

• PO-CH/NL/0524
PART A

Part. A.

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Begins : 20/5/88 .
Ends : 9/12/88 .

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Chancellor's (Lawson) Papers :
Liberalisation of Capital Movements
In the European Community .

DD's : 25 Year

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FRAME ECONOMIC

YOUR TELNO 185

LIBERALISATION OF CAPITAL MOVEMENTS: FINANCIAL QUESTIONS GROUP 20
MAY

SUMMARY

X | 1. GOOD PROGRESS ON LIBERALISATION DIRECTIVE (SETTLEMENT ON
SAFEGUARD CLAUSE AND TRANSITIONAL MEASURES IN SIGHT), 1972 DIRECTIVE
(REPEAL, IN EXCHANGE FOR BEST ENDEAVOURS TO LIBERALISE ERGA OMNES
AND OBLIGATION TO CONSULT ON RESPONSE TO DISRUPTIVE CAPITAL
MOVEMENTS TO AND FROM THIRD COUNTRIES), MEDIUM TERM CREDIT FACILITY
(TEXT ALMOST AGREED). AGREEMENT AT 6 JUNE ECOFIN POSSIBLE, BUT 2
DIFFICULT DANISH PROBLEMS AND AN AWKWARD DRAFT COUNCIL DECLARATION
ON 'ACCOMPANYING MEASURES' HAVE YET TO BE SETTLED. |

DETAIL

2. THE FINANCIAL QUESTIONS GROUP TODAY WORKED THROUGH ALL
OUTSTANDING ISSUES ON THE COMMISSION'S PROPOSALS IN THE LIGHT OF
DISCUSSION AT THE INFORMAL MEETING OF FINANCE MINISTERS TRAVEMUNDE
(TUR).

MEDIUM TERM CREDIT FACILITY

3. TEXT ALMOST AGREED. ONLY A VERY FEW MINOR RESERVES REMAIN.

THIRD COUNTRIES

4. COMMISSION TABLED DRAFT PROPOSAL (SUBJECT TO FORMAL ADOPTION
BY COMMISSION) TO:
(A) REPEAL 1972 DIRECTIVE.
(B) INCLUDE IN THE MAIN LIBERALISATION DIRECTIVE AN ARTICLE OBLIGING
MEMBER STATES TO ENDEAVOUR TO ATTAIN THE SAME DEGREE OF
LIBERALISATION VIS A VIS THIRD COUNTRIES AS WITHIN THE COMMUNITY;
AND TO CONSULT IN THE MONETARY COMMITTEE AND COMMITTEE OF CENTRAL
BANK GOVERNMENT MEASURES IF THERE ARE LARGE SCALE CAPITAL MOVEMENTS
TO OR FROM THIRD COUNTRIES.

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GENERAL SUPPORT FOR THIS APPROACH, THOUGH THE TEXT IS LIKELY TO BE REFINED A LITTLE YET.

MAIN LIBERALISATION DIRECTIVE

5. SATISFACTORY PROGRESS ON MAIN POLITICAL ISSUES DISCUSSED AT TRAVEMUNDE, AS FOLLOWS:

(A) SAFEGUARD CLAUSE. COMMISSION SUBMIT REVISED TEXT OF ARTICLE 3, WITH SIX MONTHS TIME LIMIT, SLIGHTLY TOUGHER PROVISION THAN IN ARTICLE 73 OF TREATY FOR CASES WHERE MEMBER STATES IMPOSE PROTECTIVE MEASURES WITHOUT PRIOR AUTHORISATION, REVIEW IN 1992. CONSIDERABLE SUPPORT FOR APPARENT COMMISSION WILLINGNESS TO ACCEPT OVERRIDE POWER FOR COUNCIL ON MODEL OF ARTICLE 73.

(B) TRANSITIONAL ARRANGEMENTS FOR CERTAIN MEMBER STATES. GENERAL SUPPORT FOR REVISED COMMISSION PROPOSAL: FULL COMPLIANCE BY 1992 FOR SPAIN, IRELAND, PORTUGAL, GREECE: TO EXTEND DEADLINE COUNCIL TO DECIDE ON POSSIBLE FURTHER EXTENSION FOR THE LAST TWO, GREECE PORTUGAL WANT THE POSSIBLE EXTENSION TO BE FOR THREE YEARS, RATHER THAN TWO, AS PROPOSED BY COMMISSION.

(C) BELGIUM/LUXEMBOURG DUAL EXCHANGE MARKET. AGREEMENT ON ABOLITION BY 1992, WITH DUAL MARKET MEANWHILE ADMINISTERED SO AS TO PREVENT 'APPRECIABLE AND LASTING DIFFERENCES' BETWEEN THE TWO RATES.

6. THE MAIN REMAINING AREAS OF DIFFICULTY ARE:

(A) THE DANISH TAX PROBLEM ON ARTICLE 4.2, ON WHICH NO PROGRESS WAS MADE.

(B) A SECOND DANISH PROBLEM, WHICH TODAY MANIFESTED ITSELF IN A WISH TO HAVE THE NOMENCLATURE OF CAPITAL MOVEMENTS DECLARED 'INDICATIVE' BUT WHICH APPEARS TO RELATE TO THE INCOMPATIBILITY WITH THE DRAFT DIRECTIVE OF A PROVISION IN THE DANISH CONSTITUTION, INSERTED IN 1953 APPARENTLY WITH THEIR SOUTHERN NEIGHBOURS IN MIND, FORBIDDING FOREIGNERS TO PURCHASE LAND IN DENMARK. (THE DANES SEEMED TODAY EVEN MORE CONCERNED ABOUT THIS POINT THAN ABOUT THEIR TAX PROBLEM, MUTTERED IN THE MARGINS ABOUT THE LUXEMBOURG COMPROMISE, AND SWORE US TO SECRECY ABOUT THEIR PROBLEM BECAUSE OF THE DELICATE POLITICAL BALANCE IN DENMARK. IT IS A WONDER THAT THE DANES HAVE GOT AWAY WITH SUCH A RESTRICTION FOR SO LONG).

(C) A DRAFT COUNCIL AND COMMISSION DECLARATION ON 'ACCOMPANYING MEASURES' WHICH DELORS HAD IN HIS POCKET AT TRAVEMUNDE BUT CHOSE NOT TO TABLE THERE.

7. THE DRAFT DECLARATION SAYS:

(A) THE PROPER FUNCTIONING OF THE INTERNAL MARKET AND PROGRESS TOWARDS THE EMU REQUIRE INCREASED STABILITY IN EXCHANGE RATE MECHANISMS: THE LIBERALISATION OF CAPITAL MOVEMENTS SHOULD BE

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ACCOMPANIED BY PARALLEL EFFORTS TO ACHIEVE EQUAL PARTICIPATION BY 1992 OF ALL EC CURRENCIES IN THE EMS EXCHANGE RATE MECHANISM: THIS IS A PRIORITY FOR 'MEMBER STATES WHICH HAVE ALREADY MADE THE GREATEST HEADWAY IN THE PROCESS OF FINANCIAL LIBERALISATION'.
(B) RAPID PROGRESS SHOULD BE MADE ON THE PROGRAMME OF MEASURES RELATING TO FINANCIAL SERVICES IN THE INTERNAL MARKET WHITE PAPER.
(C) WHILE THE NEW DIRECTIVE IS BEING IMPLEMENTED THE COUNCIL SHOULD DEFINE AND ADOPT AT COMMUNITY LEVEL MEASURES DESIGNED TO ELIMINATE OR REDUCE THE DANGERS OF DISTORTIONS AND TAX EVASION RESULTING FROM THE VARIETY OF NATIONAL RULES CONCERNING THE TAXATION OF SAVINGS. THESE MEASURES COULD (REPEAT COULD) COMPRISE APPROXIMATION OF COMPANY TAX, A HARMONISED WITHHOLDING TAX OR STRENGTHENED COOPERATION PROCEDURES AMONG MEMBER STATES.

8. WE SAID (AS DID SEVERAL OTHERS) THAT THE DRAFT DECLARATION RAISED MAJOR POLITICAL ISSUES WHICH WERE NOT LIKELY TO BE RESOLVED ON A MERE WORKING GROUP. BUT, RESERVES NOTWITHSTANDING, MOST MEMBER STATES DECLARED THEMSELVES READY TO CONSIDER SOMETHING ON THESE LINES: AND THE PRESIDENCY WISH TO TAKE DISCUSSIONS FURTHER IN NEXT WEEK'S MEETING OF THE GROUP. IT IS FOR CONSIDERATION WHETHER AT THAT MEETING WE SHOULD INDICATE WHAT SORT OF TEXT WE COULD ACCEPT.

TIMETABLE

9. FQG AGAIN ON 25 MAY: COREPER IN WEEK OF 30 MAY. THE NUMBER OF POINTS STILL OUTSTANDING IS SMALL ENOUGH FOR FINAL AGREEMENT AT ECOFIN ON 6 JUNE (WITH FORMAL ADOPTION PERHAPS AS AN A POINT A FEW DAYS LATER) TO BE TECHNICALLY POSSIBLE. WHETHER IT WILL BE POLITICALLY POSSIBLE IS LIKELY TO DEPEND ON WHETHER A SUITABLE FORM OF WORDS CAN BE FOUND ON THE 'ACCOMPANYING MEASURES' - AND PERHAPS ABOVE ALL ON THE DANISH PROBLEM.

10. NEW TEXTS BY HAND OF GOODMAN (TREASURY) AND LINDLEY (BANK OF ENGLAND).

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ECD (I)
SIR J FRETWELL

MR BRAITHWAITE
MR KERR

ADDITIONAL 2

FRAME

MR P J WESTON CAB OFFICE

NNNN

Capital liberalisation
2. Can the declaration be approved or does it require unanimity?
Ch
Content with Miss O'Mara's recommendations (para. 9)? The joint declaration is surely no more than a Commission attempt to break out tail - and others will not (if they have learnt anything) seek to press it or no at ECOFIN.

FROM: MISS M O'MARA
 DATE: 26 MAY 1988

(No. if (imp))

CHANCELLOR OF THE EXCHEQUER

- cc
- Economic Secretary
 - Sir P Middleton
 - Sir G Littler
 - Mr Lankester
 - Mr Scholar
 - Mr A J C Edwards
 - Mrs Lomax
 - Mr Peretz
 - Miss Noble
 - Mr Parkinson
 - Mr Nelson
 - Mr Tyrie
 - Mr Hyett - T/Sol
 - Mr Bostock - UKREP
 - Mr Arrowsmith - B/E
 - Mr Lindley - B/E

CAPITAL LIBERALISATION

Following the informal ECOFIN at Lubeck, capital liberalisation has been making rapid progress in Brussels and most of the outstanding points now appear to have been resolved, broadly to the UK's satisfaction. However, there are two issues on which we should be grateful to have your views before the subject returns to COREPER next week.

1972 Directive

2. The Commission have at long last proposed the repeal of the 1972 Directive in a new article to be inserted in the main capital liberalisation Directive. This is a considerable prize for the UK since, at the end of the day, most other Member States would probably have been content to allow the original Directive remain in existence, if the Commission had dropped their proposal for a new text. As a quid pro quo for repeal, the Commission have,

26/5

as we suspected, insisted on a second article providing for consultation among Member States on an appropriate response where large-scale capital movements to or from third countries disturb the monetary or financial situation with the Community. I attach the Commission's proposed text at Annex A.

3. We had two major concerns on the Commission's draft:

(i) Exchange rates

The original Commission text refers to the case where large-scale capital movements to or from third countries disturb "...the stability of exchange rate relationships within the Community". In discussion in the Financial Questions Group in Brussels yesterday, an alternative text was proposed which reads:

"Where [short-term] large-scale capital movements to or from third countries seriously disturb the domestic or external monetary or financial situation of Member States or produce serious stresses in exchange rate relationships in the Community or between the Community and third countries, Member States shall consult with one another on the measures to be taken to counteract such difficulties."

We would have preferred the text to read "any measures" but found no support for that amendment. Nevertheless, we think the revised text is acceptable. No other Member State has objected to the wording but all wish to reflect upon it.

(ii) Reciprocity

The new article also notes that its provisions shall not prejudice the application to third countries of domestic rules or Community law, "and in particular of any reciprocal conditions concerning operations involving establishment, the provision of financial services and of admission of securities to the capital markets." FIM regard the text as such as innocuous but we were concerned at the introduction of a reference to reciprocity in this article, given our problems over the Second Banking Directive. The passage is, in any case, quite redundant.

However, there was apparently strong pressure in Brussels yesterday from the French, supported by the Commission, for some reference to reciprocity to be included. No other delegations pressed for omission, although the Germans had some difficulties with the wording, and others actively favoured a reciprocity reference. The Commission assured us that a reference here was without prejudice to discussions on any other Directive and the Council's Legal Services are to produce a note on this. At present, we have placed a reserve on the wording. Would you be content for us to lift that at COREPER, provided the Legal Services' note is satisfactory? (We think we should then be able to press for an entry in the Council Minutes reflecting the Legal Services' view.) We are concerned that if we make this issue a sticking point, the Commission could withdraw both new articles, so that repeal of the 1972 Directive falls.

Declaration on complementary questions

4. As you know, the Commission put forward three "complementary questions" to be discussed in the context of capital liberalisation: the relationship between capital liberalisation and the EMS, harmonisation of supervisory and prudential rules and fiscal issues. The April ECOFIN agreed that these should not be regarded as preconditions for adopting the Directive but that a high level group should be set up to report to the June Council on the fiscal implications of capital liberalisation. The French, especially, attach importance to this, although we are slightly suspicious of their motives.

5. The Commission have now drawn up, very late in the day, a joint Council/Commission declaration, clearly designed to ensure that Finance Ministers do not lose sight of the complementary questions. The text is at Annex B.

6. As it stands, the draft is clearly unacceptable to us. It argues that capital liberalisation will not achieve its full effect or significance unless it is accompanied by parallel efforts to secure equal participation of all currencies in the ERM, with attainment of this objective a priority for those Member States which have made the greatest headway in liberalisation (the UK). It also refers to the Community adopting measures designed to eliminate or reduce tax distortion and evasion as a result of different national rules on the taxation of savings, mentioning that these measures could include, inter alia, company tax approximation and a harmonised withholding tax on payments of interest and dividends.

7. A number of delegations raised objections to the detailed drafting of the text and most suggested the tax references would have to be re-examined in the light of the work of the high level group which meets for the first time tomorrow. However, none appeared to have the UK's major objections. We suggested that if the Commission's primary concern was to keep the complementary questions in play, all that was required was a short text along the following lines:

"The Council and Commission declare:

The adoption of this Directive establishes the principle of the liberalisation of capital movements in the Community. Liberalisation is necessary for the completion of the internal market and marks an important step towards the achievement of economic and monetary union. It will help to bring about greater financial integration in the Community. To further this, the Council will continue to examine the three complementary questions referred to in the Commission's document COM(87)550, The Creation of a European Financial Area."

This approach has so far met with no support. However, the Dutch counselled against spending time on seeking to agree a text which was clearly contentious and the Greeks, Spaniards and Danes all suggested this issue was "too political" to be decided by officials.

8. It is difficult to see how detailed amendment of the text could meet our concerns and, unless the Commission are prepared to withdraw it or to put forward a much shorter version on the lines we have proposed, we recommend that we reserve our position until ECOFIN. You might then try to float the shorter version of the text there, if fellow Finance Ministers are looking for a compromise.

Recommendation

9. We recommend that you accept the text of the new articles, as redrafted, subject to a satisfactory note from the Council Legal Services on reciprocity, but that we reserve our position on the complementary questions declaration until ECOFIN itself (for which we shall, of course, provide detailed briefing). Are you content? It would be helpful to have your reaction tomorrow so that we can brief UKREP before next Wednesday's meeting of COREPER.

MOM

MISS M O'MARA

Article X

1. In their treatment of transfers in respect of movements of capital to or from third countries, the Member States shall endeavour to attain the same degree of liberalisation as that which applies to operations with residents of other Member States of the Community, subject to the other provisions of this Directive.

The provisions of the above subparagraph shall not prejudice the application to third countries of domestic rules or Community law, and in particular of any reciprocal conditions concerning operations involving establishment, the provision of financial services and of admission of securities to the capital markets.

2. Where large-scale capital movements to or from third countries disturb the domestic monetary or financial situation of Member States or the stability of exchange rate relationships within the Community, Member States shall consult with one another on the measures to be taken to counteract such difficulties. This consultation shall take place within the Committee of Governors of Central Banks and the Monetary Committee on the initiative of the Commission or of any Member State.

Article Y

Directive 72/156/EEC is hereby repealed.

DECLARATION BY THE COUNCIL AND THE COMMISSION
re Article 1

The Council and the Commission declare:

The adoption of this Directive establishes the principle of the liberalisation of capital movements in the Community. Liberalisation is necessary for the completion of the internal market and marks an important step towards the achievement of economic and monetary union. It does not, however, represent a sufficient condition for the creation of a truly integrated financial area in the Community.

1. The proper functioning of the internal market and continued progress towards economic and monetary union also require an increasingly higher degree of stability in exchange rate relationships between the Member States, based on close convergence and increased cooperation in the framing and conduct of their economic and monetary policies, and their membership of a common exchange rate discipline.

Seen in this light, the measures to liberalise and unify the foreign exchange market which flow from the implementation of the present Directive will not take on their full significance and exert their full effects unless they are accompanied by parallel efforts to achieve the equal participation by 1992 of all the currencies in the exchange rate mechanism of the European Monetary System. Attainment of this objective is a priority for the Member States which have already made the greatest headway in the process of financial liberalisation.

2. The liberalisation of capital movements should take place in a framework which ensures a satisfactory level of protection for savers and depositors, a high degree 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.

It is therefore essential that the programme already launched to harmonise prudential and supervisory rules in the field of financial services be actively pursued along the lines and according to the timetable laid down in the White Paper on completing the internal market.

3. Under a system of complete liberalisation, tax considerations will play a greater part in determining capital movements.

The period of ... months adopted for the implementation of this Directive should be used to define and adopt at Community level measures designed to eliminate or reduce the dangers of distortions and tax evasion resulting from the variety of national rules concerning the taxation of savings and the monitoring thereof. These measures could comprise:

- an approximation of systems of company taxation, including the tax base and rates of tax, in the Member States,
- a harmonised system for withholding tax on payments of interest and dividends to Community residents,
- a strengthening of the procedure governing cooperation between national tax authorities and reporting obligations on financial intermediaries.



Handwritten initials and date: JMG 26/5/88

FROM: J M G TAYLOR

DATE: 26 May 1988

MISS O'MARA

cc Mr A J C Edwards
Mr Peretz

Handwritten signature

LIBERALISATION OF CAPITAL MOVEMENTS

... UKREP TelNo.1601 (attached) records that agreement at the 6 June ECOFIN is possible, but that two difficult Danish problems, and an awkward draft Council declaration on "accompanying measures" have yet to be settled.

2. The Chancellor would be most grateful for a short note on these points.

Handwritten signature

J M G TAYLOR

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LIBERALISATION OF CAPITAL MOVEMENTS: FINANCIAL QUESTIONS GROUP 20
MAY

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(B) INCLUDE IN THE MAIN LIBERALISATION DIRECTIVE AN ARTICLE OBLIGING MEMBER STATES TO ENDEAVOUR TO ATTAIN THE SAME DEGREE OF LIBERALISATION VIS A VIS THIRD COUNTRIES AS WITHIN THE COMMUNITY: AND TO CONSULT IN THE MONETARY COMMITTEE AND COMMITTEE OF CENTRAL BANK GOVERNMENT MEASURES IF THERE ARE LARGE SCALE CAPITAL MOVEMENTS TO OR FROM THIRD COUNTRIES.

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10. NEW TEXTS BY HAND OF GOODMAN (TREASURY) AND LINDLEY (BANK OF ENGLAND).

HANNAY

YYYY



FROM: J M G TAYLOR

DATE: 27 May 1988

MISS O'MARA

cc PS/Chief Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Scholar
Mr A J C Edwards
Mrs Lomax
Mr Peretz
Miss Noble
Mr Parkinson
Mr Nelson
Mr Tyrie

Mr Hyett - T.Sol.
Mr Bostock - UKREP
Mr Arrowsmith - B/E
Mr Lindley - B/E

CAPITAL LIBERALISATION

The Chancellor has seen your minute of 26 May, and is content with your recommendations.

A handwritten signature in dark ink, appearing to be "JMG".

J M G TAYLOR

*Thanks -
The House can't
come, or out there.
I doubt if they will
make the last
compromise again.
No further forward.*

FROM: MISS M O'MARA
DATE: 2 June 1988

CHANCELLOR OF THE EXCHEQUER

cc PS/Economic Secretary
Sir G Littler
Mr Lankester
Mr Culpin
Mr Peretz
Mr Mortimer
Mr Parkinson
Mr Nelson
Mr Bostock-UKREP
Mr Lindley - B/E
Mr Alpe - IR

*Ch. I asked Miss O'Mara for
further advice on the French unhelpfulness
about tax/cap. liberalisation. She said
that Sir ZBL is the man to date on
this - I will phone with him on his return
on Monday.*

LIBERALISATION OF CAPITAL MOVEMENTS

You asked (Mr Taylor's minute of 26 May) about the Danish problems on the capital liberalisation Directive and the joint Council/Commission declaration, both referred to in UKREP Tel No 1601 reporting on the meeting of the Financial Questions Group of 20 May.

Declaration

2. You have now seen my minute of 26 May which explained our difficulties over the proposed joint Council/Commission declaration. I attach a copy of the text for ease of reference. The Financial Questions Group went over the ground again yesterday. The UK explained why we regarded the present wording as wholly unacceptable and, as you agreed, entered a reserve on the text. In an effort to be helpful, the Commission proposed that the whole of the second paragraph of sub-point 1 be deleted and that the remaining paragraph should be amended to read:

"The proper functioning of the internal market and continued progress towards economic and monetary union also require by 1992 an increasingly higher degree of stability in exchange rate relationships...." (my underlining).

This deletion of any specific reference to sterling's participation in the ERM is certainly an improvement on the present text, although the implication remains pretty clear.

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3. There was no discussion on sub-point 3 on tax yesterday, pending the report from the High Level Group on fiscal issues which met on Friday. In fact, the Group reached no conclusions but there were ominous signs that the French were seeking once again to make progress in this area a precondition for adoption of the capital liberalisation Directive.

4. UKREP will maintain the UK's reserve on the whole declaration at COREPER tomorrow.

Danish problems

5. The Danes have identified two problems on the text of the Directive itself.

(i) Land

6. As UKREP have explained, the Danes are concerned about the scope of the Directive. Article 1 currently states:

"1. Without prejudice to the following provisions, Member States should abolish restrictions on the movement of capital taking place between persons resident in Member States. To assist the application of the present Directive, movements of capital are classified according to the nomenclature set out in Annex I."

7. Annex I includes "investments in real estate on national territory by non-residents". This causes the Danes a particular problem since a Danish law, passed in 1953 and aimed at the Germans in particular, prevents non-residents from purchasing land in Denmark. The Danes have therefore proposed that Article 1 should make it clear that the nomenclature is purely illustrative. We would have no problem with that - indeed, we ourselves suggested at an early stage that the nomenclature should be accorded just such a status, since we believed the Annex would otherwise become out of date as a result of financial innovation. However, our proposal met with opposition from the Commission and other Member States, just as the suggested Danish amendment has subsequently done.

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8. The Danish law of 1953 is, of course, already in breach of existing Community legislation and it is therefore surprising that the Danes have drawn attention to this fact. They claim that land is a highly sensitive issue in Danish politics and have told us that if the point cannot be resolved satisfactorily, they may have to invoke the Luxembourg compromise. However, they have made no further reference to the problem since the meeting on 20 May and we suspect that the German Presidency have persuaded them to keep quiet in the interests of securing early adoption of the Directive. We may have a clearer idea of whether this remains a burning issue for them after COREPER have met tomorrow.

(ii) Tax

9. Article 4 of the draft declares that its provisions shall not prejudice the right of Member States:

"to take all requisite measures to prevent infringements of their laws and regulations, notably in fiscal matters or in matters of prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information."

However, it goes on to state:

"Application of those measures and procedures may not have the effect of obstructing the movements of capital carried out according to Community law."

10. As you know, the Danish tax system relies on automatic reporting of interest income by Danish banks to the Danish revenue, so if Danish residents are in future free to deposit funds abroad, there is clearly a risk that they will evade tax. To overcome this problem, the Danes have suggested (although we have seen nothing on paper) that they should impose a requirement on Danish residents who hold funds with banks in other Community countries, whereby those institutions would report details of the deposits direct to the Danish authorities and place themselves under Danish tax law. If the overseas bank refused to co-operate, the Danes would wish to prevent the capital movement from taking place. They

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want the Council and Commission to confirm in the Council's Minutes that it would be consistent with Article 4 for them to proceed in this way. The last sentence of the Article clearly creates difficulties for them and they are therefore pressing for its deletion.

11. This is quite unacceptable. We, and a number of other Member States, attach considerable importance to the sentence the Danes wish to delete: its absence would create a major loophole in the Directive which other Member States might seek to exploit for quite different reasons. As far as the specific Danish proposal is concerned, we could not, of course, accept that UK institutions should in any sense place themselves under Danish tax law. The Commission, realising that this particular requirement is likely to cause difficulties for most Member States, have suggested that the Danes should drop it. Even so, we remain unhappy with any proposal that a UK bank should provide information direct to the Danish revenue authorities.

12. However, at an earlier stage, the Commission (Mr Fitchew) proposed that the obligation to supply information to the Danish revenue might rest with Danish taxpayers. They would be required to ask the Community institution with which they held funds to supply the necessary information to them and they themselves would have to pass it on to their own revenue authorities. This approach looks much more promising. It should raise no problems of banking secrecy, nor should it bring other Community institutions within the scope of Danish tax law.

13. The Commission, the Council Secretariat and the Danes are to see whether they can produce an acceptable Minutes entry, but we are clear that we can go no further than the compromise Mr Fitchew has already put forward.

MOM

MISS O'MARA

DECLARATION BY THE COUNCIL AND THE COMMISSION
re Article 1

The Council and the Commission declare:

The adoption of this Directive establishes the principle of the liberalisation of capital movements in the Community. Liberalisation is necessary for the completion of the internal market and marks an important step towards the achievement of economic and monetary union. It does not, however, represent a sufficient condition for the creation of a truly integrated financial area in the Community.

1. The proper functioning of the internal market and continued progress towards economic and monetary union also require an increasingly higher degree of stability in exchange rate relationships between the Member States, based on close convergence and increased cooperation in the framing and conduct of their economic and monetary policies, and their membership of a common exchange rate discipline.

Seen in this light, the measures to liberalise and unify the foreign exchange market which flow from the implementation of the present Directive will not take on their full significance and exert their full effects unless they are accompanied by parallel efforts to achieve the equal participation by 1992 of all the currencies in the exchange rate mechanism of the European Monetary System. Attainment of this objective is a priority for the Member States which have already made the greatest headway in the process of financial liberalisation.

2. The liberalisation of capital movements should take place in a framework which ensures a satisfactory level of protection for savers and depositors, a high degree 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.

It is therefore essential that the programme already launched to harmonise prudential and supervisory rules in the field of financial services be actively pursued along the lines and according to the timetable laid down in the White Paper on completing the internal market.

3. Under a system of complete liberalisation, tax considerations will play a greater part in determining capital movements.

The period of ... months adopted for the implementation of this Directive should be used to define and adopt at Community level measures designed to eliminate or reduce the dangers of distortions and tax evasion resulting from the variety of national rules concerning the taxation of savings and the monitoring thereof. These measures could comprise:

- an approximation of systems of company taxation, including the tax base and rates of tax, in the Member States,
- a harmonised system for withholding tax on payments of interest and dividends to Community residents,
- a strengthening of the procedure governing cooperation between national tax authorities and reporting obligations on financial intermediaries.



FROM: J M G TAYLOR

DATE: 6 June 1988

pmf

MISS O'MARA

cc PS/Economic Secretary
Sir G Littler
Mr Lankester
Mr Culpin
Mr Peretz
Mr Mortimer
Mr Parkinson
Mr Nelson

Mr Bostock - UKREP
Mr Lindley - B/E
Mr Alpe - IR

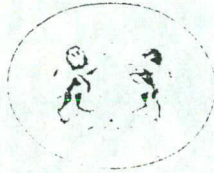
LIBERALISATION OF CAPITAL MOVEMENTS

The Chancellor was grateful for your minute of 2 June.

2. He has commented that the Danes can, of course, be out-voted. He doubts if they would invoke the Luxembourg Compromise against the Fitchew formula.

JMG

J M G TAYLOR



cc Ps/chancellor
 Sir P Middleton
 Sir G Lillie
 Mr Lancaster
 Mrs Lomas
 Mr Odling -
 Snee
 Mr Rig Allen
 Mr Martine
 Miss Olman
 Mrs Evans
 Mr Parkinson
 7 June 1988
 Mr Nelson
 Mr Cropper
 Mr Bostock
 UKREP
 Mr Arrowsmith
 - Bee

Nigel Spearing Esq MP
 Chairman of the Select Committee
 on European Legislation
 House of Commons
 LONDON SW1

Dear Nigel,

CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY

I sent the Select Committee an explanatory memorandum on 6 January on the Commission's paper 9510/87 COM(87)550 "The Creation of a European Financial Area". That described the three proposals put forward by the Commission:

- (i) for a Council Directive to extend liberalisation to all capital movements, subject to a safeguard clause permitting controls to be imposed in certain specified circumstances;
- (ii) for a Council Directive amending earlier Community legislation on regulating international capital flows, which would allow measures to be introduced on the recommendation of the Commission and which would include a statement of intent to liberalise flows with third countries; and
- (iii) for a Council Regulation establishing a single facility (in place of the two existing facilities) to provide medium term financial support for Member States' balance of payments, inter alia when a Community country undertook a programme of capital liberalisation when its balance of payments was "fragile".

The Committee asked to be informed of developments before these proposals went to the Council for final consideration.

The Commission texts have now been discussed in detail at working level and will be reconsidered by Community Economic and Finance Ministers at their meeting on 13 June. A number of changes have been proposed, which the UK has supported.

Capital Liberalisation Directive

Provision has been made in the draft Directive for the repeal of the earlier Community legislation on regulating international capital flows: the UK had argued its continued existence was quite inconsistent with the commitment to full liberalisation. At the same time, the text is likely to provide that where short-term large-scale capital movements to or from third countries seriously disturb the domestic or external monetary or financial situation of Member States or produce serious stresses in the exchange rate relationships in the Community or between the Community and third countries, Member States shall consult with one another on any measures to be taken to counteract such difficulties.

The safeguard clause, which allows member states to introduce temporary restraints on capital flows in the face of exceptional short-term pressures, is likely to be subject to a 6 month time limit from the date the protective measures enter into force, with a review before the end of 1992 to check whether its retention remains appropriate.

The transitional arrangements for Greece, Ireland, Spain and Portugal will probably be extended until the end of 1992, with provision to examine the situation of Greece and Portugal by that date to determine whether any further prolongation is necessary. The extension would in any way not exceed two years and would be decided by the Council.

Medium Term Financial Support

The limit on the outstanding amount of loans to be granted to Member States under this facility is likely to be 16,000 million ecu. As I indicated in my memorandum, market borrowing would be the usual method of financing Community support and the outstanding amount of loans so granted would be limited to 14,000 million ecu but if market conditions were unsatisfactory or the amount available through market borrowing were insufficient, Community loans would be financed in full or in part by the other Member States, subject to Council agreement. The UK's contribution would be limited to 2,715 million ecu, 19.5 per cent of the total.

No specific reference is to be made to Member States who encounter balance of payments difficulties when embarking on a programme of capital liberalisation in the text of the Directive although it will be understood that medium term financial support could be provided in these circumstances.

Complementary Questions

The Commission have drafted a joint Council/Commission declaration which would note that while capital liberalisation is necessary for the completion of the internal market and marks an important step towards the achievement of economic and monetary union, it is in itself insufficient for the creation of a truly integrated financial area in the Community. Further progress therefore needs to be made on the "complementary questions" the Commission identified in their document COM(87)550:

EC Budget

the harmonisation of supervisory and prudential rules;

fiscal issues; and

the relationship between capital liberalisation and the EMS.

The wording of this text is still under discussion.

I enclose a copy of the latest English version of the draft Council Regulation, although this has subsequently undergone some further slight amendment. As yet, we have no English version of the capital liberalisation Directive but we shall send this to you as soon as we receive it.

Capital liberalisation is one of the elements to which the UK Government attaches particular importance in the context of completing the Community's internal market by 1992. It would therefore be most helpful if the Committee could consider the revised Commission proposals as soon as possible. It is possible that substantive agreement may be reached on the texts at the ECOFIN Council on 13 June.

I am copying this letter to the Chairman of the Lords Select Committee on the European Communities, Baroness Serota.

Yours ever

Peter

PETER LILLEY

PROPOSAL FOR A COUNCIL REGULATION

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

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 for 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 and in a situation where orderly exchange rate conditions prevail, economic policy measures likely to prevent the occurrence of an acute balance-of-payments crisis and to support its efforts towards convergence;

(1)

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 credit-worthiness 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 last amended by Decision 86/656/EEC ⁽²⁾, the Council set up machinery for providing medium-term financial assistance which was initially valid for 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;

(1)
(2)

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 the ceiling on amounts outstanding under the mechanism should be adjusted accordingly;

Whereas, however, it is appropriate that the financing obligations on Member States 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,

(1)
(2)

HAS ADOPTED THIS REGULATION:

Article 1

1. A Community facility providing medium-term financial support shall be established, enabling loans to be granted to one or more Member States which are experiencing or are seriously threatened with difficulties in their balance of current payments or capital movements.

The outstanding amount of loans to be granted to Member States under this facility shall be limited to 16 000 million ECU in principal.

2. To this end, in accordance with a Decision adopted by the Council pursuant to Article 3 and after consulting the Monetary Committee, the Commission shall be empowered to contract loans on the capital markets or with financial institutions.

The outstanding amount of loans so granted to Member States shall be limited to 14 000 million ECU in principal.

3. If conditions available on capital markets or with financial institutions are unsatisfactory or if the amount available under the ceiling referred to in paragraph 2 is insufficient, Community loans shall be financed in full or in part by the other Member States whose contributions in principal may not exceed the ceilings specified in the Annex.

Article 2

Where a Member State proposes to call upon sources of financing outside the Community which are subject to economic policy requirements, 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. The medium-term financial support facility may be implemented by the Council on the initiative:
 - of the Commission acting pursuant to Article 103 of the Treaty in agreement with the Member State seeking Community financing;
 - of a Member State experiencing or seriously threatened with difficulties as regards its balance of current payments or capital movements.

2. The Council, after examining the situation in the Member State seeking medium-term financial assistance and the recovery or back-up programme presented in support of its application, shall decide, as a rule during the same meeting:
 - whether to grant a loan or appropriate financing facility, its amount and its average duration;
 - the economic policy conditions attached to the medium-term financial assistance with a view to re-establishing or ensuring a sustainable balance-of-payments situation;

- the techniques for disbursing the loan or financing facility the release or drawings of which shall as a rule be by successive instalments, the liberalization of each instalment being subject to verification of the results achieved in implementing the programme, in terms of the objectives set.

3. Any full or partial financing of medium-term financial assistance by recourse to the Member States shall be decided on by the Council. In that event the Council, in addition to taking the decisions referred to in paragraph 2, shall decide on the size of the contributions of these States 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

In cases where restrictions on capital movements are introduced or re-introduced pursuant to Article 109 of the Treaty during the term of the medium-term financial assistance, its conditions and arrangements shall be re-examined 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 Article 3. 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, after consulting the Monetary Committee, shall decide on the release of 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 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.

Article 7

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

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 refinance all or part of its initial borrowings or restructure the corresponding financial conditions.

Refinancing or restructuring operations shall be carried out in accordance with the conditions set out in paragraph 1 and shall not have the effect of extending the average duration of the borrowing concerned or increasing the amount, expressed at the current exchange rate, of capital outstanding at the date of the refinancing or restructuring.

3. The costs incurred by the Community in concluding and carrying out each operation shall be borne by the beneficiary Member State.
4. The Monetary Committee shall be kept informed of developments in operations referred to in the third sub-paragraph of paragraph 1 and the first sub-paragraph of paragraph 2.

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 under the conditions laid down in Article 7;
 - 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. Member States concerned shall notify the Commission and Monetary Committee of the transfer.
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 Monetary Committee of the operation.

Article 9

For the application of the ceilings referred to in Article 1, 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, 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 Co-operation Fund shall make the necessary arrangements for the administration of the loans.

The funds shall be paid only for the purposes indicated in Article 1.

Article 12

Before 31 December 1992, the Council shall examine, on the basis of a report from the Commission, after consulting the Monetary Committee and the European Parliament, whether the facility established still meets, in its principle, its arrangements and its ceiling, the need which led to its creation.

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.

The ceilings for outstanding loans provided for in Article 1(3) shall be as follows:

Member State	Million ECU	% 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	<u>13 925</u>	<u>100,00</u>

EC
Budget

EST
20/6

Treasury Chambers, Parliament Street, SW1P 3AG

Nigel Spearing Esq MP
Chairman
Select Committee on European Legislation
House of Commons
LONDON
SW1A 0AA

20 June 1988

cc. PS/CHANCELLOR
SIR P MIDDLETON
SIR G LITTLER
MR LANKESTER
MR SCHOLAR
MRS LOMAX
MR OOLING-SMEE
MR RIG ALLEN
MR PERETZ
MISS O'MARA O/R
MS CEVANS
MR PARKINSON
MR NELSON
MISS R. WRIGHT
MR CROPPER
MR BOSTOCK-UKREI

Dear Nigel,

CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY

I am today submitting two explanatory memoranda describing progress on the proposals in this area, originally set out in the Commission's paper 9510/87 COM(87)550 "The Creation of a European Financial Area", up to and including the decisions taken at the ECOFIN Council on 13 June.

The text of the Regulation remains as attached to my letter of 7 June. I am attaching the revised text of the Directive.

In my letter of 7 June I also mentioned that the Commission had drafted a joint Council/Commission declaration concerning the "complementary questions" the Commission identified in Document COM(87)550. In the event, this declaration took the form of a confidential entry in the Council Minutes. It was entirely satisfactory to the UK.

On the relationship between capital liberalisation and the EMS the Council noted that the proper functioning of the internal market and continued progress toward economic and monetary union will require an increasing degree of stability in exchange rate relationships, greater convergence of economic performance based on price stability, and increased co-operation in economic and monetary policies. On the harmonisation of supervisory and prudential rules, the programme of work already underway in the Community was endorsed. Finally, in fiscal issues, the Council made the request, to the Commission,



to make proposals by 31 December 1988, incorporated in Article 6 of the Directive.

I am copying this letter to the Chairman of the Lords Select Committee on the European Communities, Baroness Serota.

Yours ever
Peter

PETER LILLEY



Treasury Chambers, Parliament Street, SW1P 3AG

Baroness Serota
Chairman
Lords Select Committee on the
European Communities
House of Lords
LONDON
SW1A 0PW

June 1988

Dear Beatrice,

CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY

Treasury officials gave an account of progress on this subject to Sub-Committee A of your Select Committee on 14 June. They described the agreement reached at the 13 June meeting of European Economic and Finance Ministers, and promised to forward to your Committee a written account as soon as possible.

I am attaching a copy of a letter I have written today to Nigel Spearing, as Chairman of the House of Commons Committee, together with two further explanatory memoranda. At the ECOFIN meeting on 13 June the Chancellor of the Exchequer placed a Parliamentary scrutiny reserve on the proposals. I very much hope that your Committee can now clear the proposals for the purpose of listing this reserve.

Yours ever
Peter

PETER LILLEY

From: Nigel Spearing MP

BF 23/88 24/6



OVERSEAS OFFICE
HOUSE OF COMMONS
LONDON SW1A 0AA
01-219 3000 (Switchboard)
01-219 5467 (Direct Line)

CH/EXCHEQUER	
REC.	21 JUN 1988
ACTION	EST
COPIES TO	

21/6

HM TREASURY - MCU	
RETR.	20 JUN 1988
ACTION	

EUROPEAN LEGISLATION COMMITTEE

Dear Nigel. Took no'm, B/BT

A note drafted ASAP pssr. for my signature. 20 June 1988

Creation of a European Financial Area

I received on Wednesday, 8 June a letter signed by Peter Lilley and dated 7 June in response to a request by the Committee in its Thirteenth Report of the current Session for information on developments in negotiations on the Commission Communication on the creation of a European Financial Area. The Committee had deferred a decision on whether to recommend a debate pending receipt of this information, which it had asked to receive in good time before the proposal went to the Council of Ministers for final consideration.

The Committee was therefore surprised that Peter Lilley said in his letter that it would be most helpful if the Committee would consider the revised Commission proposal as soon as possible, as it was possible that substantive agreement might be reached on it at the ECOFIN Council on 13 June. The letter was accompanied by the latest English version of a draft Council Regulation covered by the Communication, but there was then no English version of the capital liberalisation Directive nor any text of the proposed Council - Commission Declaration calling for further progress on certain matters.

It is, of course, established procedure for Ministers to write to the Committee about developments or for Explanatory Memoranda or Supplementary Memoranda to be provided by Departments whether or not official texts of instruments likely to come before the Council are available, especially where speedy adoption is likely. However, the Committee has grave doubts that the Treasury needed to wait until less than a week before a crucial Council meeting to report on negotiations which had presumably been ongoing since the proposal was tabled by the Commission. It takes the view that a proper regard for the Parliamentary scrutiny procedure, plus awareness of the fact that the Committee has regular weekly meetings, would have allowed the Committee's staff and the Committee itself much more time to consider the information contained in Peter Lilley's letter.

The Committee at its meeting on 8 June did not recommend that these proposals be further considered by the House in the light of Peter Lilley's statement about the possibility, which I understand turned into reality, of substantive agreement on 13 June. This was because there was no prospect of a debate ahead of that date. However, certain elements of the Commission proposal are due to come before the Committee formally in the near future, and the Committee will then consider anew whether the importance of these proposals justifies debate in the House at some point. In the meantime, the Committee has asked me to make clear to you that, in all the circumstances, it is unhappy at the extent to which it was rushed into considering them further, and to ask you to ensure that future cases are handled in a more satisfactory manner.

Yours sincerely,

Nigel Spear

Chairman

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

FROM: N P WILLIAMS

DATE: 23 June 1988

- ✓* *23/6*
1. MR PERETZ
 2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Scholar
Mrs Lomax
Mr Odling-Smee
Mr R I G Allen
Mr Gieve
Mr Mortimer
Miss O'Mara
Miss C Evans
Mr Parkinson
Mr Nelson
Miss R Wright
Mr Cropper

Chy
Content? (I have
made some amendments
to tidy up / shorten the
draft).

of 23/6
OK as
forwarded
& signed.

Mr Bostock UKREP

CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY: REPLY TO MR NIGEL SPEARING MP

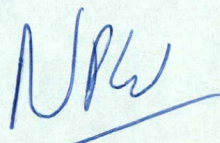
Mr Spearing, Chairman of the Select Committee on European Legislation, has written to you to complain that the Economic Secretary's letter to him of 7 June, which asked the Committee to consider the revised Commission proposals on capital liberalisation as soon as possible in the light of the ECOFIN Council meeting on 13 June, did not allow the Committee an opportunity to debate the proposals and did not show a proper regard for Parliamentary scrutiny procedure.

2. Mr Bowen Wells MP made a similar complaint about the lack of opportunity for the House to discuss European legislation prior to agreement by the Council of Ministers in an exchange with the Leader of the House on 9 June. Mr Nelson's note of 13 June, covering a draft reply for the Leader of the House, indicated that Mr Spearing was intending to complain to a Treasury Minister.

3. I attach a draft reply to Mr Spearing. This follows closely the letter from the Leader of the House to Mr Bowen Wells (copy

attached), explaining that substantial progress on the Directives was made only at a very late stage and there were no developments appropriate for the Committee before the Whitsun recess. The Economic Secretary's letter of 7 June reached the Committee the first day after the Parliamentary recess.

4. The English version of the agreed revised text on the capital liberalisation Directive was not available until Friday 10 June, and I understand that the Economic Secretary's office was unable to deliver this to the Committee until the morning of Monday 13 June. In a further letter to Mr Spearing on 20 June, which is not acknowledged in this undated letter (indeed the two may well have crossed), the Economic Secretary noted that the joint Council/Commission declaration concerning the "complementary questions" was written into the Council Minutes as a confidential entry. In addition, he enclosed two further explanatory memoranda. You reported on the outcome of ECOFIN to Parliament by way of an arranged PQ on 20 June.



N P WILLIAMS

DRAFT LETTER FROM CHANCELLOR TO:

Nigel Spearing Esq MP
Chairman,
Select Committee on European Legislation

CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY

You wrote to me earlier this week, expressing concern that the European Legislation Committee could not consider the revised Commission proposals on capital liberalisation before the ECOFIN Council meeting on 13 June.

As you know, Peter Lilley sent the Committee an explanatory memorandum on the Commission's proposals ^{as far back as} on 6 January this year. ^{However,} ^{at the end of May} ^{early} ^{in June,} but, until very recently, little progress was made ^{with the item} thereafter in the ECOFIN Council negotiations. However, the Germans, who attached considerable importance in bringing these discussions to a successful ^{Conclusion} completion during their Presidency, were able to make substantial progress in a short period at the end of May and in early June. Peter Lilley informed the Committee of developments in his letter of 7 June immediately after the Whitsun Recess. ^{This was} as soon as there was anything of substance to report, and as soon as the shape of the revised proposals to be put to ECOFIN were clear. ~~He enclosed a copy of the text of the revised Community regulation on balance of payments support, as soon as it became available in English.~~

~~[]~~ But at that time no English version of the revised capital liberalisation Directive was available, ^{bwt} I understand Peter's office sent one across to you as soon as it reached us from Brussels. ~~##~~ In his letter of 20 June, which ^{may have} ~~[no doubt]~~ crossed with your own, Peter explained that a joint Council/Commission declaration concerning the so-called "complementary questions" had now been written into the Council Minutes as a confidential entry. He also submitted two explanatory memoranda to your Committee, describing progress on the proposals in this area up to and including the decisions taken at the ECOFIN Council on 13 June and, of course, I myself made a statement on the outcome of the ECOFIN Council meeting in the House on 20 June, in the form of a Written Answer.

~~[]~~ ^{I have at all times} ~~we~~ ^{carefully} have been very much aware of the Committee's wish to consider the issues raised by capital liberalisation before final decisions are taken. I am sorry that, in the event, the timing has proved so awkward. ~~[]~~ but I am sure you will appreciate that this is something over which we ourselves have very little control, ^{and} I am most grateful that the Committee was able to consider this matter so speedily.

I am copying this letter to Baroness Serota, as Chairman of the Lords Select Committee on the European Committies.



Mr Nelson, -107/G, HMT, PRIVY COUNCIL OFFICE

WHITEHALL, LONDON SW1A 2AT

As requested

15 June 1988

[Handwritten signature]

Dear Bowen

During Business Questions last Thursday you reminded me of your concern about the way in which EC legislation has sometimes not been considered by the House as it was intended to be considered. In particular, you referred to what I have assumed to be Peter Lilley's letter of 7 June to the EC Scrutiny Committee which contained details of the recent developments on the Commission's proposals for "the Creation of a European Financial Area". I said that I would look into this matter, which I have now done.

I understand that the Commission's paper, which was presented to the Council of Ministers last November, contains proposals for the full liberalisation of capital movements in Europe, but no proposals on a European Central Bank or, directly, on monetary union. I am also advised that in accordance with the request of the EC Scrutiny Committee in January this year, my colleagues in the Treasury have kept the House informed of developments in the ECOFIN Council negotiations about this matter in the normal way by written answers.

As I am sure you are aware, until very recently little progress had been made in these negotiations. However, the Germans, who attach considerable importance in bringing these discussions to a successful completion during their Presidency, were able to make substantial progress in a short period at the end of May and in early June. Peter Lilley informed the Committee of this as soon as there was anything of substance to report and as soon as the shape of the revised proposals to be put to ECOFIN were clear. I can assure you that the Government have been mindful of the Committee's desire to ensure that it has an opportunity to discuss these matters in good time, and I regret that the Committee had very little time to discuss the issues before the ECOFIN Council on 13 June. In the circumstances, we were most grateful that the Committee was able to consider this matter so speedily.

[Handwritten signature]

[Handwritten signature]

JOHN WAKEHAM

Bowen Wells Esq MP
House of Commons

Peretz

From : D L C Peretz
Date : 23 June 1988

ECONOMIC SECRETARY

cc **Chancellor**
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Scholar
Mr R I G Allen
Miss O'Mara
Mr N Williams
Mr Parkinson
Mr Cropper

Mr Bostock - UKREP

CAPITAL LIBERALISATION DIRECTIVE : PARLIAMENTARY COMMITTEES

Baroness Serota has written today to confirm that the House of Lords Committee are content for us to agree to adoption of the Directive and Regulation, although they will continue their own enquiry and may recommend a debate in due course.

2. The House of Commons Scrutiny Committee also confirmed, when they met yesterday, that they are content for us to agree to adoption of the Directive and Regulation, though I understand they may be recommending the subject for debate in the House of Commons in due course, as a matter to be taken note of in some future general debate on economic and monetary policy.

3. This means that the way is clear to remove our Parliamentary scrutiny reserve when the Directive and Regulation come up on the agenda of tomorrow's Industry Council as "A" points. Since there are no other remaining obstacles (the Danes have removed their Parliamentary reserve) the Directive and Regulation will be adopted tomorrow.

* attached

DLCP

D L C PERETZ

From: BARONESS SEROTA
Chairman of the Select Committee on the European Communities



COMMITTEE OFFICE
HOUSE OF LORDS
LONDON SW1A 0PW
01-219 3146

23rd June, 1988

Dear Peter Lilley,

Capital liberalisation in the European Community

Thank you for your undated letter received yesterday about progress at Council level on capital liberalisation in the European Community and for sending me a copy of your letter to Nigel Spearing. I will draw both of them to the attention of Lord Kearton and the members of Sub-Committee A.

As you know Sub-Committee A are already aware of the imminence of Council decisions on this subject. Both they and the Select Committee will understand why you may wish to agree to the adoption of documents 9510/87 and 6427/88 despite the fact that the scrutiny process has not been completed in this House.

The Sub-Committee consider however that the proposals will continue to merit examination not least because of the wider issues they raise, so they will wish to complete their enquiry and the Select Committee will then wish to report to the House.

In this context the two new explanatory memoranda which you enclose will be of assistance to us, even though they were apparently designed for use by the Commons and make no mention of the Lords enquiry.

*Yours,
Baroness Serota.*
SEROTA

Peter Lilley, Esq.,
Economic Secretary to the Treasury,
HM Treasury,
Treasury Chambers,
Parliament Street,
LONDON,
SW1P 3AG.

ps3/51T



CH
27/6
cc
Chief Secretary
Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Scholar
Mrs Lomax
Mr Odling-Smee

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

24 June 1988

Nigel Spearing Esq MP
Chairman
Select Committee on European Legislation
Overseas Office
House of Commons
LONDON SW1A 0AA

Mr Peretz
Mr R I G Allen
Mr Gieve
Mr Mortimer
Miss O'Mara
Mr N P Williams
Miss C Evans
Mr Parkinson
Mr Nelson
Miss R Wright
Mr Cropper
Mr Bostock - UKREP

CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY

You wrote to me earlier this week, expressing concern that the European Legislation Committee could not consider the revised Commission proposals on capital liberalisation before the ECOFIN Council meeting on 13 June.

As you know, Peter Lilley sent the Committee an explanatory memorandum on the Commission's proposals as far back as 6 January this year. However, until a short period at the end of May and early June, little progress was made with them in the ECOFIN Council negotiations. Peter Lilley informed the Committee of developments in his letter of 7 June immediately after the Whitsun Recess. This was as soon as there was anything of substance to report, and as soon as the shape of the revised proposals to be put to ECOFIN were clear.

At that time no English version of the revised capital liberalisation Directive was available, but I understand Peter's office sent one across to you as soon as it reached us from Brussels. In his letter of 20 June, which may have crossed with your own, Peter explained that a joint Council/Commission declaration concerning the so-called "complementary questions" had now been written into the Council Minutes as a confidential entry. He also submitted two explanatory memoranda to your Committee, describing progress on the proposals in this area up to and including the decisions taken at the ECOFIN Council on 13 June and, of course, I myself made a statement on the outcome of the ECOFIN Council meeting in the House on 20 June, in the form of a Written Answer.



I have at all times been keenly aware of the Committee's wish to consider the issues raised by capital liberalisation before final decisions are taken. I am sorry that, in the event, the timing has proved so awkward. I am sure you will appreciate that this is something over which we ourselves have very little control, and I am most grateful that the Committee was able to consider this matter so speedily.

I am copying this letter to Baroness Serota, as Chairman of the Lords Select Committee on the European Committies.

A handwritten signature in black ink, appearing to be 'Nigel Lawson', written over a large, faint circular watermark or stamp.

NIGEL LAWSON

From: Nigel Spearing MP



OVERSEAS OFFICE
HOUSE OF COMMONS
LONDON SW1A 0AA
01-219 3000 (Switchboard)
01-219 5467 (Direct Line)

ECONOMIC SECRETARY	
REC'D	29 JUN 1988
ACTION	MC PELETZ
COPIES TO	PS/CHX PS/SIC P. MIDDLETON SIR G. LITTLE MC LANKESTER MRS COMAX MR DOLING-SMEE MR GIEVE MR NORTON

MISS O'MARA MISS EVANS
MC PARKINSON MR NELSON
28 June 1988
MCCROPPEL

EUROPEAN LEGISLATION COMMITTEE

Dear Peter,

Capital Liberalisation in the European Community

Thank you for your letter of 20 June and for the two Explanatory Memoranda describing progress on the proposals on the Creation of a European Financial Area. The Committee considered this at its meeting yesterday and asked me to thank you for the steps you have taken to keep it informed of developments.

The Committee gave careful consideration to the revised texts and to the Council's conclusions on the 'complementary questions', which were summarised in your letter. It considered that these had wide policy implications. Although it did not recommend further consideration by the House of the Directive and the Regulation, prior to their adoption, the Committee did recommend their further consideration on the occasion of a debate on economic and monetary policy. I enclose a copy of the report.

*Yours sincerely,
Nigel Spearing*

Chairman

Peter Lilley Esq MP
Economic Secretary
HM Treasury
Treasury Chambers
Parliament Street
London SW1P 3AG

CREATION OF A EUROPEAN FINANCIAL AREA

The Committee has given further consideration to the first of the following on the basis of a Supplementary Explanatory Memorandum and maintains its opinion¹ that this raises questions of political importance. The Committee considers that the second of the following raises questions of political importance and now recommends further consideration by the House of both documents on the occasion of a debate on economic and monetary policy. Adoption of these proposals need not be delayed pending such a debate:-

HM TREASURY

(9785) 9510/87
COM(87)550

Commission Communication on the creation of a European financial area:
- draft Directive for the implementation of Article 67 of the EEC Treaty - liberalisation of capital movements;
- draft Directive amending Directive 72/156/EEC on regulating international capital flows;
- draft Regulation establishing a single facility providing medium-term financial support for Member States' balances of payments.

(10357) 6427/88
COM(88)279

Amended draft Regulation establishing a single facility pending medium-term financial support for Member States' balance of payments.

In its Twenty-Seventh Report² of the current Session the Committee considered a letter of 7 June from the Economic Secretary to the Treasury up-dating the position on a Commission Communication on the creation of a European Financial Area, and containing three proposals for implementing the final stage in the liberalisation of capital movements in the Community, which it had earlier considered in its Thirteenth Report of the current Session.¹ It has now given further consideration to a version of

1. HC 43-xiii (1987-88) para 2 (27 January 1988)
2. HC 43-xxvii (1987-88) para 3 (8 June 1988)

the first two proposals for Directives (now contained in one Directive) implementing Article 67 of the Treaty on liberalisation of capital movements, which reflects discussions in the Council. This was agreed at the Council meeting on 13 June and is expected to be adopted shortly.

The Department has submitted a Supplementary Explanatory Memorandum which states that only significant changes made by the Council to the Commission's proposals as described in the 7 June letter are:

- a new paragraph requiring the Commission to submit proposals before 31 December 1988, for decision by 30 June 1989, aimed at reducing the risks some countries see of distortion, evasion and fiscal fraud, arising from different national systems of the taxation of savings; and
- a new provision, to meet a Danish problem, to permit existing national legislation regulating the purchase of secondary residences to continue for the time being.

The Committee has also given consideration to an amended proposal from the Commission for a Regulation establishing a single facility providing medium-term financial support for Member States' balance of payments. It notes that this was not amended by the Council when it considered it on 23 June and is expected to be adopted shortly.

In a further letter, dated 20 June, the Economic Secretary to the Treasury says that in his earlier letter he mentioned that the Commission had drafted a joint Council/Commission declaration

concerning certain "complementary questions" identified by the Commission. In the event, this declaration took the form of a confidential entry in the Council Minutes, which he describes as entirely satisfactory to the United Kingdom. On the relationship between capital liberalisation and the European Monetary System (EMS), the Council noted that the proper functioning of the internal market and continued progress toward economic and monetary union would require an increasing degree of stability in exchange rate relationships, greater convergence of economic performance based on price stability, and increased co-operation in economic and monetary policies. On the harmonisation of supervisory and prudential rules, the programme of work already underway in the Community was endorsed. Finally, on fiscal issues, the Council requested the Commission to make proposals for a new paragraph in the Directive as already noted.

The Committee notes that the Government has always fully supported the Commission's aim of securing the removal of barriers to the free movement of capital in the Community and with third countries and that the Government therefore welcomes the proposed Directive and Regulation. It further notes that there are no new financial implications for the United Kingdom arising from the new Medium Term Financial Support facility. However, it notes that the conclusions of the Council about the relationship between capital liberalisation and the EMS and the implications of the Council's decisions on capital liberalisation for harmonisation of supervisory and prudential rules in the financial sector and on fiscal issues related to the taxation of savings have wider policy

implications. Thus, whilst the Committee does not recommend further consideration of the present proposals, as amended in Council consideration, prior to adoption, it does recommend their further consideration by the House on the occasion of a debate on economic and monetary policy.

From: Nigel Spearing

SPEARING
117

B/1 112
12/7

HM TREASURY - MCU	
REC'D	- 4 JUL 1988
ACTION	
SIGNATURE	
REF No.	



OVERSEAS OFFICE
HOUSE OF COMMONS
LONDON SW1A 0AA
01-219 3000 (Switchboard)
01-219 5467 (Direct Line)

EUROPEAN LEGISLATION COMMITTEE

1 July 1988

Dear Nigel,

Capital Liberalisation in the European Community

Thank you for your letter of 24 June explaining how it came about that the Committee was given a very short period in which to scrutinise developments on the Commission's proposals on capital liberalisation prior to substantial agreement on these at the ECOFIN Council meeting on 13 June. The Committee considered your letter at its meeting on 29 June and noted your description of the circumstances.

On one matter the Committee has asked me to seek your further comments. Peter Lilley, in his letter of 20 June, said the proposed joint Council/Commission declaration concerning certain "complementary questions" had been written into the Council Minutes as a confidential entry, and in consequence he gave an outline summary only of what this said. However the Press Release 6848/88 (Presse 83) issued by the Council General Secretariat about the ECOFIN Council meeting on 13 June contained what appears to be a verbatim version of the entry, or at least a very substantial part of it. As the Press Release seems on the face of it to be somewhat at variance with Peter Lilley's statement that the Council Minutes' entry was confidential the Committee decided that I should ask you for your comments.

Yours sincerely,

Nigel Spearing

Chairman

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

CH/EXCHEQUER	
REC.	- 8 JUL 1988
ACTION	Mr PERETZ
COPIES TO	PS/EST, PS/EST, PS/PME PS/EST, Sir P. MIDDLETON, Sir G. LITTLE, Mr LANKESTER, Mr SCHOLAR, Mr LOMAX, Mr ODLING-SMEE, Mr R. E. ALLEN, Mr GIEVE, Mr MORTIMER, Miss O'MARA, Mr N. P. WILLIAMS, Miss C. EVANS, Mr PARKINSON, Mr NELSON, Miss R. WRIGHT, Mr CROPPER, Mr BOSTOCK - UK REP.

117

FROM: N P WILLIAMS
DATE: 13 July 1988

- 1. MISS O'MARA
- 2. CHANCELLOR OF THE EXCHEQUER

- cc Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir G Littler o/r
- Mr Lankester
- Mr Scholar
- Mrs Lomax
- Mr Odling-Smee
- Mr Peretz o/r
- Mr R I G Allen
- Mr Gieve
- Mr Mortimer
- Miss C Evans
- Mr Parkinson
- Mr Nelson
- Miss R Wright
- Mr Cropper

mom 13/7

Draft OK, Ann 1 Ann 2, which at Annex 2, which drafts significant from what was agreed at the ECJ Council. In particular, X is wrong - a Y in Ne press release - so right.

9/20/6

Office manager.

CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY - NIGEL SPEARING'S LETTER OF 1 JULY

Mr Spearing, Chairman of the Select Committee on European Legislation, wrote to you on 1 July asking for your comments on the apparent discrepancy between the statement in the Economic Secretary's letter of 20 June that the joint Council/Commission declaration concerning the Commission's "complementary questions" took the form of a confidential entry in the Council Minutes, and Press Release 6848/88 (copy of relevant section attached: Annex 1) from the Council's General Secretariat which appears to give a verbatim version of the entry. (In fact, although the press release uses quotation marks, it is different in wording, but not substance, from the confidential entry, which is at Annex 2.)

2. UKREP have been unable to establish why a "confidential entry" in the Council Minutes has now been issued in a press release, although such practice is not without precedent. The Secretariat may have been subject to lobbying from other EC members; alternatively, they may have acted on their own initiative, publishing material they consider to be of interest.

3. We recommend that you reply to Mr Spearing (draft attached) to the effect that we are surprised that the confidential entry has been published but the Economic Secretary's letter of 20 June told the Committee of the broad contents of the confidential entry and therefore the press release is not news.

NPW

N P WILLIAMS

Pre type final

~~DRAFT LETTER FROM CHANCELLOR TO:~~

Nigel Spearing Esq MP
Chairman
Select Committee on European Legislation

CAPITAL LIBERALISATION IN THE COMMUNITY

You wrote to me on 1 July, asking me to comment on the inclusion in the Council General Secretariat's Press Release 6848/88 of text relating to the "complementary questions", when Peter Lilley had told you in his letter of 20 June that this declaration took the form of a confidential entry in the Council Minutes.

What Peter told you was quite correct. The convention is that entries in Council Minutes are confidential and it was on that basis that we felt unable to release the text to the Scrutiny Committee. We were therefore as surprised as you were to discover subsequently that the Council Secretariat had reproduced the substance (although not, in fact, the verbatim text) in a press release. However, I think you will agree that Peter's letter of 20 June picked out the main points.

I am copying this letter to Baroness Serota, as Chairman of the Lords Select Committee on the European Communities.

ANNEX I : PRESS RELEASE

Lastly, the Council and the Commission placed the text of the Directive on capital movements in a wider political context by stating that:

"The Directive involves the full liberalization of capital movements within the Community and lays down the timetable and detailed procedures for implementing it. This liberalization is necessary for the completion of the internal market and marks an important step towards the achievement of economic and monetary union. It is not, however, a sufficient condition for the creation of a financial area genuinely integrated into the Community.

1. The proper functioning of the internal market, greater economic and social cohesion within the Community and continued progress towards economic and monetary union demand that between now and completion of the large market an increasingly high degree of stability be sought in exchange relations between Member States, with that stability being based on price stability, close convergence of economic performances and strengthened co-operation in the definition of the conduct of economic and monetary policies.
2. The liberalization of capital movements must fit into a framework which ensures a satisfactory level of protection for savers and depositors, a high degree of transparency and information for investors and shareholders, equal conditions of competition on the financial markets and the solvency of banks and other financial institutions.

It is therefore important that the programme already initiated, in particular as regards the harmonization of the safeguard and supervision rules in the field of financial services, be pressed ahead with in accordance with the guidelines and timetable laid down in the White Paper on the completion of the internal market.

3. Under full liberalization arrangements, capital movements could be influenced to a greater extent by tax considerations.

The deadline laid down for applying this Directive must be put to advantage to define within the Council, taking into account in particular the Member States' budget and tax constraints, the measures to eliminate or attenuate the risk of tax distortions, evasion and avoidance linked with the diversity of the national schemes concerning tax on savings and monitoring of their application.

Y According to the Commission's point of view expressed in its communication COM(87) 550 accompanying the proposal, these measures could include the harmonization of the tax systems, bases and rates and a strengthening of the detailed procedures for co-operation between the national tax authorities."

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

The aim of this proposal is to establish a single medium-term facility by amalgamating the present two mechanisms, that of Community loans and that of medium-term financial assistance.

ANNEX 2: CONFIDENTIAL ENTRY

Statements concerning the Directive for the implementation of Article 67 of the Treaty.

I. re Article 1

The Council and the Commission state:

This Directive entails full liberalization of capital movements in the Community and lays down the timetable and the details of its implementation. Liberalization is necessary for the completion of the internal market and marks an important step towards the achievement of economic and monetary union. It does not, however, constitute an adequate condition for the creation of a truly integrated financial area in the Community.

1. The proper functioning of the internal market, greater economic and social cohesion in the Community and continued progress towards economic and monetary union require, between now and the completion of the single large market, an increasingly higher degree of stability in exchange rate relationships between the Member States, based on price stability, close convergence of economic performance and increased co-operation in the framing and conduct of their economic and monetary policies.
2. The liberalization of capital movements should take place in a framework which ensures a satisfactory level of protection for savers and depositors, a high degree of transparency and information for investors and shareholders, equal conditions of competition on financial markets and the solvency and stability of banks and other financial institutions.

It is therefore essential that the programme already launched in particular to harmonize prudential and supervisory rules in the field of financial services be actively pursued along the lines and according to the timetable laid down in the White Paper on completing the internal market.

3. Under a system of complete liberalization, tax considerations could have a greater influence on capital movements.

The period adopted for the implementation of this Directive should be used to define at Council level, taking account of Member States' budgetary and fiscal constraints, measures designed to eliminate or reduce the dangers of distortions, evasion and avoidance resulting from the diversity of national systems for the taxation of savings and for monitoring the application of those systems.

X In accordance with the point of view expressed by the Commission in its communication COM(87) 550 introducing the proposal for this Directive, these measures could in particular take the form of an approximation of taxation systems, their bases and rates, as well as increased co-operation between national tax authorities.



A handwritten signature in the top right corner of the page.

FROM: J M G TAYLOR

DATE: 18 July 1988

MR N P WILLIAMS

cc PS/Chief Secretary
 PS/Financial Secretary
 PS/Paymaster General
 PS/Economic Secretary
 Sir G Littler
 Mr Lankester
 Mr Scholar
 Mrs Lomax
 Mr Odling-Smee
 Mr Peretz
 Mr R I G Allen
 Mr Gieve
 Mr Mortimer
 Miss O'Mara
 Miss C Evans
 Mr Parkinson
 Mr Nelson
 Miss R Wright
 Mr Cropper

**CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY - NIGEL SPEARING'S
 LETTER OF 1 JULY**

The Chancellor has seen your minute of 13 July, and is content to write as proposed.

2. He is, however, very concerned about the "confidential entry" in the Council Minutes. This differs significantly from what was agreed at the ECOFIN Council. In particular, the wording of the first phrase in the last paragraph ("In accordance with the point of view expressed by the Commission...") is wrong - whereas the wording in the Press Release ("According to the Commission's point of view expressed...") is right. He has commented that the difference between these two phrases is manifest.

A handwritten signature in the bottom center of the page.

J M G TAYLOR

FROM: N P WILLIAMS

DATE: 25 July 1988

1. MISS O'MARA *mom 25/7*
2. CHANCELLOR *10/2*

cc Chief Secretary
 Financial Secretary
 Paymaster General
 Economic Secretary
 Sir G Littler
 Mr Lankester
 Mr Scholar
 Mrs Lomax
 Mr Odling-Smee
 Mr Peretz
 Mr R I G Allen
 Mr Gieve
 Mr Mortimer
 Miss C Evans
 Mr Parkinson
 Mr Nelson
 Miss R Wright
 Mr Cropper
 Mr Bostock - UKREP

CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY - NIGEL SPEARING'S LETTER OF 1 JULY

You commented on my minute of 13 July that you were very concerned about the difference between the text of the "confidential entry" in the Council Minutes and the agreement reached at ECOFIN. In particular you commented that the wording of the first phrase in the last paragraph of the English version of the Minutes (Annex 1) ("In accordance with the point of view expressed by the Commission...") was incorrect. The phrase should read "According to the Commission's point of view....", as in the English version of the Council Secretariat's press release (Annex 2).

2. The French version of the Minutes, which I understand was the text tabled at ECOFIN, reads: "Selon le point de vue de la Commission exprime....". You will see from Annex 3 that the FCO translate this phrase in the same way as the press release.

3. When they received the English text of the Council Minutes, UKREP asked the English language Jurist's Linguist to correct the "confidential entry", but the request was apparently ignored. Mr Bostock is now writing to the General Secretariat of the Council to get the English version of the Council Minutes corrected.

NPW

N P WILLIAMS

ANNEX I. CONFIDENTIAL ENTRY

Statements concerning the Directive for the implementation of Article 67 of the Treaty.

I. re Article 1

The Council and the Commission state:

This Directive entails full liberalization of capital movements in the Community and lays down the timetable and the details of its implementation. Liberalization is necessary for the completion of the internal market and marks an important step towards the achievement of economic and monetary union. It does not, however, constitute an adequate condition for the creation of a truly integrated financial area in the Community.

1. The proper functioning of the internal market, greater economic and social cohesion in the Community and continued progress towards economic and monetary union require, between now and the completion of the single large market, an increasingly higher degree of stability in exchange rate relationships between the Member States, based on price stability, close convergence of economic performance and increased co-operation in the framing and conduct of their economic and monetary policies.
2. The liberalization of capital movements should take place in a framework which ensures a satisfactory level of protection for savers and depositors, a high degree of transparency and information for investors and shareholders, equal conditions of competition on financial markets and the solvency and stability of banks and other financial institutions.

It is therefore essential that the programme already launched in particular to harmonize prudential and supervisory rules in the field of financial services be actively pursued along the lines and according to the timetable laid down in the White Paper on completing the internal market.

3. Under a system of complete liberalization, tax considerations could have a greater influence on capital movements.

The period adopted for the implementation of this Directive should be used to define at Council level, taking account of Member States' budgetary and fiscal constraints, measures designed to eliminate or reduce the dangers of distortions, evasion and avoidance resulting from the diversity of national systems for the taxation of savings and for monitoring the application of those systems.

In accordance with the point of view expressed by the Commission in its communication COM(87) 550 introducing the proposal for this Directive, these measures could in particular take the form of an approximation of taxation systems, their bases and rates, as well as increased co-operation between national tax authorities.

ANNEX 2 ; PRESS RELEASE

Lastly, the Council and the Commission placed the text of the Directive on capital movements in a wider political context by stating that:

"The Directive involves the full liberalization of capital movements within the Community and lays down the timetable and detailed procedures for implementing it. This liberalization is necessary for the completion of the internal market and marks an important step towards the achievement of economic and monetary union. It is not, however, a sufficient condition for the creation of a financial area genuinely integrated into the Community.

1. The proper functioning of the internal market, greater economic and social cohesion within the Community and continued progress towards economic and monetary union demand that between now and completion of the large market an increasingly high degree of stability be sought in exchange relations between Member States, with that stability being based on price stability, close convergence of economic performances and strengthened co-operation in the definition of the conduct of economic and monetary policies.
2. The liberalization of capital movements must fit into a framework which ensures a satisfactory level of protection for savers and depositors, a high degree of transparency and information for investors and shareholders, equal conditions of competition on the financial markets and the solvency of banks and other financial institutions.

It is therefore important that the programme already initiated, in particular as regards the harmonization of the safeguard and supervision rules in the field of financial services, be pressed ahead with in accordance with the guidelines and timetable laid down in the White Paper on the completion of the internal market.

3. Under full liberalization arrangements, capital movements could be influenced to a greater extent by tax considerations.

The deadline laid down for applying this Directive must be put to advantage to define within the Council, taking into account in particular the Member States' budget and tax constraints, the measures to eliminate or attenuate the risk of tax distortions, evasion and avoidance linked with the diversity of the national schemes concerning tax on savings and monitoring of their application.

According to the Commission's point of view expressed in its communication COM(87) 550 accompanying the proposal, these measures could include the harmonization of the tax systems, bases and rates and a strengthening of the detailed procedures for co-operation between the national tax authorities."

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

The aim of this proposal is to establish a single medium-term facility by amalgamating the present two mechanisms, that of Community loans and that of medium-term financial assistance.

ANNEX 3: FCO TRANSLATION

STS 445/88

[Translation of marked paragraph in Section I of draft declarations]

According to the Commission's point of view expressed in its communication COM(87)550 accompanying the proposal relating to this directive, this might involve in particular alignment of systems, bases and rates of taxation and strengthening of procedures for cooperation between the national tax authorities.

RESTRICTED



FROM: J M G TAYLOR

DATE: 26 July 1988

A large, stylized handwritten signature in the top right corner of the page.

MR N P WILLIAMS

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir G Littler
Mr Lankester
Mr Scholar
Mrs Lomax
Mr Odling-Smee
Mr Peretz
Mr R I G Allen
Mr Gieve
Mr Mortimer
Mrs O'Mara
Miss C Evans
Mr Parkinson
Mr Nelson
Miss R Wright
Mr Cropper
Mr Bostock - UKREP

**CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY -
NIGEL SPEARING'S LETTER OF 1 JULY**

The Chancellor has seen your minute of 25 July. He has noted that Mr Bostock is seeking to get the English version of the Council Minutes corrected; he has commented that our preference must prevail.

A handwritten signature, likely of J M G Taylor, located below the main text.

J M G TAYLOR

MOM

FROM: MISS M O'MARA
DATE: 2 AUGUST 1988

CHANCELLOR OF THE EXCHEQUER *12/2* cc

Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir G Littler
Mr Lankester o/r
Mr Scholar
Mrs Lomax
Mr Odling-Smee
Mr Peretz
Mr R I G Allen
Mr Gieve
Mr Mortimer
Mr Parkinson
Miss Simpson
Mr N P Williams
Mr Cropper
Mr Bostock - UK Rep

This confirms what I told you last week.
2
3/8

CAPITAL LIBERALISATION IN THE EUROPEAN COMMUNITY - CONFIDENTIAL ENTRY IN COUNCIL MINUTES

You will recall that the English version of the confidential entry in the ECOFIN minutes on the tax implications of the capital liberalisation directive incorrectly stated:

"In accordance with the point of view expressed by the Commission ... "

Mr Williams explained in his minute of 25 July that Mr Bostock was seeking a correction.

2. Mr Bostock has reported that the matter has now been sorted out satisfactorily, with the Council Secretariat issuing corrigenda on 26 July both to the draft minutes of the June ECOFIN and to the Council Minutes declarations which accompanied the adoption of the capital movements directive. I attach the revised text. A future Council will be asked to approve the Minutes of the June ECOFIN as an "A" point on the basis of the corrigendum.

MOM

MISS M O'MARA

CORRIGENDUM TO THE NOTE

from : General Secretariat of the Council

No. prev. doc.: 6982/88
No. Cion prop.: 9510/87

Subject: Directive for the implementation of Article 67 of the
Treaty - liberalisation of capital movements
- Statements

re : Paragraph 1.3., third subparagraph

The text of this subparagraph should read as follows :

"According to the Commission's point of view expressed in its
communication COM(87) 550 ". (rest unchanged)

=====

*refax Min (1) Main H
p w 1) pps in EcoFi
Council 13/v
2) pps in liberalis
of capital movement*

Bullard

09 SEP 1988

IOD
Institute of Directors

pmf *BF* *22/9*

FINANCIAL SECRETARY	
REC.	9 SEP 1988
COPIES TO	Mr. Houghton <i>IN</i> PPS, CST, PM9, EST Sir. P. Middleton Mr. Gilheoly Mr. LANKESTER Mr. Cropper Mr. Dyer Mr. Call P8 J.C.

8 September 1988

Rt Hon Norman Lamont MP
Financial Secretary
Treasury Chambers
Parliament Street
London
SW1P 3AG

Dear Mr Lamont,

OECD/COUNCIL OF EUROPE CONVENTION
ON MUTUAL ADMINISTRATIVE ASSISTANCE

I am writing to express the IOD's serious concern at the possibility that H.M. Government might sign this Convention, even with reservations.

In the first place, it is unsatisfactory that consultation with representative bodies and interested parties is taking place after the text of the Convention has been finalised, so that consultation is limited to the issue of whether to sign the Convention and, if so, subject to what reservations (to the limited extent that reservations are permitted). We appreciate that there was some prior consultation with the International Chamber of Commerce only but, from what we understand, few of their comments were taken into account in the final text and anyway the ICC does not purport to represent all the personal as well as corporate taxpayers who might be affected in all the countries belonging to the OECD or Council of Europe.

As the text is a fait accompli, we see little point in commenting on it in detail and would merely add our support to any detailed comments made by the ICC. In any event, there are in our view enough objections to the Convention on grounds of principle and major substance to make detailed objections superfluous.

Although Article 30 permits countries to make reservations when signing the Convention, these may only, for example, limit the taxes to which the Convention will be applied and the extent to which assistance will be provided in the recovery of taxes claimed. The effect of the major flaws in the Convention may, therefore, be somewhat reduced by the reservations permitted but they will remain major flaws.

Need for the Convention

The Convention provides for mutual assistance by the fiscs of countries which have signed and ratified the Convention in two main ways:

1. obtaining and passing over of information concerning taxpayers' affairs;
2. recovery of tax debts claimed by the other fisc.

As to the first, there is already an extensive network of bilateral and multilateral treaties to combat tax evasion and provide for the mutual exchange of information. In particular an EC Directive was adopted for direct taxes in 1977 and extended to indirect taxes in 1979. The practical need for a new multilateral treaty has not been demonstrated, because there has not been a serious attempt to make full use of the existing treaties which might test their effectiveness. In principle, moreover there is a good case for the bilateral approach, given the wide variation in the tax systems and quality of tax administration among OECD/Council of Europe countries and

the desirability of tailoring safeguards accordingly: for example, some fiscs can be relied on more than others to preserve the confidentiality of commercially sensitive information. This would suggest that the appropriate way forward, if there is a problem at all, might be a model bilateral treaty like the OECD model double taxation treaty whose terms could be adopted or varied as appropriate.

As to the second, there are no precedents anywhere in the world, so far as we know, for mutual assistance in the recovery of outstanding tax claims except for an old (superseded?) treaty between France and Belgium. Such a major, new incursion into personal liberty and surrender of sovereignty (by the assisting country) would demand compelling justification. The justification would need to be sustainable in the light of the existing nature of the Governments, tax administrations and tax structures of the OECD/Council of Europe countries but also of possible radical changes to these in future (including changes in the membership of the OECD/Council of Europe).

In our view it is fundamental to a free society that a person who finds the regime oppressive should be free (subject of course to honouring his existing tax and other obligations) to move to another country with a less oppressive regime that will accept him. That applies as much to fiscal as to other forms of oppression (fiscal oppression may be general e.g. high tax rates or specific e.g. an anomaly which bears particularly harshly on the person concerned). The existence of this safety valve both makes it less likely that an oppressive regime will be introduced in the first place and makes it more tolerable if it is introduced. By giving the fiscs the means to pursue and enforce claims against anyone in the other countries which had ratified it, the Convention would be an open invitation to those countries to extend the scope of their tax systems beyond their borders and in particular to prevent emigrants from enjoying the benefits of a less oppressive fiscal regime overseas. Thus the Convention could become an instrument of oppression in circumstances where there was no suggestion of tax evasion, the problem to which it is supposedly addressed. It would also dull the edge of the current competition between countries to have the lowest tax rates. Without that competition Governments would find it much more difficult to resist the institutional and political biases in favour of ever higher government spending and (as a consequence) ever higher taxes.

Double Taxation

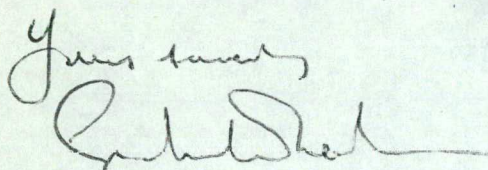
The Convention anyway puts the cart before the horse. We assume that the ultimate objective is to ensure that nobody can escape their fair share of the tax burden of the countries with which they are connected (by residence or otherwise) through locating themselves or their assets or conducting their affairs in other countries. That requires first an international tax system which gives a reasonably equitable and, above all, unique answer to the question of what share of which countries' taxes any particular person should bear and second the means to collect and enforce those taxes. The second without the first would increase substantially the already unacceptable amount of international double taxation arising from the incompatibility of different national tax systems and from the absence of a procedure for resolving disputes where fiscs take conflicting views on the facts of individual cases.

We see no prospect in the foreseeable future of the OECD and Council of Europe agreeing a Convention which achieves compatible definitions of residence for tax purposes let alone sets precise and non-overlapping bounds to the fiscal jurisdiction of each country. Arbitration and other dispute-resolving procedures have been discussed at length in various international forums but no progress has been achieved (even the inclusion of the EC's proposals for an arbitration procedure in the programme for completion of the internal market by 1992 does not seem to have resulted in any more progress). This lack of progress is understandable since the negotiations on the issue are in the hands of the various fiscs who have a mutual interest in the perpetuation of a system which results overall in a higher combined tax take for the Exchequers. Moreover, the political cost of the injustice is negligible since the minority of taxpayers affected have a vote in only one or none of the countries concerned.

From the above, it will be clear that we consider the Convention is neither necessary nor desirable and is objectionable in principle. We should, however, mention some of the major flaws in the Convention, even if it were acceptable in principle:

1. the absence of a dispute-resolving procedure (as mentioned in the previous paragraph) and the absence even of a provision requiring a country which has supplied information resulting in the taxpayer having a higher tax liability in another country to make a corresponding adjustment to the double taxation relief it has allowed the taxpayer;
2. the inadequate safeguards in Article 7 on the spontaneous exchange of information, which would give the fiscs ample scope to go on "fishing expeditions" even where there were no grounds for suspecting fraud;
3. the inadequate protection for the taxpayer who does not even have the right under the Convention (he may under national law) to be told when and what information is being passed to another fisc, even where no fraud is involved and even though the transfer of the information may have commercial implications for the business;
4. information exchanged should not be capable of being passed down to lower tiers of government (one of the most potent arguments used by this Government against a locally-administered local income tax is the implications of local authorities acquiring confidential information on the financial affairs of local residents);
5. different considerations apply to social security taxes (for example, curtailment of benefits is an alternative means of enforcement and social security departments are organised differently from the main fiscal departments) and these should be outside the scope of the Convention.

As the text of the Convention can no longer be amended, these flaws cannot be corrected (except for the last one, which could be covered by a reservation). The Convention is anyway objectionable in principle and we urge the Government not to sign it, and further to discourage others from signing it.



Graham Wheeler
Chairman, Taxation Committee



Inland Revenue

International Division
Somerset House

JPB

From: J P B Bryce
Date: 30 September 1988

FINANCIAL SECRETARY

**OECD/COUNCIL OF EUROPE CONVENTION
IOD LETTER OF 8 SEPTEMBER**

You will recall that in March you announced that you would be glad to consider views which interested parties wished to express on whether the UK should sign this Convention. You asked for comments to be received by the end of September.

2. So far six representations have been received - all advising against signature. We understand that the CBI are sending in their comments next week, and we are meeting the Law Society to discuss a number of points on Tuesday. We will then submit a full report to you.

3. The IOD letter of 8 September expresses serious concern at the possibility that the UK might sign this Convention. At this stage you may wish to do no more than send a short acknowledgement - but you might find it helpful to have some brief comments on the main points which they raise.

a. The IOD point out that there is already an extensive network of bilateral treaties to combat tax evasion and provide for the mutual exchange of information.

cc. PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Mr Gilhooly
Mr Cropper
Mr Tyrie

Mr Isaac
Mr Houghton
Mr Bryce
Mr Alpe

Comment. There are two important distinguishing features of the multilateral convention - its wide coverage (even to social security contributions and motor vehicles licences), and its provisions to enforce recovery of tax claims in another country.

b. The IOD know of no precedents for mutual assistance in the recovery of outstanding tax claims, except for an old treaty between France and Belgium.

Comment. This is not the case. The OECD produced a Model Convention for Mutual Administrative Assistance in the Recovery of Tax Claims in 1981 which reported a 1954 agreement between Austria and Germany, a 1952 agreement between the Benelux Countries and the 1972 agreement between Denmark, Finland, Iceland, Norway and Sweden.

c. The IOD expresses the view that the Convention would assist a country with an oppressive tax regime to pursue its claims against people who had moved elsewhere.

Comment. This is a justified concern which is, at least partially, addressed in the Convention (Article 21.2(e)). This enables a requested State to refuse administrative assistance if it considers the taxation in the applicant State to be contrary to generally accepted taxation principles etc.

d. The IOD considers that there is already an "unacceptable amount of double taxation" arising from the incompatibility of national tax systems and the absence of an arbitration procedure for settling disputes between fiscal authorities.

Comment. Although we have never been given details of such double taxation by representative bodies the European Commission's proposal for an arbitration procedure has been on the table for many years without obtaining the agreement of all the EC Member States. The UK has never opposed this proposal.

e. The IOD refers to a number of other matters which it considers to be flaws in the Convention. These include

- inadequate safeguards on exchanges of information which would enable fiscal authorities to go on "fishing expeditions";
- the absence of any requirement to tell a taxpayer when and what information is being passed to another authority; and
- Insufficient protection against information being passed down to lower tiers of government.

Comment. While not denying that these are genuine concerns, the essential point is that by exercising the maximum number of reservations provided for in the Convention, the UK would not commit itself to taking any action which is not already covered in our existing bilateral treaties and the EC Directive concerning mutual assistance in tax matters.

Next Step

4. A draft letter to the IOD is attached for your approval. In view of their obvious concern about this

matter, you may wish to have some further briefiing
before you attend the IOD Dinner. We will be glad to
provide this.

A handwritten signature in dark ink, appearing to be 'J P B Bryce', written in a cursive style.

J P B BRYCE

DRAFT

Graham Wheeler Esq
Chairman
Taxation Committee
Institute of Directors
116 Pall Mall
LONDON SW1

October 1988

**OECD/COUNCIL OF EUROPE CONVENTION ON MUTUAL
ADMINISTRATIVE ASSISTANCE**

You wrote to me on 8 September expressing the
Institute's serious concerns abouts this Convention.

I have read your views with considerable interest. I
can assure you that we shall take them, together with
the other representations which we have received, fully
into account when we come to decide whether the UK
should participate in the Convention.

NORMAN LAMONT

CONFIDENTIAL - URGENT

FROM: P J CROPPER
DATE: 3 October 1988

FINANCIAL SECRETARY

Cc: PS/Chancellor
PS/CST
PS/PMG
PS/EST
Sir P Middleton
Mr Gilhooly
Mr Tyrie

Mr Isaac IR
Mr Houghton IR
Mr Bryce IR
Mr Alpe IR
PS/IR

Which major countries have to sign, or a break in Convention?
PPS M

OECD/COUNCIL OF EUROPE CONVENTION
IOD LETTER OF 8 SEPTEMBER

You invited my comments on this: they run along the same lines as Mr Bryce's advice to you in his minute of 30 September.

2. I hasten to put this note in to you because the subject may be raised at the IOD tax dinner on Wednesday night.

3. My understanding from Mrs Chaplin is that the IOD letter was inspired by Mr Bruce Sutherland, who is no longer on the tax committee and who will not be present on Wednesday. Nevertheless this subject is so precisely in line with the Prime Minister's Brugges concerns that it probably will be brought up.

4. It is clear that we would prefer not to subscribe to the OECD Convention, and that few other countries' have yet done so. But I do ask "what happens if people don't subscribe to an OECD Convention?" Do the OECD just go away and forget it, or does it get brought up in some other context as a quid pro quo for something we might want?

5. I do not feel that simply ignoring the thing will necessarily be the answer.

P J CROPPER



Inland Revenue

International Division
Somerset House

*Thanks.
I got no answer for
Mr. Vre for Mr. [unclear]
happy @ all b
Sgt. [unclear]
I got to
quite [unclear]
[unclear]*

FROM: J P B BRYCE
DATE: 4 OCTOBER 1988

PS/CHANCELLOR

IOD DINNER: OECD/COUNCIL OF EUROPE MULTILATERAL CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE

1. You asked for information about the current and likely signatories of this Convention.
2. The Convention was opened for signature in January this year. We understand that no country has yet signed.
3. The only countries to have firmly declared their intention to sign are Norway, Finland and Sweden. The United States is expected to approve the Convention with some reservations regarding the recovery of tax and the delivery of documents.
4. Countries which have indicated positively that they will not sign the convention are West Germany, Liechtenstein, Luxembourg, Malta, Portugal and Switzerland. Other possible signatories in the OECD/Council of Europe have yet to come to a decision.

J P B BRYCE

- c PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir Peter Middleton
- Mr Gilhooly
- Mr Cropper
- Mr Tyrie

- Mr Isaac
- Mr Houghton
- Mr Bryce
- Mr Alpe
- PS/IR

FROM: J M G TAYLOR

DATE: 5 OCTOBER 1988



DMG

MR BRYCE - IR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Gilhooly
Mr Cropper
Mr Tyrie

Mr Isaac - IR
Mr Houghton - IR
Mr Alpe - IR
PS/IR

**IOD DINNER: OECD/COUNCIL OF EUROPE MULTILATERAL CONVENTION ON
MUTUAL ADMINISTRATIVE ASSISTANCE**

The Chancellor was grateful for your minute of 4 October.

2. He has commented that he sees no reason for the UK to be in any hurry at all to sign this Convention.
3. He would be grateful for the Financial Secretary's views.

JMG

J M G TAYLOR



FROM: FINANCIAL SECRETARY

DATE: 24 October 1988

CHANCELLOR

cc

Chief Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Mr Culpin
 Mr R I G Allen
 Mr Gilhooly
 Miss Hay
 Mrs Chaplin
 Mr Tyrrie

Mr Isaac - IR
 Mr Houghton - IR
 Mr Bryce - IR
 PS/IR
 PS/C&E

Ch.
 Content to proceed as
 proposed?
 26 24/10
JK

OECD/COUNCIL OF EUROPE CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS

You asked for my views on whether the UK should sign this Convention.

The hostility which this Convention has provoked from the IOD, CBI and others seems a little overdone. It is true that we already have an extensive network of bilateral and multilateral treaties to combat tax evasion and provide for the mutual exchange of information. And it also true that the Convention would take us some way beyond that. Nevertheless, the reservations available to us under it are so wide, that we could be signatories to the Convention without having to take any action which is not already covered by an existing treaty.

The arguments are not decisive either way. But on balance, I agree with the Revenue that it would be slightly better not to sign, than sign and make a lot of reservations. The IOD and CBI would be grateful; and we would not be the only country not to sign. I also believe that we should announce the decision by a

Written Answer and Press Release. John Isaac would like to wait a week or two to see if there are any developments on the EEC front in Brussels; I see no reason to disagree.

Finally, Customs will be writing to the Economic Secretary shortly to cover the VAT angle. But I understand that their advice will be similar to the Revenue's.

Al.

NORMAN LAMONT



FROM: J M G TAYLOR
DATE: 24 October 1988

PMJ

Handwritten initials

Handwritten initials

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Culpin
Mr R I G Allen
Mr Gilhooly
Miss Hay
Mrs Chaplin
Mr Tyrie

Mr Isaac - IR
Mr Houghton - IR
Mr Bryce - IR
PS/IR
PS/C&E

OECD/COUNCIL OF EUROPE CONVENTION ON MUTUAL ADMINISTRATIVE ASSISTANCE IN TAX MATTERS

The Chancellor has seen the Financial Secretary's minute of today's date. He is content to proceed as proposed.

Handwritten signature

J M G TAYLOR



Inland Revenue

Savings and
Investment Division
Somerset House

FROM : B O'CONNOR
3 November 1988

PS/CHANCELLOR

EC : LIBERALISATION OF CAPITAL MOVEMENTS : TAXATION OF SAVINGS

1. You asked for comments on the attached article "Taxing bankers' ingenuity" in today's Financial Times.
2. The article is a follow-up to an earlier piece by Haig Simonian which appeared on 31 October (copy also attached).
3. The two articles simply confirm the view that the imposition of a withholding tax on interest leads to one or other or a combination of the following results:-
 - i. A flight of investment elsewhere.
 - ii. The setting up of off-shore finance subsidiaries.
 - iii. An increase in the cost of borrowing because the interest rate is grossed up to take account of the withholding tax. The investor then receives the same return and the withholding tax is effectively paid by the borrower.

cc. PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr Culpin
Mrs Lomax
Mr Mortimer
Mr Ilett
Miss Noble
Miss O'Mara
Mrs Chaplin

Chairman
Mr Isaac
Mr Bush
Mr Corlett
Mr Houghton
Mr McGivern
Mr Bryce
Mr Sullivan
Mr Davenport
Mr Orhnial
Mr Alpe
Mr O'Connor
PS/IR

4. As today's article suggests many loan contracts, particularly in the eurobond field, include a clause that the interest will be paid net of all taxes. This leaves the borrower with no alternative but to pay any tax imposed or redeem the bond.

5. The articles suggest that Luxembourg, the UK and Netherlands, are the main beneficiaries of the flight of investment from Germany. If a Community wide withholding tax were imposed, it is reasonable to conclude that the flight (including a flight from London) would head elsewhere either to a country which did not impose withholding tax under domestic law or reduced it to nil under a double taxation treaty with the country of residence of the investor. Likely beneficiaries would be USA, Switzerland and the well known tax havens.

6. The third copy article attached, published on 29 October, concentrates on the controversy aroused in Germany and suggests second thoughts on the wisdom of introducing a withholding tax are being widely expressed.



B O'CONNOR

Taxing bankers' ingenuity

Haig Simonian looks at efforts to escape Bonn's new withholding tax

WEST GERMAN bankers have grown used to calling their stock exchange turnover tax an indirect subsidy for the London stock market. But few expected the Government's planned 10 per cent withholding tax due to come into effect next year to turn into a boost for the UK advertising industry.

That is precisely what it has become in recent weeks, as evidenced by the monster ads announcing, in tiny print, special meetings of bondholders in quiet corners of the City of London.

What has been discussed is often arcane. But the events have thrown an unexpected light on yet another of the peculiarities of the tax, which is still being bitterly opposed by bankers barely two months before it is due to come into operation.

The latest problem does not bother the giants of German banking, but many smaller and middle-sized institutions, often in the public sector, which have jumped on the Euro-borrowing bandwagon.

Like their bigger private-sector cousins, many semi-public institutions like Landesbank Stuttgart and Badische Kommunale Landesbank (soon to merge), Hessische Landesbank or Landesbank Schleswig-Holstein, have issued Eurobonds in a wide variety of currencies in recent years. High-coupon Australian dollar deals, which have been snapped up by interest-hungry German retail investors, have proved particularly attractive.

The trouble is that, as details of the withholding gradually emerged this year, bankers grasped that interest payments on many such deals would be subject to the tax.

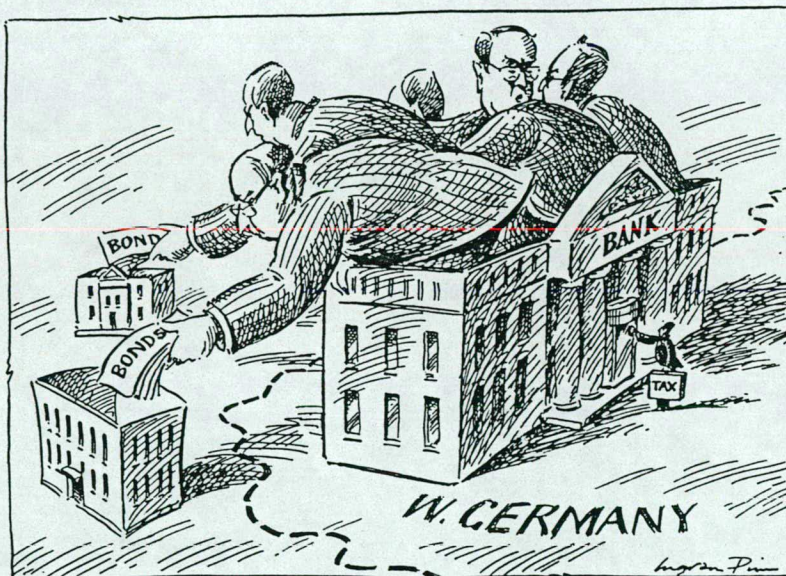
Germany's largest banks breathed a sigh of relief. As regular Euro-borrowers from the days when Germany last had a coupon tax, they had long since set up foreign issuing subsidiaries.

Much as the finance ministry would have liked to bring such issues into the net, it recognised that withholding tax could not be applied to German subsidiaries domiciled abroad.

By contrast, many of the smaller banks which issued bonds from their domestic base or, in some cases, a foreign branch - which does not count as a separate entity - will be hit.

Ironically, many of the banks concerned are either semi-public, like the landesbanken, which tend to be jointly owned by state governments and regional savings banks, or wholly government-owned, such as DSL Bank. The sight of public institutions struggling to avoid the tax may be political dynamite, but senior bankers say they have no choice if they are to remain competitive with their bigger rivals.

The banks concerned face



three options:

- "Grossing up" interest to the investor - a standard clause in Eurobond documentation. A bank could just agree to pay the investor extra to make up for what he will lose in tax.

- Calling the issue. Bond documentation is designed to let borrowers redeem a bond prematurely in the event of an adverse tax change.

even though a bank could save money if present interest rates in a currency are lower than those at the time of issue, by using the tax as an excuse to redeem its paper and to launch a cheaper new deal.

However, bankers have tended to view calling their bonds as a loss of face or public prestige.

That only leaves the lawyers. Some smaller German banks,

ment would only apply it to new issues, allowing previous deals to escape unaffected.

While most of the deals for smaller German banks in currencies like Australian and Canadian dollars have been arranged by London-based Eurobond houses under English law, some German financial institutions are feeling particularly hard done by.

They were persuaded to use

Banks wanting to arrange a "substitution clause" have to convene a special bondholders' meeting to approve the change. Under English law, holders representing not less than a majority of the principal amount outstanding then have to agree.

But assembling so many bondholders is a tall order. Thus meetings have tended to be inquorate, leading to the next step - an adjourned meeting. Matters then are much simpler;

English law only requires two or more people to be present, each holding bonds or being proxies for those who do.

So far, only Hessische Landesbank has had its substitution clause approved. Most of the banks concerned are still between steps one and two, with a clutch of adjourned meetings due to take place this month.

However, it is not always plain sailing. In late September, Bank für Gemeinwirtschaft (BfG), one

of the first to test the waters, was blocked when not enough bondholders agreed to switch its \$200m floating-rate note to a Dutch subsidiary.

BfG also suffered from the fact that switching a dollar FRN is unattractive for US investors, as it would then be classed as a new issue and subject to sales restrictions. The bank paused for thought; it decided to cut its losses and call the bond on November 28.

- Seeking some legal means to get round the tax, normally by way of a "substitution clause" switching the obligation to a new borrowing vehicle.

Grossing up is highly unpopular among banks as it is both expensive and would upset any attempts to match assets to liabilities over the life of the bond.

Moreover, with the vast majority of high-coupon deals issued as part of a swap, any change to the payments flow on one side of the equation would upset the arithmetic which made the transaction attractive in the first place. Calling the bond is little better,

such as the Frankfurt-based Deutsche Girozentrale, which borrowed via its domestic head office, had the foresight to include a substitution clause in their documentation.

The error of those that did not is partly understandable. "You have to see it in context. There was never any question of a withholding tax coming back in Germany. The Bundesbank had constantly opposed it, and the Government itself was against it until recently," says one senior banker.

And even after the tax was announced this time last year, many banks hoped the Govern-

domestic lead managers, like Deutsche Bank, part of whose sales pitch was that preparing documentation under German law would save time and possibly money, as well as overcoming the language barrier.

But the concept of extraordinary bondholders' meetings is fuzzy under German law, and even then 100 per cent attendance would be required. For top-notch borrowers like Kreditanstalt für Wiederaufbau, which made its Euromarket debut with a Deutsche Bank-led \$200m deal in January 1987, there is no option but to gross up, or, much more likely, to call the issue.

Tax threat leads to capital flight

IT HAS been a year of surprises for West Germany's banks. Hard on the heels of last October's shock announcement of a 10 per cent withholding tax on most savings and investments from the beginning of next year, came the stock market crash which hit German equities particularly hard.

Bankers have now largely recovered from both events, but the ripples are still being felt.

The threat of withholding tax has prompted an unprecedented flight of capital from Germany, with some DM60bn leaving the country in the first six months of this year alone. While part of the outflow derives from the normal investment needs of German companies abroad, much is attributable to a flight of capital by German investors.

Luxembourg has been the main beneficiary - reflected in the extraordinary growth of a number of public investment funds there. Eurorenta, the Luxembourg-based fixed-income fund set up by Deutsche Bank in January, had reached DM6.4bn by late of September. Though the rate of growth has slowed, some DM15-25m is still pouring in daily, according to its managers.

A second consequence of the withholding tax has been to split the domestic and offshore Deutschemark capital market - precisely the situation the Bundesbank hoped to be rid of when it dropped coupon tax earlier in the 1980s.

As a result of the planned withholding tax, borrowing costs on the domestic DM market have risen, meaning that foreign-domiciled borrowers can now raise DM funds more cheaply than the Federal Gov-

ernment itself. The most striking anomaly created came in late July, when the Bank for Foreign Economic Affairs of the USSR raised a DM500m DM Eurobond at finer terms than available to Bonn itself.

While withholding tax has led to precisely the consequences the Bundesbank foretold, the anger among senior central bankers at not being consulted in advance about the new tax has largely subsided. Yet although hard to oppose on moral grounds in view of the alleged widespread tax evasion by domestic taxpayers, withholding tax remains a serious barrier to those supporting *Finanzplatz Deutschland* - Germany as a financial centre.

As to the crash, German equities remain well below their pre-October 1987 levels. However, the market has recovered of late thanks to higher than expected corporate profits and domestic economic growth and the stable dollar.

Thus, banks' profits, which tumbled last year on account of the substantial write-downs on equity portfolios, should improve in 1988. Many banks' interim results at the end of June were already up, although making meaningful comparisons from their half-year figures is notoriously difficult.

A large number of banks have used the rise in share prices to take profits on their portfolios, reflected in the substantial improvements in their income from trading on their own account in their interim results. And the upturn in the domestic economy has helped their mainstream credit business too, with lower lending margins often being more than compensated by a higher volume of business.

However, one of the longer-run consequences of the crash has been a shift away from the securities business towards more traditional forms of commercial banking. For the time being at least, the gloss has gone off investment banking, and a new emphasis has been placed on less glittery activities like mortgage lending and credit cards.

But two of the biggest current talking points in German finance stem neither from the crash nor from withholding tax. Spurred by domestic com-

The banks are going through a consolidation - or link-up - phase

petition and, more distantly, the prospect of the European Community's planned free market in financial services after 1992 or thereabouts, German banks are going through a marked consolidation phase. And some are looking also more closely at alliances with other financial institutions, including insurance companies.

The pressure for consolidation has been seen most evident in two sectors; the Landesbanken (state banks) and co-operative banking movement. In both cases, the banks work on a state or regional level, and attention has now focused on whether further horizontal links might not be desirable in order to create even bigger operations so as to obtain synergies and economies of scale.

Leading the way are the

merger talks between Westdeutsche Landesbank (WestLB), based in Duesseldorf, and Frankfurt-based Hessische Landesbank.

WestLB is already Germany's fourth biggest bank. Together, the combined unit would form the country's second biggest bank, with total assets of about DM227bn.

Meanwhile, interest on the co-operative banking side has centred on the initiative by Mr Helmut Guthardt, chief executive of Deutsche Genossenschaftsbank (DG Bank) to merge with the country's five regional co-operative central banks. If it comes off, that combine would have total assets of some DM215bn.

The approach of 1992 has given all the merger talks an added momentum. The Landesbanken in particular are trying to avoid the danger of being squeezed from below by the country's biggest city savings banks - to which they partly belong - while meeting the ever-rising challenge from the big commercial banks.

Whether any of the discussions will come off remains an open question. The idea is not new, but the chances of success are looking brighter than ever before. However, political opposition from state governments - which normally own a half-share in their state's Landesbank - cold feet among the smaller partner in any merger, and legitimate considerations as to whether the Landesbanken may not be better served by improving their links with local savings banks may yet scupper any deals.

Despite the many uncertainties thrown up by 1992 and the likelihood earlier still of even greater competition from other financial services groups, senti-

ment in banking circles remains largely positive.

One strong sign of that is the continuing arrival of new foreign investment banks in Frankfurt. The Japanese have taken up the slack of late. Three new investment banking operations are being established between September and the end of this year, with another three likely to go ahead in early 1989. And more Japanese banks are said to be waiting in the wings.

Business may be slow at present, but the Japanese newcomers are showing a traditional emphasis on longer-term prospects. Their confidence may not be misplaced.

Among the important new developments in German finance are the planned arrival of the Deutsche Termin Boerse (DTB), Germany's new financial futures and options exchange, at the end of next year. With futures and options trading all but impossible in Germany at present, the DTB will plug an important gap in German financial services.

In the meantime, the authorities are continuing to take smaller steps to improve the domestic capital market and keep competitive with foreign financial centres.

While the Frankfurt stock exchange - by far Germany's leading bourse - is nearing the end of its heavy investment programme, the fixed-income market has recently been bolstered by the introduction of continuous trading in leading government bonds on the stock exchange and the removal of the barrier on foreign purchases on *Bundesobligationen* or five-year federal bonds.

Haig Simonian

Tax confusion hits German bonds

By Halg Simonian in Frankfurt and Stephen Fidler in London

WEST GERMAN financial markets were thrown into confusion yesterday after conflicting reports about the Bonn government's intentions for the country's planned 10 per cent withholding tax on most savings and investments, due to come into effect in January.

A meeting of the budgetary committee of the Bundestag (Federal Parliament) has been considering a variety of options, including, according to some reports, a one-year postponement of the tax.

According to a Reuters report, Mr Michael Glos, financial affairs spokesman for the Christian Democratic Union and Christian Social Union, the government plans to delay for 12 months a decision on imposing the tax on accrued interest earnings in response to persistent criticisms from the banking sector.

At all events, the reports encouraged a sharp rise in German government bond prices yesterday and a fall in the price of mark-denominated

Eurobonds, which would be unaffected by any withholding tax. The prospect of a withholding tax levied on interest or dividends paid abroad, had led to weakness in the price of government bonds to such an extent that some foreign governments and institutions could borrow more cheaply in D-marks than the Germans themselves.

The withholding tax has been widely attacked both in principle and on technical grounds. Earlier this week, both Mr Karl Otto Poehl, president of the Bundesbank, and West Germany's five leading economic research institutes echoed some of the objections raised by bankers.

However, information on the government's intentions remained highly uncertain yesterday, recalling the confused circumstances this time last year when the tax was first announced. According to a finance ministry official, "discussions have not yet been finalised and no decisions have

yet been made". The official said he was unable to comment on reports that the tax might even be postponed.

Further details of the government's plans for the tax are not likely to emerge until November 9, when the budget committee will meet again to try to resolve outstanding differences.

However, the committee appears to have already accepted bankers' objections regarding the tax treatment of interest payments on bonds. According to some reports, withholding tax will not now be levied on accrued interest on fixed-income securities, but only on coupon payments. That will make possible the practice of "bond washing", whereby bonds are sold before the coupon payment date on which tax would be due and bought back afterwards.

Meanwhile, many German bankers remain dissatisfied with the preparations for the tax, amid suggestions that implementation on January 1

will not be possible for technical reasons. The German Banks' Federation has been pressing for a postponement on the grounds that its members will not have enough time to prepare necessary computer programmes for deducting tax at source in view of the uncertainty over details.

The gains in government bond prices yesterday were close to a percentage point in longer maturities, as Mark-denominated Eurobonds lost up to 1½ percentage points, with the price drop most marked in the bonds of highly-rated institutions bought by foreigners as a substitute for German government bonds. A week ago, 10-year Eurobonds for top-rated institutions yielded around 40 basis points less than equivalent maturity government bonds, while yesterday the gap was only 12 basis points.

In the Dutch market, one of those that had benefited from switching out of German bonds, prices also fell yesterday, by close to ¼ point.



Inland Revenue

International Division
Somerset House

Ch. Potentially v. awkward.
But I certainly think we should not extend any statement on the OECD Convention to cover the Directive (para 23). We should see what the Commission actually

FROM: J P B BRYCE

DATE: 17 NOVEMBER 1988

1. MR HOUGHTON *12/11*
2. MR ISAAC *Approved in draft. 25/10/11*
3. CHANCELLOR OF THE EXCHEQUER

Vass & John O'X
PSI psr.

CAPITAL LIBERALISATION: INFORMATION POWERS

1. As Mr Isaac explained at an earlier meeting, we need to be sure that there is no inconsistency between the statement which the Government proposes to make on its attitude towards the OECD/Council of Europe Multilateral Convention and the response which you may wish to make to any Commission initiatives an exchange of information.

2. This note sets out

- our present stance on the EEC mutual assistance directive (MAD);

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 PS/IR

- the (broad) implications of the likely Commission initiatives in this area; and
- raises the possibility of a "package" statement covering both the Convention and the MAD.

Background

3. The Mutual Assistance Directive was approved by the Council of Ministers in December 1977 and the provisions which were considered to be necessary to comply with it were included in the 1978 Finance Act.

4. Essentially, the mutual assistance consists of the provision of information by tax authorities to each other to help each to assess its own taxpayers correctly. All that was thought to be necessary at that time was legislation to enable us to disclose information about the affairs of taxpayers to the competent authorities of other Member States.

5. The Directive contains provisions which envisage cooperation by

- automatic exchange of information in certain areas;
- spontaneous exchanges of information eg where there are grounds for supposing that there may be a loss of tax in the other State; and
- in response to specific requests.

6. The Directive sets certain limits to the exchange of information, the most important of which is that a State is not obliged to provide information which it would be

prevented by its laws or administrative practices from obtaining for its own purposes. Subject to that limitation, we are obliged to use our information powers for the benefit of another Member State. Therein lies the difficulty.

7. Under our domestic law, we can use our information powers only where there is a clear UK tax interest. We cannot use our powers on behalf of another Member State to obtain information which we do not require for our own purposes.

8. This was never recognised as a problem in 1978, and indeed has not arisen in practice subsequently, because information has generally been provided under the terms of our double taxation treaties with other Member States rather than under the terms of the Directive. The wording of our double taxation treaties is slightly different, but sufficiently so for us to argue that we are not required to use our domestic information powers for the sole purposes of the other country's taxes.

9. In some cases where we have been asked for information under the terms of the Directive, however, information has been provided by the person concerned even though there is no obligation on him to do so. In other cases, questions about (eg) a potential large undeclared French tax liability may provoke a genuine question in our minds, whether there may be also an undeclared UK tax liability. But it is not too difficult to construct a plausible scenario in which we could not properly seek a formal information notice. At that point, we would be in breach of a Community obligation and, at the extreme, could find ourselves at the receiving end of infraction proceedings for failing to implement the Directive correctly.

10. It must be added that this is a highly unlikely outcome. Nonetheless, the Commission have identified the gap in our information powers, just as they have identified larger deficiencies in many other member States in their implementation of the directive.

Commission Proposals

11. We do not of course yet know what the Commission will propose in the area of exchange of information, but the very minimum which they are likely to come up with is that all Member States should take steps to implement the terms of the Directive. Since this is already a Community obligation, it is simply not open to Member States to contest that.

12. This would mean that we would need to introduce legislation to drop the requirement that there must be a UK tax reason for obtaining information about, say, a French taxpayer's financial affairs. Of course, if there are statutory safeguards for the British taxpayer resident here - for example, if an information notice requires prior authorisation from the Special Commissioners - those safeguards would apply equally to a request from the French authorities about a French taxpayer.

13. In many cases this legislation would make little difference. But where there is no suggestion of a legitimate UK tax interest - where for example we might be dealing with a French taxpayer, resident in France with no UK connections - other than having transferred money at some point to or through a UK bank account - we would be required to carry out the necessary steps to secure the information as we would for a taxpayer resident here.

Implications

14. This is a very sensitive area; and there is likely to be controversy about powers enabling the Revenue to go to (eg) a UK bank, with a request for information to establish the depositor's French or Italian tax liability at the request of the French or Italian authorities. Controversy has to be expected, even though (as would be the case here) our information powers for the benefit of foreign tax administrations would go no further than our existing powers for UK tax purposes, and would be subject to all the existing statutory and judicial safeguards.

15. So far as the administrative impact is concerned, we use our present information powers in relation to the Banks with a good deal of discretion, and relatively infrequently. It could well be that some foreign tax administrations, with different administrative traditions, could ask us to exercise these powers much more frequently. We could, for example, see a doubling of the use of formal information powers against banks just to deal with French requests. There could therefore be significant resource implications for the Revenue, for the Commissioners and for the Bank (this is of course one reason why the proposal would be controversial). [One important question is whether it would be for the Revenue, or for the foreign tax administration, to appear before the Commissioners and answer any questions that they might ask, to satisfy themselves that the information request was reasonable.]

Strengthening the Directive

16. The signals from Brussels are that the Commission are not likely to rest with merely implementing the 1977 MAD.

They are likely to seek some "strengthening". We must wait to see what precisely they propose.

17. Meanwhile, however, you should perhaps be aware that some proposals have been floated in Brussels which we think could give Ministers considerable difficulty or indeed be wholly unacceptable. Thus, for example, we have heard proposals on the lines of

- extending the use of the Directive in the case of evasion; in effect, requiring member States to amend, if necessary, their domestic laws so that information can always be obtained where evasion is suspected, or

- a much more radical option (suggested recently by the French) that information is provided to a foreign country in accordance with the powers and subject to the safeguards of that country rather than of the requested country. This takes us into wholly different territory since, on the face of it, it would require a British bank, to provide information (possibly concerning a British national) for (eg) French tax purposes of the kind which we would not ask for UK tax purposes - and without the safeguards which Parliament has laid down for UK tax purposes.

18. The first of these options is certainly in line with the signals the Commission have been giving in recent months.

Policy Options

19. You will wish to look at this matter in more detail when the Commission proposals are received but, so far as

implementation of the Directive is concerned, there would seem to be 3 possible approaches:

- i. do nothing - at least unless and until other countries have implemented the MAD and we find ourselves at risk of being isolated.

Given the Community obligations which we have undertaken, this could be a difficult line to hold - depending in part on how other countries respond - and it is not one which could be held to the bitter end. But it could be argued that, although hypothetical cases might be constructed where we could not carry out the terms of the Directive, until such cases actually arise in practice we do not intend to take any action which could lend to considerable controversy about the extent of our domestic information powers.

- ii. Commitment to put right in future

Under this course we would

- admit that there was a possible lacuna in our ability to carry out the obligations which we have undertaken, and

- indicate an intention to take action to put it right, but not until any cases arise in practice.

- iii. Commitment to immediate action

Under this course, we would put ourselves on the side of the angels by promising to legislate in the next Finance Act to enable our information powers to be used solely on behalf of another member State. Against that, it would mean taking legislation through Parliament when, by the

end-June deadline for the Council of Ministers to take a view of the Commission's proposals, it might be clear that differently-framed legislation was needed.

20. Our recommendation would be that you move no further than the second option. But you will wish to consider nearer the time, and in the light of the precise Commission proposals, whether you would wish to start with the first option and be prepared to move to the second in the interests of a good "communautaire" settlement. An alternative would be to start from the second option and stand firm on it thereafter.

Link with Statement on OECD/Council of Europe Multilateral Convention

21. Following the Financial Secretary's recommendation, you have decided that, on balance, it would be better not to sign this Convention and that this decision should be announced by a Written Answer and Press Release. Clearly it is important that the statement in relation to this Convention does not conflict with any subsequent action which may need to be taken in relation to the Mutual Assistance Directive.

22. At a minimum, you will want to ensure that the statement rejecting the Multilateral Convention for extending our international information powers is not drafted in terms which give any hostages to fortune - or which, otherwise, would be embarrassing - if within a few months or so we find ourselves compelled to strengthen those powers in the context of the EEC Mutual Assistance Directive. This is of course a point of presentation (not substance), but a potentially sensitive point.

23. More ambitiously, we have considered the arguments for and against combining the two things in a 'package' statement, setting out the Government's position in relation both to the Multilateral Convention and to the EEC MAD. The arguments for a 'package' statement are perhaps that

- it would use the good news (no Multilateral Convention) to help cover the bad news (extending our information powers to implement the EEC MAD).

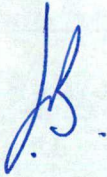
The arguments against are perhaps

- it would obviously blunt the likely good reception of the Government's decision on the Multilateral Convention; and
- it would commit the Government to controversial legislation on information powers - to implement the EEC MAD - before events in Brussels have moved to the point where Ministers are clearly compelled to act.

24. On balance, you may not find the "package" attractive; and you may feel that the better course is to announce the decision on the Multilateral Convention independently of any action on the EEC MAD, but draft it in a way that gives no unnecessary hostages to fortune.

25. As we said in our earlier note, uncertainty about the UK Government's intentions on the Multilateral Convention is beginning to have some harmful effects on relations with the representative bodies. There is therefore a lot to be said for an early announcement on the Multilateral

Convention, to clear this matter from the political agenda. If you agree - and subject to your views on the best tactical approach - we should be glad to prepare a draft statement for the Financial Secretary.

A handwritten signature in blue ink, consisting of a stylized 'J' and 'B' with a dot at the end.

J P B BRYCE



Inland Revenue

International Division
Somerset House

cc: PS/FST
NB Mr RIG-Allen's
ms. note below.

FROM: J P B BRYCE
DATE: 17 NOVEMBER 1988

1. MR HOUGHTON *12/14*
2. MR ISAAC *Approved in draft.*
3. CHANCELLOR OF THE EXCHEQUER *off 24/11*

CAPITAL LIBERALISATION: INFORMATION POWERS

1. As Mr Isaac explained at an earlier meeting, we need to be sure that there is no inconsistency between the statement which the Government proposes to make on its attitude towards the OECD/Council of Europe Multilateral Convention and the response which you may wish to make to any Commission initiatives an exchange of information.

2. This note sets out

- our present stance on the EEC mutual assistance directive (MAD);

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 Mr Corlett
 Mr Houghton
 Mr Shepherd
 Mr Bryce
 Mr Sullivan
 Mr Hugo
 Mr Alpe
 PS/IR

PS/Chaplin

I'm not sure I fully agree with his view in para 20 of his submission. There is no need to take any immediate decisions on his front, certainly not before his next Finance Act: EoFIN is only required to take a position on his taxation of savings by June 1989. You will also recall that the Commission's forthcoming proposals (i.e. Directive) on

(P10)

380
/1

69 9/13
29



X 4340

FROM: J M G TAYLOR
DATE: 21 November 1988

PS/FINANCIAL SECRETARY

- cc PS/Financial Secretary
- PS/Economic Secretary
- Sir P Middleton
- Sir G Littler
- Mr Lankester
- Mr Scholar
- Mr R I G Allen
- Mr Culpin
- Mrs Lomax
- Mr Mortimer
- Mr Gilhooly
- Mr Ilett
- Miss Noble
- Miss O'Mara
- Miss Hay
- Mrs Chaplin
- Mr Tyrie

- Mr Isaac - IR
- Mr Beighton - IR
- Mr Houghton - IR
- Mr Brice - IR
- PS/IR

** To be done*
The last will have Poyes' minutes
in his notebook.
Need to get some to think
we need get something
done next week.
If Poyes' views are needed quickly
I will go back + set a deadline.
Tony

Bryce
A. Beithborough
26

CAPITAL LIBERALISATION: INFORMATION POWERS

The Chancellor has seen Mr Bryce's note of 17 November.

2. He would be grateful for the views and recommendations of the Financial Secretary on this matter.

Jonathan
The TGT has now seen Bryce's note
of 17/11. He now wants to get the
minutes in like arranged
in the next (2) weeks.
He will not be getting anything until
he has had his meeting.
Tony

JMGT

J M G TAYLOR

MAD will be part of a package including proposals for
a withholding tax: there may be possibilities for trading some
concessions in the area of the MAD against a more rigid
position on the withholding tax.

Part.

21/11

PPA



FROM: FINANCIAL SECRETARY

DATE: 7 December 1988

CHANCELLOR

- cc Economic Secretary
- Sir P Middleton
- Sir G Littler
- Mr Lankester
- Mr Scholar
- Mr R I G Allen
- Mr Culpin
- Mrs Lomax
- Mr Gilhooly
- Mr Ilett
- Mr Mortimer
- Miss Noble
- Miss O'Mara
- Miss Hay
- Mrs Chaplin
- Mr Tyrie

- Mr Isaac)
- Mr Houghton) IR
- Mr Bryce)
- PS/IR

Ch/ Agree FBI?

1 - V. much agree - but still Announce X

Keep an eye on MAD

to confirm with the Govt as up a bang in country.

Don't also need to know that other jobs are working & would be help as we wd help them.

CAPITAL LIBERALISATION: INFORMATION POWERS

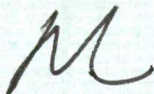
You asked for my views on this issue.

The 1978 Finance Act legislation which implements the EC Mutual Assistance Directive has a lacuna in it. Under U.K. tax law we can only use our information powers on behalf of another Member State (or indeed any other country) where there is a UK tax interest. Yet under the terms of the MAD, if we can procure that information for UK purposes, then we are obliged to obtain it for the benefit of another Member State, irrespective of whether there is a U.K. tax interest or not. The U.K. position is therefore in breach of EC law; though it is more a theoretical breach than one in practice, since we have used our double taxation treaties under which it is clear that such information does not have to be provided. (Moreover, I should add that many other Member States have much greater deficiencies in their implementation of the Directive than we have.)

I believe there are strong arguments for legislating to put this anomaly right, and not just because we are in breach of EC law. In an increasingly international world, it is fair and reasonable that tax authorities should cooperate. This view is subject of course to the usual caveats about the confidentiality of the taxpayer. And herein lies the problem. In parallel with the implementation of the Capital Movements Directive, the Commission are due to put forward early next year proposals covering the exchange of information in the tax field. We do not know yet what they will be; but at the very minimum they are likely to ask that all Member States implement the terms of the MAD. And it is quite possible that they will go further than that, and put forward proposals to extend the use of the Directive in the case of fraud. This could have implications for banking secrecy as well as for taxpayer confidentiality, which could cause us difficulties.

So that in turn raises a tactical question as to whether we should simply put the lacuna right or use our willingness to do so as a bargaining counter in our negotiations with the Commission over the second stage of their proposals. We do not have to decide this until January; but my inclination would be to keep something up our sleeve. I am influenced in this by two adverse personnel changes in coming up Brussels; the arrival of Madame Scrivener, who is likely to get this portfolio (the French are the driving force behind these proposals), and the removal of this topic from Geoffrey Fitchew's empire in DGXV. Together they will reduce the influence of the U.K.'s line of thinking within the Commission and increase that of the French.

X | I do however believe that the delay until early next year gives us an excellent opportunity to clear out of the way our statement announcing we will not be signing the OECD/Council of Europe Multilateral Convention. We must of course ensure that our line is consistent throughout; but an announcement on this now will not cause problems later on. We should be able to lay the Written Answer before Christmas.



NORMAN LAMONT



FROM: J M G TAYLOR
DATE: 9 December 1988

PS/FINANCIAL SECRETARY

pmf
cc Economic Secretary

Sir P Middleton
Sir G Littler
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr Culpin
Mrs Lomax
Mr Gilhooly
Mr Ilett
Mr Mortimer
Miss Noble
Miss O'Mara
Miss Hay
Mrs Chaplin
Mr Tyrie

Mr Isaac - IR
Mr Houghton - IR
Mr Bryce - IR
PS/IR

CAPITAL LIBERALISATION: INFORMATION POWERS

The Chancellor has seen the Financial Secretary's minute of 7 December.

2. He very much agrees with the Financial Secretary's views. We should announce that we will not be signing the OECD/Council of Europe Multilateral Convention, and keep any legislation to conform with the Mutual Assistance Directive up our sleeve as a bargaining counter. He has commented, further, that we shall also need to ensure that other fiscs are willing and able to help us as much as we help them.

A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR