary - Federal Ministry of the Economy
9.	Dr Hans Tietmeyer	State Secretary - Federal Ministry of Finance

Greece

10.	Mr Dimitris Tsovolas	Minister for Finance

11.	Mr C Simitis	Minister of National Economy
12.	Mr Athanasopoulos	Alternate Minister of Finance

Ireland

13.	Mr R MacSharry	Minister for Finance
14.	Maurice F Doyle	Secretary - Department of Finance

Italy

15.	Mr Giuliano Amato	Minister for the Treasury

Luxembourg

16.	Mr Jacques Santer	Prime Minister and Minister of Finance
17.	Mr Jean Claude Juncker	Minister of Labour, Minister Delegate for Finance, responsible for the Budget
18.	Mr Jacques Poos	Vice-President of the Government Minister of the Economy
19.	Mr Pierre Werner	Honorary Minister of State

Netherlands

20.	Dr Ruding	Minister for Finance

Portugal

21.	Dr Miguel Jose Ribeiro Cadilhe	Minister of Finance

Spain

22.	Mr Carlos Solchaga Catalan	Minister of the Economy and Finance

Secretariat

23.	Mr Ersbøll	Secretary General of the Council Secretariat

Commission of the European Communities

24.	Mr Jacques Delors	President
25.	Lord Cockfield	Vice President
26.	Mr Christophersen	Vice President
27.	Mr Andriessen	Vice President
28.	Mr Willy De Clercq	Member
29.	Mr Peter Schmidhuber	

MAYSTADT, PHILIPPE

Minister for Economic Affairs ~~the Budget, Scientific Policy and Planning.~~ Former Minister for the Civil Service and Scientific Policy (1980-81). Deputy for Charleroi since 1977.

Born 1948. Spent 2 years in the US where he gained a degree in Public Administration at the University of Los Angeles. He also has a law degree from Louvain University. State Secretary for the Walloon region (October 1979-April 1980).

A young and articulate politician with an important portfolio, who has an enthusiastic following among the younger members of the PSC. One of the few members of his party to improve his standing in the November 1981 elections and a possible future leader.

Married with three young children. Speaks quite good English.

EYSKENS, MARK

Minister for ~~Economic Affairs~~ Finance. Former Prime Minister (April-December 1981) and Minister of Finance (October 1980-April 1981). CVP Deputy for Leuven since April 1977.

Born Leuven 1933.

Son of former Prime Minister, Gaston Eyskens. Doctorate from Leuven University (KUL) and MA from Columbia University. Adviser to Finance Minister 1962-65, Professor of Economics at KUL since 1966. Commissaire-Générale responsible for links between the French and Dutch speaking universities of Leuven (UCL-KUL) since 1972.

Held office in both Tindemans' governments, first as State Secretary for Land Management and then as State Secretary for the Budget and Flemish Regional Economy. Served as Minister for Cooperation and Development under Martens, April 1979-October 1980.

An eminent economist and influential adviser to his party on economic matters, on which he generally takes a conservative line. As State Secretary for the Flemish Regional Economy he was active in seeking new investments for Flanders, especially from the United States, whose diminished confidence in Belgian economic prospects he tried hard to revive. He brought a change of style to the Cooperation and Development Ministry where he attempted to alter the pattern of Belgian aid, hitherto directed almost exclusively to francophone countries.

He is married. Both he and his charming wife speak excellent English, are very sociable, and are seen about more than any other Belgian Minister.

3

CONFIDENTIAL

Now Minister for Economic Affairs

ENGGAARD, KNUD

Minister for the Interior since March 1986 (Venstre).

Born June 1929. Degree in Engineering Science 1954. Civil Engineer with Danish Air Force from 1955-62. Active in local politics and Venstre Youth organisation (Deputy Chairman 1957-59, Chairman 1959-62). Member of Venstre Party board 1957-62 and since 1965; Party Vice Chairman 1978-82. Member of the Folketing since 1964. A respected Chairman of the party's group in the Folketing 1970-71 and 1973-77. (Vice Chairman 1971-73). Minister for the Interior during short Social Democratic/Venstre coalition 1978-79. Minister for Energy from September 1982-March 1986.

Intelligent and influential in his party. His political future came into question after the dispute with Jens Christensen (qv) which led to the latter's being sacked from DONG in November 1983. The Social Democrats (who had appointed Christensen and given him free rein) insisted that Enggaard had acted for purely political reasons. With full support from Schluter he weathered this storm but it did not help his reputation for touchiness.

Married. A compulsive talker. Speaks reasonably good English.

SIMONSEN, PALLE
MINISTER OF FINANCE SINCE JULY 1984.

Minister for Social Affairs (Conservative) ~~since~~ FROM September 1982. UNTIL JULY 1984

Born 1933. After training at a business school in Jutland, worked in industry. Member of the Folketing 1968-75 and since 1977. Chairman of the Defence Committee for several years. Deputy Chairman of the Conservative Party since 1975. Member of the Radio Council and the Civil Defence Council. Would have preferred Defence portfolio, but was pressed to take what was seen as the more difficult Social post, where he seems to be doing well. Met Mr Norman Fowler briefly in March 1983. Visited Britain as guest of Government to study defence early 1982. Some tip him for high office. Helpful over visit by House of Commons Select Committee on Social Affairs 25-26 April 1983, when they studied Danish policy on children in care.

Married: both speak English. Very approachable and ready to accept invitations. Active in local charities in Gentofte.

BALLADUR, EDOUARD

Minister of the Economy, Finance and Privatisation.

As the only Minister of State in the Government, clearly the most important figure after Chirac. He will supervise Junior Ministers for the Budget, Privatisation and Foreign Trade. Born 1929. ENA. 1963-74 worked for Pompidou, first as Social Affairs Adviser (alongside Chirac) when Pompidou was Prime Minister, later Assistant Secretary-General of the Elysee in 1969 and Secretary-General in 1973. After Pompidou's death in 1974, Head of a Subsidiary of the CGE Electronics Group before moving back into the political world in the late 1970s as an increasingly influential adviser to Chirac.

Although largely unknown to the French public (he had not stood for elected office before last Sunday), he is intelli gent, calm and discreet and has a high reputation for efficiency and good sense. He has little direct experience of the Ministry he now directs or of financial affairs and, while open-minded, is generally seen as prudent rather than particularly liberal in his approach to economic affairs. This is in contrast to the more obviously liberal approach of other ministers in the economic field, notably Juppé (Budget), Noir (Foreign Trade) and Madelin (Industry).

STOLTENBERG, DR GERHARD, HON GCMG

Federal Minister of Finance.

Born 1928 in Kiel, the son of a clergyman. War Service 1944-45. Studied history, social science and philosophy at Kiel University, taking his doctorate in 1954 with a thesis on the work of the First Reichstag. Thereafter worked as an assistant at Kiel University. Appointed Lecturer in Modern History in 1960, his special topic being Tirpitz and his naval policy. 1965 and again 1969-70, a Director of Friedrich Krupp, and Head of the company's Economic Policy Department.

He entered politics through the Young CDU, of which he was Federal Chairman from 1955-61. A member of the Schleswig-Holstein Land Parliament from 1954-57, and again since 1971. A member of the Bundestag from 1957-71. 1965-69 Federal Minister for Scientific Research. Elected a Vice-Chairman of the CDU in 1969 and from 1969-71 was Vice-Chairman of the CDU-CSU Parliamentary Party. He resigned from the Bundestag in 1971 to lead the CDU compaign in the Schleswig-Holstein Land elections, as a result of which he became Minister-President. Re-elected in 1979 after a hard and close-fought contest. Returned to Bonn as Finance Ministe on the formation of the CDU/CSU/FDP Government in October 1982.

Stoltenberg was the first of the younger generation of CDU politicians from North Germany to reach the top rank. He appeared to be Dr Kohl's main rival within the CDU for the nomination in 1975 as CDU/CSU Chancellor-Candidate. But in the event Kohl's control of the party machinery allowed him to out-manoeuvre Stoltenberg completely, and the latter's candidature never got off the ground. This has reportedly left a legacy of some bitterness between them. His age and abilities should ensure him an important future in the CDU. The CDU's unimpressive showing in Schleswig-Holstein in the 1976 and 1980 Federal elections slightly tarnished his image but in the latter contest his loyal support for Herr Strauss' cause (he stood as Vice-Chancellor candidate) earned him much credit with the Union as a whole, particularly in Bavaria. The obvious choice as Finance Minister in Chancellor Kohl's Cabinet.

Stoltenberg is tall, well-built and good-looking. Reserved, even a little cool, but an effective speaker. He is normally courteous and friendly, but occasionally shows signs of impatience or a touch of arrogance. As Minister for Scientific Research, he favoured European cooperation in the scientific field and showed himself well-disposed to the UK. He often refers to the fact that the Angles came to Britain from his Land. Visited the UK as the guest of HMG in 1974.

Protestant. Married. One daughter and son. His wife is quiet and takes little part in her husband's public life. He speaks good English.

7

MARTIN BANGEMANN

Born in 1934. A lawyer by profession, he joined the Liberal Free Democrat Party (FDP) in 1963 and rose quickly to become Chairman of the Baden-Wuerttemberg party (the FDP's most important region) in 1974. He was elected to the Bundestag in 1969 and became a Member of the Foreign Affairs Committee.

Genscher (Vice Chancellor and Foreign Minister) made him FDP Secretary-General in September 1974. Bangemann never settled in the job. He stands well to the right in the FDP and was out of tune with the party at a time when it was committed to a coalition with the Social Democratic Party (SDP). He felt strongly that the FDP should keep open the option of future coalition with the Christian Democrats (CDU/CSU). His reluctance to lead his party in to the Baden-Wuerttemberg Regional (land) election in 1976 with a commitment to the SPD caused Genscher to engineer his resignation as Secretary-General. Bangemann was subsequently rejected by the Baden-Wuerttemberg party and resigned as regional Chairman in 1978.

He has spent the last four years as leader of the FDP Parliamentar Group in the European Parliament. As a result he has been out of touch with Federal politics and out of the public eye. He re-emerged with his energetic campaign as the FDP's leading candidate in this year's European election. Although the FDP failed to clear the 5 per cent hurdle necessary for representation at Strasbourg, the blame for this has been laid on Genscher, and Bangemann has managed to emerge relatively unscathed.

Bangemann was an effective member of the European Parliament and leader of the FDP group there. He is a genuinely dedicated European. A strong character and a man brimming with bright ideas. He played a leading role in forming the Federation of European Liberal Parties.

In so far as Bangemann has taken an interest in Economics, his views are Liberal. But in a typical German way he also has a strong social conscience. He is a strong believer in détente.

Bangemann is stout, bespectacled, friendly and a keen traveller. He speaks English and French.

SCHLECHT, DR OTTO

Official State Secretary in the Federal Ministry of the Economy.

Born 1926 in Biberach (Swabia). The son of a butcher. War service; American POW. From 1947–52 studied economics at Freiburg University. Joined the Federal Ministry of the Economy in 1953 and has risen rapidly by sheer ability. A non party figure who has served Ministers of different parties with equal success, impressing each in turn. The right hand man of the Economics Minister, Graf Lambsdorff.

In 1967 Professor Schiller made him Head of the Department dealing with economic policy. Following the General Election in 1972 and the resignation of Dr Mommsen he was promoted to his present position where he is responsible for general domestic economic policy and European Community policy.

Schlecht has consistently held the line against attempts to erode the social market economy from within, and although pragmatic in his private view of the policies of others can be relied upon to voice opposition of what he regards as protectionist trends.

A tall, bulky human man, who retains a strong Swabian accent and simple tastes. His Bonhomie and sometimes coarse humour do not mask his ability. Friendly and well disposed towards Britain, but a firm defender of German interests.

Married, no children. Understands English quite well, although prefers to speak through an interpreter. His wife speaks English quite well. Both are keen, not very good, golfers.

9

TIETMEYER, DR HANS
State Secretary - Federal Ministry of Finance

Born 1931 in Metelen (Westphalia). Studied economics at Münster, Bonn and Cologne. 1959–62 Secretary of Catholic Church organisation. Joined Federal Ministry of the Economy in 1962. 1970 Head of the department dealing with the European Communities and relations with third countries. 1972 Head of the department dealing with economic and growth policy. 1973 promoted to present position.

A South German, friendly and easy in manner if a bit professorial (he spends quite a bit of the time lecturing to professional bodies on behalf of his Minister). Has SPD sympathies, though not a Party man, and has in the past taken a relatively less restrictionist view than some of his economic colleagues. Has a good academic reputation, is highly articulate, and outspoken on his own subject. His views are widely respected. As Chairman of the EC Economic Policy Committee was deeply involved in the EMS and Concurrent Studies and reportedly played fair.

A good contact with an enquiring and objective mind. Married with two children by a first wife who died in 1978. Catholic. Good English.

TSOVOLAS, DIMITRIS

Minister of Finance. Deputy for Arta

Born 1942 near Arta. Studied law at Salonica University then practiced in Arta until 1977 when he was elected as PASOK Deputy.

As a Deputy he has been active in promoting PASOK's interests and before his ministerial appointment he was a lively parliamentarian. Since his appointment as Under Secretary of Finance in 1981 he has kept a low profile. But his promotion in 1984 to Alternate Minister following the resignation of Pottakis, and then to Minister of Finance in July 1985, suggest that he is well regarded.

Married with a son and a daughter.

CONFIDENTIAL

SIMITIS, PROFESSOR CONSTANTINE (COSTAS) now Minister of National Economy

previously Minister of Agriculture. Not a Deputy.

Born Athens 1936. Studied politics in Athens and law in Germany, where he later pursued an academic career. Spent two years at the LSE in the 1960s. Professor of commercial law at the Panteios Higher School of Political Science since 1977, he also maintained a commercial law practice in Athens. A founding member of "Democratic Defence" in 1967, he left Greece secretly in September 1969 and became a leading member of PAK in Germany. A founder member of PASOK, he was a member of the Central Committee and Executive Bureau and one of the party's leading ideologists until he fell out of favour with Papandreou in 1978. Much to his regret, he was not adopted as a parliamentary candidate in 1981, and his apparently sudden return to favour took many by surprise.

His removal from the Executive Bureau in 1978 apparently reflected concern about a possible challenge to Papandreou's authority. But, in or out of favour, Simitis has never wavered in loyalty to the party and its line. Intelligent with a strong personality but an unassuming manner. One of the most capable of the Government. His inner political convictions are difficult to fathom.

Married. Good English and German. Charming wife Daphne also speaks English.

ATHANASOPOULOS, NIKOS

Alternate Minister of Finance. Deputy for Salonica 'A'.

Born 1923 in Arkadia. Attended Patras Agricultural College and the University of Athens, where he studied law. Worked as Deputy Public Prosecutor at the Court of Appeal.

Elected Deputy in 1977, 1981 and 1985. Appointed to his present post in July 1985.

Married with two sons.

13

MACSHARRY, RAYMOND TD MEP

Fianna Fail Deputy and Honorary Treasurer.

Born Sligo 1948. Educated Summerhill College, Sligo. Member of Sligo County Council since 1967 and of Northern Western Health board since 1971. Deputy since 1969 for Sligo/Leitrim. Opposition front bench spokesman on the Office of Public Works 1973-75. Member, Committee of Public Accounts 1969-77. He was nominated as a Minister of State at the Department of the Public Service in December 1977, in recognition of his outstanding poll in the general election of June 1977. A loyal supporter of Mr Haughey, he was Minister for Agriculture from 1979-81 where he proved his ability.

A relatively competent Minister of Finance in 1982, he came unstuck when he was found to have bugged a meeting with an anti-Haughey deputy. Resigned from the front-bench. Mr Haughey's most loyal supporter in the leadership contests of 1982 and 1983, he is now regarded as a rising candidate for the succession to Mr Haughey. A hawk on Anglo-Irish relations, but argued for abstention on the Anglo-Irish Agreement, 1985.

Married Elaine Neilan. Three sons, three daughters.

MAURICE F DOYLE

Secretary, Department of Finance

Born in Dublin, 1932. Educated at the O'Connell Christian Brothers School; University College Dublin (BA in Economics), and Kings Inns Dublin (Barrister at Law).

Mr Doyle entered the Irish Civil Service as an Administrative Officer and, apart from two years in the Office of the Revenue Commissioners, has worked exclusively in the Department of Finance. He was involved in the preparation of Dr Whitaker's paper "Economic Development" which laid the foundation for Irish industrialisation and rapid economic growth. For a time he was Assistant Secretary to the National Industrial and Economic Council. He led the official Irish negotiating team on the establishment of the EC Regional Development Fund and was elected the Vice Chairman of the EC Regional Policy Committee. In 1976 he was appointed Second Secretary in charge of economic policy and in 1977 assumed responsibility for control of public expenditure. He was appointed Secretary of the Department on 1 November 1981.

He is an impressive official, frank and friendly. He has not been linked to either political party and has a civil servant's somewhat cynical view of the motives of his political masters.

He is married with two children.

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AMATO, ONOREVOLE GIULIANO

Under-Secretary in Prime Minister's Office (Socialist).

Born at Turin in 1938, but lives in Rome. Professor of Constitutional Law at Rome University. Joined the PSI in 1958 and became a member of the Party Central Committee in 1978. Author of a number of books on constitutional questions. President of the Commission for the Review of the Office of the Prime Minister in 1979 and President of the Commission for the Reform of State Holdings in 1980. Has held university teaching posts in the USA.

Elected Deputy for Turin-Novara-Vercelli in June 1983. Diminutive, intelligent and very hard-working: known as "the subtle doctor". His big chance came after the 1983 elections when Craxi took him to Palazzo Chigi to be Secretary to the Council of Ministers (Cabinet). A follower of Giolitti (qv) and bitter critic of Craxi during the 1970's, he has now burnt his boats with the PSI left and become Craxi's right-hand man. In the absence of any formal structure for interministerial coordination, Amato has built up an active rôle for himself as Prime Ministerial "Chief of Staff". Respected for his skills in negotiation and public presentation of policy, he has played a central rôle at times of crisis (such as the Achille Lauro hijacking in 1985), and has general oversight under Craxi of coordination of action against terrorism.

Speaks English well.

SANTER, JACQUES

Prime Minister since July 1984

Minister of State, President of the Government, Minister of Finance, of National Development, and of Posts, Telecommunications and Information Technology. Leader of the Christian Social Party.

Born 1937. Education in Luxembourg, Strasbourg and Paris, where he obtained a doctorate in law. 1961-65 Lawyer at the Luxembourg Court of Appeal. 1963-65 worked as a Civil Servant in the Private Office of the (Socialist) Minister of Labour and Social Affairs. Government Attaché to the Ministry 1965. 1966 Secretary to the Christian Social Party's parliamentary group. 1970 Assistant General Secretary of the Party. 1972 State Secretary for Labour, Social Services and Culture. The same year became General Secretary of the Christian Social Party, and its President from 1974-84. Member of the Luxembourg Chamber of Deputies since 1974. Member of the European Parliament from 1974-79, when he was re-elected but appointed Minister of Labour, Social Security and Finance. Elected leader of the Christian Social Party in December 1983 in succession to Pierre Werner.

A strong performer on EC matters, he is now the doyen of EC finance ministers. He is able and friendly. Although in the past he was accused of lack of substance, he has shown himself a competent administrator and is growing in assurance. His public bonhomie conceals a good brain.

Speaks English but prefers French. COI visitor (1973).

Has an attractive and vivacious French wife who teaches biology, but is something of a liability for her husband's political prospects (eg in speaking not a word of Luxembourgish).

Minister of Labour. Minister Delegate for Finance, responsible for the Budget.

He is a lawyer. In 1979 he became Secretary of the Christian-Social parliamentary group and National President of the Christian-Social Youth Organisation. Appointed State Secretary for Labour and Social Security in December 1982 at the age of 28, the youngest ever member of a Luxembourg government.

A capable and forthright young man.

CONFIDENTIAL

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POOS, JACQUES

Vice-President of the Government, Minister of Foreign Affairs, Foreign Trade and Cooperation, of the Economy, of the Middle Classes and of the Treasury. (Socialist).

Born 1937. Educated Lausanne University where he obtained a Doctorate in Economic and Commercial Science. 1959-62 Attaché at Ministry of Economic Affairs; 1962-64 Head of Research at the Government Statistical Service. In 1964 appointed Director of the Socialist daily, 'Tageblatt', though he relinquished day-to-day editorial responsibility when elected to the Chamber of Deputies in 1974. He became Leader of the Parliamentary Group of the POSL in 1975 and in June 1976 was elected to the party's Executive Committee. Minister of Finance 1976, at the same time becoming a director of the World Bank, IMF and the EIB and of the Banque Continentale de Luxembourg and Paribas. Re-elected to the Chamber of Deputies in 1979, and appointed one of two Vice-Presidents of the Socialist Parliamentary Group. Led the POSL in the 1984 elections, gained the highest personal vote of all the candidates, and played a large part in the formation of the coalition with the PCS.

He is a clever, though rather vain man and an ambitious politician. As editor of the 'Tageblatt' he occasionally advocated extreme policies, but he mellowed after entering the Chamber of Deputies and proved an uncontroversial Minister of Finance.

His chief interests at the MFA are economic and financial matters. He leaves political affairs outside the EC largely to his State Secretary, but he has the reputation of always reading and commenting on his briefs and being willing to learn.

Has written several books on economic and financial matters. Married for the second time. His wife devotes herself to her family and seldom accompanies her husband to official functions. 3 children, one of them by the first marriage.

Speaks good English. His wife prefers French.

Honorary Minister of State (Christian Social).

Born near Lille in 1913. Educated in Paris. Doctor of Law (1938), but soon left the Bar for the Banque Generale. 1945 appointed Banking Control Commissioner. 1953 appointed Minister of Finance and (1954) of the Armed Forces. Prime Minister from 1959 of successive coalition governments; with the Democrats (1959-64 and 1969-74); and with the Socialists (1964-69).

A very impressive public servant who has commanded widespread respect and esteem during his long years of office, not least for the patience he showed in allowing decisions to emerge by consensus. An excellent speaker. In the 1974 elections his party lost a number of seats and though it was still the largest party, he decided to resign, devoting a year to the organisation of the party. The considerable success of his Party in the 1979 elections was largely due to his efforts. Following M Thorn's departure from Luxembourg politics at the end of 1980, M Werner's commanding political position increased and there was general regret when he left politics after the 1984 elections. He is extremely well-informed on Luxembourg affairs but since his retirement he seems to have lost some of his interest in politics, and tires more easily.

He is well-known internationally as a speaker and writer, especially on financial matters. Much of the credit for the growth of Luxembourg as a financial centre belongs to him. Paid an official visit to the UK with his wife in October 1982.

M Werner has a relaxed, friendly, open and attractive personality. He inspires confidence with his peasant shrewdness and sophisticated intelligence. From 1979 to 1984 he was Prime Minister and Minister of Culture, Religious Affairs, Information and the Press, Development and the Treasury. He speaks fluent English and listens to the BBC every morning. He understands better than most the British way of doing things. He is a devoted family man, fond also of music (he is a good pianist) and gardening. His wife died in January 1984 after a long illness. 5 children.

DR H O C R RUDING (CDA)

Minister of Finance (since November 1982) for the Netherlands.

Born in Breda in August 1939. Grew up in a Catholic family. Studied at the Rotterdam School of Economics (later Erasmus University). 1965 to 1970 Head of the International Monetary Affairs Division of the Ministry of Finance. 1971 to 1977 Managing Director of the AMRO Bank in Amsterdam. 1977 to 1980 Executive Director of the IMF in Washington. 1980 to 1982 member of the Board of Management of the AMRO Bank.

A friend of the new Prime Minister, Lubbers, from University days. Ruding was first offered the Finance Ministry in 1980 when Andriessen resigned, but on that occasion he turned it down.

CONFIDENTIAL

Dr Miguel Jose Ribeiro Cadilhe

Minister for Finance

Born 10 November 1944 in Barcelos. Graduated in Economics at the University of Porto and did research at the London School of Economics. Has pursued a career teaching and writing about economics before serving as Secretary of State for Planning between 1981 and 1983, and subsequently headed the Department of Economic and Financial Studies of Banco Portugues Do Atlanttico in Oporto. Friendly and intelligent, though his approach can seem more academic than practical. Speaks fair English.

Married (Antonia) with one son.

SOLCHAGA CATALAN, CARLOS

Economy and Finance Minister since 4/7/85

Minister for Industry and Energy since 1982; PSOE Deputy for Alava since 1979.

Born 1944 in Navarre. After reading Economics at Madrid University entered the research department of the Bank of Spain. While in the Bank spent two years at the MIT in Cambridge, Massachussets, doing further research. With the Bank of Spain until 1974, when he joined the Research Department of the State industrial holding, INI, for a brief spell. Began to take an active interest in politics in early 1975, when he joined both the PSOE and the UGT. Head of the Research Department of the Banco de Vizcaya in Bilbao in 1975-77. Joined the Basque Socialist Party in 1978, and elected to the Executive.

An intelligent and fluent speaker, he was one of the leading lights of the PSOE in Congress debates on the economy. He made his name during the debates on the vote of censure motion against Suarez (q.v.) in May 1980. He was influential in drafting the PSOE's economic programme before the 1982 elections.

As Industry Minister he has borne the brunt of criticism arising from the government's programme of industrial restructuring in the steel and shipbuilding sectors. Gonzalez (q.v.) refused his offer to resign in 1983, when criticism reached a peak. Solchaga's talent is unquestioned and in the event of a government reshuffle he would expect another job.

Married with two children. Speaks English and French.

ERSBØLL, NIELS (DANISH)

Secretary-General of the Council since October 1980.

Born 1926. Graduated in Law. Joined MFA 1955, served Paris (Mission to NATO) 1958-60, EFTA Secretariat, Geneva 1960-63 MFA 1964-73. Permanent Representative to EC 1973-77. Second Permanent Secretary for Foreign Economic Affairs in the Ministry of Foreign Affairs 1977-80, responsible for economic and Community affairs. Chairman of the International Energy Agency in Paris 1979-80.

A charming man, who speaks excellent English. Always calm, courteous and intelligent. He had much to do to clear up the staff troubles which his predecessor bequeathed to him.

Married; his wife is an economic journalist.

Confidential
President of the Commission since January 1985.
Responsible for monetary affairs

DELORS, JACQUES

Minister for the Economy and Finance. (Ministre de l'Economie et des Finances).

Born 1925. Worked for the Banque de France and later the Economic and Social Council. Counsellor for Social Affairs in the Commissariat-Général of the Plan, 1962-68. A member of the French equivalent of the Consumers' Association (a Government body) 1968-70. Secretary-General of the Inter-ministerial committee for Industrial Training and Social Affairs 1969-73. Appointed adviser to the Prime Minister on Social and Cultural Affairs, June 1969 and from 1971-72 Chargé de Mission in the Cabinet of M. Chaban-Delmas when he played an important part in the development of Chaban's 'new society' policy. M. Delors is in particular credited with the idea of long term progressive wage contracts (contrats de progrès) in the public sector. He left the Inter-Ministerial Committee in 1973 to take a position at the University of Paris-Dauphine where he lectured on social policy and became an Associate Professor. Founded the 'Association 1973-80' to study economic, social and environmental planning in 1973. Member of the Board of the Bank of France, 1973-79. Joined the PS at the time of the Presidential election in 1974. 1976-81 he was the Party's National Delegate for international economic affairs. Elected an MEP in 1979, he was President of Economic and Monetary Commission of the European Parliament. During the 1981 Presidential election campaign, he acted as one of M. Mitterrand's principal advisers on economic affairs. Member of Management Committee of the PS since 1981. Appointed to present post May 1981.

Although a member of the Mitterrand faction, M. Delors is on the social-democratic wing of the PS. He is therefore suspect to his colleagues on the Left. But he retains M. Mitterrand's ear.

Delors is intelligent, hard-working and pleasant to deal with. His background is modest (he is of Christian trade union stock).

Married with 2 children. Has a slight knowledge of English.

Lord COCKFIELD

Vice President of the Commission - responsible for Internal market, taxation, financial institutions

Francis Arthur Cockfield. Born 28 September 1916.
Married Aileen Monica Mudie, choreographer. Created Life Peer 1978.

Graduate London School of Economics (LLB, BSc (Econ)). Called to the Bar (i.e. qualified as Barrister) 1942. Cabinet Minister since 1982.

Previous appointments: Home Civil Service, Inland Revenue 1938; Assistant Secretary to Board of Inland Revenue 1945; Director of Statistics and Intelligence to Board of Inland Revenue 1945-1952; Commission of Inland Revenue 1951-1952; Financial Director, then Managing Director and Chairman of Executive Management Committee, Boots Pure Drug Co 1953-1967; Member National Economic Development Council 1962-1964 and 1982-1984; Member, Court of Governors of University of Nottingham 1963-1967; President, Royal Statistical Society 1968-1969; Adviser on Taxation Policy to Chancellor of Exchequer 1970-1973; appointed Honorary Fellow, London School of Economics 1972; Chairman, Price Commission 1973-1977; Minister of State, HM Treasury 1979-1982; Secretary of State for Trade 1982-1983.

CHRISTOPHERSEN, HENNING

Since January 1985 Vice President of the Commission Responsible for - Budget - Financial control - Personnel and administration

Finance and Deputy Prime Minister
September 1982 — 1984

Born 1939. Graduated in political science 1965. Head of the Industrial Economy Division of the Artisans Council 1965-70. Principal of a liberal 'high school' 1971-72. Subsequently an economic consultant for various organisations and an economic and political journalist for the leading weekly 'Weekendavisen'. Member of the Folketing since 1971. Deputy chairman of the Venstre (Liberal) Party Organisation from 1972-77, when he became provisional chairman on Mr Poul Hartling's departure. He was confirmed in office at the Party Congress in September 1978. Visited Britain as a FCO sponsored visitor 1975. Minister of Foreign Affairs 1978-80.

Although his previous experience was more with internal than external affairs he took the Foreign Ministry as the senior post offered to Venstre in the coalition Government formed in August 1978. Although not formally appointed Deputy Prime Minister, he deputises for the Prime Minister in the latter's absence. During the difficult early stages of the coalition, he had to give much of his attention to party and government business centering on domestic economic and financial issues. But his senior officials soon spoke admiringly of his rapid grasp of foreign affairs briefs. Venstre is the most pro-European of Danish political parties and Mr Christophersen takes a keen personal interest in work in Brussels as well as in political cooperation.

He displayed courage and political skill in bringing about a major realignment in policy within his party, and grew in public esteem during the negotiations for the formation of the coalition. The odds must be that he will be prominent on the Danish political scene for many years to come.

Personally friendly, with more than passable English. Married. His wife's sister is the widow of Sir Donald Hopson.

2 7

Vice President of the Commission - responsible for agriculture and forestry.

ANDRIESSEN Frans H.J.J.

born on 2 April 1929 at Utrecht - Married: 4 children

1951	Degree in law at the State University of Utrecht;
1954 to 1972	Discharged various duties at the Catholic Institute for Housing (last position held: Director)
1958 to 1967	Member of the Utrecht Provincial States
1967 to 1977	Member of the Second Chamber of the States-General (specializing initially in matters relating to low-cost housing
1971 to 1977	President of the KVP Group of the Second Chamber
1977 to 1979	Minister for Finance
1980	Member of the First Chamber of the States-General (Senate)
6.1.81	Member of the Commission of the European Communities with responsibility for relations with the European Parliament and for the competition sector

Mr Andriesen is a knight of the Order du Lion Néerlandias and an officer of the Order of Orange-Nassau.

.../...

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responsible for external relations and trade policy

DE CLERCQ, WILLY
Member of the European Commission since Jan 1985

Former Deputy Prime Minister, Minister of Finance and Foreign Trade. Former President of the PVV. Former Minister of Finance in the 1974-77 Tindemans government. President of the Liberal group to European Parliament since 1981. Chairman of IMF's Interim Committee. ~~He is to be the next Belgian member of the European Commission~~.

Born 1927.

A brilliant student, and Doctor of Law summa cum laude. Studied at Syracuse, USA (MA in Social Sciences). He is a lawyer. He entered politics when he was very young, and became a town councillor of Ghent in 1952. He entered Parliament in 1958 and was elected leader of the PLP Parliamentary group after the elections of May 1965. In 1960 he was an Under-Secretary in charge of the Budget in the Eyskens government. He was Deputy Prime Minister in charge of the Budget under Vanden Boeynants and established a reputation as an able economist. In 1973 Leburton re-appointed him Deputy Prime Minister and Minister of Finance and he continued to hold the latter post during the Tindemans government (1974-77). During the Belgian EC Presidency in 1977 his handling of the Finance Ministers' meetings was much superior to the performance of his colleague, Foreign Minister Van Elslande. He enjoys considerable popular support in Ghent and was largely responsible for the PVV's gains in the communal elections of 1976. However, in the April 1977 national elections, De Clercq unexpectedly failed to be re-elected, partly because of the unpopular economic measures he had had to take as Minister of Finance, but, more importantly, because of his long-standing friendship with a local judge, who had shortly before the elections, been arraigned on corruption charges. He is considered to be a moderate Fleming and tolerant in his general outlook.

Friendly, speaks good English. His intelligent wife (also a lawyer) helped to run his chambers when he was a Minister, and is involved in PVV activities in the Ghent area.

CONFIDENTIAL

PETER SCHMIDHUBER

EC Commissioner since 1987 Responsible for economic affairs

Born 1931 in Munich. Studied jurisprudence and economics. Civil Servant in Bavaria from 1961. CSU member of Bundestag from 1965-69 and 1972-78. Member of the Bavarian Land Parliament and Bavarian Minister for Federal issues since 1979. In this capacity he represented Bavaria in Bonn and presided over the Bavarian EC Information Bureau in Brussels.

Although he carried out his representational duties in Bonn fully, he began to look as if he no longer enjoyed the full confidence of Franz Josef Strauß, the Bavarian Prime Minister and Chairman of the CSU, who took to using other channels for his dealings with Kohl. Schmidhuber's career in FRG politics thus seemed blocked, and he was probably not sad to succeed Alois Pfeiffer in September 1987.

An intelligent, thoughtful and rather introspective man with an interest in art and a small private picture collection. Married.

ANNEX

CURRICULUM VITAE

OF

Mr Peter M. SCHMIDHUBER

=========

Born: 15 December 1931 in Munich, Roman Catholic, widower, one daughter

1951: School-leaving examination

Studies in Law and Economics at the University of Munich

1955 Bachelor of Economic Science Examination

1956 First State examination in law

1960 Second State examination in law

1961-1972 Worked in the Bavarian Ministries of State for Finance (Legal Department), Economics and Transport (Fiscal Law and Competition Law); finally, head of sub-division for competition

1969-1971 Head of Department in an industrial federation

Since 1972 Lawyer in Munich

Since 1952 Member of the CSU (Christian Social Union)

Various party offices, including member of the executive federal board of the CDU (Christian Democratic Union)/CSU Association of the Middle Classes, Member of the CSU "Land" executive board

From 1960-1966 honorary councillor of the "Land" capital, Munich

From 1965-1969 and from 1972-1978 Member of the "Bundestag" (Federal Lower House of Parliament)

Member of, inter alia, the Economic Committee (responsible for competition law and Middle Classes issues) and of the Fiscal Law Reform Committee and the Economic Criminality Prevention Committee; member of the Council of Europe and of the WEU (Western European Union) Assembly

Since 1978, Member of the Bavarian Parliament

Since 9 November 1978, Bavarian Minister of State for Federal Affairs and Federal Government representative of the Bavarian Free State

Since 1978 Member of the "Bundesrat" (Federal Upper House of Parliament), of the Mediation Committee of the Federal Lower and Upper House and of the North Atlantic Assembly.

FRANCE/WEST GERMANY PLAN JOINT ECONOMIC COMMITTEE NRIA

PARIS, NOV 13 - FRANCE AND WEST GERMANY ARE PLANNING TO SET UP A JOINT ECONOMIC AND FINANCE COMMITTEE TO IMPROVE POLICY COORDINATION BETWEEN THEIR TWO GOVERNMENTS, DENIS BAUDOUIN, SPOKESMAN FOR FRENCH PRIME MINISTER JACQUES CHIRAC, SAID.

HE TOLD JOURNALISTS THAT CHIRAC HAD PROPOSED THE IDEA DURING THE FRANCO-GERMAN SUMMIT CURRENTLY TAKING PLACE IN KARLSRUHE, AND THAT WEST GERMAN CHANCELLOR HELMUT KOHL APPROVED THE IDEA.

HE GAVE NO DETAILS, BUT SAID A FORMAL ANNOUNCEMENT OF THE MOVE WOULD PROBABLY BE INCLUDED IN THE STATEMENT AT THE END OF THE SUMMIT LATER TODAY.

13-NOV-1028 MON473 MONO

CONTINUED ON - NRIM

P

DEALING - SEE AADA 1438

FRANCE/WEST GERMANY PLAN =2 PARIS NRIM

IN KARLSRUHE, WEST GERMANY, WHERE FRENCH AND WEST GERMAN LEADERS AND MINISTERS ARE HOLDING A TWO DAY SUMMIT, A SENIOR FRENCH GOVERNMENT SOURCE TOLD REPORTERS THAT THE COMMITTEE WOULD BRING TOGETHER WEST GERMAN AND FRENCH ECONOMICS AND FINANCE MINISTERS AND NATIONAL BANK CHIEFS.

THE IDEA, PROPOSED BY CHIRAC TO BONN CHANCELLOR HELMUT KOHL ON THURSDAY, AIMED TO IMPROVE COORDINATION OF POLICIES. "IT IS INTENDED TO COORDINATE POLICY IN THE FINANCIAL AND ECONOMIC AREA AS CLOSELY AS WE DO IN SECURITY AND FOREIGN AFFAIRS," THE FRENCH SOURCE SAID.

13-NOV-1110 MON540 MONP

CONTINUED FROM - NRIA

CONTINUED ON - NRIN

P

DEALING - SEE AADA 1438

FRANCE/WEST GERMANY PLAN =3 PARIS NRIN

LAST WEEK, FRANCE AND WEST GERMANY COORDINATED INTEREST RATE MOVES IN A BID TO EASE TENSION WITHIN THE EUROPEAN MONETARY SYSTEM.

13-NOV-1111 MON541 MONP

CONTINUED FROM - NRIM

REUTER

P

DEALING - SEE AADA 1438

REUTER REPORT

1777.41 Secret. 13/11/87.

Foreign Markets + EMS

FOREIGN MARKETS DEVELOPMENTS AND THE EMS

Immediately following the stock markets' falls foreign exchange markets remained steady. However continuing worries about the US's trade and budget deficits exascerbated by a public row between Baker and Stoltenberg, brought about an accelerating decline in the dollar against major currencies.

2. Initially the dollar's poor showing had little effect on the EMS but towards the end of October this weakness caused significant tensions to appear as the DM moved up against the dollar and the French franc came under severe pressure against the DM. The comment by M Delors on 28 October to the effect that the US was prepared to see the dollar as low as DM 1.60 (subsequently denied by the US Treasury) did little to ease the tensions as the dollar fell further. The EC Monetary Committee meeting on 30 October further fuelled rumours of a relaignment.

3. Between 27 and 30 October when the franc's parity with the DM was under pressure, the French sold DM 5.9 billion with further selling of DM 2.3 billion the following week up to 5 November. The EMS band moved between $1^{3}/_{16}\%$ and $1^{5}/_{8}\%$ over the period.

4. At the Monetary Committee meeting the Germans were put under pressure to cut interest rates, in the hope of influencing the Bundesbank Council meeting on 5 November, with the aim of easing the tensions which had appeared in the EMS. UK's lead on 4 November in cutting interest rates was followed by agreement between the French and German authorities on 5 November - on a reduction in Germany's short term rates and an increase in the French. This concerted action had the desired effect with the Franc improving against the DM. The dollar recent firmness has kept the EMS on an even keel and intervention this week at a much reduced level.

1777.42

Secret

MARKET INTERVENTION BY EUROPEAN COUNTRIES SINCE MONDAY 9 NOVEMBER TO LUNCHTIME 13 NOVEMBER 1987

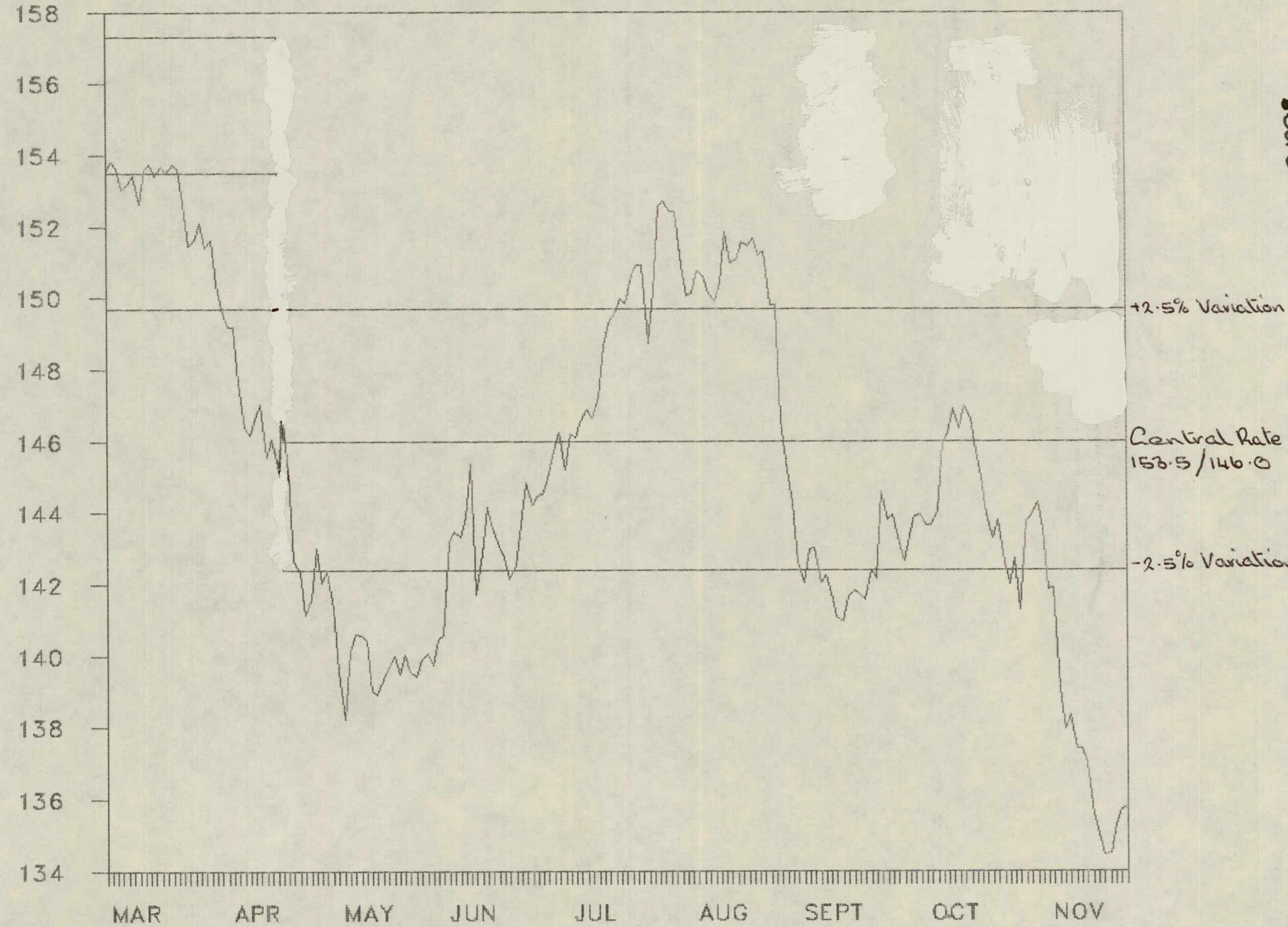
	$ MILLION EQUIVALENT
EMS	
GERMANY	+100$
FRANCE	-
BELGIUM	+22$ agst DM, -37 DM
ITALY	-40 DM, +29$
IRELAND	-26DM
DENMARK	+23$
HOLLAND	+25$ (forward)
NON-EMS	
SWITZERLAND	+30$
GREECE	-5$
SWEDEN	+125$ agst Y, -15$, - 24DM
NORWAY	-145$ +120$ agst DM, -15DM
SPAIN	+100$, +225DM

MARKET INTER-VENTION TABLE

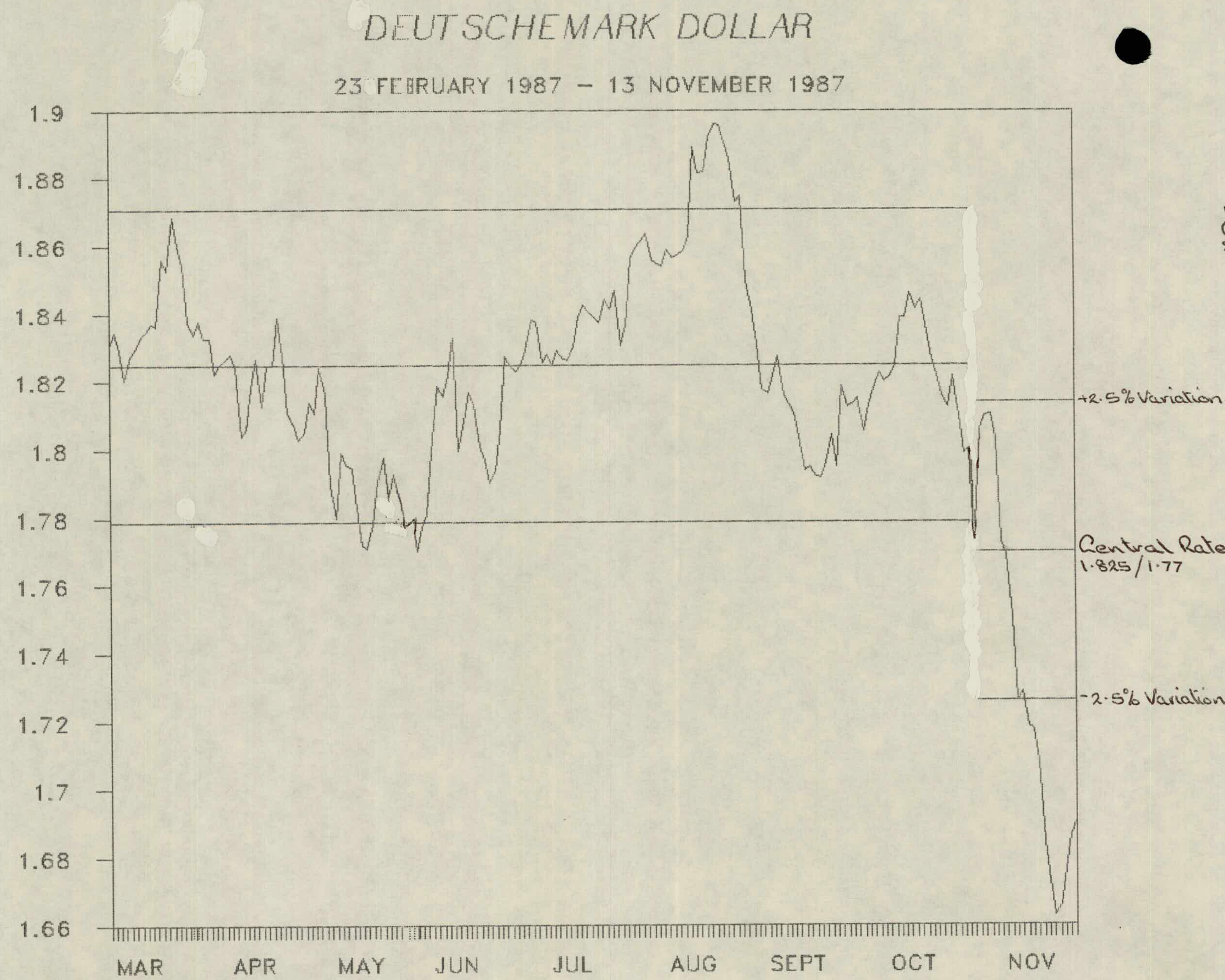
Secret

YEN DOLLAR

23 FEBRUARY 1987 – 13 NOVEMBER 1987



YEN/ DOLLAR



Secret

D.MARK/DOLLAR

SECRET

TOTAL MARKET INTERVENTION ($ TRANSACTIONS) SINCE 19 OCTOBER FRANKFURT AGREEMENT

$ million equivalent

OCTOBER/ NOVEMBER	(1) US	(2) Japan	(3) W.Germany	(4) France	(5) UK	(6) Rest of EEC Countries		(7) Total EEC Countries
19 OCT 87	1494	4940	1424	224	3645	Italy	752	
TO					*(+3388)	Spain	-591	
13 NOV 87						Greece	-2	
						Belgium	97	
						Denmark	78	
						Holland	265	
						Ireland	39	
TOTAL	1494	4940	1424	224	3645 * (+238)		638	5931
% OF TOTAL G5 PLUS OTHER EEC COUNTRIES INTERVENTION	12.1	40.0						48.0

overall total: 12.365 billion

* figure in brackets shows market intervention reported at concertation

note: col (7)=cols(3)+(4)+(5)+(6)
overall total=cols(1)+(2)+(7)

****

Other countries dollar intervention:

	Canada	-761
	Sweden	91
	Norway	-336
	Switz.	350
Total:		-656

INTER-VENTION

INT7

SECRET

TOTAL MARKET INTERVENTION (NON-$ TRANSACTIONS) SINCE 19 OCTOBER FRANKFURT AGREEMENT

$ million equivalent

OCTOBER/ NOVEMBER	(1) US	(2) Japan	(3) W.Germany	(4) France	(5) UK	(6) Rest of EEC Countries	(7) Total EEC Countries
19 OCT 87 TO 13 NOV 87				-8135 DM		Ireland -435 DM Italy -884 DM Belgium -618 DM Greece -66 DM Spain -729 DM	
TOTAL	0	0	0	-8135 DM	0 DM * (0DM)	-2732 DM	-10867 DM ------ -10867
% OF TOTAL G5 PLUS OTHER EEC COUNTRIES INTERVENTION	0.0	0.0					

Totals:
-10.867 billion DM

Overall
Total:
-10.867 billion

* figure in brackets shows market intervention reported at concertation.
notes: col (7)=cols (3)+(4)+(5)+(6)
overall total = cols (1)+(2)+(7)

****

Other countries non-$ intervention: Norway -113 DM
Sweden -274 DM

Total : -387 DM

ECONOMIC AND MONETARY SIT. BRIEF.

1777.40

COVERING SECRET

FROM: H C GOODMAN

DATE: 13 November 1987

CHANCELLOR

cc: PS/Chancellor
Sir G Littler
Mr Peretz
Mr R I G Allen
Mr Kelly
Miss O'Mara
Mr M Parkinson
Mr Edwards
Mr C Budd - Cab Off
Mr J S Wall - FCO
Mr D Bostock - UKREP (8)

secret papers only.

ECOFIN

I attach briefing for the discussion of the economic and monetary situation, to be taken ~~over lunch~~ in the morning session.

It comprises a note on the Eyskens paper, a market commentary focussing particularly on the ERM, charts (not to all) and tables on the exchange rates and intervention. In addition is a Reuters report of a joint Franco/German economic co-ordinating committee to be set up by their Governments and Central banks.

H C Goodman.

H C GOODMAN

1777.29

ECONOMIC AND MONETARY SITUATION

UK Objective

Avoid a declaration on the lines outlined in the Eyskens paper.

Line to Take

No purpose would be served, need action. Empty words more likely to unsettle market.

1777.30

BACKGROUND

Minister Eyskens of Belgium has circulated a paper on the Current World Economic Situation, which will be discussed informally ~~(presumably over lunch)~~. No further papers will be tabled. The paper draws attention to the recent problems in the markets and the problems of the US economy it calls for "a coherent community stand" to "agree on a common declaration".

As far as the EC is concerned it ranges over the whole spectrum of economic policies, recommending progress on the internal market, tax harmonisation and capital liberalisation. On the monetary and fiscal front it recommends exchange rate stability and higher investment. It also seeks a re-affirmation of the Louvre Accord from the G7.

This is all pretty empty and a declaration along these lines would serve no purpose.

Confidential

FROM: MARK PARKINSON
DATE: 13 November 1987

13/11

1. SIR GEOFFREY LITTLER
2. CHANCELLOR

ECOFIN 16 NOVEMBER

ECOFIN on 16 November is in the Charlemagne in Brussels. You will be accompanied by Sir Geoffrey Littler, Mr Knox (C and E), Mr Allen, Mr J Taylor and me; Mr Craske (C and E) will attend in the afternoon. The Council begins in principle still at 10.00.

2. The expected agenda is as follows:

<u>In the morning session of the Council:</u>

(a) the economic and monetary outlook.

(b) liberalisation of capital movements (now relabelled by the Commission 'creation of a European financial area').

<u>Over lunch</u>

(c) future financing

<u>In the afternoon session</u>

(d) indirect tax approximation
(e) the seventh VAT directive on second hand goods
(f) the eighteenth VAT directive.

In the margins Mr Balladur may raise the oils and fats tax issue in the context of future financing.

Briefs are attached on all these items~~, except (a) on which Mr Goodman is submitting a separate note to you on the current situation in the markets~~. (Ms Goodman's note is the first brief behind, under the green flag).

<u>The economic and monetary outlook</u>

3. See separate brief by Ms Goodman on the markets. Although the larger countries preferred a lunch discussion, the Belgians have asked for a discussion in the formal session, but the Presidency intends the discussion to be informal. This is the first ECOFIN since Mr Delors made his unfortunate remarks to the European Parliament on the level of the dollar, and there may be some comment. This will be a restricted session.

<u>Creation of a European financial area.</u>

4. This is covered in Brief A.

10. The UK has asked for a lunch discussion of future financing. Although ECOFIN does not have an operational role, the future financing negotiations are clearly of concern to finance ministers. So a discussion at this stage is appropriate.

11. The discussion will give you a valuable opportunity to signal clearly the UK's firmness of purpose in the critical areas of budget discipline and budgetary imbalances.

Tax approximation

12. This is covered in Brief C.

13. The September informal ECOFIN agreed that Lord Cockfield should present the Commission's proposals to the October ECOFIN. In the event that meeting was cancelled and the presentation was rearranged for the November meeting.

14. The Commission's proposals were published on 7 August following the Commission's 1985 White paper on completion of the internal market and the June 1986 ECOFIN conclusion that more details on tax proposals were needed before decisions of principle could be taken. A two rate structure for VAT is proposed with rate bands of 4-9% and 14-20%. Harmonisation of rates on excise duties is proposed. The proposals do not specify any particular provisions for derogations, but some form of accommodation of certain features of member states tax systems may be recognised as appropriate. A central clearing mechanism is proposed to ensure that VAT continues to accrue to the country of consumption.

15. The Presidency does not expect a substantive discussion after Lord Cockfield's presentation although Ministers could of course comment if they wished. The discussion will be procedural. The September ECOFIN agreed that the proposals would be remitted for further study by the Economic Policy Committee. It is not certain whether the Presidency will propose a specific remit along the lines of evaluating the economic consequences for member states of the Commission's proposals; or whether the remit will be to study and report back more generally. EPC are likely to interpret the remit fairly widely in any event. It is in our interests that the remit is as wide as possible to include alternative approaches. At the September ECOFIN the intention was that the EPC should report back in December. The EPC has arranged a meeting for 26-27 November, but there is scarcely time for more than an interim report for December. Our interest is to ensure full consideration by the EPC; a report back to ECOFIN in March at the earliest might be realistic.

16. We have it on good authority from Bonn that Genscher, Bangemann and Stoltenberg have agreed, with pressure from the Danes, not to give tax approximation a high profile or urgency during their Presidency. This seems to make it still less necessary to make substantive points at this stage, beyond perhaps reiterating our concern on zero rates.

17. The Commission may press for earlier progress on the convergence proposal that changes in member states' tax rates should converge towards the proposed bands. Our argument is that we cannot agree to such a proposal because it presupposes there is agreement on where we are converging.

The seventh VAT directive (A common system for second hand goods)

18. This is covered in Brief D.

19. Following failure to reach agreement, the Commission is withdrawing its proposal for the seventh VAT directive for a common VAT system for secondhand goods, works of art, antiques and collectors' items. The effect of withdrawal is not serious for the UK because we already have such a scheme as the Danish Presidency proposal would allow. The Presidency has reserved the right to have a general discussion on outstanding problems at the November ECOFIN.

20. The Presidency has been proposing a compromise which in its first phase would not cover import/export transactions or determine a definite regime to be applied after 1992. There has been opposition from the Commission because the compromise did not produce a harmonised regime. Although the UK sympathises with the Commission, we like most others are prepared to be open minded. There is no need to intervene, although the UK supports the Presidency view and we could support a Commission offer to come forward with a new proposal.

The 18th VAT directive

21. This is covered in Brief E.

22. This concerns the abolition of certain derogations contained in Article 28 of the 6th VAT directive which permits taxation of some supplies which in the 6th directive would normally be exempt; and vice versa. The Commission produced an amended proposal in June and the Presidency has now produced a compromise suggestion. We have had six reserves on this directive, concerning sporting and cultural activities, financial transactions and fuelling and provisioning of private ships.

23. C and E have recommended to the Economic Secretary that these should be raised subject to certain safeguards detailed in the Brief and he has agreed. We have to maintain a Parliamentary reserve on the Directive for the moment as the Directive is subject to Parliamentary scrutiny procedures.

Oil and Fats tax

24. This is at Brief F. In the margins Mr Balladur may raise the oils and fats tax issue; the Foreign Secretary agreed at an ad hoc meeting on 28 October that this would be helpful.

Personality notes

25. These are attached (top copy only).

"A" and "B" points

26. The "A" points we have so far received is attached. The UCITs investment policies directive will be taken as a B* point ie it has been agreed at COREPER but the Germans, who voted against, want the opportunity to make an oral statement. We support this directive, but subject to raising the Parliamentary Scrutiny reserve. A brief is at Brief G.

27. A set of tables giving statistics on the US, EC and Japan is attached at Brief H.

28. Copies of the briefing go to those on the attached list.

Mark Parkinson

M PARKINSON

CIRCULATION

PS/Chancellor
Sir Geoffrey Littler
Mr Edwards
Mr R Allen
Mr C Budd, Cabinet Office
Mr J S Wall, FCO
Mr D Bostock, UKREP (8 copies)

Steering brief only

PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Mr Byatt
Mr P Cropper
Mr Scholar
Mr Peretz
Mr Ilett
Mr Matthews
Mr Mercer
Mr Mortimer
Mr Kelly
Ms Sinclair
Mr C Evans
Mr Savage
The Governor B/E
Mr J Kirby B/E
Mr Jay - Paris
Mr A C Thorpe - Bonn
Mr T P Lankester - Washington
Miss C Elmes - Rome
Ms French C&E
Mr Knox C/E
Mr Craske C/E
Mr Crease DTI.