

PO-CH/WY 0596

PART A

Part A.

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Begins : 7/4/89 .
Ends : 22/5/89 .

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PO - CH | NL | 0556 . PT.A .

Chancellor's (Lawson) papers :
Meetings with International Ministers
on Middle Income Debt strategies.

DD's : 25 Years

Lawson

26/4/96 .

PO - CH | NL | 0556 . PT.A .

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FROM: N L WICKS
DATE: 7 APRIL 1989
Ext : 4369

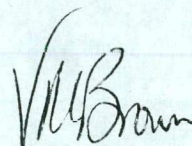
NOTE FOR THE RECORD

cc PPS
Sir P Middleton
Sir T Burns
Mr Lankester
Mr Evans
Mr Mountfield
Mr Walsh

PS/Governor) B/E
Mr Crockett)

Deputies
MEETING OF G7 AT US TREASURY: MIDDLE INCOME DEBT
^

I attach a note of the G7 *Deputies* discussion on Saturday 1 April.
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N L N L WICKS

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MEETING OF G7 DEPUTIES IN THE U.S. TREASURY
BUILDING ON SATURDAY, 1 APRIL 1989

1. The meeting began at 2.00pm.
2. It was agreed, exceptionally, that in Sarcinelli's absence, through illness, his deputy, Pedone, should be allowed to join the meeting when he arrived at 3.00pm.

Middle Income Debt

3. Tietmeyer reported that Minister Stoltenberg was unhappy about the US proposals for interest support. Mulford replied that interest support was a crucial element in the US approach. There needed to be clear agreement in the G7 and Interim Committee communiqués on the cornerstones and main principles of the approach together with an understanding about procedure for taking the matter forward. Reporting on the US Treasury's further discussions with banks, he said that banks were still in the process of adjusting to reality. They had wanted Secretary Brady to issue a statement saying that there should be no bank arrears. The Treasury had refused. Debtor countries were fearful, too, that the banks would withdraw short-term trade loans. This mutual fear was perhaps helpful to acceptance of the US approach. The US's aim was to move fast to apply the proposal for example to Venezuela, Mexico and Costa Rica. This would require expeditious action by the International Financial Institutions (IFIs). To that end

he suggested that the EDs and the G7 Deputies should meet together so that there would be a broad G7 front in the IMF and Bank Boards. This should prevent Camdessus linking further work with quota negotiations. Another possibility was for Ministers to meet with Camdessus and Conable on Monday or Tuesday to put them on the right lines. Yet a further approach was for G7 Deputies to meet the bankers to hear their concerns as part of the follow-up work with the banking communities. G7 countries needed to carry out further work on regulatory and tax aspects. It was clear that an important issue would be the amount of money available in early stages of programs - "front-end loading".

4. Mulford said that Camdessus was causing considerable anger in US government circles in his attempt to link the debt proposals to the size of the quotas. That linkage was totally unacceptable to the US. It was impossible for the Administration to approach Congress for approval for the new debt proposals on the basis that the quota increase would be required to pay for the debt proposals.

5. In further discussion of the US approach, Mulford said that its purpose was to get through a difficult period of time before something additional had to be done.

N.L.W.
N.L. Wicks
April 4, 1989

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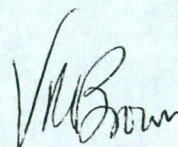
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Mr Evans
Mr Mountfield
Mr Walsh

PS/Governor) B/E
Mr Crockett)

Deputies
MEETING OF G7 AT US TREASURY: MULTILATERAL SURVEILLANCE
^

I attach a note of the G7 *deputies* discussion on Saturday 1 April.
^



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MEETING OF G7 DEPUTIES IN THE U.S. TREASURY
BUILDING ON SATURDAY, 1 APRIL 1989

Multilateral Surveillance

1. Discussion then turned to the world economy.

2. There was general agreement that the Japanese absence from a recent concerted intervention had been noticed by market participants. Gyohten posed the question of whether the dollar was too high. He thought that the underlying strength of the dollar was not soundly based, at least according to views of some market participants. Tietmeyer responded that the dollar was near its upper limit. Mulford's fear was that the trends were for a further increase in dollar strength. Trichet thought that the situation was very threatening and that the dollar was much too high.

3. Discussion then turned to the draft G7 communique.

N.L.W.

N.L. Wicks
April 4, 1989

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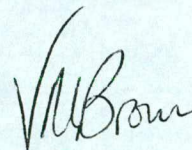
NOTE FOR THE RECORD

cc PPS
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Evans
Mr Peretz

PS/Governor) B/E
Mr Crockett)

MEETING OF G5 AT US TREASURY, ~~SATURDAY 1~~ ^{SUNDAY 2} APRIL 1989

I attach a note of the G5 discussion last weekend.



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MEETING OF G5 AT THE U.S. TREASURY
BUILDING ON SUNDAY, 1 APRIL 1989

1. The meeting began at 8.30am. Gyohten deputised for Muryama who was absent because of Parliamentary duties in Tokyo.
2. Brady (US) said that the policy of exchange rate intervention had been successful in bringing a measure of stability. That had been good for the world community. Markets may now have a feeling that the G5 was tolerating a higher dollar. Indeed, the dollar might be higher than the group thought was right.
3. Stoltenberg (Germany) agreed. He believed that the upward trend of the dollar could cause problems. A stronger dollar could undermine the adjustment process. The absence of a Japanese contribution from recent concerted interventions had been noticed by the international press. He wished to see a high and visible contribution from the Japanese. The yen was now at a high level. From remarks of Governor Sumita, he thought he had agreed.
4. Gyohten (Japan) replied that he shared the view that cooperation was important. Japan would cooperate if that was the general wish. The absence of Japanese participation in last weeks exercise had arisen because the need for intervention had gone away by the time that the Tokyo market had opened. Then, the yen dollar level had been at the

level before intervention had begun so the Japanese had seen no reason to intervene. But in a similar situation in the future, Japan would stand ready to do their share. More generally, Gyohten discerned a divergence between the dollar's short-term strength and the markets bearish sentiment for the medium-term. Personally, he was puzzled about current dollar strength. The market ascribed it to differential interest rates; the firmer oil market; bearish sentiments about the Japanese political situation; and a feeling that the US authorities were aggressive about inflation. It appeared that the market was not paying attention to fundamental factors like the US balance of payments. Sumita agreed with Gyohten's analysis. There had been strong concern about the recent rise in the dollar. If it appreciated further, Japan would take the necessary measures, including intervention. Regarding his reported comments referred to by Stoltenberg, he had spoken just as he had done so then.

5. Lawson welcomed the Japanese comments. Answering Gyohten's question about the differences between the current strength of the dollar and the markets bearish sentiments for the medium-term, he said that the short-term perceptions were operational and medium-term perceptions were non-operational. After recalling the history of the US exchange rate in 1983, the Chancellor urged the importance of exercising a stabilising influence on exchange rates. G5 should be united. That was why it was important for Japan to play her part. Japan should have participated even in the circumstances described by Gyohten. Her noticeable absence damaged the cooperation process. He

supported the language in the draft of the G7 communique with its implication of an asymmetric presentation.

6. Berezovoy agreed with Lawson that the G5 cooperation agreement needed to be reasserted. The markets may be sensing a certain doubt about the agreements. He believed that the dollar was being driven upwards by interest rates. The markets had to be convinced that the cooperation agreements, based on continued intervention, still existed. If there was a departure from those agreements, he would be very concerned about the future. If one partner remained outside the cooperation, the markets would have doubts, and stability and predictability of exchange rates would be undermined.

7. Greenspan saw significant benefits in stable exchange rates in reducing uncertainty and helping economic activity. That did not imply a need for fixed exchange rates but exchange rates should not fluctuate to the extent that they inhibited economic decision making. Recent interest rate increases in the US were intended to halt price pressures. Growth was now clearly in a slowing pattern and the pressures were receding. So the US authorities had stabilised monetary policy and intended to continue in that mode so long as the relaxation of price pressures was maintained. Reflecting more generally on the outlook, Greenspan observed that business expansion manifested itself through a series of pauses and expansion. There was some evidence now that after a period of considerable growth, the US economy was moving to a lower growth rate. If that evidence was confirmed, short-term

interest rates were likely to have peaked. But he found it difficult to say whether he was expressing hope or a realistic forecast.

8. Stoltenberg expressed doubts whether the adjustment process would proceed. In Germany, domestic demand had been high in the first quarter, but the trade surplus was still substantial, especially with the European Community.

9. Gyohten reported that in 1988 the Japanese current account surplus had fallen by dollars 6-7 billion. Certainly the trade surplus had increased in recent months, but he believed that this development did not represent a basic change in trend for a number of reasons. First, imports had grown more slowly due to lower oil prices last year, though this factor would soon be reversed as the higher recent oil prices showed in the figures. Last year, too, there had been large imports of aircraft which vitiated the comparison with this quarters figures. Export demand had been strong in 1988 because of the high demand for investment goods. A particular factor affecting Japan here was that Japanese companies were increasingly investing abroad and equipping their new factories with Japanese plant, which obviously added to Japanese exports. But in due course, the need for new plant would fall and the companies might even export to Japan.

10. Brady interjected that since February, the Group had been successful in not exporting interest rate rises around the world. Poehl commented that in his view the pattern of interest rates was

sufficient to bring monetary expansion under control, though there was still some question marks. He observed some inflationary pressures, mainly as a result of a weaker deutsche mark. The issue was whether these pressures would feed through into wage demands, though there was no evidence yet that this was happening on any significant scale. So like Greenspan he hoped that interest rates had peaked.

11. Referring to the situation in Japan, Sumita said that producer and consumer prices were reasonably stable, but the environment surrounding prices was becoming tighter, particularly in the labour markets and for manufacturing goods. Japanese money supply was still growing at a high level. Other inflationary factors were the cheaper yen and the increased price of oil. All this pointed to the need for increased vigilance. The Japanese monetary authorities had no immediate intention to increase the discount rate, but they intended to let the natural evolution of the market take place so that interest rates in the market would gradually rise. Lawson emphasised his concern about the renewed inflationary pressures in the UK. 1987 and 1988 had seen two years of exceptional growth, at 4 1/2 per cent, with particularly buoyant investment. That was unsustainable. Associated with buoyant growth was the current account deficit which was associated, too, with the investment boom. The fiscal position was very strong; even excluding privatisation proceeds, the budget surplus for 1989-90 was projected to reach some 2 per cent of GNP. The policy response to the inflationary pressures had been the increase in interest rates. That response was particularly suited to the UK

situation where the UK personal sector was a net borrower so that higher interest rates would bite particularly on personal consumption. There was therefore a good prospect that the level of interest rates in the UK was sufficiently high. But it was impossible to be sure. The evidence needed to be watched. If the pound came under pressure, it would clearly be necessary to defend the exchange rate by intervention and by interest rates. To accede to a fall in the pound would provide an unacceptable inflationary impetus.

12. Beregovoy reported that inflation in France was under control and would, in his view, remain so. As a member of the ERM, France was much affected by events in Germany. There had been good cooperation between the two countries in recent weeks. France was obviously interested in developments in the US because they had a direct effect on the deutsche mark and thus on France. His observation of events suggested that the markets were not reacting in a way which suggested that they were expecting a fall in the US deficit. Indeed, the markets seemed to be anticipating a rise in US interest rates as US authorities had perforce to place an excessive reliance on monetary policy. He sought clarification from Secretary Brady on the US budget position. He had left his last discussion with the Secretary in an optimistic frame of mind, but market reactions since then had made him more pessimistic.

13. Brady described the current negotiations with Congress. He thought the talks were going "rather well" and believed that agreement was pretty much on schedule. Greenspan saw no grounds for pessimism

on the US budget, but agreed that to an outsider the process must look agonisingly slow. Lawson asked about outturn for fiscal year 1989 in relation to plans since this was an important determinant of market psychology. Brady replied that Gramm-Rudman had set a target of dollars 145 billion for 1989 while outturn looked to be in the order of dollars 165-170 billion. But this increase was due to exceptional factors, such as the dollars 11 billion extra expenditure for the savings and loan rescue package and some dollars 4-5 billion for defense. Excluding these items, outturn would be within a reasonable range of Gramm-Rudman. Greenspan interjected that analysis suggested that the underlying trends on outlays and revenues were moving in a beneficent direction. Larosiere asked about interest rate and growth assumptions. Greenspan replied that even with adjustments for realism, the expectation was that there would be a realistic target showing a significant decline from the present position. The need was for a process which was moving inexorably in the right directions. Brady believed that the budget assumptions for economic growth were reasonably accurate. He recalled that in the period after the announcement of the Gramm-Rudman proposals, interest rates had fallen by some 300 basis points. No doubt some of this fall had been due to other factors, but it did suggest that a realistic cut in the budget deficit would have a beneficial effect on interest rates. Beregovoy then said that after these explanations, he again felt more optimistic, but he wished that the markets would be as well. Greenspan replied that the markets were properly skeptical and would await results.

14. In a brief discussion of the language on exchange rates suggested for the G7 communique, Brady said that existing undertakings could clearly be confirmed in view of Gyohten's clarification of Japanese intentions. As he understood it, Japan had agreed to join in concerted intervention if the yen went above present levels of yen 132.70. Gyohten replied if it looked that the yen was going above that level, the Japanese authorities should be consulted and they would cooperate. Poehl cautioned against giving any impression that a certain target level would be defended. He preferred a much briefer treatment in the communique. Stoltenberg pointed out that similar words had been used in the past. The Governor said that a careful reading of the language gave no indication that a particular rate would be defended.

15. The meeting concluded at 10.00am.

N.L.W.

N.L. Wicks
April 4, 1989



16/5
df. 15/5

10 DOWNING STREET
LONDON SW1A 2AA

273-0156

From the Private Secretary

10 April 1989

Dear Alex.

pmf

INTER-AMERICAN DEVELOPMENT BANK

The Prime Minister has agreed to see Mr. Enrique Iglesias, President of the Inter-American Development Bank, on 18 May. I should be grateful for a short brief in time for the meeting.

I am copying this letter to Bob Peirce (Foreign and Commonwealth Office) and Myles Wickstead (Overseas Development Administration).

CH/EXCHEQUER	
REC.	10 APR 1989
ACTION	Mr BOTTRILL
COPIES TO	PS/EST.
	Mr WICKS,
	Mr LANKESTER,
	Mr H.P. EVANS,
	Mr MOUNTFIELD,
	Mr WALSH.

✓ 10/4

Gen. Secy.
C. D. Powell

(C. D. POWELL)

Alex Allan, Esq.,
HM Treasury.

CONFIDENTIAL

FROM: N L WICKS
DATE: 12 APRIL 1989
Ext : 4369

C. FACHEQUER	
REC.	13 APR 1989
ACTION	Mr MELLISS
COPIES TO	EST P. MIDDLETON, Sir T. BURNS, Mr WICKS, Mr LANKESTER, Mr H. P. EVANS, Mr R. I. G. ALLEN, Mr EDMONDS, Mr TYRRE.

13/4

cc.

PRIME MINISTER

[Handwritten signature]

PARIS ECONOMIC SUMMIT

During the Sherpas' meeting at the weekend, the outlines of the likely Summit discussion became firmer, though it was evident that the attention of the US President has not yet been engaged on the subject. The position on the main issues is as follows.

World Economy

2. There is a clear division between the UK, Germany, Canada and perhaps Japan who regard the control of inflation as the main priority and the US, France, Italy and the Commission, who ascribe equality of importance to reducing inflation and to a reduction in the world trade imbalances.

3. Those in the former camp, while not wishing to be alarmist, pointed out that the 12-month rate of G7 consumer price inflation was the highest in January since mid-1985, the G7 producer price inflation index had increased from 2.3 per cent in November to about 3.5 per cent in January, oil prices were on the rise and capacity utilisation rates close to or above previous peaks. They argued too that imbalances ought to be financeable provided that the G7 countries followed sound monetary and fiscal policies and continued their programmes of structural reform. The latter camp put more emphasis on the maintenance of growth (even at the expense of risking inflation) and prophesy problems in the international financial markets if action (by which they probably mean stimulatory fiscal action) is not taken by the surplus countries to reduce trade imbalances.

4. This divergence in approaches will no doubt be debated at the Summit. But I doubt whether it will lead to serious rifts. The

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French will no doubt press, too, as they did at the Sherpa meeting, their ideas for international monetary reform with a view to the establishment of some sort of G7 EMS system. They received no support and there was a consensus among the G7 countries that exchange rate policy cannot be divorced from the fundamentals of economic policy.

5. The Sherpa meeting had difficulties in getting to grips with the issue of structural reform - or increasing economic efficiency as the French prefer to call it. At the next meeting I intend to direct the Sherpas' attention to particular items of structural reform in Japan and Germany which could have particular reference to trade imbalances in Germany and Japan.

Trade & Agriculture

6. Last week's agreements in Geneva should provide a useful background for the Summit to urge progress in the GATT round and to emphasise the importance of maintaining the open multilateral trading system and resisting protectionism. It is, however, just possible that trade relations between the US and the rest of the world, particularly Japan, may have taken a turn for the worst by the Summit. The US Sherpa drew attention to the fact that the US Administration will have responded, by the Summit, to Congress' request, in last year's Trade Bill, to list those countries which did not provide fair trading opportunities for the US. From what he said, most of the trading nations in the world could figure on that list. He went on to warn that if US trade deficit was not showing signs of a decrease by the Summit and the Japanese trade surplus continued to increase, the temperature in the US Congress would be such that the US Administration might be forced to strike some tough attitudes in trade matters. If this does transpire, it could provide an awkward backdrop on trade before the Summit with the US taking, or threatening, action which is hardly compatible with GATT. But it is still too early to come to judgements here.

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International Debt

7. The French clearly wish to try to build upon the US's recent proposals, about which the Chancellor minuted you on 7 April, so that the Summit can be crowned by agreement to a French initiative. In fact the US have stolen many of the French ideas in their own initiative. Their one substantial proposal left is a fund for helping debtors financed by SDRs. The Germans, the US and ourselves have hitherto resolutely opposed an SDR issue, but US opposition at the Spring Meetings was somewhat softer so a flip flop on their part cannot be altogether ruled out. If the follow-up to the US proposal is not completed before the Summit the Heads may become drawn into complex discussions in order to resolve outstanding issues.

Environment

8. Our paper on the economics of the environment was well received by the Sherpas. Tietmeyer also circulated a paper, a copy of which is attached, personally endorsed by Chancellor Kohl. It includes many ideas with which we can agree. The French are still pushing their ideas for flood alleviation in Bangladesh, though they seem to accept that the Summit cannot get into details here and should do no more than give the project political impetus and encourage World Bank co-ordination. The French are aware of your personal interest following your conversation with President Ershad. The next task for the Sherpas is to weld together the approaches and ideas in the various papers.

Money Laundering etc

9. It became even clearer during the Sherpa discussion that President Mitterrand's letter to Heads of 10 February was motivated more by domestic political pressures than by deep analysis of problems of the misuse of the international capital markets for money laundering etc. We think, however, that his letter can be turned to useful advantage in prompting a discussion of money laundering in the drug trade with the aim of getting Heads to urge countries to ratify the recent UN convention on

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illicit traffic in narcotic drugs and psychotropic substances and to negotiate further agreements to enhance co-operation etc in combating the drug trade. The French, for domestic political reasons, are likely to want discussion of measures to combat insider trading. This ought not to cause us problems.

Export Credits

10. The Canadians have circulated a note on a possible Summit initiative on subsidised export credits. We will need to consider this interdepartmentally before putting forward advice.

Political Matters

11. The Germans have suggested, with obvious French concurrence, that the Summit might issue, on this 200th Anniversary of the French Revolution, a declaration on human rights, liberty, democracy and all that. I said that you would want a good discussion of East/West issues and would probably wish to have issued a political declaration summarising the Heads' conclusions. The Canadians suggested that such a declaration could be incorporated into the proposed German declaration on human rights. I was somewhat sceptical. A human rights declaration may not be the right place for East/West issues which go beyond human rights, such as arms control. Many Heads seem to want to discuss, either under this political heading or separately, economic developments in Eastern Europe. While not disagreeing, Attali thought that such a discussion could be divisive if there was a split between those like the French who wanted to give to Eastern Europe substantial economic support, through credits etc, and those who while wanting to offer support, were more cautious. Attali again raised the blockage that COCOM might place on expanding East/West trades. With strong US support, I said: COCOM was not an obstacle to East/West reconciliation; controls affected only a very small percentage of trade (approximately 2 per cent in the case of the UK); they were based on legitimate security grounds; there was no sense in compromising our strategic concerns which remain valid; this was not an area in which Heads needed to become involved, especially as the issue was under active

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consideration in the COCOM Executive Committee. No-one dissented, though this will not prevent the French from raising the issue at the Summit if they so wish. The Germans did not refer at this meeting to their interest in controls on chemical weapon precursors. Our interest in carrying forward co-operation against terrorism was recognised. There was not much interest among Sherpas in the Middle East, but acceptance that it would be a topic for the Summit; Southern Africa was not mentioned.

12. In the Annex to this minute I set out each Sherpa's description of how he sees his Head's objectives for the Summit.

Organisation of the Summit

13. Attali reported that some 25 of 30 Heads of State or Government would attend the Revolutionary celebrations. They would include the Presidents of Uruguay, Argentina, Mexico, Venezuela, Brazil, Ivory Coast, Senegal, Zimbabwe, Togo, Egypt, Uganda, the Philippines, India and Pakistan. The UN Secretary General and the Presidents (sic) of Portugal and Greece have also been invited. The celebrations, to which the above and the Summit 7, have been invited, will take the following form:

Thursday 13 July

Noon - Ceremony at Place de Trocadero
13.15 - Lunch at the Elysée
17.00 - An unspecified celebration
19.00 - Inauguration of the new Bastille Opera
21.00 - Dinner at the Musée d'Orsay

Friday 14 July

10.00 -
11.30 - The Grand Parade
- Lunch for the assembled Presidents/Prime Ministers at the Ministry of Foreign Affairs

Attali assured the Sherpas that there would be no organised multilateral meetings, though there would be opportunities for

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informal bilaterals, trilaterals etc. Some Sherpa colleagues were a little suspicious that the unspecified celebration at 17.00 hours on the Thursday might mask a formal meeting, but Attali dismissed such fears, emphasising that this would not be a "North/South" Summit.

14. On the timetable for the Summit itself, the latest, and Attali hopes the final, edition of the programme is attached. In accordance with Charles Powell's minute of 23 March, I pressed for the reinstatement of a separate session for Heads of Government on the first full day. I received little support from other Sherpas on the grounds that the Heads had plenty of time for discussion by themselves (the restricted session on Friday, dinner that evening, lunch and dinner on Saturday and the informal restricted session at 18.00 hours on Saturday) and Attali was unwilling to change the programme .

15. The Sherpas will meet again at the beginning of June after the OECD Ministerial to carry forward the preparations.

16. I am sending a copy of this minute to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and to Sir Robin Butler.

N.L.W.

N L WICKS

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HEADS OF STATES AND GOVERNMENTS' OBJECTIVES FOR THE PARIS SUMMIT

The Sherpas described their Heads' objectives in the following terms.

France

- Establishing an ambiance of co-operation reflecting shared common values on freedom, human rights and democracy in this bicentenary of the French Revolution.
- An announcement of some concrete measures on middle income debt.
- A step forward in protection of the environment.

Canada

- Expression of shared values.
- Allowing Mr Mulroney to place his Government's economic reforms into an agreed international context.
- Besides helping middle income debtors, building on what was agreed last year for the debt of the poorest.
- Possibly an initiative in the trade field on export credit.

Italy

- Initiatives on middle income debt and the environment.
- Strengthening international co-operation against the illicit drug trade.

Japan

- Demonstrating confidence in open economic and political systems.
- Building up the process of economic policy co-ordination established during recent Summits, and in particular allowing peer pressure to be brought to bear on the Japanese Prime Minister.
- Initiatives on debt and the environment.

United States

- A demonstration of unity.
- Strong support for the debt strategy.
- Carrying forward structural adjustment.
- Renewed commitment to economic policy co-ordination in Summit countries.
- Protecting the environment.
- Keeping up the momentum of trade liberalisation (though this might cause difficulties for the US if Japanese trade surpluses were still increasing at the time of the Summit).
- Support for the Canadian export credit initiative.
- A good discussion on East/West issues.

The United Kingdom

- A reaffirmation of the second cycle sound economic policies with particular reference to the reduction of inflation.
- Renewed emphasis on structural reform, especially in Germany and Japan with particular emphasis to structural reforms which would help bring down trade deficits.
- Strengthening the multilateral trade system and avoiding bilateral restrictions on both trade and investment.
- Using the Summit to chart the way ahead for the world's response to global atmospheric pollution, with particular reference to economic aspects.
- Carrying forward international co-operation against the illicit trade in drugs.
- A good discussion on East/West.

The European Commission

- Making sure that words and actions, for example on economic policy co-ordination, correspond.
- Initiatives on debt and the environment.
- Discussion on East/West, especially the economic aspects.

Germany

- Reflecting the bicentenary celebrations, emphasis on human rights.
- Avoiding disarray at what will be the first Summit discussion with President Bush.
- Giving particular weight to worldwide environmental problems.
- Emphasising the importance of further co-operation on economic policy.
- Maintaining free trade and the multilateral system.
- Making progress on the debt strategy.

Bonn, 23 March 1989

Protection of the earth's atmosphere

Recent scientific findings on climatic changes and on the state of the stratospheric ozone layer give cause for alarm. The consequences of this development pose a threat to ecological systems and man's vital interests. Solutions are therefore urgently needed. Since this is a problem of global magnitude, worldwide solutions must be sought in a spirit of partnership.

1. The production and consumption of substances harmful to the ozone layer (FCHCs, halons) must be radically reduced above and beyond the commitments already assumed under the Montreal Protocol, especially since these substances are also a major cause of the greenhouse effect. The reduction quotas specified in the Montreal Protocol should as soon as possible be raised to at least 85% and till the end of this century to 100%.

The countries participating in the economic summit should, in addition, advocate the complete abandonment of the production and consumption of FCHCs covered by the Montreal Protocol by the end of the century. They should do their utmost so that all countries, not least developing countries, can use suitable substitute substances and technologies.

2. The Montreal Protocol addresses only part of the problems concerning the earth's climate. Emissions of other so-called greenhouse gases, especially carbon dioxide, must also be quickly and substantially reduced. This calls for far-reaching global measures in the energy and other sectors, especially the improvement of energy efficiency, energy conservation in all areas, increased use of renewable sources of energy and conversion to energy types leading to a reduction of carbon dioxide emissions.

No international commitments exist yet for limiting carbon dioxide emissions in particular. It is essential to conclude as soon as possible a convention on the earth's climate, with concrete commitments for individual fields being laid down in protocols to the convention.

The summit countries should also advocate that existing institutions be strengthened within the United Nations system or that a new institution be set up. This would improve the organizational preconditions for combating the global warming of the atmosphere and taking the requisite decisions. To ensure effective implementation of and compliance with the decisions made, suitable measures monitored by the International Court of Justice should be taken.

The summit countries should strongly support the work of the Intergovernmental Panel on Climatic Change (IPCC) and the proposals for new institutional structures concerning the responsibilities.

3. The clearing of tropical forests, which is assuming an ever more threatening magnitude, also influences the earth's climate by contributing to the greenhouse effect. Large forest areas are falling a prey to extensive development programmes. Economic structural problems and a shortage of foreign exchange prompt countries to overexploit their natural resources.

The summit countries should consider it a common duty of industrial and developing countries to restrict the use of tropical forests to such types as are compatible with overriding ecological requirements and with the conditions for survival of the people living there.

It is essential that the governments of tropical countries be placed in a position to ensure that overexploitation is avoided and that forests are used only in an ecologically beneficial manner within the limits of their growth. Utilization of the forests for timber purposes and the export earnings from timber products are also a strong economic incentive for preserving them. The international tropical timber trade and industry bear special responsibility in this respect, for example through voluntary pledges (cf. the enclosed code of conduct of the German tropical timber industry). The International Tropical Timber Organization (ITTO), which unites consumer and producer countries, is a suitable forum in this respect.

An internationally accepted concept for a global strategy aimed at protecting tropical forests exists in the form of the Tropical Forest Action Plan (TFAP) adopted in 1986; its actual implementation must be greatly expedited. The summit countries should assist the efforts of nations with tropical forests through financial contributions.

4. The three outlined problem areas are closely interrelated. To cope with their complexity, comprehensive and deepened research activities are required. Policies and measures to solve the problems should be based upon a growing understanding of the interconnections between causes and effects. New technologies and substances must substitute the harmful ones.

Summit countries are therefore requested to increase their national R+D activities and to intensify their cooperation within the framework of international research programs.

5. In view of the global threats to the earth's atmosphere and their causes, the summit countries bear special responsibility vis-a-vis the international community. Acting in solidarity with developing countries and in collaboration with international institutions, they must take the decisions and measures needed to protect the earth's climate and atmosphere. In the context of the necessary development of the international debt management, the opportunities should be exploited to take into account environmental needs.



SUMMIT OF THE ARCH

14-16 JULY 1989

April 8, 1989

PROGRAMME OF THE SUMMIT OF THE ARCH (14-16 JULY, 1989)

July, 13 Thursday and 14 Friday morning

Participation of Heads of delegations in official ceremonies for the Bicentennial of the French Revolution.

July, 14 Friday

15 h 45 - 16 h 30

Heads of delegation are met by the President of the Republic at the Louvre Pyramid.

16 h 30

Opening restricted session of the XVth Summit of the industrialized nations at the Louvre Pyramid.

Simultaneously

Working session of the Ministers of Foreign Affairs at the Ministry of Foreign Affairs (Quai d'Orsay).

Working session of the Ministers of Finance at the Ministry of Economy, Finance and Budget (Bercy).

At approximately 18 h 30

At the end of the opening session, the Heads of delegation leave for their residence.

20 h 30

Dinner hosted by the President of the Republic in honour of the Heads of delegation at the Hotel de la Marine, Place de la Concorde.

Simultaneously

Dinner hosted by the Minister of State, Minister of Foreign Affairs in honour of the Ministers of Foreign Affairs at the Palace of Foreign Affairs (Quai d'Orsay).

Dinner hosted by the Minister of State, Minister of Economy, Finance and Budget in honour of the Ministers of Finance at the Ministry of Economy, Finance and Budget (Bercy).

Dinner of Personal Representatives at the Hotel de la Marine, Place de la Concorde.

July, Saturday 15

From 9 h 45

Arrival of delegations at the Arche de la Défense.

Group photo at the Arche de la Defense.

10 H 00 *

Restricted session.

10 H 15

Plenary session.

12 h 30

End of plenary session.

13 h 00

Working luncheon offered by the President of the Republic to the Heads of delegations.

Simultaneously

Lunch offered by the Minister of State, Minister of Foreign Affairs for the Ministers of Foreign Affairs at the Arche de la Défense.

Lunch offered by the Minister of State, Minister of Economy, Finance and Budget for the Ministers of Economy at the Arche de la Défense.

** to agree the Political Declaration,
probably with Foreign Ministers*

	Lunch for the Personal Representatives at the Arche de la Défense.
15 h 00	Plenary session (continuing).
18 h 00	Informal meeting of Heads of delegation and Personal Representatives in the Louvre Pyramid.
20 h 00	Dinner offered by the President of the Republic for the Heads of delegation in the Louvre Pyramid.
Simultaneously	Dinner offered for the Ministers of State, Minister of Foreign Affairs to the Minister of Foreign Affairs at the Palace of Foreign Affairs (Quai d'Orsay).
	Dinner offered by the Minister of State, Minister of Economy, Finance and Budget, for the Ministers of Economy at the Ministry of Economy, Finance and Budget (Bercy).
	Dinner for the Personal Representatives at the Arche de la Défense.

July 16, Sunday

From 9 h 45	Arrival of delegations at the Arche de la Défense.
10 h 00 - 12 h 30	Plenary session.
13 h 00	Lunch offered by the President of the Republic for the Heads of delegation and the Ministers of Foreign Affairs at the Arche de la Défense.
Simultaneously	Lunch offered by the Minister of State, Minister of Economy, Finances and Budget for the Ministers of Economy at the Arche de la Défense.
	Lunch for the Personal Representatives at the Arche de la Défense.
15 h 00 - 17 h 00	Plenary session.

17 h 15

Reading of the joint communiqué by the President of the Republic, in the presence of the Heads of delegation at the Arche de la Défense.

Press Conferences given by the Heads of delegation at the Arche de la Défense.

20 h 30

Dinner offered by the President of the Republic and Mrs François Mitterrand at the Elysée Palace in honour of the members of Summit delegations and their spouses.

July 17, Monday

Departure of delegations./.

FROM TOKYO TO FCO

PS/CHANCELLOR OF THE EXCHEQUER
TREASURY

TELNO 3 SAVING

UNCLASSIFIED

Addressed to FCO Telegram 3 Saving of 13 April 1989

Repeated for information to:

Paris, Rome, Bonn, Washington, Brussels, Dublin, Stockholm, UKRep
Brussels, UKMis Geneva, UKDel OECD, Ottawa, Bangkok, Canberra,
Peking, Seoul, Jakarta, Singapore, Manila, Kuala Lumpur, Governor
Hong Kong, BTC Hong Kong, Osaka.

JAPAN: ECONOMIC REPORT: MARCH 1989

- The Diet has so far been unable to approve the FY 1989 budget as the opposition parties have boycotted discussions in order to reinforce their demand that Mr Nakasone should testify to the Diet about his relationship with Recruit. A 50 day provisional budget has been passed to cover essential government expenditure from 1 April (para 28).
- The 3% consumption tax was introduced on 1 April. The government and the Bank of Japan have warned that they will be checking carefully to ensure that price rises are justified. Meanwhile, the wholesale price index rose by 0.3% in February - the first year on year increase since 1985 (para 17).
- Real GNP grew by 0.7% in the fourth quarter of 1988, rather slower than in the third quarter but giving GNP growth of 5.7% for the year as a whole. During 1988 personal consumption grew by 5.0%, business investment by 15.9% and imports by 21.2% (paras 1-5).
- Industrial production fell by 1.4% in February, probably reflecting the loss of working around the time of the funeral of Emperor Showa (para 6).
- Inventories, which ceased falling in mid-1988, have been rising at an increasing pace - by 4.8% year on year in the December quarter, and by 7.5% and 8.5% year on year in January and February. Nevertheless, business confidence remains very high (paras 9 and 11).
- The annual shunto, or round of pay negotiations, appears to have led to average pay increases of around 5.2% - 0.8% higher than last year (para 15).
- The seasonally adjusted trade surplus rose to a record high of \$10.1 billion in February. Exports stayed flat, and imports fell by 7.3%. The funeral of the late Emperor may again have been a contributory factor (para 18).

- There was a record capital inflow of \$11.4 billion in February, as non-residents bought Euroyen bonds and Japanese equities (para 22).
- The yen remained weak during March, closing at ¥132.05. In early April the Bank of Japan intervened to support the yen in the markets for the first time for four years.
- Despite some worries about the Recruit scandal, the Tokyo Stock Exchange closed the financial year on an optimistic note, with the Nikkei index at a new record of 32,839.

GNP DATA (TABLE 1)

TABLE 1: GROSS NATIONAL EXPENDITURE
(Real, seasonally-adjusted base year = CY 1980)
Percentage change over the preceding period

	FISCAL YEARS			1987				1988	
	1985/86	1986/87	1987/88	SEP	DEC	MAR	JUN	SEP	DEC
Consumers' Expenditure	2.8	3.4	4.5	1.3	0.9	2.2	0.6	1.4	0.0
Private Housing	2.8	11.0	25.6	9.5	11.6	1.9	-8.6	6.0	5.6
Private Investment	13.2	4.3	10.0	2.7	3.7	4.0	4.6	4.2	3.0
Private Inventories	8.2	-50.5	24.4	-8.0	74.1	-13.7	42.0	2.4	-22.5
Government Current Expenditure	1.6	6.3	-0.9	-0.3	0.2	0.9	0.5	0.7	0.6
Government Capital Expenditure	-6.3	7.0	10.0	2.3	5.6	4.0	-2.4	-1.8	0.6
Government Inventories	79.0	187.5	-94.7	-	-6100.3	-	-71.3	-289.0	-
External (Net)	20.9	-34.5	-36.0	16.8	-36.3	-14.0	-132.0	-	-50.1
Exports	2.1	-3.6	5.2	6.0	-0.4	3.4	-3.8	10.1	0.1
Imports	-2.3	5.4	12.6	4.7	4.6	4.9	5.1	7.5	0.3
GNE (Percentage Change)	4.5	2.7	5.2	2.2	1.7	2.4	-0.8	2.3	0.7
GNE (Y Billion)	293,981.8	301,833.8	317,589.4	314,467.6	319,940.4	327,750.6	324,982.8	332,443.8	334,870.2
Memo item: Nominal GNE	6.0	4.1	5.0	2.8	1.3	2.8	-1.1	3.1	0.6
Y Billion	321,290.3	334,569.4	351,187.7	348,793.4	353,376.2	363,220.1	359,160.3	370,452.3	372,632.8

1. Real GNP grew by 0.7% seasonally adjusted in the fourth quarter of 1988, equivalent to 3.0% at an annual rate. This was well down on the previous quarter, which showed 2.3% growth (9.5% at an annual rate). However, the increase brought real GNP growth in 1988 as a whole to 5.7% (6.1% in nominal terms) - the fastest rate of growth since 1973 when GNP grew by 7.9% in real terms.

2. Domestic demand grew by 0.8% in the fourth quarter, with the external sector declining by 0.1%. During 1988, domestic demand grew by 7.6%, offset by a 1.9% decline in the net external sector. Personal consumption was flat during the fourth quarter reflecting - according to some commentators - the slowdown in economic activity associated with the illness of the late Emperor. However, during the year, personal consumption rose by 5.0%.

3. Private housing investment grew by 5.6% in the quarter, a surprisingly buoyant figure which gave an annual rate of 13.4%. This was down from the 22.2% increase seen in 1987, but the quarterly figure suggests that the private construction boom, which apparently slowed down during mid-summer, has not lost all momentum. Private non-residential investment grew by only 3.0% in the fourth quarter, its lowest quarterly increase since September 1987, but registered a strong 15.9% increase during 1988 as a whole. This was more than double the increase of 8.0% seen in 1987, and was also the highest rate since the 19.8% increase seen in 1970.

4. During 1988 imports grew by 21.2%, up from 8.7% in 1987. However, exports also increased their rate of growth, to 7.9%, after a 3.8% increase in 1987 and a 5.2% fall in 1986, when the impact of the appreciation of the yen was at its strongest.

5. Real GNP growth is likely to have been higher in the first quarter of 1989 than in the last quarter of 1988, and the continuing buoyancy of the economy is scarcely in doubt for the immediate future. Nevertheless, some commentators are suggesting that the peak of the boom may have been seen in the September 1988 quarter: and that the government's official forecast of 4.0% real growth in FY 1989 - which would imply a significant slow down from last year's figure may not be too much of an underestimate. Evidence of inventory accumulation since the third quarter of 1988, discussed in para 9 below, tends to support this view.

INDUSTRIAL AND BUSINESS ACTIVITY (TABLE II)

TABLE II: PRODUCTION AND BUSINESS ACTIVITY
Seasonally adjusted, except figures for fiscal years
Percentage change over previous period

	FISCAL YEARS			1988				1989	
	1985/86	1986/87	1987/88	SEP	OCT	NOV	DEC	JAN	FEB
Industrial Production Mining and Manufacturing (1985 = 100)	2.5	-0.2	5.8	0.5	-1.0	2.8	0.9	0.9	-1.4
Manufacturing Operating Ratio	-0.6	-4.8	2.5	1.2	-2.0	4.0	-0.9	0.3	n.a
Housing starts (Total units)	3.6	11.9	23.5	-7.3	-4.1	-2.2	0.6	0.1	-2.2
Domestic Machinery Order (Total)	-1.8	4.1	7.7	-16.8	23.3	3.7	16.6	-17.4	n.a
Retail Sales	3.2	1.1	5.0	0.6	1.7	1.2	-0.4	-2.8	2.9
Leading Indicators Index (1980 = 100) End of Period	50.0	75.0	n.a	46.2	53.8	61.5	61.5	70.0	n.a

6. Industrial production fell by 1.4% in February, on provisional data, after a 0.9% increase in January. The decline, which was larger than expected, reflected the loss of at least one working day as a result of the Emperor's funeral. However, industrial production still registered a 5.1% year on year increase.

7. By industry, seasonally adjusted declines in output were registered in electrical machinery (-3.6%), transport (-3.0%) and iron and steel (-1.9%). Output of durable goods fell by 5.6%, and of producers' goods by 1.6%.

8. The diffusion indexes showed a buoyant picture in January, with the leading indicator at 70 - the highest level for 12 months - and the coincident indicator at 80. The lagging indicator stood at 42.9.

9. Manufacturing production capacity rose by 0.9% in 1988, little changed from a 0.7% increase in 1987. However, the manufacturing operating ratio, which measures capacity utilisation, rose by 6.0% during the year, against only 1.2% in 1987. Producers' shipments (in mining and manufacturing) rose by 8.6%, and inventories by only 1.5% during the year, so that the inventories to shipments ratio fell by 4.1% during 1988 as a whole. However, the pattern of inventories reversed sharply during the year, with destocking during the first half being replaced by inventory accumulation. Inventories rose by 4.8% year on year in the December quarter and have since risen by 7.5% and 8.3% respectively in January and February of this year.

10. Housing starts fell by 2.2% in February, or by 9.5% at an annual rate. Reflecting the pattern of recent months, housing starts fell more sharply in the public sector (down 19.3%) than in the private sector (down 3.9%). Other industrial construction orders rose by only 5.3% year on year in February, with orders from the public sector down by 18.3%. New orders for machinery rose by 21.2% year on year in January, but fell by 17.4% on a seasonally adjusted basis.

11. Nevertheless, business confidence appears to continue to be very strong. 52% of the respondents to the latest Bank of Japan short term economic survey felt that their business situation had improved since the last survey in November 1988, with sales expected to rise by an average of 4.8% in FY 1989 (with exports rising by 2.5%). Capital expenditure (in all industries) is expected to rise by 6.0% in FY 1989 - lower than the 17.6% rise expected in FY 1988, but as the Bank points out capital expenditure forecasts are often revised upwards as the year progresses.

12. A Nikkei survey of 938 listed companies (in manufacturing and service industries, but excluding financial services) shows that corporate profits are thought to have risen by an average of 20.3% in FY 1988. In manufacturing industry the average rise will be 40.4%, but in non-manufacturing only 1.3%: the latter reflects profit falls in power and gas industries.

13. Average household spending by all families rose by 3.1% in real terms during 1988, or by 3.6% in nominal terms. This was the largest annual rise since 1975. Expenditure rose most strongly on electrical

goods, package holidays and cars, whilst expenditure on furniture and other household goods was relatively sluggish - possibly reflecting the slow down in housing construction.

LABOUR MARKET (TABLE III)

TABLE III: LABOUR MARKET
All figures seasonally adjusted except figures for fiscal years

	Fiscal Years			1988				1989	
	1985/86	1986/87	1987/88	SEP	OCT	NOV	DEC	JAN	FEB
Unemployment Number (mns)	1.58	1.71	1.70	1.53	1.50	1.48	1.44	1.43	1.44
% of Workforce	2.65	2.8	2.78	2.49	2.43	2.39	2.31	2.31	2.31
Employment Regular workers (1985 = 100)	100.4	101.7	102.1	104.0	104.2	104.2	104.3	104.4	104.6
Overtime Hours Worked (All industries) (1985 = 100)	99.9	96.2	102.7	108.7	108.7	109.1	108.6	108.5	109.0
Job Opening/Job Seeking Ratio	0.67	0.62	0.76	1.09	1.10	1.12	1.13	1.14	1.15

14. The seasonally adjusted unemployment rate stayed unchanged at 2.31% in January and February. Other indicators of conditions in the labour market also showed very little change, with the index of employment edging up only marginally to 104.6 in February, and the ratio of job opening to job seekers rising one point to 1.15.

15. With many of the annual "shunto" wage negotiations now completed, the average pay award appears to be around 5.2%, against 4.4% in 1989. Also, for the first time, increases in holidays seem to be a widespread feature of pay deals. The highest major award seen so far is for employees of the private railways, who will obtain a 5.91% increase. NTT employees will obtain 5.46%, whilst Honda is conceding a 5.36% increase, with a reduction of 3 working days per year. On the other hand, workers at Nippon Steel have accepted a pay award of 2.44%, and a cut of 2 working days: although the pay award is well below average, it is still higher than their award of 1.79% in 1988. In general, therefore, it is evident that employers have been persuaded by the buoyant state of corporate profits to award more generous increases: and in some cases the tightness of the labour market and labour shortages may have obliged them to concede higher increases.

PRICES AND EARNINGS (TABLE IV)

TABLE IV: PRICES AND EARNINGS
Percentage change on year earlier, not seasonally adjusted

	FISCAL YEARS			1988				1989	
	1985/6	1986/7	1987/8	OCT	NOV	DEC	JAN	FEB	MAR
Consumer Prices - National	1.9	0.0	0.5	1.1	1.2	1.0	1.1	1.0	n.a
- Tokyo	2.3	0.3	0.9	1.6	1.7	1.2	1.5	1.4	1.6
Wholesale Prices - Total	n.a	-9.3	-2.0	-1.5	-1.6	-1.1	-0.1	0.3	n.a
- Domestic	n.a	-5.3	-1.7	-1.1	-1.1	-1.0	-0.4	0.0	n.a
Average earnings all industries (real) 1985 = 100	1.1	2.6	1.7	2.9	2.3	4.1	5.3	2.6	n.a
Unit labour costs	2.1	2.9	n.a	-0.4	-3.2	-3.4	-3.9	n.a	n.a
Labour Productivity (1985 = 100) manufacturing	4.4	1.8	5.9	124.4	124.5	n.a	n.a	n.a	n.a

16. Consumer prices rose by 1.1% in January and 1.0% in February, year on year - similar to the rates of increase seen in the last quarter of 1988. Prices in metropolitan Tokyo rose by 1.6% in March, producing an increase of 1.1% in FY 1988, up from 0.9% in FY 1987. The introduction of the 3% consumption tax from 1 April is likely to produce a substantial year on year rise in the CPI, possibly of as much as 3% year on year in April: the authorities will be concerned to ensure that the month on month series does not show any upturn in succeeding months.

17. Wholesale prices rose by 0.3% in February - the first year on year increase since February 1985. The export price index rose by 2.1%, and the import price index rose by 0.7%, whilst the domestic price index stayed the same. The wholesale price index has been on an increasing trend, reflecting the weakness of the yen and the increase in the price of crude oil, since the autumn of last year.

TRADE (TABLE V)

TABLE V: TRADE
(ALL FIGURES IMF BASIS, SEASONALLY-ADJUSTED)

	FISCAL YEAR (NSA)			1988				1989	
	1985/86	1986/87	1987/88	SEP	OCT	NOV	DEC	JAN	FEB
Exports (\$ mn)	180,664	211,293	233,389	22,260	22,173	22,981	22,520	23,722	23,635
Imports (\$ mn)	119,063	109,645	139,108	14,448	13,559	14,476	14,156	14,548	13,486
Trade Balance (\$ mn)	61,601	101,648	94,281	7,812	8,614	8,505	8,364	9,174	10,149
Current Account Balance (\$ mn)	55,019	94,139	84,540	6,618	6,976	7,647	6,673	6,734	8,832
Indices, NSA, % change over same period of previous year Volume (1985 = 100)									
- Exports	3.6	-0.5	0.1	7.1	3.3	10.4	4.5	6.9	5.6
- Imports	1.1	10.5	12.6	13.3	8.5	12.5	12.7	13.0	-2.7
\$ Unit Value									
- Exports	n.a	18.3	10.5	6.3	9.7	8.4	7.2	4.7	4.7
- Imports	n.a	-13.6	14.6	5.2	4.8	1.0	-1.1	0.0	3.8
Indices, SA Volume (1985 = 100)									
- Exports	99.8	99.1	99.6	106.1	104.5	107.7	106.0	109.2	109.0
- Imports	100.4	111.2	124.4	140.8	132.6	145.1	145.2	147.4	135.7

18. The seasonally adjusted trade surplus rose sharply to \$9.2 billion in January and to \$10.1 billion in February - the latter figure representing a new record high as exports stayed roughly flat and imports fell by 7.3% in dollar value terms. (Before seasonal adjustment, the trade surplus fell sharply to \$4.2 billion in January - traditionally a month when the surplus is low - but more than doubled to \$9.0 billion in February). Officials have suggested that self-restraint before the late Emperor's funeral may have been responsible for the decline in imports during February; other commentators have pointed out that although this may have some validity, the sharp increase in the surplus reflects a pattern that has been emerging during the last six months.

19. The invisibles deficit rose sharply to \$2.4 billion in January, as investment income fell to a seasonal low of \$1.0 billion and outflows on travel and transport together exceeded \$2 billion as a result of the boost to overseas travel around the New Year. The deficit narrowed to \$1.3 billion in February as investment income recovered, although the deficit on travel remained at a high level. As a result, the seasonally adjusted current account surplus stayed little changed at \$6.7 billion in January, but rose by over \$2 billion to \$8.8 billion in February.

20. Export volumes rose by 5.6% year on year in February, but showed a small decline month on month. Import volumes fell by 2.7% year on year, apparently the first monthly fall in this series since 1985, and by 7.9% in the monthly series.

21. A survey carried out by the EPA in January confirms expectations that the trade surplus is unlikely to diminish, at least at current exchange rates, in the immediate future. Of the 1,127 major firms surveyed, 44% thought that they could compete in overseas markets if the yen stayed between 120 and 130 to the US dollar: and the average exchange rate at which exporters thought that they could compete was Y128 - Y12 lower than the average of Y140 in the same survey the previous year.. The companies polled predicted an average yen/dollar rate of Y120 by January next year.

CAPITAL ACCOUNT (TABLE VI)

TABLE VI: LONG TERM CAPITAL

	<u>CALENDAR YEARS</u>				<u>Q4</u>	<u>JAN</u>	<u>FEB</u>
	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>			
<u>OUTWARDS</u>							
Direct Investment	6.5	14.5	19.5	34.1	10.6	2.7	2.6
Trade Credit	3.0	2.0	1.7	6.7	2.3	-	(0.1)
Loans	10.6	9.1	16.1	14.9	3.2	1.6	0.9
Securities							
- Stocks	1.0	7.0	16.8	3.0	1.9	(0.6)	0.7
- Bonds	58.8	95.1	70.7	84.1	20.2	4.8	10.2
Other	2.2	4.6	8.7	6.4	1.8	0.2	0.4
	<u>82.1</u>	<u>132.4</u>	<u>133.5</u>	<u>149.2</u>	<u>40.0</u>	<u>8.7</u>	<u>14.7</u>
<u>INWARDS</u>							
External Yen Bonds	12.8	18.4	30.3	35.1	6.8	1.0	9.5
Stocks	(0.7)	(15.7)	(42.8)	6.8	7.9	5.5	2.6
Bonds	4.5	(2.1)	6.6	(21.6)	(10.4)	(2.3)	(0.2)
Other	(0.7)	(0.1)	2.2	1.3	(0.5)	(0.1)	(0.5)
	<u>17.3</u>	<u>0.5</u>	<u>(3.7)</u>	<u>19.0</u>	<u>3.8</u>	<u>4.2</u>	<u>11.4</u>
<u>NET OUTFLOW</u>	<u>64.8</u>	<u>131.9</u>	<u>137.2</u>	<u>130.2</u>	<u>36.2</u>	<u>4.6</u>	<u>3.3</u>

22. During February a substantial gross outflow of long term capital, of \$14.7 billion, was offset by a record inflow, totalling \$11.4 billion. Of the former figure, \$10.2 billion was invested in overseas bonds, the highest figure since May 1988, as confidence in the dollar became stronger and more widespread. (Gross investment in overseas bonds totalled \$11.2 billion, but investment by Japanese residents in Euroyen bonds, which are netted out from the figures, exceeded \$1 billion for the first time). Euroyen bonds were also the main feature of investments by non-residents, totalling \$9.5 billion: however, investment in Japanese stocks was also substantial - now totalling \$8.1 billion for the first two months of 1989, which is more than the total investment seen during the whole of calendar 1988.

FINANCIAL DEVELOPMENTS (TABLE VII)

TABLE VII: MONETARY INDICATORS

	FISCAL YEARS			1988			1989		
	1985/86	1986/87	1987/88	OCT	NOV	DEC	JAN	FEB	MAR
M1 Annual Growth (%)	4.5	8.4	10.2	7.3	9.0	10.3	8.6	9.8	n.a.
M2 + CDs Annual Growth (%)	8.7	8.6	11.2	11.0	10.3	10.4	10.0	10.4	n.a.
Discount Rate (%) (end of period)	3.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
3-month Gensaki Rate (end of period)	4.395	3.983	3.835	4.272	4.183	4.166	4.238	4.211	4.200
Government Bond Yield End of Period	4.40 (No 10)	3.79 (No 10)	4.430 (No 10)	4.485 (No 105)	4.555 (No 105)	4.750 (No 111)	4.805 (No 111)	5.020 (No 111)	5.180 (No 111)
Nikkei 225 Stocks Index End of Period	n.a.	21566.66	26260.26	27982.54	29578.90	30159.00	31581.30	31985.60	32838.68
Yen/Dollar rate (end of period closing)	160.10	145.80	124.50	125.00	121.85	125.90	125.13	127.15	132.55
Yen/Sterling T.T. Selling rates (AV)	237.59	234.30	283.93	227.83	226.83	229.73	232.46	228.33	227.89

23. M2+CDs, the broadly defined measure of the money supply, grew by 10.1% in January and 10.4% in February, continuing the more moderate rate of growth seen in recent months. Bank lending grew more modestly in the fourth quarter of 1988 than in the same period in 1987, increasing by Y14.9 trillion after an increase of Y15.3 trillion. Bank of Japan officials suggested that demand from major corporations, and from real estate companies was relatively weaker (offsetting strong growth in loan demand from smaller companies) and housing finance also slowed down. On the liabilities side, the increase in bank deposits was also much smaller in the fourth quarter of 1988 than in 1987, at Y9.1 trillion, down from Y16.8 trillion: this may reflect to a considerable extent the fact that the banks are now relying much more heavily on bills and call money in the money markets for their funds, following the Bank of Japan's reforms introduced in November.

24. The yen remained generally weak against the dollar for much of February, although it closed slightly stronger at Y125.15 on 28 February, some Y4 stronger than at the beginning of the month. During March, the strength of the dollar put the yen under rather stronger pressure, with the currency slipping to close at Y132.05 on 31 March. The yen's weakness reflected not only the strength of the

dollar, but also on occasion concerns about an upturn in inflation in Japan, and the implications of the Recruit scandal. On 3 April the Bank of Japan intervened in the markets to buy yen - reportedly the first intervention in this direction since 1985. The move had an important psychological effect, bringing the rate back to Y131.70 on 4 April.

25. Interest rates continued to edge up, with 3-month CD's reaching a peak of 4.75% on 27 March, before slipping back in the final few days of the financial year. The weakness of the yen, and the increase in the US discount rate at the end of February led to persistent expectations that short term interest rates in Japan would rise, and that the Bank of Japan would in due course be obliged to raise official discount rate. Pressure was however consistently resisted by the Bank of Japan.

26. The bond markets began March with weak conditions, following the increase in US interest rates and reflecting the weakness of the yen. The yield on the benchmark JGB No 111 opened at 5.065%, and reached a high point (for the year so far) of 5.305% on 14 March, before recovering gradually to close at 5.17% at the end of the month.

27. Prices on the Tokyo Stock Exchange fluctuated during both February and March but the underlying tone was very strong, backed by the weight of institutional investment. Optimism about the strength of institutional demand for equities in the new financial year led to a spurt in prices during the final week of March, with the Nikkei index rising 1,327 points, or 4.2%, to close the month at an all time high of 32,839. Trading volume on the exchange has been very strong since the beginning of the year, with average transactions per day totalling 1.1 billion in January and 1.5 billion in February - the second highest monthly total, after 1.75 billion in June last year. Prices have also been encouraged by the revival of foreign investor interest (see para 22).

THE FY 1989 BUDGET

28. Very little progress has been made in the Diet towards approving the draft budget for FY 1989 (described in the February Economic Report), because the opposition parties have boycotted discussions to reinforce their demand that former Prime Minister Nakasone should testify before the Diet about his relationship with the Recruit Group of companies. A provisional budget totalling Y9.2 trillion was passed on 31 March, designed to cover expenditures for the first 50 days of fiscal 1989: this means that the lower house pass the main budget by 21 April, in order to allow a further 30 days for its passage through the House of Councillors.

JCER SHORT TERM FORECAST

29. The Japan Centre for Economic Research has published its latest short term economic forecast, covering the period up to the third quarter of 1990. The Centre predicts real GNP growth of 5.0% in

FY 1988, followed by only a modest slowing to 4.5% in FY 1989 (0.5% higher than the official government forecast for this financial year). No significant slowdown is expected throughout the forecast period (ie, up to September 1990). The growth of domestic demand is expected to be 6.1% in FY 1989, with consumer expenditure rising by 4.4% and private fixed business investment rising by 14.3%. The trade surplus is expected to rise to \$99 billion in FY 1989, up from \$96 billion in FY 1988, reflecting continued strong growth in exports and some weakening of the growth of import volumes as a result of the slightly lower rate of growth of domestic demand. The ratio of manufactured imports in total imports is expected to rise to 53.3% (from 49.5% in FY 1988). The consumption tax is expected to increase the consumer price index by 1.5% in FY 1989, leading to an overall increase in the CPI of 2.6% (with the wholesale price index rising by 0.6%). However, the JCER remains fairly sanguine about inflation and does not anticipate the need for any significant tightening of monetary policy. The yen/dollar exchange rate is assumed to rise gradually to reach an average of Y110 during the third quarter of 1990.

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 MR MCLAREN
 MR GOULDEN
 ADDITIONAL 44
 JAPAN POLITICAL AND ECONOMIC 44

SVB:02 MSS:99 MIS:79 PTR:00 DEF:06

CONFIDENTIAL

FROM: PS/N L WICKS
DATE: 13 APRIL 1989
Ext : 5409

NOTE FOR THE RECORD

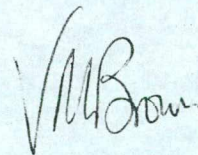
1. Jonathan
2. ~~Maria~~
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cc PPS
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Evans
Mr Peretz

PS/Governor) B/E
Mr Crockett)

**MEETING OF G7 AT RIVER FARM, ALEXANDRIA ON SUNDAY 2 APRIL:
MULTILATERAL SURVEILLANCE**

The note of the G7 discussion arrived this morning, having been delayed in transit from Washington, and is now attached.



MRS V M BROWN

CONFIDENTIAL

NOTE FOR THE RECORD

MEETING OF G7 AT RIVER FARM, ALEXANDRIA,
VIRGINIA ON SUNDAY, 2 APRIL 1989

1. The meeting began at 10.30am. Gyohten deputised for Muryama who was absent because of parliamentary duties in Tokyo.

Multilateral Surveillance

2. The Managing Director of the IMF was invited to join the meeting to present his paper on economic prospects. The Managing Director said that many developments since the last G7 meeting had been in a worrisome direction: increases in both short-term and long-term interest rates in most countries; greater inflationary pressures; a confirmation of the stalling of the adjustment process; and exchange rates moving in a direction unhelpful for the adjustment process. These adverse factors gave no grounds for panic, but suggested that the strategy needed to be strengthened.

3. The Managing Director then proceeded to describe the three scenarios referred to in the IMF paper considered at the Deputies' meeting in Amsterdam. He concluded his presentation with the view that the scenarios demonstrated that the best way forward was the preservation of the international coordination process, vigilance on inflation and an emphasis on savings policies, structural adjustment and open trade.

4. Brady (US) then asked the group to consider questions 1 and 2 in the Deputies paper. These were:

1. Do Ministers and Governors consider the recent rise in interest rates to be adequate to check inflationary pressure?
2. In the absence of support from fiscal policy, is there a risk that monetary policy is overburdened and may have to be tightened further with adverse implications for exchange markets, investment, growth, and the debt burden of developing countries?

Greenspan (US) argued that US data showed little evidence of inflation in 1988 in the underlying cost structure. But this year, there had been some quickening in underlying costs, including labour costs. The current softness in the US economy might be enough to suppress the

upward pressures on the wage side so that the recent increase in producer prices might prove to have been an aberration.

5. Sumita (Japan) repeated his presentation on Japanese inflation given to the G5 earlier that day.

6. Amato (Italy) said that inflation in Italy was above 6 per cent for the first time since 1986. This was due to the increases in VAT in July and December 1988, higher oil prices, increased domestic demand, especially in Northern Italy and strong capacity utilisation. The government had responded with appropriate monetary measures. Wages were causing concern, especially if future wage increases had to be linked to the consumer price increase of 6 per cent. He expected inflation to fall during the second half of the year.

7. Lawson (UK) said that inflation was the major problem concerning all countries, and certainly the UK. This had risen as a consequence of unexpectedly strong growth, which was unsustainable. Excess demand had also manifested itself in higher imports. These imports were in part due to the increase in investment, though consumption had also risen partly because of the deregulation of financial services. Monetary policy had been tightened. Long-term interest rates had not increased. Inflation looked as if it was on a plateau and would come down later in the year. He stood ready to tighten monetary policy if need be. On the world economy, the Chancellor said that the responsibility was to keep economies strong and open and be ready to raise interest rates if that was necessary to combat inflation bearing in mind that one reason for the world's recent strong growth performance was inflation control.

8. Beregovoy (France) described France's inflation prospects in the terms used earlier that day in G5. Wages policy was providing some pressures on inflation in the public sector, though the contagion had yet to spread to the private sector. Money supply was growing less fast than growth in nominal GNP. The fiscal policy was continuing tight with a reducing budget deficit. If he had to give himself a mark as in a school report, he would comment "good job, but don't give up trying".

9. Wilson (Canada) noted that inflationary pressures in Canada had been worsening. Growth was strong. Fiscal policy needed tightening and his forthcoming budget would move in that direction. Inflationary problems were worse in some regions of Canada than in others. His answer to the Deputies second question was certainly "yes". Some influences which had been formerly positive for prices, like oil prices and the increase in the level of the Canadian dollar, were unlikely to continue to be favourable. The conclusion was that policy in Canada had to be vigilant.

10. Stoltenberg (Germany) reported a strong economy in Germany with continued investment growth, though private demand did not seem to be quite as strong. There was concern about the 5.9 per cent rise in

import prices as well as higher oil prices. So far, strong upward pressures on wages had not appeared, partly as a result of the benefits of three year wage contracts in certain industries. The trade surplus was stronger than he would want. The growth of exports was concentrated on two countries, Italy and the UK. A 12 per cent increase in imports from developing countries was welcome. The authorities would continue to strengthen domestic demand.

11. Discussion then turned to questions 3, 4 and 5. These were:

3. Are Ministers and Governors concerned with the apparent slowdown in the pace of external adjustments?
4. If the perception of such a slowdown prevails, is there a risk of a negative reaction in financial and currency markets and a danger of intensified protectionist pressures associated with a global economic slowdown?
5. What are the policy measures the Ministers and Governors consider to be appropriate in order to achieve both external adjustment and the domestic goals of sustained growth and lower inflation?
 - (a) What should the United States do to reduce their current account deficit?
 - (b) What should Germany and Japan do to reduce their current account surpluses and sustain growth?
 - (c) What should deficit countries do in order to strengthen their domestic savings?

12. Gyohten (Japan) believed it important to maintain non-inflationary growth based on strong domestic demand. Some Japanese commentators feared that the Japanese economy was growing at a rate a little above what was sustainable in the longer term. He expected GNP to rise by some 4 per cent in 1989, of which domestic demand would account for some 5 per cent. Structural reform was needed, particularly to redirect export industries to domestic needs. The Japanese authorities recognised the need to streamline the distribution system and to make a better use of land for residential purposes.

13. Amato then described his harrowing time in funding the government's deficit. The markets had realised, a number of times recently, that too great a burden was being placed on monetary policy. In those circumstances, there had been enormous difficulty in selling government debt. At times it was impossible to sell medium-term government paper. He drew the lesson that fiscal policy, not monetary policy, determined the markets' appetite for medium-term paper.

14. Lawson after expressing sympathy for Amato's problems, emphasised that the overriding need for monetary policy was to bear down on inflation, supported by appropriate fiscal stance and measures to improve the efficiency of the economy. The rectification of the imbalances was secondary. He believed that markets would willingly accept, in a world of global capital flows, the financing of the imbalances. It was unrealistic to expect that they would disappear quickly. Protectionism had to be resisted. As regards the encouragement of private savings, the answer was a sufficiently high level of interest rate, which both encouraged saving and discouraged borrowing. Beregovoy answered question 3 positively, but thought it impossible to say that there was for the moment a real slowdown. Certainly, protectionism had to be guarded against. He hoped that Japan would increase activity and the US should deal with its budget deficit. World savings seemed to be drawn towards the US. The surplus countries had taken necessary action to stimulate domestic demand.

15. Wilson answered questions 3 and 4 in the affirmative. He described his approach to the forthcoming Canadian budget, and emphasised that a beneficent outcome for the Canadian economy required correct policies in the US, especially on their budget deficit.

16. Greenspan recounted recent events in the exchange market which suggested that the markets were not concerned about the level of the imbalances. Nevertheless, he did not think that the current level of imbalances was sustainable for the longer term. But he could not point to obvious action which would help. Exchange rate adjustment had to be excluded since it was difficult to believe that the surplus countries could do more to increase domestic demand. Perhaps the answer was to slow down the domestic demand in the deficit countries.

17. Brady repeated his confidence of February in the prospects for reducing the budget deficit, emphasising that it would be a long process. He urged the group to put out a strong statement on intervention.

18. Discussion then turned to questions 6 and 7, namely:

6. Do Ministers and Governors believe that the present pattern of exchange rates is still broadly satisfactory? Are they concerned with the recent strengthening of the US dollar?
7. What are the implications of interest rate developments for exchange market stability and what role do Ministers and Governors see for official intervention in this regard?

Gyohten reported that the Japanese authorities were not comfortable with the recent strengthening of the dollar. This gave the impression that the market was not acting on fundamentals. Japan was willing to cooperate and be active in the exchange market. He repeated what he had said to the G5 group, emphasising that the market did not seem to believe that the dollar would remain strong for the medium-term.

19. Amato agreed with Camdessus' earlier comment that the exchange rate was pointing in the wrong direction. It would be artificial if the dollar strengthened further. Increases in the dollar created problems for the ERM as it strengthened the deutsche mark, effectively devaluing the lire and other currencies. Cooperation had to be strengthened to prevent further dollar increase.

20. Lawson argued that a framework of exchange rate stability was beneficial to the world economy though he would not argue for immutable or fixed exchange rates over a period of time. The strength of the dollar was a concern, especially when the events of 1983-85 were recalled. But with the US economy close to capacity, dollar depreciation would be inflationary, as would depreciation of sterling. Exchange rate stability provided an important discipline for economies. There was certainly a role for intervention in the coordination process. But it was important not to have exaggerated expectations of its results, though the markets certainly believed that it had some effect.

21. Larosiere believed that the dollar had risen for not very good reasons - because of the markets short-term view on interest rates. The level of the dollar would be regretted if the markets thought that the US current account would not improve. So long as the markets were unconvinced that the US authorities were not dealing with the budget deficit, interest rates would, he feared, rise again. Wilson believed that the high level of the dollar stood in the way of adjustment. He saw a role for official intervention. He did not expect a substantial drop in the dollar and the communique language pointed too far in that direction.

22. Stoltenberg thought that the further strengthening of the dollar would have disadvantages and that cooperation should proceed. Poehl added that he would not rely too much on intervention. Coordinated intervention had to be realistic. More than \$11 billion intervention had taken place this year - and without much effect. If interest rates in the US declined - and he was not suggesting they should - then the dollar would fall.

23. The group then adjourned for lunch at 1.00pm.

24. After lunch, Creonspan said that it had been argued that if interest rate differentials were removed, the dollar would move back to a level conducive to adjustment. The data did not support that thesis. This suggested that some other factor was affecting dollar strength, and increasing the preference for holding dollar assets. That increase preference might be ascribed to the development of international financial markets and the consequent secular increase abroad in demand for US dollars. If that was true, it implied that deficits could be financed for a further period. But the downside to

that argument was that there was considerable potential for substantial fluctuations in the dollar if people decided to divest themselves of that currency.

25. This part of the discussion concluded at 2.15pm.

N.C.W.

N.L. Wicks
6 April 1989

CONFIDENTIAL

FROM: PS/N L WICKS
DATE: 13 APRIL 1989
Ext : 5409

NOTE FOR THE RECORD


cc PPS
Sir P Middleton
Sir T Burns
Mr Lankester
Mr Evans
Mr Mountfield
Mr Walsh

Mr Cassell - UKDEL

PS/Governor) B/E
Mr Crockett)

MEETING OF G7 AT RIVER FARM, ALEXANDRIA ON SUNDAY 2 APRIL:
INTERNATIONAL DEBT

The note of the G7 discussion arrived this morning, having been delayed in transit from Washington, and is now attached.



MRS V M BROWN

CONFIDENTIAL

NOTE FOR THE RECORD

MEETING OF G7 MINISTERS AT RIVER FARM, ALEXANDRIA, VIRGINIA
ON SUNDAY, 2 APRIL, 1989

1. The meeting turned to international debt matters at 2.15pm.
2. Gyohten said that Japan strongly supported the framework of the Brady proposals. They hoped that there would be unanimous support for the basic thrust of the new strategy. His particular points on the proposals were:
 - (i) He could find no clear answer in the proposals to the question how in practice flight capital would be repatriated; would this be done through high interest rates, or exchange controls, though both had adverse effects; or through tax privileges, which had dead weight costs?
 - (ii) Banks may be reluctant to grant the waivers which were necessary for the proposals, until they saw more clearly the advantages for them.
 - (iii) The banks would need some assurances that burdens were being shared fairly among them.
 - (iv) There were obvious dangers if countries had bilateral negotiations with commercial banks.
 - (v) Interest service reduction was, in the Japanese banks' view, an essential element in the scheme. The World Bank and IMF should be urged to come up with some viable proposal. The escrow account proposal looked to be a possible way forward.
 - (vi) The link between debt service reduction and debt reduction needed careful exploration. Flows of new money would probably be postponed for a little time following debt or debt service reduction.
3. Amato thought that the communique would have to go beyond general statements, but could not go into detail. He wondered how waivers were intended to work. Would banks singly or jointly deal with each debtor country? Mulford answered this question by reference to the nature of the loan agreements which differed between countries. That was a point to discuss with the banks. Amato then said that a clear difference in view was likely to appear between the large and small banks. Mulford retorted that giving a waiver was not the same as participating in new money packages. His feeling was that only a small number of banks

would resist waivers. Amato responded that the Italian banks had said that they would be willing to make waivers only if they got a guarantee from the state. Repatriation of capital flight would, he thought, depend on sound policies. He had some difficulty with the issue of interest support, but saw value in the device. It caused legal problems for the IMF, but no doubt the lawyers could be told to come up with a solution. A critical point was whether creditor governments were willing to accept transfer of risk implicit in the proposal. There needed to be clarity about the resources required.

4. Lawson agreed with many of Amato's points. He agreed that we were moving, in an evolutionary way, to a stage when market based debt reduction would take a more prominent role. The financial system was no longer in danger of collapse, partly as a result of the tax relief given in some countries as an incentive for the banks to make provisions. So debt reduction could now become a reality. The key point was that the debts remained a responsibility of the banks and their debtors. The question raised by the US proposals was the extent to which public sectors should participate in the process.

5. Lawson then said that there were two broad sorts of approach to debt reduction. There was a bureaucratic public sector managed approach. This carried great danger. The other approach was a market based approach, which was his preference. This left it to the banks and the debtor countries. His concern was that before too long the tax payer would be paying a larger role than creditor governments ever intended, quite contrary to the understandings in the Berlin communique. More generally, he was concerned that expectations had been aroused in the debtor countries which could not be satisfied. Pressure was being taken off the banks. He was prepared to accept that, as a signal a small proportion of IFI money might be used for debt reduction. But he was not prepared to do this in a way which penalised countries like India, which were good performers. There needed to be many tough conditions, like membership of MIGA, repatriation of flight capital, debt equity swaps, privatisation and so on, before countries could be eligible for IFI debt reduction money. It would be necessary to ensure that the Paris Club was protected. Too often the Club was at the end of the queue and was expected to fill financing gaps. Waivers were a matter for the banks. If we entered into discussions with them, they would no doubt seek further state support. He was not ready to accept the proposal for interest support. Concluding his remarks, Lawson said that the governments needed to give two signals: they were prepared to help in debt reduction, but were not prepared to transfer further risk from the private to the public sector.

6. Brady replied to this last point that the transfer had already been happening. If it were stopped, the whole financing system would break down. Lawson replied that if the transfer was maintained, public sector institutions would in due course own most of the middle-income countries' debt. Brady disagreed. The demand for funds would go down. Mulford said that the effect of the US proposals was that a more explicit transfer of risk would be accepted, but for lesser and more

controlled amounts. Lawson replied that the approach should be to place the banks in a position where they would negotiate debt reconstruction. Brady insisted that public sectors had to get the process started.

7. Beregovoy agreed with Brady's responses. Banks had to accept their responsibilities. The real problem was that the middle-income countries had difficult social and political situations which made it necessary to reduce debt stock and debt service. He preferred President Mitterand's scheme to that put forward by Brady, partly because of the flexibility given by the issue of SDRs. The details of the US proposals could not be agreed that day, but Ministers should not disappoint the hopes that had been raised.

8. Wilson agreed that the debt overhang needed to be dealt with. Policy reform had to be carried forward in the debtor countries and some IFI involvement was inevitable. So he gave Brady's proposals his strong support.

9. He then reported that the Canadian banks were sceptical and pessimistic about the failure of the middle-income debtors. They did not see much policy reform coming forward. Nor did he think that they would sign general waivers. He felt that resources would fall short of what the countries were expecting. In his view banks needed to do more outside the Brady proposal. If the banks did not do this, creditor governments would be in the moral hazard business and finding themselves pressed to make more funds available. He hoped that the Brady proposal could act as a catalyst. But it was important for governments to show that there was a real limit to what they were going to do. It was important to start framing attitudes and expectations so as to contain pressure for further action. The Brady proposals must not result in a bank bail-out. Brady then interjected at this point to ask that the proposals should not be called after him. They were an amalgam of many peoples' ideas.

10. Stoltenberg said that in his view the Berlin language on risk transfer still stood. He was concerned that countries which had successfully carried through economic reform programmes without the need for rescheduling, like India, and which were poorer than the middle-income debtors, should not suffer. It was important to make urgent progress with the proposals since reforms were already being delayed in debtor countries. The emphasis should be on debt reduction linked to successful reform. Obviously only those countries cooperating with the IMF could expect the new support. Certainly there should be emphasis on repatriation of flight capital, but he would not wish to exaggerate the amount of capital which would be repatriated. He attached importance to debt equity swaps, but would not make it mandatory because some countries would not go down that route. The approach could not be restricted to a particular group of countries. All the Fund's membership needed to be eligible, though strict conditions needed to be laid down for use of the new arrangement. He agreed in principle that a portion of the Fund and Bank resources should be set aside for debt reduction, but wanted to discuss the size

of the proportion. He had problems with the proposal for interest support. He feared that there would be great pressure to make the support permanent. It might be possible to devise an acceptable arrangement which put the responsibility for an interest support arrangement on the debtor countries and the banks.

11. Commenting on the repatriation of flight capital, Brady said that the amount of flight capital outside the debtor countries probably exceeded the total of their debt. People had constantly to be reminded of that. Commercial bankers were telling him that they were increasingly selling debt to local people. That process needed to be catalysed. He accepted that his proposals did not represent a total solution. They were an evolution. More time was being bought. Mulford said that we should not let the banks get away with the position that they would undertake waivers only if the government did something to help them. It was also necessary to avoid an emotional reaction regarding interest rate reduction. Some banks preferred to reduce debt stock, others preferred to forego interest. Debt reduction and interest rate reduction were essentially the same thing. Debt reduction was not by itself enough. There had to be debt service. Unless governments were prepared to support interest reduction, the job could not be done. He believed that Gyohden was too pessimistic about the prospects for new money. The banks would certainly continue to provide trade finance and that would account for some new money flows.

12. The meeting then turned to the drafting of the communique.

N.L.W.

N.L. Wicks
April 6, 1989

CONFIDENTIAL

FM LAGOS

TO DESKBY 171330Z FCO

TELNO 351

OF 171146Z APRIL 89

INFO DESKBY 171300Z TREASURY

INFO PRIORITY ODA, BANK OF ENGLAND, DTI, UKDEL IMF/IBRD WASHINGTON

INFO PRIORITY ABIDJAN (FOR SUTHERLAND AFDB), RIYADH, TOKYO

MY TELNO 333 : NIGERIA : IMF MISSION

SUMMARY

1. IMF STAFF PRAISE NIGERIANS' BUDGETARY DISCIPLINE AND DEREGULATION MEASURES, BUT EXPRESS CONCERN OVER EXCHANGE AND INTEREST RATES. ECONOMIC TEAM UNDER SEVERE POLITICAL PRESSURE, WITH SPECIAL WORRIES ABOUT INFLATION. IMF URGE NEED FOR RAPID DELIVERY OF US DOLLARS 100M BRITISH AID AND A FIRM MESSAGE TO NIGERIANS OF NEED FOR 'RESOLUTION'.

DETAIL

2. BROAD, JENNINGS AND I HAD OVER AN HOUR'S TALK WITH JIMENEZ, LEADER OF THE IMF TEAM CURRENTLY IN NIGERIA, ON 15 APRIL. JIMENEZ CONFIRMED MUCH OF WHAT HUSAIN OF IBRD HAD TOLD ME EARLIER (TUR), ESPECIALLY ABOUT IMF CONCERN OVER FIXING OF THE EXCHANGE RATE AT LEVEL WELL BELOW BLACK MARKET RATE, AND LACK OF ACTION TO RAISE INTEREST RATES. BUT THERE WERE SEVERAL POSITIVE INDICATORS. HE HAD EXPECTED OVERSPENDING TO BE THE MAIN PROBLEM, BUT IN FACT BUDGET MINISTER (AAA) HAD IMPOSED TIGHT DISCIPLINE. (JIMENEZ SAID CONTINUED SPENDING ON AJAOKUTA STEEL WORKS WAS A WORLD BANK RATHER THAN IMF CONCERN.) DEREGULATION, INCLUDING THE PRIVATISATION AND COMMERCIALISATION PROGRAMME, WAS ALSO GOING WELL. SECOND TRANCH OF WORLD BANK'S TRADE AND INVESTMENT POLICY LOAN WOULD THEREFORE GO AHEAD.

3. JIMENEZ'S MAIN CONCERN WAS THAT AAA AND AHMED (GOVERNOR OF CENTRAL BANK) WERE LOSING THEIR INFLUENCE ON ECONOMIC POLICY TO UNIDENTIFIED FORCES IN THE MILITARY GOVERNMENT. LATTER WERE CLEARLY AND UNDERSTANDABLY WORRIED ABOUT 50% INFLATION AND FOOD SHORTAGES. THEY WERE ACCORDINGLY NOT READY TO ACCEPT FURTHER DEVALUATION OR RISES IN INTEREST RATES. PROBLEM FACING AAA AND AHMED WAS THAT THEY HAD LITTLE TANGIBLE RESULT TO SHOW FOR THEIR REFORMING EFFORTS AND INTERNATIONAL

AGREEMENTS. ALTHOUGH AGREEMENT ON JAPANESE US DOLLARS 200M BALANCE OF PAYMENTS SUPPORT HAD BEEN SIGNED, NO MONEY HAD YET APPEARED FROM THEM OR OTHER BILATERAL DONORS'. JIMENEZ HAD URGED NIGERIANS TO SIGN UP RAPIDLY FOR OUR US DOLLARS 100M CONTRIBUTION NOW THAT WE HAD PROPOSED MODALITIES. ECHOING HUSAIN'S VIEW, JIMENEZ SAW NO NEED TO HOLD OUR MONEY BACK AS A LEVER ON NIGERIANS. ON THE CONTRARY, THEY NEEDED ENCOURAGEMENT AND AN EARLY INJECTION OF FUNDS.

4. JIMENEZ SAW LITTLE CHANCE OF MONEY FROM THE SAUDIS, WHO HAD THEIR OWN FINANCIAL PROBLEMS. BUT HIGHER OIL PRICE, AND REASONABLE PROSPECT THAT IT WOULD CONTINUE, MEANT NIGERIANS NO LONGER NEEDED TO CONTEMPLATE AN IMF DRAWING.

5. JIMENEZ CONFIRMED THAT RECENT MEASURES TO RECALL FOREIGN-GUARANTEED LOANS (MY TELNO 349) HAD BEEN INTRODUCED IN AN ABRUPT NIGERIAN STYLE, ALLOWING INSUFFICIENT TIME TO PUT MEASURE INTO EFFECT. BUT ITS ECONOMIC LOGIC WAS STRONG. IT WAS TOUGH ON CONSTRUCTION COMPANIES, BUT SOMEONE HAD TO SUFFER. JAPANESE AMBASSADOR HAD ALREADY MADE REPRESENTATIONS TO THE NIGERIANS, BUT IMF WERE UNMOVED BY THIS. (WE HAVE ALSO NOW RECEIVED STRONG COMPLAINTS FROM BALFOUR BEATTY, BEING REPORTED SEPARATELY.)

6. JIMENEZ SAID THAT FOLLOWING FURTHER MEETINGS HE PLANNED TO LEAVE ON EVENING 18 APRIL, AND HAD ARRANGED TO CALL ON LANKESTER AT TREASURY ON 19 APRIL. HE WOULD LEAVE A STRONG NOTE WITH NIGERIANS ON NEED FOR ACTION ON EXCHANGE AND INTEREST RATES, AND WOULD RETURN TO LAGOS AS SOON AS NECESSARY TO REVIEW MATTERS FURTHER. IN MEANTIME, HE WOULD PREPARE ARTICLE IV CONSULTATIONS PAPER FOR CONSIDERATION BY IMF BOARD IN ABOUT 3 MONTHS' TIME. HE HOPED THIS WOULD IN ITSELF ACT AS SPUR ON NIGERIANS TO TAKE NECESSARY ACTION. IN ANSWER TO MY QUESTION, JIMENEZ SAID HE WOULD LIKE UK MESSAGE TO NIGERIANS DURING STATE VISIT TO BE NEED FOR ''RESOLUTION.''

COMMENT ~

7. IMF ARE ADOPTING A SENSIBLE ''WAIT AND SEE'' APPROACH AT THIS STAGE. RATHER THAN CRYING FOUL NOW ON NIGERIAN MANAGEMENT OF EXCHANGE RATE, THEY ARE PREPARED TO RECOGNISE POLITICAL CONCERNS UNDERLYING THIS AND GOOD PROGRESS ON OTHER AREAS, AND ALLOW FURTHER TIME FOR REMEDIAL ACTION. BUT IMF WORRIED ABOUT PRESSURES ON AAA AND AHMED TO DELIVER, AND THEREFORE ANXIOUS THAT BILATERAL AID SHOULD FLOW AS

SOON AS POSSIBLE.

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FROM UKREP BRUSSELS.

ECOFIN COUNCIL: 17 APRIL 1989
ANNUAL ADJUSTMENT OF FINANCIAL PERSPECTIVES FOR 1990

SUMMARY

1. COMMISSION PROPOSAL FOR ANNUAL ADJUSTMENT OF FINANCIAL PERSPECTIVES (FOR YEARS 1990-1992) AGREED AS AN A POINT. GERMANY, SUPPORTED BY UK AND NETHERLANDS, ASK COMMISSION WHEN PRESENTING NEW PROPOSALS WITH FINANCIAL IMPLICATIONS TO STATE EXPLICITLY THAT THESE CAN BE FOUND WITHIN THE FINANCIAL PERSPECTIVES. COMMISSION EVASIVE IN REPLY, BUT PRESIDENCY CONCLUDED THAT THIS QUESTION SHOULD BE DEALT WITH IN THE NEAR FUTURE.

DETAIL

2. COMMISSION PROPOSAL FOR ANNUAL ADJUSTMENT OF FINANCIAL PERSPECTIVES ADOPTED BY QUALIFIED MAJORITY. ADJUSTMENT TO TAKE ACCOUNT OF ANNUAL IMPLEMENTATION, INCLUDING 9 MECU FOR FISHERIES IN LINE 4, ADOPTED UNDER ARTICLE 10 OF THE FINANCIAL PERSPECTIVES ONLY (ARTICLE 11 ON MULTI-ANNUAL PROGRAMMES NOT MENTIONED.)

3. SUBSEQUENTLY, TIETMEYER (GERMANY) RAISED A RELATED QUESTION. THE COMMISSION HAD RECENTLY PROPOSED A NUMBER OF PROGRAMMES INVOLVING SUBSTANTIAL EXPENDITURE, SUCH AS THE STATISTICAL PROGRAMME (SOME 200 MECU OVER 4 YEARS), WITHOUT SPECIFYING WHETHER THEY COULD BE FUNDED WITHIN THE FINANCIAL PERSPECTIVES ATTACHED TO THE INTER-INSTITUTIONAL AGREEMENT. COULD THE COMMISSION IN FUTURE INDICATE THE COMPATIBILITY OF ANY NEW PROPOSAL WITH THE PERSPECTIVES IN THE FORM OF A BINDING STATEMENT THAT EXPENDITURE ON A PARTICULAR PROPOSAL COULD BE FOUND (E.G.) WITHIN THE 'OTHER POLICIES' LINE OF THE PERSPECTIVES. THIS WAS INDISPENSIBLE IF THE COUNCIL WAS TO AGREE PROPER FINANCING ARRANGEMENTS. RUDING (NETHERLANDS) SUPPORTED.

4. ELLIOTT (UK) ALSO SUPPORTED TIETMEYER'S SUGGESTION. GIVEN LAST YEAR'S DECISION BY ALL THREE INSTITUTIONS TO LIVE WITHIN THE CEILINGS SET BY THE PERSPECTIVES DURING THE BUDGET PROCEDURE, IT WAS ESSENTIAL THAT THIS INFORMATION WAS AVAILABLE SO THAT THE COUNCIL COULD TAKE POLICY DECISIONS WHICH WERE CONSISTENT WITH THE BUDGETARY LIMITATIONS ALREADY AGREED, AS THE COMMISSION HAD SO OFTEN URGED DURING THE FUTURE FINANCING NEGOTIATIONS LAST YEAR.

5. SCHMIDHUBER (COMMISSION) SAID HE WAS AWARE OF THIS PROBLEM. THE COMMISSION TOOK THE INTER-INSTITUTIONAL AGREEMENT VERY SERIOUSLY AND HE WOULD DO HIS UTMOST TO ABIDE BY IT. BUT HE DOUBTED WHETHER THE STATEMENT REQUESTED BY GERMANY WOULD BE COMPATIBLE WITH THE BUDGET PROCEDURE. IT WAS POSSIBLE THAT THE TIME-TABLE FOR EXPENDITURE IN A PROPOSAL WOULD BE MODIFIED BETWEEN THE TIME IT WAS TABLED BY THE COMMISSION AND WHEN IT WAS ADOPTED BY THE COUNCIL. THIS PROBLEM MAINLY CONCERNED LINES 3 AND 4 OF THE PERSPECTIVES. THE COMMISSION WOULD MAKE EVERY EFFORT TO LIVE WITHIN THOSE LIMITS, BUT WHEN IT MADE A PROPOSAL IT COULD NOT COMMIT ITSELF TO A FIXED BUDGETARY AMOUNT. THIS WOULD ONLY EMERGE AT THE END OF THE DECISION MAKING PROCEDURE. RUDING AND ELLIOTT REMAINED UNCONVINCED BY THE COMMISSION'S PROCEDURAL PROBLEMS.

6. SOLCHAGA (PRESIDENCY) CONCLUDED THAT THE COMMISSION SHOULD TAKE NOTE OF THIS PROBLEM WHICH SHOULD BE DEALT WITH IN THE NEAR FUTURE.

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ECOFIN COUNCIL 17 APRIL: TAXATION OF SAVINGS

SUMMARY

1. DENMARK AND (ALMOST CERTAINLY) GREECE JOIN NETHERLANDS, LUXEMBOURG AND UK IN OPPOSING WITHHOLDING TAX. BUT FURTHER DISCUSSION TO TAKE PLACE IN HIGH LEVEL GROUP (12 MAY) AND AT MAY INFORMAL ECOFIN.

DETAIL

2. DURING THE LAST TWO MONTHS A HIGH LEVEL AD HOC GROUP HAS DISCUSSED THE COMMISSION'S PROPOSALS FOR A 15 PERCENT MINIMUM WITHHOLDING TAX ON INTEREST PAID TO RESIDENTS OF OTHER MEMBER STATES OF THE COMMUNITY AND FOR AN AMENDMENT TO THE 1977 MUTUAL ASSISTANCE DIRECTIVE. THE GROUP'S REPORT (5458/1/89) WAS BEFORE THE COUNCIL TODAY. THE PRESIDENCY SOUGHT TO FOCUS DISCUSSION ON A NUMBER OF TECHNICAL ISSUES (THE EXEMPTIONS FROM WITHHOLDING TAX PROPOSED FOR INTEREST ON EUROBONDS AND SMALL SAVINGS SCHEMES AND FOR INTEREST PAID TO RESIDENTS OF THIRD COUNTRIES: THE TREATMENT OF INTEREST ON DEBT INSTRUMENTS ANTEDATING THE ENTRY INTO FORCE OF THE DRAFT DIRECTIVE: AND HOW BEST TO DEVELOP COOPERATION AMONG TAX AUTHORITIES). ALL MINISTERS ALSO SET OUT THEIR GENERAL VIEWS ON THE PROPOSED WITHHOLDING TAX.

3. MRS SCRIVENER (COMMISSION) INDICATED THAT THE COMMISSION WAS PREPARED TO BE FLEXIBLE ON THE DETAILS OF ITS PROPOSALS - E.G. ON INTEREST PAID TO MIGRANT WORKERS AND ON THE EXEMPTION OF EXISTING PUBLIC SECTOR DEBT - PROVIDED THE OVERALL BALANCE WAS RETAINED. THE EXEMPTION OF INTEREST PAID TO THIRD COUNTRY RESIDENTS AND ON EUROSECURITIES WAS NECESSARY IN ORDER TO ATTRACT FUNDS AND TO PROTECT THE EUROBOND MARKET. THE COMMISSION'S PROPOSALS WERE MINIMALIST MEASURES DESIGNED TO PROVIDE NECESSARY ACCOMPANIMENT TO THE LIBERALISATION OF CAPITAL MOVEMENTS.

GENERAL STATEMENTS OF POSITION

4. BEREGOVY (FRANCE), MAYSTADT (BELGIUM), CALAMIA (ITALY), PEREZ (SPAIN), REYNOLDS (IRELAND) AND CADILHE (PORTUGAL) REAFFIRMED THEIR GENERAL SUPPORT FOR THE PROPOSAL. BEREGOVY SAID THAT THE COUNCIL HAD CREATED A MORAL AND POLITICAL LINK BETWEEN THE TAXATION OF SAVINGS AND THE LIBERALISATION OF CAPITAL MOVEMENTS IN JUNE 1988. FRANCE COULD BE FLEXIBLE ON DETAILS: BUT THE LIBERALISATION OF CAPITAL MOVEMENTS MUST BE ACCOMPANIED BY A MINIMUM DEGREE OF TAX HARMONISATION AND MEASURES TO DISCOURAGE TAX FRAUDS. CALAMIA AGREED. CADILHE WENT FURTHER, SAYING THAT PORTUGAL COULD NOT LIBERALISE CAPITAL MOVEMENTS IN THE ABSENCE OF AGREEMENT ON MEASURES SUCH AS THOSE PROPOSED BY THE COMMISSION.

5. THE CHANCELLOR OF THE EXCHEQUER, SANTER (LUXEMBOURG) AND RUDING (NETHERLANDS) CONFIRMED THE OPPOSITION TO THE PROPOSAL VOICED AT THE FEBRUARY ECOFIN. THE CHANCELLOR SAID THAT IN JUNE 1988 ECOFIN HAD DECIDED NOT TO MAKE THE LIBERALISATION OF CAPITAL MOVEMENTS CONDITIONAL ON AGREEMENT ON MEASURES RELATING TO THE TAXATION OF SAVINGS. THE CAPITAL MOVEMENTS DIRECTIVE OF JUNE 1988 PROVIDED MERELY THAT THE COMMISSION SHOULD MAKE PROPOSALS ON THIS SUBJECT AND THAT THE COUNCIL SHOULD TAKE A POSITION BY THE END OF JUNE 1989. THE PROPOSED WITHHOLDING TAX PROPOSAL WOULD NOT COMBAT FRAUD: IT WOULD HARM THE DEVELOPMENT OF COMMUNITY FINANCIAL MARKETS. THE COMMISSION HAD BEEN OBLIGED BY THE 1988 CAPITAL MOVEMENTS DIRECTIVE TO PRESENT PROPOSALS: THE COUNCIL'S OBLIGATION NOW WAS TO REJECT THEM.

6. RUDING PROMISED TO CIRCULATE A PAPER SETTING OUT DUTCH COMMENTS ON THE COMMISSION'S PROPOSALS: AND REMINDED THE COUNCIL THAT AGREEMENT ON MEASURES SUCH AS THOSE PROPOSED BY THE COMMISSION WAS ESSENTIAL WAS NO MORE NECESSARY FOR COMPLETION OF THE INTERNAL MARKET THAN FOR THE LIBERALISATION OF CAPITAL MOVEMENTS. SANTER LISTED THE RISKS ATTACHED TO THE PROPOSED WITHHOLDING TAX (FLIGHT OF CAPITAL, AN INCREASE IN PRE TAX INTEREST RATES AND, LESS CREDIBLY, THE STABILITY OF THE EMS) AND SAID THAT LUXEMBOURG OPPOSED THE WITHHOLDING TAX IN PRINCIPLE.

7. TWO NEW OPPONENTS OF THE WITHHOLDING TAX EMERGED: GREECE AND DENMARK. HELVIG PETERSEN (DENMARK) SAID THAT THE WITHHOLDING TAX WAS NOT A REALISTIC PROPOSAL. IT WOULD BE INEFFECTIVE AND WOULD CAUSE MAJOR ADMINISTRATIVE DIFFICULTIES. MINISTERS SHOULD BE GIVEN THE CHANCE TO CHOOSE BETWEEN THE WITHHOLDING TAX AND A REQUIREMENT FOR BANKS TO TELL THE RELEVANT TAX AUTHORITIES OF INTEREST PAID TO COMMUNITY RESIDENTS (I.E. AN EC VERSION OF THE DANISH SYSTEM).

8. PAPANIKOLAOU (GREECE) SAID THAT THE WITHHOLDING TAX PROPOSAL WOULD SERIOUSLY REDUCE THE FLOW OF REMITTANCES BY GREEK MIGRANT WORKERS, AN IMPORTANT FINANCIAL FLOW FOR THE GREEK ECONOMY. IT THEREFORE POSED MAJOR PROBLEMS FOR GREECE. HE STOPPED SHORT OF DESCRIBING THE GREEK POSITION AS OUTRIGHT OPPOSITION: BUT DID NOT OBJECT WHEN THE CHANCELLOR AND RUDING DESCRIBED IT AS SUCH.

9. THE CHANCELLOR AND RUDING REFERRED TO REPORTS OF DOUBTS BY THE GERMAN FINANCE MINISTER DESIGNATE, WAIGL, ABOUT THE FUTURE OF THE GERMAN WITHHOLDING TAX AND TO THE SURGE IN THE MARK WHICH RUMOURS OF WAIGL'S VIEWS HAD CAUSED, TIETMEYER (GERMANY) SAID THAT ONLY THE DETAILS OF THE GERMAN WITHHOLDING TAX (E.G. ITS APPLICATION TO SMALL SAVERS) WERE LIKELY TO BE EXAMINED: GERMANY STILL WANTED A COMMUNITY AGREEMENT ON THIS SUBJECT.

EXEMPTIONS

10. OF THOSE WHO ADDRESSED THE PRESIDENCY'S DETAILED QUESTION NO ONE OBJECTED TO THE EXEMPTION OF INTEREST PAID UNDER SCHEMES TO ENCOURAGE SMALL SAVINGS.

11. OPINIONS WERE DIVIDED ON OTHER EXEMPTIONS. TIETMEYER, CALAMIA, PAPANIKOLAOU, REYNOLDS AND BEREGOVY EITHER SUPPORTED OR COULD ACCEPT THE EXEMPTION OF INTEREST ON EUROBONDS. CADILHE AND PEREZ WERE OPPOSED. MAYSTADT OBTAINED MRS SCRIVENER'S AGREEMENT TO THE PROPOSITION THAT MEMBER STATES COULD EXEMPT ONLY A SUBSET OF EUROBONDS FROM THE PROPOSED WITHHOLDING TAX.

12. PEREZ, CALAMIA AND REYNOLDS SUPPORTED THE EXEMPTION OF INTEREST PAID TO THIRD COUNTRY RESIDENTS: CADILHE AND TIETMEYER WERE OPPOSED: PAPANIKOLAOU AND MAYSTADT THOUGHT THAT SUCH INTEREST SHOULD BE EXEMPT ONLY WHEN DOUBLE TAXATION AGREEMENTS SO PROVIDED.

13. PAPANIKOLAOU, MAYSTADT, CALAMIA, REYNOLDS AND CADILHE SAW DIFFICULTIES IN APPLYING A WITHHOLDING TAX TO PRE-ZERO DEBT INSTRUMENTS: BEREGOVY, PEREZ AND TIETMEYER ARGUED AGAINST ANY SUCH EXEMPTION.

14. NO SIGNIFICANT COMMENTS ON COOPERATION AMONG FISCAL AUTHORITIES APART FROM DUTCH AND DANISH SUPPORT FOR CROSS REPORTING OBLIGATIONS AS A BETTER WAY TO COMBAT TAX FRAUD THAN ON WITHHOLDING TAX.

PROCEDURE

15. SUMMING UP, SOLCHAGA (PRESIDENCY) SAID THAT SOME MEMBER STATES SAW MAJOR DIFFICULTIES IN THE COMMISSION'S PROPOSALS. BUT THE COUNCIL WAS OBLIGED TO EXHAUST ALL POSSIBILITIES IN ORDER TO REACH AGREEMENT BY 30 JUNE. THE HIGH LEVEL GROUP SHOULD MEET AGAIN ON 12 MAY: FINANCE MINISTERS SHOULD RECONSIDER THE DOSSIER AT THEIR INFORMAL MEETING IN MAY.

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ECOFIN 17 APRIL: 18TH VAT DIRECTIVE

SUMMARY

1. DIRECTIVE AGREED BY ALL EXCEPT THE NETHERLANDS, WHO NEED TO CLEAR ONE POINT (INSURANCE SERVICES) WITH THE HAGUE PRIOR TO JUNE ECOFIN. COMMISSION SILENT ON ARTICLE SAFEGUARDING UK TAX TREATMENT OF SPORT AND CULTURE.

DETAIL

2. DISCUSSION FOCUSED ON THE NEW PRESIDENCY COMPROMISE, AMENDED IN THE LIGHT OF COREPER 13 APRIL, DESIGNED TO BREAK THE FIVE YEAR DEADLOCK ON THE ENDING OF CERTAIN DEROGATIONS FROM THE SIXTH VAT DIRECTIVE (NOT ZERO RATES) - DOCUMENT 6016/89.

3. KONING (STATE SECRETARY IN THE DUTCH FINANCE MINISTRY) BEGAN BY STATING THAT THE NETHERLANDS COULD NOT AGREE TO THE EARLY ENDING DEROGATION F11 (WHICH ALLOWS EXEMPTION OF CERTAIN INSURANCE CLAIM SERVICES). BUT HE CAME UNDER PRESSURE FROM MAYSTADT (BELGIUM) WHO POINTED TO THE DISTORTIONS OF COMPETITION THIS DEROGATION CAUSED: AND TIETMEYER (FRG) WHO SAID GERMANY COULD ACCEPT THE PRESIDENCY COMPROMISE (INCLUDING THE NEW TEXT ON GOLD AND TRAVEL AGENTS) ONLY IF IT WAS LEFT INTACAT AND THE NETHERLANDS LIFTED THEIR RESERVE. HE THEREFORE UNDERTOOK TO CONSULT THE DUTCH CABINET AND PARLIAMENT AND REPORT BACK TO PRESIDENCY IN TIME FOR THE JUNE ECOFIN.

4. THE COMMISSION SAID NOTHING.

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ECOFIN 17 APRIL: DIRECT TAX MEASURES TO ENCOURAGE CROSS-BORDER
COOPERATION

SUMMARY

1. SOME INDICATIONS OF FLEXIBILITY FROM GERMANY ON SHARE EXCHANGES AND WITHHOLDING TAX RATES ON DISTRIBUTED PROFITS: BUT BELGIUM AND THE NETHERLANDS NOT PREPARED TO BUDGE AT THIS STAGE. BACK TO WORKING GROUP AND COREPER.

DETAIL

2. DISCUSSION FOCUSED ON COMPROMISE (DOC 5915/89) DESIGNED TO OVERCOME WHAT THE PRESIDENCY SAW AS THE MAJOR OUTSTANDING PROBLEMS ON THE TWO DIRECTIVES. (THE DRAFT MERGERS DIRECTIVE SEEKS TO ELIMINATE TAX AS AN IMPEDIMENT TO CROSS-FRONTIER TAKEOVERS, MERGERS AND SHARE EXCHANGES: THE DRAFT PARENTS AND SUBSIDIARIES DIRECTIVE TO END THE LEVYING OF WITHHOLDING TAXES ON PROFITS DISTRIBUTED TO ITS PARENT BY A SUBSIDIARY IN ANOTHER MEMBER STATE.)

3. CADILHE (PORTUGAL) STRESSED THE IMPORTANCE OF THE PORTUGUESE DEROGATION ON PARENTS AND SUBSIDIARIES, WHICH THEY COULD ACCEPT AS PROPOSED IF THE PERIOD WAS EXTENDED TO 8 YEARS (5 YEARS AT 15 PERCENT, 3 AT 10 PERCENT).

4. MAYSTADT (BELGIUM) AND KONING (NETHERLANDS) REHEARSED THEIR OPPOSITION TO THE NOTION OF GERMANY ACCORDING MORE FAVOURABLE TREATMENT TO THIRD COUNTRY BILATERAL PARTNERS (E.G. US, SWITZERLAND) THAN TO OTHER MEMBER STATES. KONING COULD WITH DIFFICULTY ACCEPT THE WORKER PARTICIPATION PROVISIONS (ALTHOUGH THEY WERE OUT OF PLACE IN A TAX DIRECTIVE) IF GERMANY WERE FLEXIBLE ON SHARE EXCHANGES AND WITHHOLDING TAXES.

5. TIETMEYER (FRG) COULD ACCEPT THE OVERALL COMPROMISE PROVIDED (A) THAT THE WORDING OF ARTICLE 14 (SAFEGUARDING GERMANY'S WORKER PARTICIPATION SYSTEM) REMAINED INTACT AND (B) THAT THE TRIGGER POINT FOR ENDING GERMAN WITHHOLDING TAX WAS A GAP OF 10 (RATHER THAN 11 AS IN THE COMPROMISE) PERCENTAGE POINTS BETWEEN GERMAN RATES OF CORPORATION TAX ON RETAINED AND DISTRIBUTED PROFITS. IF THESE POINTS COULD BE AGREED, HE WAS PREPARED TO JUSTIFY TO PARLIAMENT THE LIFTING OF THE RESERVE ON SHARE EXCHANGES, WHICH WOULD IN EFFECT BE REVERSING RECENT LEGISLATION DESIGNED TO PREVENT RECURRENCE OF THE FLICK TAX SCANDAL.

6. IN RESPONSE TO FURTHER NEGATIVE INTERVENTIONS BY KONING, TIETMEYER OFFERED AS A POSSIBLE CONCESSION THE REDUCTION TO 5 PERCENT OF THE GERMAN WITHHOLDING TAX RATE ONE YEAR EARLIER THAN PROPOSED. BUT WHEN KONING REFUSED TO SIGN UP ON THE SPOT, TIETMEYER WITHDREW THE OFFER.

7. MRS SCRIVENER (COMMISSION) SAID THAT SOME POLITICAL COMMITMENT TO THESE MEASURES WAS REQUIRED IF AGREEMENT WAS GOING TO BE REACHED. SOLCHAGA (PRESIDENCY) CONCLUDED THAT COREPER SHOULD TRY TO PREPARE A POLITICAL AGREEMENT IN TIME FOR THE JUNE ECOFIN. (THE PRESIDENCY CONFIRM THAT WORK WILL ALSO CONTINUE IN THE FINANCIAL QUESTIONS GROUP).

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ECOFIN 17 APRIL: ABOLITION OF FISCAL FRONTIERS

SUMMARY

1. PRESIDENCY PROGRESS REPORT STRESSES NEED FOR CONSIDERATION OF ALTERNATIVE APPROACHES. COMMISSIONER SCRIVENER PLEDGES CONSTRUCTIVE COOPERATION AND FLEXIBILITY: AND WILL REPORT TO COMMISSION IN MID-MAY ON CLEARING HOUSE, VAT RATES AND COVERAGE AND EXCISE DUTIES. PRESSURE FROM PRESIDENCY AND OTHERS TO RECEIVE COMMISSION'S REPORT IN GOOD TIME FOR DISCUSSION AT INFORMAL MAY ECOFIN.

DETAIL

2. WESTENDORP (PRESIDENCY) REPORTED ON PROGRESS IN COREPER AND THE VARIOUS WORKING GROUPS. IT WAS CLEAR THAT MANY MEMBER STATES DID NOT BELIEVE THAT THE ABOLITION OF FISCAL FRONTIERS REQUIRED A FUNDAMENTAL CHANGE IN THE WAY VAT WAS COLLECTED. AND EVEN THOSE WHO WERE NOT OPPOSED TO THE ORIGIN SYSTEM (TAXING EXPORTS AND ZERO RATING IMPORTS) HAD SERIOUS PROBLEMS IN ACCEPTING THE CLEARING HOUSE PROPOSAL.

3. DELEGATIONS HAD THEREFORE BEEN ASKED TO SUBMIT PAPERS OUTLINING ANY ALTERNATIVE APPROACHES THEY FAVOURED: SOME HAD ALREADY DONE SO AND OTHERS WERE EXPECTED TO FOLLOW SUIT. DISCUSSION OF THESE PAPERS WOULD CONTINUE IN COREPER AND COMPARISONS WITH THE CLEARING HOUSE PROPOSAL WOULD BE POSSIBLE WHEN THE COMMISSION REPORTED.

4. MRS SCRIVENER (COMMISSION) SPOKE BRIEFLY IN TERMS SIMILAR TO THOSE SHE HAD USED INFORMALLY IN COREPER ON 6 APRIL AND IN THE EUROPEAN PARLIAMENT ON 10 APRIL. THERE WAS NO PROSPECT OF UNANIMOUS AGREEMENT ON THE VAT CLEARING HOUSE OR HARMONISED EXCISE DUTIES, SO THE COMMISSION WAS PREPARED TO COOPERATE IN THE SEARCH FOR CONSTRUCTIVE ALTERNATIVE SOLUTIONS, INCLUDING THOSE NOW ON THE TABLE. SHE WOULD PUT NEW PROPOSALS TO HER COMMISSION COLLEAGUES ON

BOTH QUESTIONS AND REPORT PROGRESS ON VAT RATES (INCLUDING ZERO) AND COVERAGE.

5. UNDER PRESSURE FROM RUDING (NETHERLANDS), BEREGOVY (FRANCE) AND SOLCHAGA (PRESIDENCY), MRS SCRIVENER UNDERTOOK TO DO ALL SHE COULD TO PRODUCE A WRITTEN REPORT OF THE COMMISSION'S DELIBERATIONS IN TIME FOR A PROPER DISCUSSION AT THE INFORMAL ECOFIN IN MAY. BEREGOVY SAID HE WOULD ALSO WELCOME BY THEN THE COMMISSION'S VIEW OF THE FRENCH ALTERNATIVE PROPOSALS, WHICH WERE DESIGNED NOT AS A SUBSTITUTE FOR TAX APPROXIMATION, BUT AS A FIRST PRACTICAL STEP ACHIEVABLE BEFORE 1993. (NOTE: THE FRENCH PAPER CIRCULATED TODAY (BY MUFAX TO ALLEN, CUSTOMS) DIFFERS FROM THE FRENCH CUSTOMS PROPOSAL OF EARLIER THIS YEAR).

6. REYNOLDS (IRELAND) STRESSED AGAIN THE BUDGETARY IMPACT TAX APPROXIMATION WOULD HAVE AND SUGGESTED AN AD HOC GROUP TO STUDY THE PROBLEM.

7. TIETMEYER (FRG) TOOK THE OPPORTUNITY TO CALL FOR EARLY DISCUSSION OF THE REVISED 7TH VAT DIRECTIVE (ON SECONDHAND GOODS AND COLLECTOR'S ITEMS).

8. PETERSEN (DENMARK) RECOMMENDED THE SIMPLICITY OF A SINGLE VAT RATE SYSTEM, WHICH HE THOUGHT DENMARK SHOULD KEEP IF IT SO CHOSE.

9. HANNAY (UK) WELCOMED THE COMMISSION'S CONSTRUCTIVE APPROACH AND THEIR RECOGNITION OF THE IMPOSSIBILITY OF REACHING AGREEMENT ON THE CLEARING HOUSE AND HARMONISED EXCISE DUTIES. HE COMMENDED THE UK'S ALTERNATIVE SOLUTION AND THE IMPORTANCE OF AVOIDING EXTRA BURDENS ON BUSINESS: AND STRESSED AGAIN THE IMPORTANCE OF UK ZERO RATES.

10. SOLCHAGA CONCLUDED THAT, IF THE COMMISSION COULD MEET THE TIMETABLE OUTLINED, MAY'S INFORMAL ECOFIN AGENDA WOULD INCLUDE THIS DOSSIER.

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CHANCELLOR'S MEETING WITH LUXEMBOURG FINANCE MINISTER

SUMMARY

1. POOS CONFIRMS LUXEMBOURG POSITIONS ON WITHHOLDING TAX AND BANKING RECIPROCITY. HE INDICATES, ON A PERSONAL BASIS, CAUTION ABOUT TOO-RAPID IMPLEMENTATION OF DELORS REPORT CONCLUSIONS.

DETAIL

2. THE CHANCELLOR HAD A BILATERAL MEETING WITH THE LUXEMBOURG ECONOMICS MINISTER, POOS, BEFORE THE ECOFIN LUNCH TODAY. THREE ISSUES WERE DISCUSSED: WITHHOLDING TAX, THE DELORS REPORT AND BANKING RECIPROCITY.

WITHHOLDING TAX

3. POOS SAID THAT THE LUXEMBOURG AND UK POSITIONS WERE SIMILAR. (THE CHANCELLOR AGREED). THE QUESTION WAS WHETHER TO REMIT THE PROPOSAL AGAIN TO THE AD HOC GROUP, OR TO SEEK TO KILL IT OFF IMMEDIATELY.

4. THE CHANCELLOR DOUBTED THAT IT WOULD BE POSSIBLE TO END DISCUSSIONS NOW. THERE WOULD BE FURTHER CONSIDERATION OF BOTH THE WITHHOLDING TAX AND THE EXCHANGE OF INFORMATION BETWEEN FISCS. THE UK POSITION ON THIS, OR ANY, WITHHOLDING TAX WAS CLEAR: IT WOULD NOT ACHIEVE THE ENDS FOR WHICH IT WAS PROMOTED, AND IT WOULD DAMAGE THE COMMUNITY AS A WHOLE. POOS AGREED WITH THIS ANALYSIS. LUXEMBOURG WOULD CONTINUE TO OPPOSE THE PROPOSALS REGARDLESS OF THE OUTCOME OF THE ELECTION IN JUNE.

DELORS REPORT

5. POOS SAID THAT LUXEMBOURG'S REPRESENTATIVE ON THE DELORS GROUP HAD ACCEPTED THE FINAL DRAFT OF THE REPORT, INCLUDING ITS PROPOSAL

THAT FURTHER DEVELOPMENTS SHOULD TAKE PLACE IN THREE STAGES. THE POINT OF INTEREST WAS WHEN DISCUSSION OF TREATY AMENDMENT SHOULD BEGIN. SPEAKING PERSONALLY, HE THOUGHT THIS SHOULD NOT BE UNTIL AFTER 1992. IT WAS TOO EARLY TO START SUCH A DISCUSSION NOW.

6. THE CHANCELLOR SAID THE INSTITUTIONAL PROBLEM WAS A REAL ONE. IT WAS MOST UNFORTUNATE THAT THE REPORT HAD RECOMMENDED THAT PREPARATORY WORK ON TREATY CHANGE SHOULD BEGIN IMMEDIATELY. POOS SAID THAT IT MIGHT BE POSSIBLE TO MUSTER A MAJORITY IN MADRID IN FAVOUR OF STARTING WORK IMMEDIATELY. BUT THIS WOULD SIMPLY CREATE AN IMPASSE. THE TREATY WAS A CONSTITUTIONAL DOCUMENT. IT COULD NOT BE AMENDED EVERY YEAR OR TWO.

RECIPROCITY

7. THE CHANCELLOR SAID THAT THE LATEST DRAFT TEXT WAS A CONSIDERABLE IMPROVEMENT ON THE ORIGINAL. FURTHER CHANGES WERE NECESSARY BUT, IF PEOPLE WERE PREPARED TO BE FLEXIBLE, HE FORESAW AGREEMENT BEFORE LONG.

8. POOS SAID THAT LUXEMBOURG COULD NOT ACCEPT THAT THE COMMISSION SHOULD HAVE THE POWER TO DECIDE ON RETALIATION AS PROPOSED IN ARTICLE 5 OF THE REVISED PROPOSAL. THIS MEANT THAT THE COMMISSION MIGHT BLOCK AUTHORISATIONS AND ACQUISITIONS. LUXEMBOURG WAS ALSO CONCERNED THAT, IF ADOPTED, THE PROPOSAL MIGHT ENCOURAGE SIMILAR PROPOSALS TO DEAL WITH INWARD INDUSTRIAL INVESTMENT.

9. THE CHANCELLOR SAID WE SHARED THE VIEW THAT ANY EVENTUAL RETALIATORY ACTION SHOULD BE IN THE HANDS OF THE COUNCIL, NOT THE COMMISSION. ACTION OF THIS SORT SHOULD ONLY BE TAKEN IF IT WAS ABSOLUTELY ESSENTIAL AND IF IT WERE THOUGHT LIKELY TO BE EFFECTIVE. THAT WAS A POLITICAL DECISION. WE OUGHT TO BE ABLE TO SECURE A CHANGE IN THE TEXT ALONG THESE LINES. WE ALSO AGREED THAT RECIPROCITY OVER INDUSTRIAL INVESTMENT REGULATIONS WAS COMPLETELY UNACCEPTABLE. BUT THERE WAS NO TREATY BASE, AND IT DID NOT SEEM A REALISTIC POSSIBILITY.

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TO IMMEDIATE FCO

TELNO 101

OF 171730Z APRIL 89

INFO IMMEDIATE EUROPEAN COMMUNITY POSTS, WASHINGTON, TOKYO, BERNE
INFO IMMEDIATE VIENNA, OSLO, STOCKHOLM, UKDEL OECD

FROM UKREP BRUSSELS

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DELORS COMMITTEE REPORT ON EMU: CHANCELLOR'S PRESS CONFERENCE, 17
APRIL 1989

1. AT HIS PRESS CONFERENCE THIS AFTERNOON, WHICH FOLLOWED
DELORS', THE CHANCELLOR MADE THE FOLLOWING OPENING STATEMENT:

'AT LUNCH, WE HAD A VERY LUCID PRESENTATION BY THE CHAIRMAN OF THE
COMMITTEE ON ECONOMIC AND MONETARY UNION, MR DELORS. WE AGREED THAT
WE WOULD DISCUSS THIS IN DEPTH AT THE INFORMAL ECOFIN NEXT MONTH. IN
MY OPINION, THE REPORT IS AN EXTREMELY VALUABLE AND THOROUGH PIECE
OF ANALYSIS. IT BRINGS OUT A NUMBER OF THINGS VERY CLEARLY. FIRST,
THE FUNDAMENTAL NATURE OF EMU, AND THE FACT, AS THE REPORT SAYS,
THAT THIS WOULD BE A QUANTUM LEAP COMPARED TO ANYTHING THAT WE HAVE
AGREED TO SO FAR. SECOND, IT MAKES IT CLEAR THAT THIS WOULD NOT BE
POSSIBLE WITHIN THE TERMS OF THE EXISTING TREATY SO TREATY AMENDMENT
WOULD BE NEEDED. IT ALSO MAKES IT CLEAR THAT THERE WOULD BE A
TRANSFER OF SOVEREIGNTY FROM MEMBER STATES TO NEW CENTRAL MONETARY
AND ECONOMIC INSTITUTIONS. IT WOULD BE EASY TO SAY THAT THIS WAS
GOING TO BE A LONG PROCESS WHICH WE COULD EMBARK ON WITHOUT ANY
INTENTION OF GOING RIGHT TO THE END. BUT THAT WOULD NOT BE HONEST
AND WOULD NOT DO JUSTICE TO THIS VERY IMPORTANT REPORT. WE HAVE TO
ASK WHETHER WE WANT TO REACH THE END STAGE, HOWEVER LONG THAT MIGHT
TAKE. I MADE HMG'S VIEWS VERY CLEAR IN MY CHATHAM HOUSE SPEECH OF 25
FEBRUARY. OUR VIEW OF THE COMMUNITY IS ONE OF INDEPENDENT SOVEREIGN
NATION STATES WORKING EVERMORE CLOSELY TOGETHER. WE CANNOT ACCEPT
THE TRANSFER OF SOVEREIGNTY WHICH IS IMPLIED BY THE DELORS REPORT.
EMU AS SPELLED OUT IN THE REPORT WOULD IN EFFECT REQUIRE POLITICAL
UNION, A UNITED STATES OF EUROPE. THAT IS SIMPLY NOT ON THE AGENDA
NOW OR FOR THE FORESEEABLE FUTURE.

AS REGARDS TREATY AMENDMENT, WE ONLY RECENTLY AMENDED THE TREATY
AND THAT CAME INTO EFFECT AS RECENTLY AS 18 MONTHS AGO. THAT WAS

NECESSARY TO IMPLEMENT THE SINGLE ACT AND SINGLE MARKET. THE COMPLETION OF THE SINGLE MARKET BY 1992 IS THE MAJOR TASK OF THE COMMUNITY, TO WHICH THE UK IS TOTALLY COMMITTED. BUT THERE CAN BE NO QUESTION OF FURTHER TREATY AMENDMENT ALONG THE LINES OF THE DELORS REPORT. HAVING SAID THAT, THERE ARE A NUMBER OF THINGS WE CAN DO WITHIN THE EXISTING TREATY TO IMPROVE ECONOMIC AND MONETARY COOPERATION. SOME OF THESE ARE MENTIONED IN THE REPORT. WE WOULD BE VERY KEEN TO PRESS FORWARD WITH THESE. BUT NOT TREATY AMENDMENT OR EMU AS ENVISAGED IN THE REPORT.''

2. QUESTIONS AND ANSWERS

Q. YOU WOULD NOT HAVE SIGNED THE REPORT? THE PM WILL VETO ANY MOVE TO AN IGC?

A. A HYPOTHETICAL QUESTION. THE MEMBERS OF THE COMMITTEE WERE THERE IN THEIR PERSONAL CAPACITY. I HAVE GIVEN HMG'S VIEWS AND THAT INCLUDES THE PM'S. THIS REPORT WILL GO IN DUE COURSE TO THE EUROPEAN COUNCIL IN MADRID. THERE IS NO PROPOSAL YET ON AN IGC.

Q. WHY DO YOU NOT OPPOSE MEMBERSHIP OF ERM WHICH YOU HAVE SAID IN THE PAST YOU FAVOUR, WHEN THAT ALSO IMPLIES A TRANSFER OF SOVEREIGNTY? ANYTHING IN THE REPORT WHICH REINFORCES THE ARGUMENTS ON ERM?

A. OUR POSITION ON THE ERM OF THE EMS, WHICH IS WELL WITHIN THE EXISTING TREATY, IS CLEAR. WE WILL JOIN. THE QUESTION IS WHEN. THAT HAS ALWAYS BEEN THE CASE. THERE IS A WORLD OF DIFFERENCE BETWEEN THE EMS WHICH DOES NOT INVOLVE ANY LOSS OF NATIONAL SOVEREIGNTY AND EMU WHICH, AMONG OTHER THINGS, WOULD INVOLVE A COMMON SINGLE COMMUNITY CURRENCY AND THE ABANDONMENT OF INDIVIDUAL NATIONAL CURRENCIES. NO ONE SHOULD CONFUSE THE TWO.

Q. DO YOU AGREE WITH THE REPORTS'S ASSERTION THAT EMU IS A SINGLE PROCESS WHICH YOU HAVE TO SIGN UP TO FROM THE START?

A. TO DO THEM JUSTICE, I DO NOT THINK THE AUTHORS ARE SAYING THAT. WHAT THEY ARE REQUIRING IS A POLITICAL COMMITMENT TO THE ENTIRE PROCESS WHEN ANYONE EMBARKS ON THE FIRST STEP. THE EVENTUAL DESTINATION REPRESENTS A CONCEPT OF THE EC WHICH WE DO NOT SHARE. I BELIEVE THERE ARE A NUMBER OF OTHER COUNTRIES WHO HAVE RESERVATIONS ABOUT THE ULTIMATE OBJECTIVE ALTHOUGH WHETHER THEY MAKE THAT CLEAR AT THIS STAGE, AS I HAVE, IS ANOTHER MATTER.

Q. UK WILL BE DRAGGED INTO PROCESS, AS IT WAS ON IGC FOLLOWING

MILAN?

A. THERE IS NO QUESTION OF THAT. WE WERE NOT DRAGGED INTO THE SEA WHICH IMPLEMENTS THE SINGLE MARKET. QUITE THE CONTRARY: THE UK WAS FOREMOST IN ESPOUSING THE CASE FOR THE SINGLE MARKET. WHEN I SAY WE HAVE RESERVATIONS ABOUT EMU, WE ARE IN FAVOUR OF CLOSER COOPERATION. FOR EXAMPLE THE UK LIBERALISED CAPITAL MOVEMENTS TEN YEARS BEFORE THE COMMUNITY DECISION. WE HAVE PIONEERED THE ISSUING OF TREASURY ECU BILLS AND HAVE DEVELOPED THE ECU MARKET MORE THAN ANY OTHER COUNTRY. WE HOLD ECU'S IN OUR RESERVES, AS WELL AS OTHER COUNTRIES CURRENCIES. NOT ALL MEMBER STATES DO THAT. WE WELCOME CLOSE COOPERATION WITHIN THE COMMUNITY.

Q. POSITION OF THE GOVERNOR OF THE BANK OF ENGLAND?

A. ON THE COMMITTEE IN HIS PERSONAL CAPACITY. I UNDERSTAND HE GAVE A PRESS BRIEFING TODAY.

Q. PARA 44 OF THE REPORT IMPLIES THAT OTHER MEMBER STATES CAN GO AHEAD WITHOUT THE UK?

A. NO ONE WANTS TO SEE THE EC NEEDLESSLY DIVIDED. I AM CERTAIN THAT IS NOT DELORS' POSITION, NOR IS IT MINE. THIS IS A SUBSTANTIAL PIECE OF WORK ON A SERIOUS SUBJECT WHICH RAISES A NUMBER OF IMPORTANT ISSUES. IT IS NOW FOR THE VARIOUS COUNTRIES TO INDICATE WHERE THEY STAND ON THEM. ANY ATTEMPT TO FRAGMENT THE COMMUNITY WOULD DAMAGE IT. I THEREFORE HOPE THAT WILL NOT HAPPEN.

Q. THE OTHER MEMBER STATES WILL GO AHEAD ON A BASIS WHICH PERMITS THEM TO DO SO WITHOUT THE UK? CAN THE UK PREVENT THE COMMUNITY GOING AHEAD WITH THIS BLUEPRINT?

A. WE HAVE GOT TO SEE HOW OTHER MEMBER STATES REACT TO THE VERY FUNDAMENTAL PROPOSALS IN THIS REPORT WHICH HAS ONLY BEEN PUBLISHED TODAY. I AM NOT PREPARED TO SPECULATE AT THIS VERY EARLY STAGE ON WHAT OTHER COUNTRIES MIGHT DO. I HAVE STATED VERY CLEARLY HMG'S POSITION AND OUR RESERVATIONS ABOUT THE FINAL OBJECTIVE OF THE PROCESS OUTLINED IN THE DELORS REPORT. THE PROCESS REQUIRES TREATY AMENDMENT. THIS WOULD BE VERY PREMATURE SUCH A SHORT TIME AFTER THE MAJOR AMENDMENT INVOLVED IN THE SEA.

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FROM UKREP BRUSSELS.

ECOFIN COUNCIL: 17 APRIL 1989

CONCILIATION WITH EUROPEAN PARLIAMENT ON SUCCESSOR REGULATIONS TO
2891/77 AND 2892/77 (IMPLEMENTING REGULATIONS FOR OWN RESOURCES)

SUMMARY

1. CONCILIATION WITH EUROPEAN PARLIAMENT SUCCESSFULLY CONCLUDED
ON THE BASIS OF PRESIDENCY COMPROMISE AGREED LAST WEEK IN COREPER.
ONE OR TWO ADDITIONAL AMENDMENTS AGREED TO SATISFY EP'S REMAINING
CONCERNS, BUT NONE WHICH AFFECT THE SUBSTANCE OF EITHER REGULATION.

2. LORD PLUMB, (PRESIDENT OF PARLIAMENT) WILL PROBABLY WRITE TO
PRESIDENCY SOON TO ALLOW COUNCIL TO ADOPT REGULATIONS AS A POINTS BY
THE END OF APRIL.

DETAIL

3. IN A PRE-CONCILIATION SESSION OF THE COUNCIL, SOLCHAGA
(PRESIDENCY) ASKED WHETHER THE COMPROMISE PUT TOGETHER BY COREPER
LAST WEEK (DOCUMENT 5995/89, BY HAND OF ALLEN, HMT) WAS ACCEPTABLE
TO ALL DELEGATIONS. SUBJECT TO A UNILATERAL STATEMENT BY GERMANY ON
ARTICLE 19 OF THE NEW 2891/88 (CONTROL OF GNP BASE) THAT THE
COUNCIL'S STATEMENT RELATED SOLELY TO THE CONFIDENTIALITY OF GNP
STATISTICS AND NOT TO THE OPERATION OF THE CONTROLS, THE COMPROMISE
WAS AGREED.

CONCILIATION

4. THE EP DELEGATION WAS LED BY DANKERT (VICE-PRESIDENT OF THE
EP), CORNELISSEN (RAPPORTEUR) AND LENTZ-CORNETTE (BUDGETARY CONTROL
COMMITTEE). DANKERT COMMENDED THE PRESIDENCY'S PREPARATION OF THE
CONCILIATION AND ACCEPTED THE PRESIDENCY COMPROMISE AS A BASIS FOR
AGREEMENT. BUT A NUMBER OF POINTS REMAINED UNRESOLVED. CORNELISSEN

THEN PRESENTED THE EP'S REMAINING DEMANDS ON THE NEW REGULATION 2891/77:

A. ARTICLE 6.1: THE DECLARATION SHOULD BE AMENDED SO THAT MEMBER STATES UNDERTOOK TO PROVIDE THE COMMISSION WITH A BREAKDOWN OF TRADITIONAL OWN RESOURCES IN CONFORMITY WITH THE COMMON CUSTOMS NOMENCLATURE.

B. ARTICLE 9.1: AS OWN RESOURCES BELONGED TO THE COMMUNITY THE COMMISSION WAS ENTITLED TO INTEREST ON THE BALANCES HELD IN ITS ACCOUNTS WITH MEMBER STATES.

C. ARTICLE 12: PROBLEMS COULD STILL ARISE IF THE COMMISSION HAD TO RUN AN OVERDRAFT. DANKERT ASKED WHY THE COUNCIL COULD NOT REPEAT A STATEMENT MADE WHEN THE FIRST OWN RESOURCES DECISION WAS AGREED IN 1970: THAT, IF NECESSARY, THE COUNCIL WOULD ENSURE FUNDS WERE MADE AVAILABLE UNDER ARTICLE 201 OF THE TREATY TO COVER ANY OVERDRAFT.

D. ARTICLE 17.2: 3 MONTHS WAS TOO SHORT FOR THE COMMISSION TO RESPOND TO MEMBER STATES' EXPLANATIONS AS TO WHY SOME OWN RESOURCES COULD NOT BE PAID. THE 6 MONTHS REQUESTED BY THE COMMISSION SEEMED MORE REALISTIC.

E. ARTICLE 18.3: THEY WERE DELIGHTED THE COUNCIL HAD AGREED TO REINSTATE THIS PROVISION FOR COMMISSION INSPECTIONS ON ITS OWN AUTHORITY. THIS ISSUE COULD BE CONSIDERED SETTLED.

F. ARTICLE 23: IMPLEMENTING MEASURES UNDER THE REGULATION WERE A MATTER FOR THE COMMISSION NOT THE COUNCIL. THIS ARTICLE SHOULD BE DELETED.

G. ON THE NEW REGULATION 2892/77, LENTZ-CORNETTE ASKED FOR A REFERENCE TO 'EFFICIENCY' TO BE ADDED TO THE WHEREAS CLAUSE SETTING OUT THE COURT OF AUDITORS' ROLE IN EXAMINING REVENUE.

5. SCHMIDHUBER (COMMISSION) ALSO WELCOMED THE RE-INSTALEMENT OF ARTICLE 18.3 AS AN ESSENTIAL ANTI-FRAUD MEASURE. HE DID, HOWEVER, SUPPORT THE PARLIAMENT'S ADDITIONAL REQUESTS ON ARTICLES 6 AND 17.

6. SOLCHAGA REPLIED THAT THE COUNCIL HAD TAKEN A MAJOR STEP FORWARD IN AGREEING THAT COMMISSION ON-THE-SPOT INSPECTIONS COULD NOT BE HELD UP BY MEMBER STATES. THIS HAD BROUGHT THE EP AND COUNCIL VERY CLOSE TO AGREEMENT. HE MADE A ROBUST RESPONSE TO THE EP'S ADDITIONAL DEMANDS: (A) WAS NOT TECHNICALLY PRACTICABLE GIVEN THE THOUSANDS OF ITEMS IN THE NOMENCLATURE. (B) THE REQUEST FOR INTEREST ON COMMISSION ACCOUNTS WAS ALSO NOT FEASIBLE: IT WOULD REQUIRE CHANGES IN NATIONAL LEGISLATION AND COULD LEAD TO INEQUALITY IN PAYMENTS TO THE COMMUNITY BY DIFFERENT MEMBER STATES. THERE WAS NO DANGER OF OVERDRAFTS UNDER THE NEW FINANCING AND BUDGETARY ARRANGMENTS AGREED LAST YEAR, SO (C) WAS UNNECESSARY. ON (D), IT WAS REASONABLE FOR THE COUNCIL TO EXPECT COMMISSION COMMENTS FAIRLY

RAPIDLY. THE COUNCIL WOULD REFLECT ON (B), BUT (G) MIGHT INVOLVE SOME RE-INTERPRETATION OF ARTICLE 206A OF THE TREATY WHICH SET OUT THE ECA'S ROLE, SO IT WAS BETTER TO LEAVE THE TEXT AS IT WAS.

7. AFTER THE EP HAD WITHDRAWN, SOLCHAGA PROPOSED THAT THE COUNCIL AGREE TO DELETE ARTICLE 23 IN RETURN FOR THE PARLIAMENT ABANDONING ITS REMAINING DEMANDS. UNDER PRESSURE FROM SCHMIDHUBER, SUPPORTED BY COLOMBO (ITALY) AND MAYSTADT (BELGIUM), IT WAS AGREED TO GIVE THE COMMISSION 6 MONTHS TO CONSIDER MEMBER STATES REPORTS UNDER ARTICLE 17.2. AFTER ELLIOTT AND TIETMEYER (GERMANY) HAD POINTED OUT THAT ARTICLE 206A OF THE TREATY ALSO REQUIRED THE COURT OF AUDITORS TO EXAMINE 'GOOD MANAGEMENT', WHICH AMOUNTED TO EFFICIENCY, IT WAS ALSO AGREED TO SIMPLIFY THE WHEREAS CLAUSE TO THE NEW 2892/77 AND REFER SIMPLY TO THE ROLE ASSIGNED TO THE COURT UNDER THAT ARTICLE.

8. WHEN THE CONCILIATION MEETING RESUMED, DANKERT SAID THAT THE EP DELEGATION ACCEPTED THESE THREE ADDITIONAL CONCESSIONS AS AN ACCEPTABLE POLITICAL BASIS FOR THE CONCLUSION OF THE CONCILIATION PROCEDURE. THE DELEGATION WOULD NOW RECOMMEND AGREEMENT TO THESE REGULATIONS TO THE EP PRESIDENT AND THE NEXT PLENARY SESSION (22 MAY). HE NOTED THAT THE COMMISSION WOULD CONTINUE TO STUDY THE QUESTION OF INTEREST PAYMENTS AND MAY MAKE A FURTHER PROPOSAL IN DUE COURSE. SCHMIDHUBER CLARIFIED THAT THIS WAS PRINCIPALLY A BUDGETARY MATTER AND WOULD BE LEFT TO THE NEW PARLIAMENT TO PURSUE. DANKERT CONCLUDED BY SAYING THAT THIS CONCILIATION, FOLLOWING THAT LAST YEAR ON BUDGET DISCIPLINE, DEMONSTRATED A MORE CONSTRUCTIVE APPROACH BY THE COUNCIL TO THE CONCILIATION PROCEDURE AS A WHOLE.

9. SOLCHAGA CONCLUDED THAT THE CONCILIATION HAD BEEN SUCCESSFULLY COMPLETED AND THE REGULATIONS WOULD BE FORMALLY ADOPTED AS A POINTS BY THE COUNCIL AS SOON AS POSSIBLE. WE UNDERSTAND FROM THE COUNCIL SECRETARIAT THAT THIS COULD TAKE PLACE LATER THIS MONTH, AS SOON AS A LETTER IS RECEIVED FROM LORD PLUMB CONFIRMING THE AGREEMENT GIVEN BY THE EP DELEGATION TODAY. (FINAL CORRECTED TEXT OF AMENDMENTS AGREED TODAY BY HAND OF ALLEN, HMT.)

10. IF THESE REGULATIONS ARE SMOOTHLY ADOPTED, AS NOW SEEMS CERTAIN, THIS WILL FINALLY RESOLVE NEGOTIATIONS ON 2891/77 THAT HAVE BEEN UNDER WAY ALMOST CONTINUOUSLY SINCE 1984, AND INCORPORATE AMENDMENTS TO ARTICLE 12 OF THE REGULATION (CONCERNING OVERDRAFTS) THAT THE UK HAS BEEN SEEKING FOR FIVE YEARS.

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TELNO 103

OF 172020Z APRIL 89

INFO PRIORITY UKDEL OECD, WASHINGTON, TOKYO

INFO ROUTINE EUROPEAN COMMUNITY POSTS

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ECOFIN COUNCIL 17 APRIL 1989

SUMMARY TELEGRAM

(X DENOTES ITEMS NOT REPORTED ELSEWHERE)

1. THE CHANCELLOR, HANNAY AND ELLIOTT REPRESENTED THE UK.

2. TODAY'S COUNCIL WILL PROBABLY BE GREATLY OVERSHADOWED IN THE PRESS BY ACTION OFFSTAGE: WHILE THE COUNCIL WAS DISCUSSING THE TAXATION OF SAVINGS, DELORS WAS PRESENTING HIS GROUP'S REPORT ON EMU TO THE PRESS. BUT THREE SIGNIFICANT PIECES OF ACTION TOOK PLACE IN THE COUNCIL OR OVER LUNCH. THERE WAS A GENERAL WELCOME FOR SIR LEON BRITTAN'S REVISED RECIPROCITY ARTICLE FOR THE DRAFT SECOND BANKING COORDINATION DIRECTIVE: MRS SCRIVENER CONFIRMED THE COMMISSION'S FLEXIBILITY ON IMPORTANT ASPECTS OF THE INDIRECT TAX DOSSIER AND SOLCHAGA THE PRESIDENCY'S DETERMINATION TO MAKE AS MUCH HEADWAY AS POSSIBLE ON THIS SUBJECT: WHILE DENMARK AND (ALMOST CERTAINLY) GREECE JOINED THE RANKS OF THE OPPONENTS TO THE COMMISSION'S WITHHOLDING TAX PROPOSALS.

A POINTS (X)

3. ALL AGREED AS IN DOC 5945/89 IE INCLUDING ANNUAL ADJUSTMENT OF THE FINANCIAL PERSPECTIVE AND AGREEMENT ON A REFERENCE FRAMEWORK FOR 'OTHER COMPULSORY EXPENDITURE' FOR 1990 (GERMAN STATEMENT ON THIS REPORTED SEPARATELY): FINAL ADOPTION OF PUBLIC OFFER PROSPECTUSES DIRECTIVE: AND CONFIRMATION OF AGREEMENT REACHED IN COREPER ON 13 APRIL ON EC STATISTICAL PROGRAMME 1989/92 (SEE UKREP TELNO 1102), FINAL ADOPTION OF WHICH AWAITS AN EP OPINION.

PREPARATION FOR AND CONCILIATION WITH EP ON OWN RESOURCES SUCCESSOR REGULATIONS TO 2891/77 AND 2892/77

4. CONCILIATION WITH EP SUCCESSFULLY CONCLUDED ON BASIS OF

PRESIDENCY COMPROMISE AGREED LAST WEEK IN COREPER. ONE OR TWO ADDITIONAL AMENDMENTS AGREED TO SATISFY EP'S REMAINING CONCERNS, BUT NONE AFFECT SUBSTANCE OF EITHER REGULATION.

5. LORD PLUMB (EP PRESIDENT) WILL PROBABLY WRITE TO PRESIDENCY SOON TO ALLOW COUNCIL TO ADOPT REGULATIONS AS A POINTS BY END APRIL.

OWN FUNDS OF CREDIT INSTITUTIONS

6. COMMISSION DISTRIBUTED A REVISED PROPOSAL (BEING FAXED SEPARATELY TO KROLL, HMT) REINSTATING REGULATORY COMMITTEE PROCEDURE IIIA (THE 'FILET') WHICH FEATURED IN THEIR ORIGINAL PROPOSAL. SIR L BRITTAN (COMMISSION) RECALLED THAT WHEN THE COUNCIL HAD UNANIMOUSLY ADOPTED ITS COMMON POSITION IN DECEMBER RETAINING IMPLEMENTING POWERS TO ITSELF FOR THE TIME BEING, THE COMMISSION HAD REGRETTED THIS DECISION: THE EP HAD SINCE RECOMMENDED AT ITS SECOND READING THE USE OF THE MANAGEMENT COMMITTEE IIB (DOC 5639/89). THE COMMISSION HAD REJECTED THIS IN ITS REVISED PROPOSAL: IT WOULD HAVE GIVEN THE COUNCIL EVEN LESS CONTROL OVER IMPLEMENTATION: THEY HAD DECIDED TO REINSTATE THEIR ORIGINAL SUGGESTION FOR A 'FILET' PROCEDURE AS THE APPROPRIATE SOLUTION. SOLCHAGA (PRESIDENCY) NOTED COREPER'S RECENT REAFFIRMATION OF THE COMMON POSITION REACHED IN DECEMBER (4020/89): MINISTERS THEREUPON UNANIMOUSLY REJECTED THE COMMISSION'S REVISED PROPOSAL AND THE COMMON POSITION WAS FINALLY ADOPTED.

TAXATION OF SAVINGS

7. DENMARK AND (ALMOST CERTAINLY GREECE) JOIN NETHERLANDS, LUXEMBOURG AND UK IN OPPOSING WITHHOLDING TAX: BUT FURTHER DISCUSSION TO TAKE PLACE IN HIGH LEVEL GROUP (12 MAY) AND AT MAY INFORMAL ECOFIN.

DIRECT TAX MEASURES TO ENCOURAGE CROSS BORDER COOPERATION

8. SOME INDICATIONS OF FLEXIBILITY FROM GERMANY ON SHARE EXCHANGES AND WITHHOLDING TAX RATES ON DISTRIBUTED PROFITS: BUT BELGIUM AND NETHERLANDS NOT PREPARED TO BUDGE AT THIS STAGE. BACK TO WORKING GROUP AND COREPER.

18TH VAT DIRECTIVE

9. DIRECTIVE AGREED BY ALL EXCEPT NETHERLANDS, WHO NEED TO CLEAR ONE POINT (INSURANCE SERVICES) WITH THE HAGUE PRIOR TO JUNE ECOFIN. COMMISSION SILENT ON ARTICLE SAFEGUARDING UK TAX TREATMENT OF SPORT AND CULTURE.

ABOLITION OF FISCAL FRONTIERS

10. PRESIDENCY PROGRESS REPORT STRESSES NEED FOR CONSIDERATION OF ALTERNATIVE APPROACHES. COMMISSIONER SCRIVENER PLEDGES CONSTRUCTIVE COOPERATION AND FLEXIBILITY: AND WILL REPORT TO COMMISSION COLLEAGUES IN MID-MAY ON CLEARING HOUSE, VAT RATES AND COVERAGE AND EXCISE DUTIES. PRESSURE FROM PRESIDENCY AND OTHERS TO RECEIVE COMMISSION'S REPORT IN GOOD TIME FOR DISCUSSION AT INFORMAL MAY ECOFIN.

LUNCH DISCUSSION: DELORS GROUP REPORT ON EMU, AND RECIPROCITY IN BANKING (X)

A. EMU (X)

11. OVER LUNCH, PRESIDENT DELORS (COMMISSION), IN ADVANCE OF A PRESS CONFERENCE, OUTLINED THE MAIN FEATURES OF HIS GROUP'S REPORT ON EMU. MEMBER STATES WOULD RETAIN THEIR SOVEREIGNTY. NO IMMEDIATE NEED FOR INCREASED REGIONAL AND STRUCTURAL SPENDING HAD BEEN IDENTIFIED (ALTHOUGH THIS MIGHT BE REQUIRED AT SOME POINT). THERE WAS LITTLE DISCUSSION: THE CHANCELLOR REITERATED THE UK'S POSITION STRESSING - INTER ALIA - THE NATIONAL SOVEREIGNTY IMPLICATIONS OF EMU. BEREGOVY (FRANCE) AGREED THAT THIS WAS THE CRUCIAL ISSUE: ONE SHOULD NOT PREJUDGE NOW WHETHER SOVEREIGNTY SHOULD BE ABANDONED: BUT HE IMPLIED THAT FRANCE COULD EMBARK ON STAGE ONE WITHOUT ANY COMMITMENT TO FOLLOWING THROUGH ALL THE RECOMMENDATIONS TO THE END: HE EXPRESSED SURPRISE THAT THE REPORT HAD BEEN UNANIMOUS. SOLCHAGA SAID THERE WOULD BE A FULL DISCUSSION AT THE INFORMAL ECOFIN IN MAY: THE PRESIDENCY WOULD ALSO BE LOOKING FOR A POLITICAL DECLARATION AT THE MADRID SUMMIT IN JUNE.

B. BANKING RECIPROCITY (X)

12. THE COMMISSION'S NEW RECIPROCITY PROVISION IN THE SECOND BANKING DIRECTIVE WAS GENERALLY WELCOMED, INDEED RECEIVING STRONG FRENCH SUPPORT. THE CHANCELLOR SAID IT WAS A USEFUL STEP TOWARDS AN AGREEMENT, ALTHOUGH INTER ALIA THERE HAD TO BE A CLEAR DE-COUPLING BETWEEN AUTHORISATION AND ANY CONSIDERATION OF RECIPROCITY: AND ANY USE OF RECIPROCITY POWERS MUST BE CONSIDERED BY THE COUNCIL, NOT THROUGH A COMITOLGY PROCEDURE. TIETMEYER (GERMANY) AGREED AND WITH RUDING (NETHERLANDS) POINTED TO THE DIFFICULTIES OF DEFINING SUCH THINGS AS 'THE SAME COMPETITIVE OPPORTUNITIES' (THE ABSENCE OF WHICH WAS ONE OF THE TRIGGERS FOR POSSIBLE COMMUNITY ACTION). IN THE LATTER CASE, SIR L BRITTAN EXPLAINED THAT THE COMMISSION WISHED TO ENSURE THAT NATIONAL TREATMENT WAS NOT MERELY LEGISLATED FOR, BUT GENUINELY IMPLEMENTED. SOLCHAGA LOOKED TO CONSTRUCTIVE NEGOTIATIONS IN COREPER, PAVING THE WAY FOR AN AGREEMENT AT THE JUNE ECOFIN (THOUGH IT WAS NOT CLEAR WHETHER BY THIS HE WAS AIMING FOR A COMMON POSITION ON THE WHOLE DIRECTIVE).

13. IN THE MARGINS, THE CHANCELLOR HELD A BILATERAL WITH POOS (LUXEMBOURG) ON THE 2 ABOVE LUNCH ITEMS AND ON TAX ON SAVINGS.

14. FOR DETAILS SEE MY 7 IFTS.

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FROM: J C MAY - AEF1
 DATE: 18 April 1989
 Ext: 4902

PJS Chancellor ✓

MR LANKESTER

cc: Mr Mountfield (AEF)
 Mr Evans (IF)
 Mr Davis (AEF1)
 Mr Walsh (IF)
 Mrs Flint (AEF1)
Mr. Bottrill AEF2.

NIGERIA: DISBURSEMENT OF UK PROGRAMME AID

You wanted to know the latest position on plans for disbursing the UK aid for your meeting tomorrow with Mr Jimenez, the IMF team leader in Nigeria.

2. Two draft exchange of letters (EOL), covering the tied and untied portion of the \$100 million aid have been sent to the High Commission in Lagos for clearance and signature with the Nigerians. ODA are awaiting confirmation that these have been signed: thereafter they can commence disbursement. ODA and Crown Agents are ready to move once the Nigerians ask for the money.

3. The tied portion of the aid, £10 million, will be disbursed using direct procurement according to the normal procedures: Crown Agents will act as agents, using a negative list but without any end user appraisal. The untied element will be disbursed via reimbursement for imports, outside the negative list, already made through Nigeria's Inter-bank Foreign Exchange Market. (IFEM) Procedures for the untied element will be similar to those adopted by the World Bank for its Trade and Investment Policy Loan (TIPL) and for Japanese co-financing with that loan. There will be an additional price check to ensure reasonable value for money is achieved.

4. While ODA expect to be able to disburse the main, untied, element of the grant before the end of 1989 they are far less optimistic on the tied portion - in fact they think there is little chance of doing so. The release of UK aid was linked to disbursement of the second tranche of the TIPL. This was not a formal condition, however, and telno. 351 from Lagos indicates that TIPL is now to go ahead. We expect to hear from Lagos by the end of the week on progress on the EOLs. *We will then see if there are any problems (pace Mr. Powell's letter to PS Chancellor of 18 April).*

J C MAY



10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

Ch. ... X is understandable. But the responsibility lies with FCO/ODA, not us. Shall I get them to reply? yes

Dear Alex,

Done (1 hr at 5pm)

(See Mr May's note, behind, which in part shows that the blame for my delay lies, predictably, with the Nigerians themselves)

NIGERIA

The Prime Minister is vexed to see from Lagos tel. no. 351 that the IMF staff continue to find it necessary to urge us to disburse our special aid to Nigeria rapidly. On the basis of briefing, she gave President Babangida an assurance that we would be disbursing the aid speedily. She fails to understand why there continue to be hold-ups and would be grateful for an early explanation.

I am copying this letter to Richard Gozney (Foreign and Commonwealth Office).

CH/EXCHEQUER	
REC.	18 APR 1989
ACTION	Mr BOTTRILL
COPIES TO	CST, EST, Sir P. MIDDLETON, Mr ANSON, Mr WICKS, Mr LANKESTER, Mr SCHOLAR, Mr LOMAX, Mr ODLING-SMEE, Mr MOUNTFIELD, Mr EVANS, Mr DAVIS, Mr WALSH,

Mr THOMPSON, Mr TYRRE.

*Yours sincerely,
Charles Powell*

(CHARLES POWELL)

Alex Allan, Esq.,
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London SE1 9PJ
Telephone: 01-382 5011

FROM: P JEFFERSON SMITH
DATE: 18 APRIL 1989

CHANCELLOR

INDIRECT TAXATION IN THE SINGLE MARKET: PROGRESS REPORT

Your Private Secretary's note of 12 April mentioned that you wished to report to Cabinet on developments in this area after ECOFIN. In the light of the largely procedural discussions at ECOFIN, we assume that your report would be very brief and along the lines of the draft note to the Prime Minister which was attached to my minute of 11 April. We thought you might find helpful the attached aide-memoire which summarises the main developments.

2. As you will know, Coreper will be having another "brainstorming" session on this issue on 19 April. If this takes matters further forward we shall ensure that your office is informed on Wednesday evening.

PS

P JEFFERSON SMITH

cc Chief Secretary	CPS
Financial Secretary	Mr Nash
Paymaster General	Mr Wilmott
Economic Secretary	Mr Ferguson
Sir P Middleton	Mr P R H Allen
Mr Wicks	Mr Cockerell
Mr Scholar	Mr Brown
Mr Lankester	Mr Knox
Mr R I G Allen	Mr Oxenford
Mr Culpin	
Mr Gieve	Sir D Hannay UKREP
Mr Gilhooly	Mr Lavelle Cabinet Office
Ms Symes	
Mrs Chaplin	
Mr Tyrie	
Mr Call	

INDIRECT TAXATION IN THE SINGLE MARKET : ECOFIN 17 APRIL 1989

1. Considerable progress in UK's direction in recent months. Our persistent and realistic policy beginning to have effect.

2. Mme Scrivener has now publicly shown her acceptance of a more flexible approach, including :

(i) need to meet UK concerns on VAT zero rates;

(ii) recognition that VAT clearing house lacks support; alternatives preserving destination principle must be studied, including UK technical proposals;

(iii) acceptance that full harmonisation of excise duties not feasible.

3. On the other hand, both Mme Scrivener and many Member States remain committed to some form of tax approximation [increasingly favouring use of minimum rates rather than tax bands].

4. Overall, welcome development. Our general approach and our ability to show (through Customs & Excise technical paper) how fiscal frontiers could be removed without tax approximation or the VAT clearing house have moved focus of debate on to ground more of our choosing. But tough negotiations ahead.

5. ECOFIN agreed to keep up the pressure on this. Asked Commission for written report for informal ECOFIN on 20-21 May.

rowp

FROM: R I G ALLEN (EC)
DATE: 19 APRIL 1989
Ext 4470

CHANCELLOR

cc: Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Wicks
Mr Lankester
Mr Peretz
Mr Odling-Smee
Mr Culpin
Ms Symes
Mr Tyrie
Mr Isaac (IR)
Mr Jefferson-Smith (C&E)

*Ch. - This speaking note
incorps. key points in CTE's
further note, behind.*

*JP
19/4*

CABINET, 20 APRIL: ECOFIN

You will want to report briefly to tomorrow's Cabinet on the outcome of the ECOFIN meeting on 17 April.

2. The main areas to mention are the Delors Report, the withholding tax on savings, the second banking directive (reciprocity) and indirect tax approximation.

3. A draft speaking note is attached.

12/4

R I G ALLEN

ECOFIN, 17 APRIL: SPEAKING NOTE

Handwritten initials in red ink, possibly "R. J. O."

I represented the UK at ECOFIN on 17 April. In a fuller agenda than usual, the main topics discussed were the Delors Report on EMU, the withholding tax on savings, reciprocity in banking and indirect tax harmonisation. In the last three of these areas, I have some favourable recent developments to report.

2. On EMU President Delors made a presentation of his Group's Report over lunch. There was little discussion of it. I reiterated the UK's opposition to EMU, stressing inter alia the national sovereignty implications (a point endorsed by Beregovoy in his intervention). Both over lunch and at my subsequent press conference, I emphasised that there was no question of the UK agreeing to further Treaty amendment. Priority should be given to the arrangements for successful completion of the internal market. But we had proposed a number of practical steps for improving European monetary cooperation: an area in which we are already ahead of the field.

3. The Presidency said that there would be a full discussion of the Delors Report at the informal ECOFIN in May; and they would also be looking for a "political declaration" at the Madrid Summit in June.

4. There was quite a helpful discussion of the proposed withholding tax on savings. Four member states - Netherlands, Luxembourg, Denmark and Greece - in

addition to ourselves, now appear - for differing reasons - to have fundamental difficulties with the Commission's proposal. [The Germans said that, with Herr Waigel about to take over as Finance Minister, they were reviewing their position on the withholding tax (the DM had been boosted last week by rumours that Waigel was an opponent of the tax).) I stressed that the tax would not achieve its objective of combating tax fraud; and it would severely harm the development of Community financial markets. The prospects of killing off the proposal now appear brighter provided that the coalition of member states opposing it can be held together (strictly, of course, unanimity applies). There will be a further discussion at the informal ECOFIN in May.

5. On the second banking directive, the Commission's new reciprocity proposals were generally welcomed as a substantial improvement on the original provisions. I said that further changes were needed, however: there must be a clear de-coupling between the authorisation of individual licenses and any consideration of reciprocity; and any use of the reciprocity powers must be considered by the Council, not through a comitology procedure. Another difficulty - pointed to by the Dutch and Germans - is how to define equality of competitive opportunity for EC banks in third countries, the absence of which was one of the triggers for possible Community action. But the basis now appears to exist for constructive negotiations in COREPER, paving the way for a further ECOFIN discussion in June.

6. The Commission (Mrs Scrivener) are showing welcome flexibility on **indirect tax approximation** (abolition of fiscal frontiers). This reflects sustained pressure from the UK and others. The Commission's more flexible approach includes recognition that the VAT clearing house proposal lacks support and that alternatives - including the UK's technical proposals - preserving the destination principle should be studied; recognition of the need to meet UK concerns on VAT zero rates; and acceptance that full harmonisation of excise duties is not feasible. On the other hand, both Mrs Scrivener and most other member states remain committed to some form of approximation of VAT rates. The Presidency pressed the Commission to bring forward its new proposals in time for discussion at the informal ECOFIN next month.

7. On other ECOFIN business, I would briefly note that the Council reached agreement with the Parliament on new regulations for implementing the new Own Resources Decision . This included some useful measures to combat **fraud**, notably the ability for the Commission to make on-the-spot inspections. These are a useful addition to the action plan agreed at the March ECOFIN.

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FM DTI
TO IMMEDIATE TOKYO
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AMENDED DISTRIBUTION 24 APRIL

ANGLO-JAPANESE FINANCIAL RELATIONS

1 THE TREASURY UNDER WICKS AS CHAIRMAN LAST WEEK HELD AN INTER-DEPARTMENTAL MEETING INVOLVING FCO, DTI AND BANK TO DISCUSS FUTURE POLICY TOWARDS FINANCIAL RELATIONS WITH JAPAN. THE NOTE OF THE MEETING IS ON ITS WAY TO YOU. THE SAME GROUP IS TO MEET AGAIN ON 4 MAY TO CONSIDER A PAPER BASED ON THE DISCUSSION AT THE MEETING.

2 THE MEETING CONSIDERED THE HANDLING OF LORD YOUNG'S VISIT TO TOKYO. LORD YOUNG WILL WISH TO PRESS THE JAPANESE ON THE THREE ISSUES CURRENTLY OF GREATEST CONCERN TO THE UK: TSE SEATS, INVESTMENT TRUST LICENCES, AND ACCESS TO PENSION FUND MANAGEMENT. WE NOTE YOUR ASSESSMENT THAT THE JAPANESE WILL ALMOST CERTAINLY NOT MOVE SUBSTANTIALLY ON THE TSE DURING HIS VISIT.

3 THE MOST DIFFICULT IMMEDIATE ISSUE IS HOW WE HANDLE EBMM STATUS FOR JAPANESE FIRMS. THE CHANCELLOR HAS AGREED THAT AN ANNOUNCEMENT SHOULD BE DELAYED UNTIL AROUND THE TIME OF LORD YOUNG'S VISIT (BUT HE CONSIDERS IT WILL BE DIFFICULT TO DELAY MUCH LONGER). THE MEETING CONSIDERED WHETHER THE TIMING OF IMPLEMENTATION OF EBMS STATUS SHOULD BE TIED TO A FIRM TIMETABLE ON THE TSE ISSUE, BUT TOOK THE VIEW THAT THIS WOULD NOT BE AN EFFECTIVE BARGAINING COUNTER (EBMM STATUS HAS LITTLE VALUE TO THE JAPANESE) SO THERE WOULD BE NO ADVANTAGE IN SETTING UP DIRECT LINKAGES IN THIS WAY (PARTICULARLY ON AN ISSUE SUCH AS THIS ON WHICH THE BANK'S AUTHORITY MIGHT BE QUESTIONED AS IT WAS ON GEMMS LAST YEAR).

4 EQUALLY, THE MEETING RECOGNISED THAT AN ANNOUNCEMENT ON EBMS WHICH WAS NOT MATCHED WITH ANY CONCESSION ON THE JAPANESE SIDE COULD BE TAKEN AS SHOWING A 'LACK OF CONSISTENT PURPOSE'.

5 HENCE IT WAS AGREED TO EXPLORE A THIRD OPTION IN WHICH EACH SIDE WOULD ANNOUNCE A MODEST NEW MOVE OF SOME KIND IN THE CONTINUING PROGRESS TOWARDS OPENNESS IN FINANCIAL RELATIONS BETWEEN THE TWO COUNTRIES. THIS WOULD PROVIDE A SUITABLE CON

FOR AN ANNOUNCEMENT ON EBMMS.

6 WOULD BE GRATEFUL IF YOU COULD EXPLORE WITH THE MOF WHETHER THEY MIGHT BE RESPONSIVE TO SUCH AN APPROACH. IT MIGHT BE BEST NOT TO BE SPECIFIC ABOUT THE PRECISE NATURE OF THE CONCESSIONS ON OUR SIDE AT THIS STAGE (BUT IF PRESSED, YOU WOULD HAVE TO HINT THAT REGIONAL BANKING LICENCES ARE NOT WHAT WE HAVE MIND UNLESS OF COURSE A MOVE ON THE TSE WAS FORTHCOMING).

7 WE WOULD BE GRATEFUL FOR A RESPONSE BY 28 APRIL SO THAT WE CAN TAKE YOUR ADVICE INTO ACCOUNT IN DRAFTING THE PAPER FOR THE FURTHER INTERDEPARTMENTAL MEETING SCHEDULED FOR 4 MAY

YYYY

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ADDITIONAL

44

JAPAN POLITICAL AND ECONOMIC

NNNN



H/EXCHEQUER	
DATE	21 APR 1989
TO	Mr BOTTRILL
	CST, EST
	Sec P. MIDDLETON,
	Mr ANSON, Mr WICKS,
	Mr LANKESTER,
	Mr SCHOLAR, Mr LEMAX,
	Mr ODLING - SMCE
	Mr MOUNTFIELD, Mr EVANS,
	Mr DAVIS, Mr NAESH,
	Mr THOMPSON, Mr THRE

21/4

PHW

Foreign and Commonwealth Office

London SW1A 2AH

21 April 1989

Dear Charles,

Nigeria

You asked Alex Allan of the Treasury about the disbursement timetable for our special programme aid to Nigeria. Alex Allan has agreed that I should reply.

Conditions were attached to the UK's assistance. These were met when the IMF Board approved a 15 month Stand-by Arrangement for Nigeria in February. Subsequent discussions between DTI, FCO and Treasury about whether or not the aid should be tied took a month to resolve.

Procedures for disbursement of the grant were then finalised and the documents sent out to Lagos. We are ready to begin disbursement of the \$100m special aid as soon as the Nigerian Government agrees to the disbursement arrangements which we have proposed to them. Lagos telno 351, which the Prime Minister saw earlier this week, reported that the IMF delegation which had just visited Lagos urged the Nigerian Government to agree to the proposed arrangements as soon as possible.

Our High Commissioner in Lagos is impressing upon the Nigerians the importance we attach to getting the early agreement of the Nigerian Government, so that disbursement can begin before President Babangida's visit to Britain early next month.

I am copying this letter to Alex Allan at the Treasury, Myles Wickstead at ODA and Neil Thornton at the Department of Trade and Industry.

Yours ever,

Richard Gozney

(R H T Gozney)
Private Secretary

C D Powell Esq
10 Downing Street



*Thanks. Luke Y,
Pt X, this is a tragedy,
as we must give it a
v. high profile release.*

Board Room
H M Customs and Excise
New King's Beam House
22 Upper Ground
London SE1 9PJ
Telephone: 01-620 1313

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FROM: THE CHAIRMAN

DATE: 21 April 1989

CHANCELLOR OF THE EXCHEQUER

INDIRECT TAXATION IN THE SINGLE MARKET: GERMAN ATTITUDES

I should report that my German opposite number came to London yesterday for discussions on the Single Market. This was the latest in a series of meetings we have been having to explain the UK approach in general, and our technical proposals in particular, to our colleagues in other Member States.

cc	Paymaster General	Mr Jefferson Smith
	Economic Secretary	Mr Nash
	Mr Wicks	Mr Wilmott
	Mr Lankester	Mr Ferguson
	Mr R I G Allen	Mr P R H Allen
	Mr Tyrie	Mr Cockerell
	Mr Call	Mr Savins
	Sir D Hannay (UKREP)	Mr Brown
	Mr Lavelle (Cabinet Office)	Mr Knox
		Mr Oxenford

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2. The outcome was disappointing, if predictable. My impression was that, having been content to support the Commission's proposals in a somewhat unthinking en principe way, they have given little thought to alternative approaches. So the recent shift in Mme Scrivener's thinking has left them high and dry. It seems unlikely that they will put forward an early paper giving their own thoughts. Indeed, in view of the speed with which things are currently moving in Brussels, I suspect that, as often, they will be incapable of more than ad hoc reactions to proposals put forward by others.

3. As far as I could glean, their general approach is likely to develop along the lines that tax approximation is not necessary where goods are not tradeable across frontiers or where differences in tax rates do not distort consumer behaviour. In other cases, however, tax approximation would be necessary. Superficially, a "shopping list" approach like this appears consistent with our pragmatic approach and could, indeed, provide a basis for retaining most of our existing zero ratings. But it also contains dangers in that it would require tax approximation for tradeable goods (e.g. young children's clothing, which they specifically mentioned), especially high value items (e.g. jewellery, electronic equipment). In any case the advantages of this approach would be more apparent than real. We should want to retain the same VAT rate for items that were not tradeable across frontiers (e.g. standard-rated cinema tickets, zero-rated

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housing) as for items that were (e.g. standard-rated cassette players, zero-rated young children's clothing). In practice, therefore, the German approach would mean that all standard-rated items would be subject to tax approximation and we could retain zero rating only through having an additional reduced rate (or standard rating) for those items that would require tax approximation. This is clearly unacceptable, but it is a line that may well appeal to the Schengen countries.

4. Indeed, the Germans' main concern at the moment is the need to sort out the problems of removing frontier controls with their Schengen partners. Under the Schengen treaty, they have to remove "police" frontier controls on people by the end of this year. They also believe that it will be difficult not to be seen to remove fiscal frontier controls on people at the same time. But in view of the disparities in tax rates, this will create problems (though more for their Schengen partners than for them) unless there is early tax harmonisation. As they themselves admitted, they are in a real mess on this, and seem to have little idea of how to resolve it.

5. Other points worth noting briefly were:-

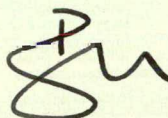
(i) In the absence of tax approximation, they appear to envisage further relaxation of their (admittedly already very simplified) existing controls. Our proposals struck them as too radical, particularly in relation to cross-border shopping.

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(ii) They did not believe that MCAs would be abolished in 1993, so controls would still be required on cross-frontier traffic in CAP goods. X

(iii) They appeared to have generally the same approach as us on trade statistics, although they gave little evidence of having thought this through.

6. I shall keep in contact with the Germans since, if they are to sway with the wind (usually, of course, from Paris), we had better try to blow on them as hard as anyone. In that respect, it might well be useful for you to have a go at the new Finance Minister on some of these issues as soon as an opportunity arises. But I fear that their position on this as on other current important policy issues in Bonn is something of a shambles and shows little sign of having been thought through carefully or properly co-ordinated. Y



J B UNWIN



FROM: J M G TAYLOR
DATE: 24 April 1989

A handwritten signature in blue ink, appearing to be 'JMT'.

MR UNWIN - Customs & Excise

cc PS/Paymaster General
PS/Economic Secretary
Mr Wicks
Mr Lankester
Mr R I G Allen
Mr Tyrie
Mr Call

Mr Lavelle - Cab.Office
Sir D Hannay - UKREP

Mr Jefferson Smith - C&E
Mr Nash - C&E
Mr Wilmott - C&E
Mr P R H Allen - C&E

INDIRECT TAXATION IN THE SINGLE MARKET: GERMAN ATTITUDES

The Chancellor was grateful for your note of 21 April.

2. He has noted your advice that it would be useful for him to have a go at Herr Waigel about these issues when an opportunity arises.

3. He has also noted that the Germans do not believe that MCAs will be abolished in 1993 (so controls would still be required on cross-frontier traffic in CAP goods). He has commented that this is outrageous, and we must give it very high profile indeed.

A handwritten signature in blue ink, appearing to be 'JMT'.

J M G TAYLOR

Mr. Das of Home

FROM: N L WICKS
DATE: 24 APRIL 1989
Ext : 4369

CHANCELLOR OF THE EXCHEQUER

CC PMG
EST
Sir P Middleton
Sir T Burns
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr H P Evans
Mr Peretz
Mrs M E Brown
Miss O'Mara
Mrs Chaplin

Ch.
Yes / *Yes :-*
You may like a
word about this at tomorrow's
'Int. Issues' meeting. Otherwise
content with line for Monetary Committee, +
with draft letter? 24/4/89
has discussion

**MEETINGS WITH PRIME MINISTER LUBBERS, CHANCELLOR KOHL AND
PRESIDENT DE MITA: THE DELORS REPORT**

1 attach a draft letter which your Principal Private Secretary might send to No 10 as briefing for the Prime Minister's meetings with Messrs Lubbers, Kohl and De Mita. The letter has, at Annex A, the list, for which you asked, of practical measures which the UK believes could be taken at an early stage.

2. You will be attending the meeting with Lubbers.

3. Though the briefing letter does not explicitly say so, it effectively sets out our strategy for the European Council, as we see it now. This is that the Community's follow-up to the Delors Report should concentrate on implementing practical steps - on the lines of those in Annex A - and that Treaty amendment - or consideration of it in an Inter Governmental Conference (IGC) - should not be on the agenda.

4. We should be able to see whether this strategy will work following these three meetings and other Community contacts in the next few weeks. (Christopherson, for instance, seemed favourably inclined to focus on practical steps this morning and clearly appreciated the problems a member of member states would face if required to commit themselves to all that full EMU would entail.)

WICKS
TO
CHEX
24/4

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But my feeling is that if it is to stand a chance of working - and it will have many opponents (De Mita is already supporting an IGC as paragraph 5 of Annex B makes clear) - HMG will have to be very active in lobbying for the "practical measures" approach. In that context, you will wish to consider over the next week or so whether you should circulate a version of the note at Annex A to your Finance Minister colleagues before the Informal ECOFIN on 19-21 May. Circulation of such a paper could be helpful. My impression is that many Finance Ministries in the Community are cautious and sceptical about the need for early Treaty amendment, but may not be able to stand out against pressures from Prime Ministers and Foreign Ministers for at least some modest Treaty amendment. Their chances of doing might be increased if they can point to a list of practical measures which would usefully carry forward economic and monetary development in the Community. A British paper might provide them with some evidence for that assertion.

5. If our strategy is to have a chance of success - and I now begin to speak like a Foreign Office diplomat - we need to avoid giving arguments to opponents in the Community and frightening off potential allies. I suspect that we would do that if we say anything which can be interpreted as backtracking on the various statements in Community texts which give some credence to the idea of EMU. If we attack such statements, we will delight the Community theologians and undermine the position of the pragmatists who might see some attraction in the approach set out in our paper. Paragraph 4 of the briefing better tries to put this point to the Prime Minister in suitable language.

6. The main item on the Monetary Committee's agenda for its meeting on Tuesday is the Delors Committee's Report. The Chairman, Sarcinelli, tells me that he intends to focus the Committee's discussion on a "blunt" exchange of views on the merits of the Report, with particular reference to the first Stage. Rather interestingly, he observed that he thought the UK would not want to talk about the first Stage but about the philosophy of EMU! He intends to put a report to the Informal ECOFIN which he will draft on his own responsibility.

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7. Subject to your views, I propose to take the following line in the Monetary Committee:

i. The Report is a valuable piece of analysis, which brings out very clearly the fundamental nature of economic and monetary union and the transfer of national sovereignty which it would involve. You have made clear, in your Chatham House speech, HMG's views on EMU. No need to elaborate. Agree with the Chairman that attention should be focused on practical steps which the Community can, and should, take to further economic and monetary co-operation among member states. Finance Ministries have a heavy responsibility here to ensure that governments concentrate on such measures.

ii. I would then draw on the measures in Annex A to make clear that we believe that there is a lot that can be done. None of the measures requires amendment of the Treaty or as the Delors Report makes clear, early institutional change. So this is not something on which attention needs to be focused at the European Council. I would also dismiss the statement in paragraph 39 "... the decision to enter upon the first Stage should be a decision to embark on the entire process".

iii. It is important that the follow-up should be remitted to ECOFIN.

8. I am also attaching the first edition of a paper on an IGC, which Mr Lankester has prepared - first edition because it does not take full account of FCO comments. In fact, some in that Department are somewhat aghast that such a paper should be prepared on the grounds that the less we think about an IGC, the less it is likely to come about! I assume that you do not wish to show the Prime Minister the paper at this stage, but keep it in reserve for use if need be.

9. Finally, just to record that I am considering the various texts on the EMS to see whether anything can be built on them.

N.L.V.

N L WICKS

ANNEX A

PRACTICAL MEASURES FOR ECONOMIC AND MONETARY DEVELOPMENT

There are a number of practical measures which the Community can take to further economic and monetary co-operation among member states. Work is already in progress on:

- (i) completion of the single market programme (especially in the fields of banking, securities and investment, transport and public procurement);
- (ii) full liberalisation of capital movements;
- (iii) a doubling of the structural funds.

Work should start straightaway on new measures:

(a) In the economic field

(i) Strengthened economic policy co-ordination. Would involve replacement of 1974 Council Decision on economic convergence. Primary role could be given to ECOFIN, with central bank Governors present, as appropriate, to ensure consistency between economic and monetary policies.

New procedures could involve

- greater co-ordination of monetary policies and policies on budget deficits;
- policy co-ordination on budget imbalances, setting recommended, but non-binding, medium-term guidelines, including a programme for the reduction, where necessary, of budget deficits;

- evolution of recommended, but non-binding, guidelines for the financing of national budget deficits, to reduce and eventually eliminate monetary financing;
- ? - multilateral surveillance, based on indicators, with deviations from objectives triggering non-binding recommendations on national policies.

(b) In the monetary field

(i) Strengthened co-ordination of monetary policy. Undertaken by Committee of Central Bank Governors, supported by a new permanent Secretariat. (This would involve revision of 1964 Council Decision defining mandate of Committee.)

New procedures could involve:

- making non-binding recommendations on overall orientation of domestic monetary and exchange rate policy and considering national monetary policy decisions;
- making non-binding recommendations on non-monetary policies affecting internal and external monetary situation;
- submitting annual report to European Parliament;
- setting up banking supervisory sub-committee.

In addition, there would be a parallel strengthening of the responsibilities and procedures of the Monetary Committee.

(ii) Promotion of the private ecu

- removal of all remaining national impediments to use;

- increased holdings of private ecu in national reserves and their use, where appropriate, in intervention;
- GL? - increased government borrowing, both denominated and payable in ecu.

(iii) EMS

- ASB - increased holdings of Community currencies in national reserves and their use, where appropriate, in intervention;
- ? - non-participants in ERM to be permitted to participate, if they wish, in very short-term financing facility (VSTF);
- ? - acceptance of private ecu in settlement of VSTF obligations;
- ? - market rate on government short-term ecu paper to be used as rate of remuneration on official ecu claims.

MS No
SMS notes
for review...

NOT TO BE SENT TO No 10

DRAFT

FOLLOW UP TO THE DELORS REPORT
THE POSSIBILITIES OF AN INTER-GOVERNMENTAL CONFERENCE

Introduction

1. The Delors report recommends that preparatory work for negotiations on a new Treaty should start immediately. Delors and the Committee members are understood to envisage detailed work before setting up an intergovernmental conference (IGC). But others might interpret the recommendation as a call for an immediate IGC.

2. Pressures for an IGC are unlikely to come to a head at Madrid, but are more likely at the Paris Council. But we cannot altogether rule out Madrid.

3. It is difficult to say how powerful the pressure for an IGC will be. (It is worth recalling that in the run-up to the 1985 Milan Council which agreed on the Single European Act IGC the UK seriously underestimated the pressures from others.) Much will depend upon the French. They seem to attach high priority to a revised Treaty, both on substantive grounds and as a grand symbol of future movement to European unification under their Presidency. We cannot yet judge how much of a row they are prepared to stand with the UK and possibly other member states. Nor can we judge whether, in the face of UK opposition, they might press for a monetary treaty outside the Treaty of Rome. President Mitterrand might conclude that the risks of an IGC ending in disagreement or the disadvantages of a monetary treaty without the UK are too

FOLLOW
UP TO
THE
DELORS
REPORT

great. Either scenario would be deeply divisive, and Mitterrand might conclude that pressing hard for an IGC in Madrid (or later in Paris) - far from leading to a triumphant Presidency - could all too easily result in the opposite. But we cannot be sure that he will not adopt the high risk approach.

4. Most other countries seem to welcome, or at least not object to, the broad thrust of the Delors conclusions. Several - for example the Dutch, the Danes and Luxembourgers - have doubts about the need for early work on Treaty amendment; they will also have doubts about an IGC in the face of UK opposition. However, it is also quite possible that they will give way to the French (who will have the support of the Italians and others) if they decide to press the issue.

5. For an IGC decision to be taken in Madrid it would require at least some orchestration by the Spanish Presidency. The Spaniards would prefer not to preside over a row, and therefore they might seek to keep any serious discussion of an IGC off the agenda. If that happened, the problem would be pushed forward into the French Presidency. On the other hand, the Spaniards seem to be in favour of Delors and might therefore go along if there were a majority move at Madrid in favour of an early IGC. Even if discussion of an IGC is not brought to a head in Madrid, we might want to give a clear indication there what our attitude to an IGC would be.

6. Against this background, it is necessary to consider what our approach to a possible IGC should be. But first some background on what an IGC and Treaty amendment would entail.

Procedure for IGC and Treaty Amendment

7. Apart from the treaties allowing UK, *Spanish, Irish,* Greek, Portuguese and Spanish accession, there have been six other Treaty amendments since 1965, most recently the 1986 Single European Act (see Annex A).

8. Treaty amendment is provided for under Article 236 of the Treaty of Rome, at Annex B. The basic procedure is:

- any government or the Commission submits a proposal (in practice this could be quite simple);
- the Council, after consulting the European Parliament and the Commission, votes by simple majority for or against calling a conference of representatives of the Governments of member states;
- if the Council is in favour, a conference is called by the President of the Council;
- the Treaty does not lay down rules on who should represent member states nor on determination of

terms of reference or timetable. In practice the conclusions would have to be agreed by heads of government who would be required to act unanimously;

- amendments only enter into force if ratified by all member states, in accordance with their constitutional requirements (ie in the UK by Parliament).

9. So an IGC can be called, by simple majority, without any specific prior agreement on terms of reference, timescale, or membership. The Council can of course indicate its wishes on all three.

10. The preparations for the Single European Act provide an illustration, but not a binding precedent. In June 1985 the European Council decided to set up an IGC, formally convened by the FAC in July 1985. There then followed 12 preparatory meetings of officials - led by the Permanent Representative - and 7 meetings of Foreign Ministers. Heads of Government reached agreement some six months later, in the European Council in December 1985, on Treaty revision. Annex C gives details.

Tactical Issues pre and post Madrid

11. There are two tactical issues that need to be addressed -

- 1) what should be our approach to the possibility of an IGC in the run-up to the Madrid Council and at the Council itself;
- 2) how should we respond if the Madrid Council decides to set up an IGC.

The answers to each of these questions depend partly on how firm is our attitude to Treaty amendment, and partly on how much we would mind if other member states decided to proceed with a monetary treaty outside the Treaty of Rome.

12. If our objections to Treaty amendment are rock solid, then an IGC would certainly be pointless. But it could also be positively damaging for two reasons. First a UK block in the IGC on all amendment proposals would inevitably cause a tremendous row and would be likely to damage our other EC interests. Secondly, the other members might end up recommending in separate conclave a freestanding Treaty between the eleven (not consisting of an amendment to the EC Treaties) to their respective heads of government. If we are not indifferent to other member states signing such a treaty (which we would by definition be unable to veto) the risks of an IGC leading indirectly to this would be another argument against an IGC taking place.

13. There is a danger that UK opposition to an IGC might provoke the other eleven member states to convening a special conclave, not under Article 236 (or any other Article), with the

objective of reaching agreement on a freestanding Treaty. Those member states might then have greater freedom of manoeuvre than they would have with an Article 236 IGC which the UK would have a right to attend. Nonetheless, it would seem right on balance to do everything we can to ensure that an IGC is not called.

How to avoid an IGC

14. There would seem to be two options for avoiding an IGC:
- i. warn early on in the strongest terms that we will not accept any Treaty amendment, that an IGC is therefore pointless and that we will vote against any proposal for one.
 - ii. while warning that we will not accept any treaty amendment, playing for time by seeking to postpone a decision whether or not IGC is needed.
15. Either option could be usefully combined with UK proposals for a positive looking agenda as an alternative to that set out in the Delors report. This could emphasise practical steps towards greater European economic and monetary cooperation.
16. Option (i) has the attraction that, in making our position loud and clear on an IGC now, we put others on notice. This might persuade them not to make treaty amendment an issue at Madrid. It would be consistent with this approach to state in advance that were an IGC called we would not attend (see paragraphs 19-21

below). But it might have the opposite effect, provoking the French and other IGC proponents into working harder to secure a majority in favour of an IGC (or even a special conclave).

17. Option (ii) looks weaker but has advantages. A less discordant note may increase the chances of our securing our objective, at least for the time being. We would argue that talk of an IGC is far too premature. Further studies are required on the Delors proposals - and experience gained of the effects of more practical measures, including some of those suggested in Stage 1 - before an IGC could be seriously considered.

18. In either case, we should lobby other member states - particularly the Dutch, the Danes, the Germans and the Spanish.

What if the Council agrees to set up an IGC

19. No decisions are needed now, but it is worth considering our tactics if we were outvoted and an IGC went ahead.

20. We could adopt the 'empty chair' approach or we could attend on the clear basis that we would still not accept any Treaty amendment. The initial view of Treasury lawyers is that the 'empty chair' would not involve a breach of the Treaty. But it would be contrary to the spirit of Article 236, which proceeds on the footing that attempts will be made to reach agreement. It might also be argued that there is a legal requirement to participate in - although not of course agree the conclusions of - an IGC, given in particular the inability of any single member state to veto the

calling of an IGC. In view of these uncertainties, it would be wise to consult the Law Officers before deciding to adopt the 'empty chair'.

21. If we chose to attend we would then need to consider whether to become closely involved in procedural decisions about composition, terms of reference, timing, and so forth.

22. The case for staying away would be strongest if we could persuade others who might have voted against the IGC to stay away too (though the chances of persuading them are probably slight). In that way we would have the best chance of avoiding either Treaty amendment or a freestanding Treaty emerging.

23. Even if we were on our own, there is a strong argument for staying away. To do otherwise would be hard to explain domestically against our stated determination to reject Treaty amendment. And the 'empty chair' would be the strongest statement to other member states that we would veto. The disadvantage of the 'empty chair' is that it might all too easily lead to proposals for a freestanding Treaty between eleven member states.

24. By contrast, if we did attend, we might be able to stave off a separate freestanding Treaty. Furthermore, we might possibly be able to persuade other member states that early Treaty amendment was neither desirable or necessary. (In a similar way we have been attending the ad hoc group on taxation of savings though we have not been quite absolute in saying we will veto.)

The drawback would be that we would come under immediate pressure to compromise, though having made our position crystal clear at the beginning it might be possible to stand up to this.

25. Politically in the UK, the 'empty chair' would be more attractive. As regards relations with our EC partners, attending would be more attractive; but any good will would rapidly disappear once it became clear that we were not prepared to negotiate seriously.

Conclusions

26. There is some risk that the French and others will push hard for a decision in favour of an IGC at the Madrid Council (though it is more likely to be delayed until the French Presidency). We should make every effort to avoid an IGC. We should go on making it clear that we will reject any Treaty amendment and we should seek to postpone a decision on an IGC. We should do the latter through constructive discussion rather than by threats. We should lobby other potential allies including the Spanish. We should avoid provoking other member states into setting up any conclave which from the outset was not set up under the existing Community Treaties.

27. There is no need to take a decision now on what we do if an IGC is agreed. But a provisional view is that if the Madrid Council decided to set up an IGC against our express objections, then it would seem politically all but impossible for us to attend - though this would be subject to a final view on legality. We

*This is such a serious conclusion that I hesitate to read it at least at this early stage. W.C.V.
24.4.*

● should at this stage perhaps keep a more open mind on attendance in the event of an IGC being agreed at the Paris Council.

ANNEX A

PAST TREATY AMENDMENTS

Apart from the accession treaties (UK et al, Greece, Spain, Portugal) there have been six treaty amendments

- i. Treaty establishing a Single Council and a Single Commission (1965).
- ii. Treaty amending Certain Budgetary Provisions (1970); involving a new Article 203, revising the budget procedure and timetable and establishing the maximum rate.
- iii. Treaty amending certain provisions of the Protocol on the Statute of the European Investment Bank (1975); largely to take account of changes in definition and convertibility of the ecu.
- iv. Treaty amending certain Financial Provisions of the Merger Treaty (1975); a further revision of Article 203 involving a new timetable and some procedural changes; modifying the organisation and powers of the Court of Auditors.
- v. Greenland Treaty (1984)
- vi. Single European Act (1986) which commits the EC to the aim of progressively establishing a single market over a period expiring on 31 December 1992. It incorporates Treaty reforms to speed up decision making by extending majority voting to most major areas of the single market programme.

SECTION II: INTER-GOVERNMENTAL CONFERENCE (IGC)

2.1 The European Council in Milan on 28-29 June 1985 decided by majority vote to convene a Conference of Governments of member states to consider institutional reform of the Community and possible treaty amendments, as well as the proposals put forward by the United Kingdom and others for a treaty on foreign policy and security.

2.2 The Foreign Affairs Council on 22 July took the formal decision to convene the Conference at Foreign Minister level. The first meeting was held in Luxembourg on 9 September, with representatives of the Commission, Spain and Portugal attending.

2.3 The Inter-Governmental Conference (IGC) subsequently met six times. The United Kingdom was represented by the Secretary of State for Foreign and Commonwealth Affairs or by the Minister of State (Mr Malcolm Rifkind). Twelve preparatory meetings of officials also took place, led on the United Kingdom side by our Permanent Representative to the European Communities. A full list of IGC and IGC related meetings is at Annex B. Discussion covered the following subjects: internal market, role of the European Parliament, powers of the Commission, technology, environment, cohesion, monetary co-operation, social policy, European Court of Justice.

2.4 At the European Council in Luxembourg on 2-3 December Heads of Government reached agreement, subject to Italian and Danish overall reserves and some outstanding reserves on individual aspects of the texts, on a Single European Act, comprising amendments to the Treaty of Rome in the areas listed in paragraph 2.3, as well as Treaty provisions codifying foreign policy co-operation among the member states. This outcome was reported by the Prime Minister to the House of Commons on 5 December.

2.5 On completion of the internal market the Community set itself a target date of 1992 and agreed to make greater use of majority voting. Unanimity will be maintained on important issues such as fiscal provisions and those relating to the free movement of persons or the rights and interests of employees. The main effect of agreement will be to speed up completion of the common market in goods and services. The agreement does not affect frontier controls to deal with terrorism, drugs or immigration. It includes safeguards enabling the United Kingdom and Republic of Ireland to protect their high standards of animal and plant health.

2.6 As regards the European Parliament, the co-operation procedure which was agreed will give the European Parliament the opportunity to play a more constructive role in Community decisions on the internal market and in other important areas, while leaving the last word with the Council of Ministers. The European Parliament's assent will be required for new accession and association agreements.

8

2.7 The new articles on technology and the environment will update the Treaty of Rome by writing into it the pattern of collaboration already established in the Research and Environment Councils, and will provide a basis for future action. In technology emphasis is placed on market-oriented programmes to improve the competitiveness of European industry.

2.8 The article on cohesion gives a treaty base for the first time to the Regional Fund, which was set up in 1975 and has had a considerable impact on the poorer regions of the European Community, including areas of industrial decline. The structural funds operated by the Community (Regional Fund, Social Fund, Agricultural Guidance Fund) are to be better co-ordinated with one another and with the activities of the European Investment Bank.

2.9 Agreement was reached that a reference should be made to the European Monetary System in the Treaty in a way which records what has already happened in this field without conferring new powers.

2.10 On the European Court of Justice agreement was reached inter alia on new Treaty articles providing power to set up a Court of First Instance. It is hoped that when this power is exercised it will enable the Court of First Instance to deal with staff matters and cases raising complex issues of fact (especially competition and anti-dumping cases). The changes are designed to reduce the Court's heavy workload.

2.11 The new treaty on European Co-operation in the sphere of Foreign Policy, based on the British text tabled earlier in 1985, formalises and strengthens the commitment to consult and concert. It applies to the existing pattern of consultation on the economic and political—but not the defence—aspects of security.

2.12 The European Council also endorsed Commission plans to relieve the burdens of Community requirements on businesses (deregulation) in response to an initiative of the Prime Minister.

2.13 A further meeting of the Inter-Governmental Conference took place in Brussels on 16 December. Discussion centred on relatively minor points which, following the decisions taken at the European Council, required clarification or further work.

9

MEETINGS OF THE INTER-GOVERNMENTAL CONFERENCE AND OTHER IGC RELATED MEETINGS

IGC Meetings (7)

9 September
21/22 October
11 November
19 November
25/26 November
30 November/1 December (conclave)
16 December

Other Ministerial Meetings at which IGC issues were discussed (5)

20/21 September—ECOFIN (Economic and Finance Council)
26/27 October—informal Foreign Ministers
28 October—ECOFIN
18 November—ECOFIN
2/3 December—European Council

Preparatory Group Meetings (13)

30 August
2/3, 17, 24, 30 September
7/8, 14/15, 30/31 October
5/6, 14, 21/23 November
6, 12 December

Other Official Meetings (5)

10, 26 October (Monetary Committee)
9 November (Monetary Committee)
28 November (Legal Experts)
10 December (Legal Experts)

46

Extracts from Council 9761 European Communities No 10 (1986) Developments in the European Community July - December 1985

Annex
B

Article 236

The Government of any Member State or the Commission may submit to the Council proposals for the amendment of this Treaty.

If the Council, after consulting the European Parliament and, where appropriate, the Commission, delivers an opinion in favour of calling a conference of representatives of the Governments of the Member States, the conference shall be convened by the President of the Council for the purpose of determining by common accord the amendments to be made to this Treaty.

The amendments shall enter into force after being ratified by all the Member States in accordance with their respective constitutional requirements.



25/4/89.

CHANCELLOR

BRIEFING LINE FOR PM ON EMU FOR MEETINGS WITH KOHL, LUBBERS, ETC

I missed commenting on this on its way in to you - I had had a word with Nigel earlier.

2. One key issue is whether the brief should try to steer the Prime Minister off saying that Treaty change and EMU is a load of nonsense and she will have nothing to do with it. Nigel is very keen to head her off this - para 5 of his note and para 4 of the draft letter.

3. I am not so sure: it seems almost inevitable that she will do it anyway; and if you try to steer her off it she'll think you've gone soft/swallowed Foreign Office line etc. I would suggest a reordering and rephrasing on the lines:

"You will of course want to make it clear that there is no question of us accepting a Treaty amendment or any commitment to adopt the later stages of the Delors Committee recommendations. It would be unwise to argue against the principle of EMU too strongly, given that we have signed up to it in the Single European Act. But you can make it clear that it is something for the long-distant future, and in the meantime the priorities are to concentrate on making a success of the Single Market and on the practical steps for improved monetary and economic cooperation outlined above."

A C S ALLAN

ACSA
TO
CHEX

FROM: MISS M O'MARA (MG1)
DATE: 25 April 1989

1. MR WICKS *N-C W. 5-4*

2. CHANCELLOR

Copies attached for:
Chief Secretary
Financial Secretary
Economic Secretary
Paymaster General

[Handwritten signature]

cc: Sir P Middleton
Sir T Burns
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr H P Evans
Mr Peretz
Mrs M E Brown
Mr N P Williams (MG1)
Mrs Chaplin
Mr Tyrie
Mr Call

DELORS COMMITTEE: STAGE 1

I attach the note, for which you asked, indicating whether we could accept the individual proposals which the Delors report set out for inclusion in Stage 1. As you will see, we could accept them all, provided the drafting was adjusted slightly in a few places.

*MAN
TO
CHECK
25/4*

MOM

MISS M O'MARA

*PS. 1 copy
Antony for
Simon for
John Steps 2-23.*

PROPOSAL

COMMENT

(a) In economic field
(paragraph 51)

i. Complete removal of physical, technical and fiscal barriers within Community, in line with internal market programme

Cannot accept fully - "physical" barriers implies removal of all frontier controls - but could accept, if wording adjusted slightly to "completion of the single market programme".

Strengthening of Community competition policy

Acceptable in principle.

ii. Reform and doubling of structural funds

Acceptable - already agreed.

iii. Replace 1974 Convergence Decision with new procedure to strengthen economic and fiscal policy co-ordination. Primary responsibility of ECOFIN, with input from central bank governors. In particular

Acceptable.

- multilateral surveillance, based on agreed indicators, leading, where necessary, to policy consultations and formulation of recommendations

Acceptable in principle but recommendations should be non-binding.

- new procedure for budgetary policy co-ordination with precise quantitative guidelines and medium term orientations

Acceptable in principle but guidelines will need to evolve and should be non-binding.

- provision for concerted budgetary action by member countries

Acceptable if refers to reduction of budget deficits, where necessary.

Handwritten red notes: "57" and "1/2 57"

(b) In monetary field
(paragraph 52)

- Removal of all obstacles to financial integration and intensified co-operation. Acceptable.
- Consideration to be given to extending central banks' autonomy. Acceptable to "consider" but UK cannot agree to greater independence for Bank of England. Raises major constitutional issues.
- i. Achievement of single financial area. Acceptable.
- ii. Inclusion of all Community currencies within ERM on same terms. Acceptable - simply implies Stage 1 will not be complete until this is secured.
- iii. All impediments to private use of ecu to be removed. Acceptable. (Only area for UK action of which we are aware is, possibly, on company accounts where existing legal position is unclear. No problem of principle there.)
- iv. Mandate of Committee of Central Bank Governors to be replaced to permit Acceptable in principle.
- formulation of opinions on overall orientation of monetary and exchange rate policy and individual monetary measures. "Normally" prior consultation on national monetary decisions eg monetary targets Acceptable in principle but UK (like many others) could not accept any commitment to prior consultation.
- expression of opinions to individual governments and Council on policies affecting internal and external monetary situation. Outcome of deliberations "could be made public" Acceptable in principle but we (like others) would have qualms about publishing outcome of Committee's discussions.

- Submission of annual report to European Parliament and European Council.

Acceptable.

(v) Committee to set up subcommittees with greater research and advisory role and permanent research staff on

Acceptable.

- monetary policy

- foreign exchange policy

- banking supervision

(c) Creation of European Reserve Fund
(paragraphs 53 and 54)

Views of Committee divided

UK shares view expressed in paragraph 54 that "not opportune at this stage".

(d) Preparation for Treaty amendment
(paragraph 50)

By time of transition to Stage 2, necessary to have prepared and ratified Treaty change.

Acceptable, as statement of fact. But UK cannot accept that preparatory work for negotiations on new Treaty should start immediately (paragraph 66) or that "competent Community bodies" should be invited now to make concrete proposals on Stages 2 and 3 (implied by paragraph 66). Nor can we accept presumption scattered throughout report (eg paragraph 61) that a single framework Treaty is preferable to a series of amendments.



pyo

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

25 April 1989

C D Powell Esq
PS/Prime Minister
10 Downing Street
LONDON
SW1

PMG
EST
Sir P Middleton
Sir T Burns — *MR Wickes*
Mr Lankester
Mr Scholar
Mr R I G Allen
Mr H P Evans
Mr Peretz
Mrs M E Brown
Miss O'Mara
Mrs Chaplin

ACSA
TO
Powell
25/4

Dear Charles,

**MEETINGS WITH PRIME MINISTER LUBBERS, CHANCELLOR KOHL AND
PRESIDENT DE MITA: THE DELORS REPORT**

The Prime Minister's meetings with Messrs Lubbers, De Mita and Kohl provide an important opportunity to begin moving the follow-up to the Delors Report in the direction that meets our interests. The Chancellor has therefore asked that I should write setting out the line he suggests the Prime Minister might take at these three meetings.

We have, of course, already made our general response to the Delors Report very clear: that it brings out starkly the fundamental nature of economic and monetary union, with the transfer of national sovereignty which it would involve, and that there is no question of the UK agreeing to further Treaty amendment. The Chancellor believes that for these three meetings, we should concentrate on the following more immediate and practical points:

- There are many useful practical measures which the Community can, and should, take to further economic and monetary co-operation among member states.
- The task of the European Council should be to concentrate attention on these measures and agree a procedure for pursuing them - almost certainly in ECOFIN and, where appropriate, in conjunction with the Committee of Central Bank Governors.

CONFIDENTIAL



- In fact, many of the practical measures to which the UK would willingly agree are included in Stage 1 of the Delors Report. These cover financial aspects of the completion of the single market, including of course capital movement liberalisation; and improving economic and monetary cooperation for example by replicating in the Community the arrangements for discussions between G7 finance ministers and central bank governors. We would also favour other measures such as the promotion of greater use of the private ecu and increased holdings of Community currencies in national foreign exchange reserves. (This last item would be unwelcome to the Germans).

We shall need to develop our line further in the run-up to the European Council, for example on exactly how we should react if other Governments press for an IGC to discuss Treaty amendment. But the Chancellor believes it is worth putting our wares on the table now, and trying to steer the discussion in the direction we want. Besides making the points above, the Prime Minister might say:

- The European Council should remit the work on practical measures to ECOFIN and central bank Governors, as appropriate, with instructions to bring as many as possible of them into effect as early as practicable. The ECOFIN should report progress to the Paris Council.

- None of these measures should require amendment of the Treaty. Suggestions for Treaty amendment are a diversion from the main task now before the Community - the completion of the single market, on which a lot of work is still needed (for example, further transport liberalisation, public procurement, and a range of measures in the area of financial services). So proposals for amending the Treaty should be set on one side. They are irrelevant to the practical work which the Community should now be concentrating upon.

- The Report itself makes clear that early institutional change is not required, so this is not something on which time should be spent at the European Council in Madrid. In any event, Parliament and public opinion in the UK would not accept further Treaty amendment, particularly when the Treaty has so recently been amended by the Single European Act.

The Chancellor believes that we stand a better chance of securing agreement to our strategy, and to heading off those who argue for early Treaty amendment, if we concentrate the Community's attention on these practical steps on which early action can take place. For that reason he thinks that it would be a tactical mistake to concentrate too much on the principle of EMU, on which the UK's views are already clear and well known, and to which all Member States feel they have signed up in the preamble to the Single European Act. So, if the Prime Minister is asked during her meetings about our attitude to EMU, the Chancellor suggests she should use the line agreed for the press briefing: namely



that EMU implies nothing less than European Government and political union. This is simply not on the agenda now, nor for the foreseeable future. In the meantime the priorities must be to concentrate on making a success of the Single Market, coupled with the practical steps for improved monetary and economic co-operation outlined above.

If the Prime Minister is asked about the sentence in paragraph 39 " ... the decision to enter upon the first stage should be a decision to embark on the entire process", the Chancellor thinks that she should say that it is quite impossible for any British Government to accept such a commitment. There is no possibility of a British Parliament passing a single comprehensive Treaty of the sort described in the Report.

Annex A of this letter describes the stance taken so far by the Dutch, Italian and German Governments on the Delors Report. The Chancellor sees no reason for the Prime Minister to differentiate the presentation of our line in her discussions with the three Heads of Government. But she might emphasise to:

Lubbers: the similarity of the UK and Dutch positions on practical next steps; the substantial nature of those steps; and the crisis in which the Community will find itself if Treaty amendment is pressed;

Kohl: that the time to transfer control of economic and monetary affairs from a national to a Community level is not on the agenda and will not realistically be so for the foreseeable future;

De Mita: the need for further work, as soon as possible, to provide a sound basis for economic and monetary development in the Community.

I am sending a copy of this letter to Stephen Wall in the FCO and to Trevor Woolley in the Cabinet Office.

*Yours
Alex*

A C S ALLAN
Principal Private
Secretary

BACKGROUND

DELORS COMMITTEE REPORT: OTHERS' VIEWS

Netherlands

1. The Dutch Government have yet to take a formal position on the report. The State Secretary for Foreign Affairs, Van Voorst Tot Voorst, said on 18 April that the proposal for a European System of Central Banks was worth considering, and observed that the Dutch position on the ESCB was likely to be in line with that of the German Government. The Finance Minister, Ruding, described the report as constructive. Duisenberg, Governor of the Netherlands Bank, said on 18 April that all member states should agree now to the final goal of economic and monetary union; but that it would be a long time before there was a single currency and a single central bank. The Dutch Cabinet is likely to have its first full consideration of the report on 28 April.

2. Senior officials have told us privately that whilst the Dutch Government may be prepared to endorse the concept of an independent central bank as a final stage in the process of EMU, Dutch attitudes towards next steps are close to our own. In particular, the Dutch may be reluctant to see follow-up referred to an Inter-Governmental Conference (IGC), and may be receptive to UK proposals for a series of practical intermediate steps. They recognise, however, the problems inherent in the fact that whilst Treaty amendment requires unanimity, only 7 member states are required to call an IGC.

Federal Republic of Germany

3. Chancellor Kohl, beset by domestic difficulties, has yet to declare his hand on the report. His position will be influenced by both Genscher (EMU enthusiast) and Pöhl (cautious welcome to report). The independence of central banks, and the possibility of increased structural funds, are central to German concerns; and Kohl will be very cautious about making commitments that could be seen as damaging to German interests. At the same time, he will be reluctant to rebuff French aspirations for substantive progress during their Presidency, and may see political benefits of his own in movement on the EMU dossier. Whilst Genscher and Dumas are reported to have called at the Franco-German summit on 19-20 April for early joint examination of Treaty amendment, officials have suggested that no work is yet under way, and that real German willingness to transfer control of economic and monetary affairs from a national to a Community level is an extremely long way off.

4. There is little evidence of liaison between the Government in Bonn and the Bundesbank in Frankfurt on follow-up to the report; or indeed of any Bundesbank strategy, beyond seeking to ensure the freedom from political influence of any European monetary institution. While Bundesbank officials see progress towards EMU as a long-term but inevitable process, they argue that Treaty amendment should not be considered until after the completion of the first of the three stages in the report. They also have reservations about the possibility of a European Reserve Fund, and about references to the structural funds, which they see as a potentially costly distraction.

Italy

5. The Italians favour rapid movement towards Economic and Monetary Union and have no objections of principle to Treaty change. In a press statement, De Mita has said that the report:

"will allow the Heads of State and Government of the twelve to show clearly their political will to pursue monetary and economic union.... The report confirms that economic and monetary union is necessary to realise the full potential of European integration. It is not only desirable but above all feasible.... The basis has now been laid for the next European Council at Madrid to agree to begin immediately the first phase and to set out the procedures for calling a conference charged with drawing up a new Treaty to provide for the institutions in the economic and monetary field".

6. The Italian Treasury and Bank of Italy have not commented publicly but have welcomed privately the report's emphasis on fiscal rectitude and the control of public deficits. The Minister for EC Affairs, La Pergola, noted in a discussion with the Ambassador on 18 April that the report set the basis for "those countries which wished to do so" to proceed with the necessary steps leading to the establishment of EMU.

PS/CHOK
12/2

mp

SUPPLY ESTIMATES 1989-90

HC 231-IV (88-89)
ISBN 0 10 282789 3

CORRECTIONS

Page 25 — Class IV, Vote 3.
Subhead A3 (2), third line of narrative, delete 6.853,
substitute 5.643.

Page 30 — Class IV, Vote 3.
Subhead D1 (2), delete (a) to (d), substitute (a) to (e).

Page 46 — Class IV, Vote 5.
Paragraph 5 of Introduction, line 3, delete 55 per cent,
substitute 51 per cent.

27 April 1989
LONDON:
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SUPPLY ESTIMATES 1989-90

HC 231-XIII (88-89)

ISBN 0 10 283589 6

CORRECTIONS

Page 6 — Class XIII, Vote 1.

Part I, Already allocated in Vote or Account (HC 691):
delete 69,100,000, substitute 69,109,000.

Part I, Balance to complete: delete 88,499,000, substitute
88,490,000.

April 1989

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SUPPLY ESTIMATES 1989-90

HC 231-XV (88-89)

ISBN 0 10 284289 2

CORRECTIONS

Page 3 — Class XV, Social Security.

Paragraph 10, line 3, delete 235 million, substitute 35 million.

Paragraph 10, line 2, delete 'after taking into the expenditure', substitute 'after taking into account the expenditure'.

Page 10 — Class XV, Vote 1.

Paragraph 5, line 5, delete '£92,808·9 million', substitute '£2,808·9 million.'

Page 17 — Class XV, Vote 3.

Paragraph 4, line 1, delete £24·7, substitute £4·7.

Page 35 — Class XV, Vote 7.

Subhead A1 (2), delete '82,773', substitute '84,397'.

April 1989

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SUPPLY ESTIMATES 1989-90

HC 231-XVI (88-89)
ISBN 0 10 283789 9

CORRECTIONS

Page 123 — Class XVI, Vote 22.

Part I, Allocated in the Vote on Account (HC 691): delete
'917,068,500', substitute '917,068,000.'

Part I, Balance to complete: delete '1,419,731,500',
substitute '1,419,732,000.'

April 1989

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SUPPLY ESTIMATES 1989-90

HC 231-XVII (88-89)

ISBN 0 10 283889 5

CORRECTIONS

Page 25 — Class XVII, Vote 2.

Table 3, move figures '874' and '5,039' from right hand column into column headed 'Estimated provision for 1989-90 against lines for 'Total projects costing over £500,000' and 'Projects costing under £500,000' respectively.

Page 38 — Class XVII, Vote 5.

Subhead BI (4), delete '22,500', substitute '22,000'.

April 1989

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SUPPLY ESTIMATES 1989-90

HC 231-XX (88-89)

ISBN 0 10 284189 6

CORRECTIONS

Page 66 — Class XX, Vote 15.

Subhead A4 (1) narrative, delete '50', substitute '150'.

April 1989

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SUPPLY ESTIMATES 1989-90

HC 231-IX, X (88-89)
ISBN 0 10 283289 7

CORRECTIONS

Page 3 — Table 1 Public and other expenditure in Class IX.
Substitute the reverse page for page 3 printed

Page 20 — Class IX, *Vote 2*.
Subhead B 10(2). Award schemes, add symbol ■

April 1989
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TABLE 1 Public and other expenditure in Class IX

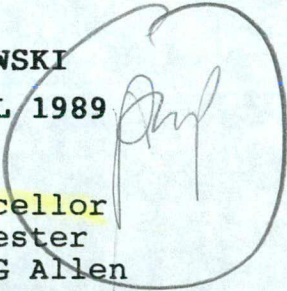
	Vote 1	Vote 2	Total	£ million Total in Cm 609
Capital Expenditure				
Housing Corporation support to private sector				
Provision for rent by				
Housing Associations	672	—	672	724
Housing Associations				
Low Cost Home Ownership	71	—	71	87
Housing Association Grant via local authorities				
Support to private sector				
Provision for rent	185	—	185	140
Home ownership	33	—	33	10
Other central government				
support to private sector				
Home ownership	1	—	1	2
Capital Grants to Housing Corporation	—	2	2	2
Gross capital expenditure	962	2	964	965
Capital receipts	-12	—	-12	-75 (1)
Net capital expenditure	950	2	952	
Current expenditure				
Subsidies to:				
Housing Associations	51	—	51	51
Local Authorities	488	—	488	487
Housing Corporation and				
central government: current	—	53	53	54
Total current expenditure	539	53	592	592
Public corporations				
Subsidies to New Towns	53	—	53	53
Housing Action Trusts	—	5	5	68 (2)
Other (non-public) expenditure	799	25	824	
Total Department of the Environment — Housing	2341	85	2426	
of which:				
Current	718	83	801	
Capital	1623	2	1625	

The symbol (—) denotes nil or less than £0.5 million.

- (1) Change reflects decision to allow Housing Corporation to receive certain receipts direct (see paragraph 3 of the introduction to Class IX, Vote 1).
- (2) Voted provision reduced to reflect revised programme.

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FROM: T TARKOWSKI
DATE: 27 APRIL 1989



MR WICKS

John
Is from 4 weeks?

cc PS/Chancellor
Mr Lankester
Mr R I G Allen
~~Mr Evans~~
Mr Mountfield
Mr Walsh

CHANCELLOR'S MONTHLY MEETING ON INTERNATIONAL ISSUES: 25 APRIL

I attach draft minutes.

2. I would be grateful for any comments from you or copy recipients by close today, if possible.

3. I have not attempted to record the discussion on indirect tax in much detail, since I am not familiar with the subject and the main conclusion was that the UK is not in a position to take a definitive line yet.

⇒

Jonathan

I have yet to hear from
NO (O) but I am
certain the lunch dinner
is June not 2 June - PM
would not host a dinner like this
on a Friday.
June.

Tarred Tarkowski
T TARKOWSKI

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INTERNATIONAL ISSUES: CHANCELLOR'S MONTHLY MEETING

11.30am Tuesday 25 April 1989 in HM Treasury

Present:	Chancellor	Mr H P Evans
	Economic Secretary	Mr Mountfield
	Sir P Middleton	Mr Gieve
	Sir T Burns	Mr Walsh
	Mr Wicks	Ms Wallace
	Mr Cassell	Mr Tarkowski
	Mr Lankester	Mr Tyrie

The meeting followed the agenda circulated under Mrs Lester's minute of 21 April.

Recent and forthcoming meetings

2. Mr Wicks reported that G7 Deputies were meeting representatives of the banks on 15 May in New York. The Bank of England (Mr Crockett) would attend in his place. All other deputies had agreed to attend however. He had written to Mulford asking for details of the banks' representation and the proposed agenda. The Chancellor said he regarded the meeting as a dangerous development. Discussion was bound to degenerate into negotiation on matters which were not properly for Governments. It was important that the UK's position was made clear: Mr Crockett would be attending on behalf of the Bank, as the interested regulatory authority, not the Government. Mr Gieve pointed to the risk that these arrangements would show the UK in a bad light if they became public. It was agreed that a line for the Press should be worked up once the agenda for the meeting was known.

3. The Chancellor said that the main issue at the informal ECOFIN on 16 May would be the follow-up to the Delors Report. Indirect taxes and withholding tax would also be discussed. Opposition to the Commission's proposal for a withholding tax seemed to be building up, and it was possible that it would be

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dropped. Increased information sharing by tax authorities would probably be advanced as an alternative. Provided that the Danish model were followed, this should cause no difficulty. On indirect taxes it would be helpful to know if Mme Scrivener was expected to circulate revised proposals in advance of the meeting. Our line should continue to be that we had advanced our own market-based solution, and that the present coverage of zero rates was not negotiable. If - but only if - the Commission could put forward an alternative proposal which met our difficulties we would consider it.

4. The Chancellor noted that the timing of the OECD Ministerial (31 May-1 June) was unfortunate. Mr Evans reported that the Foreign Secretary was considering attending on 31 May, and might want to speak on debt. It was agreed that the Chancellor should attend on 1 June, and speak on the world economy and debt [before attending G10 and President Bush's dinner ^{that evening} on 2 June]. The Chancellor said he wanted to use the opportunity to point to the ways in which the UK was making a practical contribution to the debt problem (the Chancellor's Sub-Saharan African initiative, the ESAF, Nigeria, Guyana). If any any stage it was thought helpful, background briefing could make the point that on a practical level the UK's record was considerably better than that of the US. Mr Evans suggested that it would also be useful for the Chancellor to comment on the OECD's programme of future work.

International debt

5. The Chancellor commented that the only comfort in the Brady Plan was that some of the benefit would go to UK banks. He asked whether there was any prospect of persuading the Executive Board of the IMF to draw back from the full Brady proposals. Mr Wicks noted that Camdessus had been persuaded, and that the French and Italians supported the proposals. Potential allies were limited to Germany, the Netherlands and the Nordics. Although LDCs outside Latin America remained suspicious there were signs that they would argue for debt reduction to be made generally available, rather than oppose the plan outright.

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Mr Cassell noted that there were doubts in America too. Messrs Shultz and Conable had expressed reservations, and some of the banks themselves were critical. However he thought damage limitation was more likely to be effective than root and branch opposition.

6. The Chancellor agreed that the UK's tactics should be to get the proposals toughened up in the course of Board discussions in the IMF and the IBRD. The main focus should be on trying to ensure that no additional IFI resources - for which the IMF were now lobbying - were involved. It was noted that US support on this should be forthcoming. Mr Cassell suggested that, in developing the UK's position, we should aim to get the message across to the banks that there was not much in the way of new resources for them under the Brady Plan either from the IFIs, or indeed from the Japanese parallel financing: they would be expected to bear most of the burden.

7. It was agreed that, on interest support, the UK's tactics should be similar. Our line would be sceptical, but that if interest support were to go ahead it should do so on the basis that no additional resources were involved and using mechanisms on the lines of the proposed escrow accounts - which helped distance the operation from the IFIs and which could receive bilateral as well as multilateral funds. It could be necessary to consider interest support schemes covering more than one year's interest. We would continue to oppose the use of guarantees, credit lines etc. It would be important to preserve the principle that detailed negotiations were for debtors and the banks.

8. The Chancellor said that debt reduction continued to have greater attractions than debt service reduction. Mr Wicks suggested that the latter was more appropriate if it provided a bridge to full creditworthiness within a reasonable timescale. If there were doubts, debt reduction was probably indicated. Mr Lankester pointed out that debt reduction by the US banks would require them to raise new capital. The Chancellor concluded that,

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while the UK preferred debt reduction, we should not stand out against debt service reduction. The key point was that both should be subject to demanding conditions.

9. The Chancellor noted that the UK could come under pressure to lead several Support Groups. In the light of the Canadian experience on Guyana he remained extremely reluctant. It should not be assumed that leadership of a Support Group should automatically lie with the former colonial power. Mr Lankester said we should continue to apply two tests to any proposed Support Group: evidence of a strong commitment to adjust, and sufficient willingness to provide the necessary finance on the part of Support Group members.

Other business

10. The Chancellor said he would want to discuss European Monetary Union at a meeting to be arranged later that day.

T TARKOWSKI IF1
26 APRIL 1989

cc Those present

PS/Paymaster General
Mr Scholar
Mr Odling-Smee
Mr Riley
Mr Peretz
Mr R I G Allen
Mr Bottrill
Mr P G Davis
Mr Mercer
Mrs Brown
Miss Simpson

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How much
AMT
Public
Pure
in
P.M.

Ch/ Cabinet Office have
arranged two meetings of
ODE to discuss the Social
Charter, tobacco labelling
& lorry weights, the first at
4.00pm on Thursday 4 May
when diary is clear, the
second at 3.00pm on
Tuesday 9 May - which clashes
with PM's Questions.

Options are:

- send CST to both meetings
- send CST to 2nd meeting
- miss PM's Questions & attend
both meetings yourself.

Which would you prefer?

~~WASTED~~
MUST
to be
substantive
25/4

@ public, X;
Tho' I wd
lack PM's

9/5



FROM: MRS JULIE THORPE
DATE: 28 April 89.

to Glasgow
Thanks. ~~Post~~ ask CST if go for 4/5
mtg & I will go on 9/5.

[if CST really can't, then CST]

CHANCELLOR

OD(E) 4 MAY AND 9 MAY

You asked me to find out more about the OD(E) meetings arranged for 4.00pm on Thursday 4 May and 3.00pm on Tuesday 9 May

Tobacco Labelling

This is for discussion on 4 May. FP advise that there is no need for you to get involved. The European Community are proposing a centrally imposed agreement on labelling. Dept of Health are in the lead and they are stalling and saying that we are content with the voluntary agreement which we have at present. There are no tax implications.

Lorry Weights *Also for discussion on 4 May.*

HE advise that this is more for the CST. The UK has a derogation from the EC so that we do not have to comply with a ruling about very heavy lorries until 1996. In the meantime DTp have a programme of bridge strengthening. If our derogation is not



extended beyond 1996 the programme will have to be accelerated which will have public expenditure implications.

Do you want to ask another Minister to attend the meeting on 4 May e.g. PMG/EST?

Social Charter

This is for discussion on 9 May at 3.00pm, which is the meeting which clashes with PM's Questions. EC advise that you should attend, not because there is a direct Treasury interest, but because it is a key item in the run up to the European Council and is of political interest.

Do you want to miss PM's Questions for this?

John



peg

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

28 April 1989

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2/5

CH/EXCHÉQUER	
REC.	2 MAY 1989
ACTION	CST
COPIES TO	

Dear Stephen,

PRIME MINISTER'S MEETING WITH THE ITALIAN PRIME MINISTER

The Prime Minister had a talk this morning with the Italian Prime Minister. Signor de Mita was accompanied by the Italian Ambassador and Signor Vattani (Diplomatic Adviser). H.M. Ambassador Rome was also present. By far the greater part of the discussion dealt with SNF and economic and monetary union, and was shall we say vigorous (Force 8) rising to indignant (Force 10) at times. It was not always easy to follow de Mita's thought processes which tend to be obscure. A fair amount of what is recorded in this letter is my interpretation of what he meant. I understand that H.M. Ambassador Rome will be letting you have some general reflections on the meeting.

East/West relations

After a brief discussion of reforms in the Italian health service, the Prime Minister asked Signor de Mita about Lech Walesa's recent visit to Rome. Signor de Mita said that Walesa had made some rather unrealistic requests for help in changing Poland's political system. He appeared surprisingly confident about the prospects for a multi-party system. The changes in both Poland and Hungary were very significant. The Prime Minister had, of course, seen Mr. Gorbachev recently. Did he represent real change? Or was it all a sham?

The Prime Minister said that Mr. Gorbachev had done more than she had expected in terms of political reform. But the result was to confront him with a series of new problems, in particular with the nationalities. The real difficulty, as in Poland and Hungary, was that the economy was actually getting worse. There seemed no easy way out of this. It was important that he should begin to show some results from his reforms. Her view was that we should support Mr. Gorbachev in what he was doing in the Soviet Union, while making clear that we would keep our defences

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28 APR

strong and not respond to bullying or blandishments.

Signor de Mita said that he agreed with the Prime Minister in her positive assessment of Gorbachev and what he was doing, and also that the main difficulties confronting him were economic. This led him to the conclusion that the West must find ways to help Gorbachev. There should be an overall western policy of increasing investment in, and joint ventures with, the Soviet Union in order to help create a genuine market economy there. At the same time we should take Gorbachev at his word when he spoke of his wish to reduce arms. That meant pressing ahead with arms control negotiations. The Russians would need to reach judgments quite soon on the resources they would have to devote to defence over the next five years and we should try to influence that judgement. There were many inconsistencies in Gorbachev's policies, for instance his attempt to introduce democratic principles by dictatorial methods. On balance, he was inclined to think Gorbachev was more likely to fail than succeed. That would certainly happen if the West did not act together to help him. The European Community needed to think more clearly. It was also rather surprising that the United States' Administration gave such an impression of uncertainty and lack of initiative. The Prime Minister commented that the new Administration had indeed taken a measured approach. But they were now coming forward with their policies.

SNF

The Prime Minister set out our views on SNF. NATO had guaranteed Europe's freedom for forty years and had never yielded to Soviet pressure. Our most important task was to maintain its strength and unity, giving it the weapons needed to implement the strategy of flexible response to which we were all committed. At the same time NATO had a clear arms control policy involving negotiations for 50 per cent reductions in strategic nuclear weapons, conventional force negotiations and the elimination of chemical weapons. The Soviet aim was to get rid of nuclear weapons from Europe and divide Europe from the United States. This must be resisted. Soviet policy was cynical: they had modernised all their nuclear weapons, including their SNF and were now attempting to prevent NATO from doing the same for its much smaller number of SNF. Unfortunately their efforts in this direction seemed to be succeeding in some NATO countries.

The Prime Minister continued that SNF were vital to the strategy of flexible response. Neither Britain nor the United States could agree to negotiations on them, because such negotiations would lead inexorably to a third zero which would not be in NATO's interests. The right course was to challenge the Soviet Union to reduce its vastly superior numbers of SNF to NATO's levels. We also needed to keep NATO's SNF up to date. She recognised that Chancellor Kohl's political difficulties made it impossible for him to agree at the forthcoming Summit to deploy a successor to LANCE. But the Summit must confirm the requirement for SNF, renew the commitment in the Communiqué of the 1988 Summit to

keep them up to date, and express support for the American development programme. That was the minimum we could do if we were to be in a position to deploy a successor to LANCE in the mid-1990s. She had talked very recently to President Bush and knew that he was very firmly opposed to SNF negotiations. He had our full support on this.

Signor de Mita suggested that we were making the mistake of confusing the basic goals of NATO with the temporary political difficulties of the German Government. The Prime Minister said that this sounded as though Signor de Mita was prepared to sacrifice the needs of defence for political expediency. Signor de Mita protested that this was not what he had in mind. But he did not see why we were making such a fuss about SNF. It did not have to be dealt with in a matter of days. Decisions could be taken in a few months time. After all LANCE was to remain in service until 1995. There was no rush. His main worry was about the position in Germany. We could not ignore the difficulties which the German Government faced, and any alternative to them would be worse. All they wanted was a commitment to open negotiations on SNF once the conventional force negotiations had achieved some concrete results. They were firmly opposed to a third zero. The most important task was to keep Germany in the Alliance and look for a solution on SNF which would achieve this.

The Prime Minister said that she simply could not follow Signor de Mita's reasoning. The German position as set out by Chancellor Kohl in the Bundestag was not as he described it. The Germans said that they remained committed to flexible response. But they seemed unwilling to take the steps necessary to preserve it. Indeed there was little apparent distinction between the policy of the German Government and of the SPD. The centre-right in Germany would not be saved by adopting socialist policies. We were not making unreasonable demands on the Germans. We recognised that they could not at the moment contemplate a decision to deploy a successor to LANCE. But equally we could not accept negotiations which would lead to elimination of SNF and be a victory for Gorbachev beyond his wildest dreams. The issue went to the very heart of NATO and its willingness to defend liberty. For the first time she was beginning to have doubts about Germany's reliability as an ally, although in the last resort she did not think that Chancellor Kohl would want to see Germany separated from the United States. Signor de Mita said that it was precisely this problem he was trying to solve. At all costs he wanted to avoid a division between Germany and the United States at the NATO Summit. That was why there had to be a compromise. The Prime Minister said that Britain and the United States had already compromised by agreeing not to press the issue of deployment. But we could not allow Germany to play with the defence of the West in order to deal with an electoral problem. The position which she had set out was the only one compatible with NATO's security needs. She hoped very much that Signor de Mita would reflect and realise that the right course for Italy was to stand firmly with Britain and the United States against SNF

negotiations. Nothing in Signor de Mita's demeanour suggested that he would reach this conclusion.

Economic and Monetary Union

Signor de Mita asked what view the Prime Minister took of the Delors Report. He thought it was rather good. The Prime Minister said that if he accepted the report, it meant that he accepted that the Italian Government and Parliament would have no control in future over Italy's economic, fiscal and monetary policy. It would surrender its sovereignty to faceless men and it would have to pay for the privilege by massive resource transfers to the poorer states. This was the clear implication of the report and in particular paragraph 39, which spelt out that agreement to embark on the process involved a commitment to full economic and monetary union.

Signor de Mita said that he did not see it quite like this. Italy was in favour of a European Central Bank, but only at the end of a long process. Because they believed in political integration, they did not see it as handing over power to some competing authority, but to a body which acted on behalf of Italy as of other European countries. Italy believed in political integration. But in the short term it was more a question of coordinating monetary policy. The Prime Minister said that this did not need any new institutions. It was a question of will. Such coordination was already practised in the G7.

The Prime Minister continued that she could not believe that Signor de Mita was really prepared to leave Italy without the right to determine its own economic and fiscal policies. There was no way she could go to the British Parliament and tell them to surrender their powers in this field. Signor de Mita said that the European Parliament would provide the necessary democratic control. National Parliaments would become like city councils. It was not a question of delegating power, simply of organising it in a different way. Of course the process of integration might take many decades. But if one treated the Delors Report as a vision of the future, then he believed the Community should accept it and begin to move towards the final goal. Otherwise, what had been the point of setting up the Committee. His point of view had wide support in Europe, which might create problems for Britain.

The Prime Minister said that she could not accept this approach. She believed that in practice countries would insist on keeping their sovereignty, just as France did over defence by refusing to integrate its forces into NATO. The right way forward was for sovereign states to cooperate and work together on sound economic and fiscal policies. She did not believe in taking power away from national Governments and Parliaments and handing it over to Central Bank Governors and an unrepresentative European Parliament.

Signor de Mita asked about the Prime Minister's attitude to Treaty amendment. The Prime Minister said that she would not be able to get it through the United Kingdom Parliament. Signor de Mita asked whether the Prime Minister would go along with an Intergovernmental Conference. The Prime Minister said that it required only a simple majority to convene such a conference. But it would be a waste of time since Treaty amendment needed unanimity.

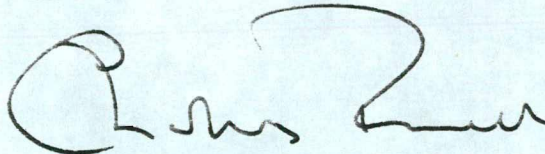
Signor de Mita asked if this meant that the United Kingdom was prepared to stand aside from progress towards economic and monetary union. The Prime Minister said that was not the point. Governments which so blithely accepted the Delors Report were in fact running away from the real issues, such as free movement of capital, and taking refuge in institution-building. The United Kingdom had in reality done much more than its partners. There were plenty of practical steps which could be taken to improve economic and monetary cooperation without amending the Treaty or creating new institutions. Signor de Mita pleaded that economic and monetary union would be a gradual process. No-one was proposing that it be adopted here and now. The Prime Minister disagreed: the Delors Report suggested just this, particularly in paragraph 39. Far from favouring a step by step approach, it required commitment to the transfer of control over economic, monetary and fiscal policy to central institutions. Signor de Mita said there had to be a goal, even if it took a long time to reach it. There would be no compulsion. It sounded as though the Madrid European Council was going to be a lively occasion. Nonetheless he believed that there would be agreement at Madrid. Only if you all agree with me, retorted the Prime Minister. Signor de Mita said he had no objection to the Prime Minister saying that everyone had agreed with her so long as there was agreement.

Middle East

Signor de Mita gave an account of his visit to Israel and suggested that the European Community could have a useful role in helping Israel to develop its proposal for elections on the West Bank. He hoped there could be a discussion of this at the Madrid European Council. The Prime Minister recounted her discussions with Mr. Gorbachev on the Middle East. She thought that the American approach of drawing out the Israelis and trying to build on their proposals was a sound one. President Bush was determined to make progress and would be ready to press Israel quite hard. Signor de Mita lamented the failure of Europe to develop a common foreign policy. The absence of it was particularly felt in the Middle East. The Prime Minister said that the Venice Declaration of 1981 formed the basis for the Twelve's Middle Eastern policy.

At the end of lunch, the Prime Minister said it was time for Signor de Mita to go back to his politics. Thank goodness they were his and not Europe's. Signor de Mita said that he would much rather they were Europe's than his.

I am copying this letter to Alex Allan (H.M. Treasury), Brian Hawtin (Ministry of Defence), Neil Thornton (Department of Trade and Industry) and Trevor Woolley (Cabinet Office). It should be given a restricted distribution only to those with a need to know.

Yours sincerely,


(CHARLES POWELL)

J.S. Wall, Esq.,
Foreign and Commonwealth Office.

*You will not
be damaged
answer @ X*

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[Handwritten signature]

CH/EXCHEQUER	
REC.	2 MAY 1989
ACTION	
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10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

29 April 1989

*[extracts circulated
separately]*

Dear Stephen,

ANGLO/DUTCH CONSULTATIONS

Anglo/Dutch consultations were held at Chequers this afternoon. They started with separate meetings between the Prime Minister and Mr. Lubbers and between Foreign and Finance Ministers. HM Ambassador at The Hague will be recording the latter. There was then a plenary and a working supper.

Virtually the whole discussion was devoted to two main issues: SNF and European economic and monetary union. British and Dutch views on the first were encouragingly close. I enclose a copy of the statement given to the press by No.10 after the meetings.

I also enclose separate notes of the Prime Minister's bilateral with Mr. Lubbers, and of the plenary session.

I am copying this letter and enclosures to Brian Hawtin (Ministry of Defence), Alex Allan (HM Treasury), Neil Thornton (Department of Trade and Industry) and Trevor Woolley (Cabinet Office).

*Yours sincerely,
C. D. Powell*

(C. D. POWELL)

PM'S
MTG
WITH
MR
LUBBERS
29 APR

Stephen Wall, Esq.,
Foreign and Commonwealth Office.

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AGREED LINE FOLLOWING MEETING WITH MR LUBBERS

The Anglo-Dutch consultations were held at Chequers this afternoon starting at four and ending about a quarter past eight. There were separate talks between the two Prime Ministers and between Foreign Ministers and Finance Ministers followed by a plenary session and a dinner.

The talks were held in an extremely good atmosphere. The main subject discussed was the prospects for the forthcoming NATO Summit. The two Governments found many points in common and will keep in close touch between now and the Summit. They also discussed the prospects for the Madrid European Council and other Community matters as well as environmental questions.

PRIME MINISTER'S MEETING WITH MR. LUBBERS,
CHEQUERS, 29 APRIL 1989

Prime Minister

Mr. Lubbers

Mr. Charles Powell

Mr. Merkelbach

SNF

The Prime Minister set out our views on SNF in familiar terms. The position adopted by the German government was very worrying and involved serious risks for NATO. She could not believe that Chancellor Kohl's heart was in it. When she visited Germany, she would stress the importance of making President Bush's first NATO summit a success. She would explain our basic minimum requirements on modernisation: confirmation of the continuing need for SNF: support for the American development programme for FOTL: and renewal of the pledge to keep NATO's weapons up to date where necessary. She would also explain why we could not accept SNF negotiations: they would lead inevitably to a third zero and undermine the whole strategy of flexible response. Rather NATO should challenge the Soviet Union to make unilateral reductions in its SNF, to bring them down to NATO levels.

Mr. Lubbers said that he shared the Prime Minister's concern. The German position, as it had now emerged, was much worse than he had expected. He was horrified by how far the Germans had gone. He had expected that they would at least confirm existing NATO positions. It would be important to avoid a conflict at the summit and the Netherlands was working on a possible compromise text. He would be seeing Chancellor Kohl the following week. We had to find a way of giving him back his confidence. Personally he had no difficulty with the sort of communiqué for the summit which the Prime Minister had outlined.

Delors Report

Mr. Lubbers said that there was some difference of perception between the Netherlands and Britain on the Delors Report. The Netherlands was certainly not happy with all parts of it. But they saw the goal of monetary union as desirable. Their experience of membership of the EMS had been generally good.

The Prime Minister said that our own experience of trying to stabilise exchange rates against the DM had not been a happy one and had contributed to inflation in this country. Mr. Lubbers said that most member states had found participation in the ERM to be stabilising. It tended to discourage speculation. He recognised that much depended on the volume of business in a particular currency and that similar considerations might not apply to sterling as to the guilder. The Prime Minister said that one could not look at participation in the ERM in isolation. We had also to consider other factors affecting competition in Europe, such as the level of subsidies paid out by some governments. There was a long way still to go before there would be fair competition in the European Community. It was more important to concentrate on practical tasks like this than to indulge in institutional fantasies like the Delors Report.

Mr. Lubbers said that the Netherlands' approach to the Delors Report would be cautious. They found it too ambitious and could not accept the proposition in paragraph 39 that entering on the first stage involved a commitment to the process as a whole. The next step should be for the Madrid European Council to ask ECOFIN and the Monetary Committee to work out what could usefully be done in a first stage. Heads of Government should also ask the advice of experts before deciding whether Treaty amendment was necessary. The Netherlands was not against Treaty amendment in principle but preferred to proceed step by step and judge at each stage what was needed. In his view, there was a long way to go before

Treaty amendment was necessary.

Withholding Tax

The Prime Minister expressed satisfaction that the Germans had abolished their withholding tax. Mr. Lubbers agreed. But he thought that the system of taxing capital ought to be fair right across Europe. At the moment, Luxembourg derived far too much benefit because of its banking secrecy laws.

Frontiers

The Prime Minister emphasised the need to preserve frontier controls at the water's edge even after 1992, to deal with terrorism, drugs and animal and plant health. Mr. Lubbers said that the Netherlands took a very similar view so far as ports and airports were concerned, although it was a different matter with land frontiers.

Commission Competence

The Prime Minister said that she was concerned by the way in which the European Court of Justice continued to enlarge the competence of the Commission in its judgments. The Commission itself was constantly trying to extend its powers into new areas. She had recently come across a proposal for a framework regulation for child care to be provided throughout the Community up to the age of 10 at taxpayer's expense. Mr. Lubbers said that he shared the Prime Minister's worries about the Socialist orientation of the present Commission.

Environment

Mr. Lubbers said that he understood that Mr. Mulroney had given the Prime Minister an account of The Hague conference. (He did not however mention the follow-up meeting.) The Prime Minister told Mr. Lubbers about the seminar we had recently

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- 4 -

held on global climate change. There was also a brief
exchange on tropical forests. /

C.D.P.

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ANGLO/DUTCH CONSULTATIONS:
PLENARY SESSION

Prime Minister	Mr. Lubbers
Sir Geoffrey Howe	Mr. Van den Broek
Mr. Nigel Lawson	Mr. Ruding
HM Ambassador, The Hague	Netherlands Ambassador
Mr. Charles Powell	Mr. Merkelbach

SNF

The Prime Minister recapitulated her talk with Mr. Lubbers. She had been pleased to find that the Netherlands' position was close to Britain's, in particular in opposing SNF negotiations and in supporting a challenge to the Russians to reduce their SNF unilaterally to NATO levels. The recent German policy statement was a retreat from existing NATO positions. It was clear that we would not be able to get a commitment at the NATO summit to deploy FOTL. But President Bush had spelled out his minimum requirements on modernisation - confirmation of the requirement for SNF, support for the American development programme, commitment to keep up to date where necessary - and these could be met by repeating earlier NATO summit or NPG communiqué language. We must have before us all the time the risk that, if the Americans were pushed too far, they might start to withdraw their forces from Europe.

Mr. Van den Brock agreed with the Prime Minister's analysis: the German position was even worse than expected. The summit must meet United States' requirements on modernisation, and there should be no commitment to SNF negotiations, only an appeal to the Soviet Union to reduce its SNF to NATO levels. But he doubted that this would be enough for the Germans. They would have to have something on

negotiations, otherwise it would be a defeat for Kohl. The answer might be to try to open up a perspective for negotiations on SNF once there was a conventional balance and Soviet SNF had been reduced to NATO levels. The purpose of such negotiations would be to fix equal ceilings, so that the Soviet Union did not have the option of increasing its SNF again. He handed over a draft text (enclosed).

The Prime Minister and the Foreign Secretary made clear that we could not accept the reference to negotiations in the second paragraph. This went beyond the language of the Reykjavik communiqué which had not referred to negotiations. We could only look at the case for reductions in SNF once there was a firm commitment to deploy FOTL and we had achieved conventional balance and the elimination of chemical weapons. The Prime Minister said that she hoped the Netherlands would not table its text in its present form. Anyway it was too early to be floating compromise texts: it would only encourage the Germans to ask for more. We needed to bring home to the Germans the risks to NATO and to Europe's relations with the United States of pressing for SNF negotiations.

Delors Report

The Chancellor of the Exchequer said that the United Kingdom could not accept the recommendations of the Delors Report or treaty amendment. If other member states tried to force the pace, there was the risk of a show-down at the Madrid European Council. But we were ready to discuss in a constructive way how to achieve closer economic and monetary cooperation within the framework of the existing treaty. This was what the Community should now focus on.

Mr. Ruding said that Britain and the Netherlands agreed on quite a number of points. Both were pragmatic and wanted to make progress step by step in a first phase, although the Netherlands accepted the objective of economic and monetary union. He thought that the United Kingdom's position in resisting the full recommendations of the Delors Report would

be greatly strengthened if we were to join the ERM. This would also be in the United Kingdom's economic interests.

X | The Prime Minister said that was a matter for us. Sterling was a very different currency from the guilder. Our first priority was to get down inflation. She was determined to keep control of monetary policy. Of course exchange rate stability was desirable, but it was secondary to getting down inflation. Our experience of trying to hold sterling to a fixed rate against the DM had been such that we would never try it again. It was what had given us our present rate of inflation. Mr. Ruding commented that membership of the ERM would be anti-inflationary if the United Kingdom entered at the right parity. Mr. Lubbers qualified this by saying that membership of the ERM could be a support to anti-inflationary policy but was not the key to it. The experience of countries that were in the ERM was that it added to stability. But maybe the United Kingdom was different.

Mr. Ruding suggested that, while it would have been impossible for the United Kingdom to join 10 years' ago because of the weakness of our economy, it would be much easier now that we were stronger. The Prime Minister pointed out that we had become stronger without being in the ERM. Mr. Ruding said that he was not suggesting that the United Kingdom should join now, only that it should promise to do so by 1 January 1993 or should link membership to completion of the internal market. The Prime Minister said that there was nothing you could do when you were in the ERM that you could not do when you were out of it. On the other hand, there was a lot you could do when you were out of it which you could not do in it. Joining the ERM would mean losing control of monetary policy. The Chancellor of the Exchequer suggested it was joining a monetary union which put control of monetary policy at risk.

Mr. Ruding - not easily deterred - said that if the United Kingdom agreed to set a deadline for joining, then it would be in a much stronger position to resist the less

CONFIDENTIAL

- 4 -

desirable recommendations of the Delors Report. The prospects of avoiding a show-down at the Madrid European Council would be greater, as would the chances of persuading others to adopt a pragmatic approach. Mr. Lubbers said that his fear was that, if the United Kingdom stayed out of the ERM, then it would be harder for us to join in other areas of monetary cooperation. He wanted to see the United Kingdom play a full part in this.

C.D.T.

CONFIDENTIAL

GEHEIM

Nederlandse suggestie voor paragraaf over SNF-wapenbeheersing in het Comprehensive Concept.

" It is evident that NATO would gain substantial security benefits from a large reduction in the threat from the WTO's short-range land-based missile force. However, present Soviet ouvertures to negotiations clearly indicate the objective of broadening their scope to all American and other NATO nuclear weapons in Europe with a view to their complete elimination.

In the short term, therefore, arms control in the field of land-based missiles should be unilateral and applied by way of mutual self-restraint in defence planning. The Alliance will restructure its SNF-posture on the basis of the minimum requirements of its strategy and will unilaterally reduce its overall stockpile i.a. through a shift of emphasis from shorter to longer ranges. The WTO is to be challenged to translate its self-proclaimed doctrine of "sufficiency" into fact and to start reducing its overcapacity in SNF-missiles down to the Alliance's level. Such action ^{could} would prepare the ground for ^{consequently} initiating, in a further phase, negotiations on equal ceilings to even lower levels. Ceilings on such lower levels, providing for further mutual reductions but not elimination, could be considered in conjunction with the establishment of a conventional balance in Europe.

In the meantime the Alliance will assess (in the SCG) specific issues to be addressed in future negotiations such as the levels to be set, the items to be limited (launchers, missiles, complete systems), the problem posed by the dual capability of systems involved, verification and other relevant questions. "

PM MEETING
WITH KOHL
LUBBERSJOB MITA



2/5

CH/EXCHEQUER	
REC.	2 MAY 1989
ACTION	Mr MELLISS
COPIES TO	CST, EST SIR P. MIDDLETON Mr WICKS, Mr LANKESTER, Mr MOUNTFIELD, Mr ROBSON, Mr H.P. EVANS, Mr PEEBLES.

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

30 April 1989

Dear Stephen,

pm

PRIME MINISTER'S MEETING WITH CHANCELLOR KOHL, 30 APRIL

The Prime Minister flew to Germany today to meet Chancellor Kohl in the village of Deidesheim in the Rhineland-Palatinate. After various ceremonies in the village, which included the planting of a vine in the Prime Minister's honour from which she will receive the wine each year, she and Chancellor Kohl talked for rather over two hours in the main hotel, continuing over lunch (for connoisseurs this consisted of potato soup, followed by pig stomach, sausage, liver dumplings and sauerkraut). There was then a press conference attended by some 200 journalists: you will be receiving the verbatim text of this separately. The Prime Minister and Chancellor Kohl subsequently drove to the nearby town of Speyer where they visited the cathedral and had a glass of wine with the local bishop. So far as outward appearances go, the meeting was cheerful and friendly. The Prime Minister was welcomed by a large and good-natured crowd in Deidesheim, with only a few banners protesting about low-flying.

The remainder of this letter records the main points of the talks on subjects other than SNF, on which I am writing separately.

South Africa

Chancellor Kohl suggested that he and the Prime Minister began by discussing South Africa. His own position remained unchanged: he was against sanctions. Nonetheless he expected pressure for them to mount again if President Botha's successor failed to take some dramatic measures fairly soon after the elections.

The Prime Minister said that she was glad to hear the Chancellor's position had not changed. She had recently met both Pik Botha and du Plessis and hoped to see de Klerk during the summer. She thought it vital not to isolate the new generation of politicians who would take over after President Botha's retirement. She was hopeful that the new government would release Mandela fairly soon after the elections. It would be easier for them to do so if Western leaders kept a fairly low profile on the issue in the meantime. She also expected a resumption of reform. All this was on the assumption that the extreme right did not make extensive gains in the elections.

CONFIDENTIAL

Chancellor Kohl asked about President Bush's attitude. The Prime Minister said that basically he agreed with her and Chancellor Kohl. But he was likely to have trouble with Congress over sanctions. There was still great pressure for disinvestment by American companies, as evidenced by Mobil's recent and most regrettable decision to pull out of South Africa.

The Prime Minister continued that we were giving substantial assistance for education of black South Africans and were now planning to give some modest help also to the Urban Foundation to finance mortgages which would allow more black people to buy their own homes. Chancellor Kohl said that he had seen my letter to Herr Teltschik about this proposal. The German government was ready to participate. Herr Teltschik subsequently handed me a letter confirming this (copy enclosed).

Chancellor Kohl asked whether the Prime Minister was optimistic about Namibia. The Prime Minister said that she thought the worst was probably over. SWAPO had behaved very stupidly. Fortunately she had been there on the day the settlement process started and had been able to persuade the South Africans that they must keep within the agreement. It was very important that the Namibia agreement should succeed, because that would give a positive signal for the future of Southern Africa as a whole.

Chancellor Kohl expressed satisfaction that he and the Prime Minister were in full agreement. They should both stick to their course and act together so far as possible. He wanted to be helpful. His main worry remained the US Congress.

Delors Report

Over lunch the Prime Minister asked Chancellor Kohl for his views on the Delors report. Chancellor Kohl turned up his speaking note and began to read it out. He thought Germany could work with the report. The key question was the extent to which Member States could agree on the three stages. The Prime Minister asked whether he was really saying that he was prepared to make the transfer of sovereignty envisaged in the report and give up national control of economic, monetary and fiscal policy. Chancellor Kohl seemed rather startled by this suggestion and commented that any such thing was a very long way off. The Prime Minister commented that there were quite a lot of practical steps which could be taken to strengthen monetary cooperation, without getting involved in treaty amendment. She would never accept the proposition in paragraph 39 of the report that embarking on the first stage committed us to the whole process of economic and monetary union. Chancellor Kohl said that this was something which required unanimity, so the Prime Minister should have no fears. The Prime Minister asked what procedure Chancellor Kohl envisaged for dealing with the report. The Chancellor said there would be first discussion at the Madrid European

Council, after which the report should be remitted to ECOFIN to continue work. The Prime Minister asked once again whether Germany would really agree to give up control over economic, monetary and fiscal policy. Chancellor Kohl answered with a question: would we ever have political union?

Frontiers

The Prime Minister explained to the Chancellor our concern to maintain adequate frontier controls against drugs, terrorism and crime, and in order to protect plant and animal health. It had been agreed at the time of the Single European Act that these matters should be dealt with by unanimity. But the Commission was trying to act under Article 43 of the Treaty which was a majority vote article, and were getting the support of the European Court in this. It was a matter of great importance and very sensitive politically in the United Kingdom. Chancellor Kohl appeared bemused by all this.

CAP

Chancellor Kohl referred to progress made in reducing agricultural surpluses. Much faster progress had been made than had been envisaged at the European Council in February 1988. The Prime Minister agreed that there had been an improvement and the recent price-fixing had been quite satisfactory. But one could hardly say that the CAP was an example of market forces at work. Chancellor Kohl conceded that it might be some time yet before the CAP was on a really sound footing. The Prime Minister referred to the problem of fraud which was causing taxpayers huge sums. She would wish to pursue this matter at the European Council in Madrid.

Environment

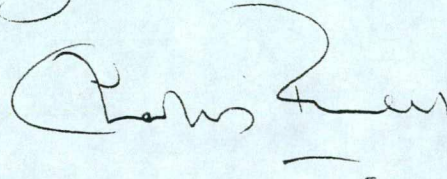
Chancellor Kohl said that he hoped for a thorough discussion of environmental issues at the Economic Summit, particularly the problem of disappearing tropical rain forests. Indeed, he would like to see agreement in principle beforehand to launch a special effort or initiative at the Summit on this issue. He had in mind some concrete action such as promising Brazil aid or credit in return for measures to preserve the rain forest. The Prime Minister said that there were a number of ideas under discussion in this area, including schemes for reducing debt in return for action to preserve the forests. But most of the debt was held by commercial banks and there was no particular reason to relieve them of it at the taxpayers' expense. Moreover, these issues were very sensitive for countries like Brazil who regarded many of the proposals made as an intrusion on their sovereignty. She was far from certain that the summit would be able to agree on a scheme.

Poland

Chancellor Kohl said that he was very encouraged by

developments in Poland. He had agreed entirely with the points made by the Prime Minister in her speech in Warsaw. The time had now come for the West to provide economic help. We should move rapidly on this. The Prime Minister cautioned that Poland must first reach agreement with the IMF and conclude bilateral debt agreements. But she agreed that the time had come to spell out the help we would be prepared to give once these steps were taken.

I am copying this letter to Alex Allan (HM Treasury), Neil Thornton (Department of Trade and Industry), Brian Hawtin (Ministry of Defence) and Trevor Woolley (Cabinet Office).

Yours sincerely,


(C. D. POWELL)

Translation

The guarantee fund to facilitate access to loans for home purchase by black South Africans envisaged by the "Urban Foundation" is fully consistent with the Federal Government's policy towards South Africa.

Positive signals are necessary to promote a better and more permanent integration of the black population into the South African community, instead of punitive measures which polarize the situation further still.

In the Federal Government's view the "Urban Foundation" is a most suitable agency for such positive steps.

The Federal Government intend to make an appropriate contribution to the guarantee fund of the "Urban Foundation". The question of finance is already being discussed in the context of the current federal budget deliberations.

Minister of Finance



Ministre des Finances

MAY - 3 1989
MAI - 3 1989

S/EXCHEQUER	
REC.	18 MAY 1989
ACTION	
COPIES	
TO	
TO	

The Right Honourable Nigel Lawson
Chancellor of the Exchequer
H.M. Treasury
Parliament Street
London, SW1P 3AG
UNITED KINGDOM

My dear Colleague:

As you may recall, I wrote in late March concerning the Support Group for Guyana. At that time, I indicated that the outstanding issues before the Support Group needed to be dealt with quickly and in a manner that reflects a level of burdensharing consistent with the cooperative spirit of the intensified collaborative approach to deal with the problem of arrears to the international financial institutions.

I am pleased to report to you that Mr. Marcel Massé, my special envoy chairing the Guyana Support Group, has informed me that we are about to reach a conclusion to the financing arrangements for Guyana. I understand that recent additional commitments have virtually closed the remaining financing gap for the three-year programme and have also contributed substantially towards resolving the cash-flow problem in the first year of Guyana's adjustment programme.

I wanted to take this opportunity to thank you personally for your support in bringing this exercise to a successful conclusion. I would also like to note the constructive participation that has been demonstrated by all members of the Support Group. Their generous responses have enabled the Support Group to assemble the financing package and secure the

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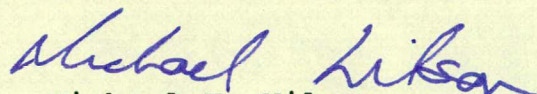
additional resources necessary to close the residual financing requirements in the first year of Guyana's adjustment programme. In addition, I would like to acknowledge the cooperation of the aid agencies and central banks involved in this initiative.

As you may know, the Guyanese authorities have already taken a number of substantive prior actions within the context of their three-year adjustment programme. These measures have been implemented under difficult circumstances and in the absence of external financial support. If the authorities' initial actions are indicative of their commitment to economic reform, I believe that we can be reasonably optimistic about prospects of sustained implementation of the adjustment programme over the medium term.

I am confident that the donors and creditors which have participated in the Support Group recognize that the importance of this exercise goes beyond Guyana. I think we have all learned some valuable lessons from this first application of the intensified collaborative approach. The process has been long and not without its share of difficulties. Perhaps the most valuable lesson which we take away from this first Support Group exercise is that it has underscored the willingness of the international community to make special efforts to help cooperating countries with overdue obligations not only to normalize their relations with the international financial institutions and other creditors but also to provide extraordinary financial support to solid programmes of growth-oriented adjustment.

In closing, I would like to acknowledge the excellent collaboration that has been demonstrated by your officials throughout this initiative. I trust that you will convey my appreciation to all those who have endeavoured to ensure the success of this undertaking. I am also writing to Messrs. Amato, Bérégovoy, Brady, Murayama and Waigel.

Yours sincerely,


Michael H. Wilson

FROM: HUW EVANS
DATE: 8 MAY 1989
EXT: 4430



MR GIEVE

cc

PPS

Economic Secretary
Mr Wicks
Mr Lankester
Mr Mountfield
Mr Walsh
Mr Tarkowski
Mr Kilpatrick
Mr Tyrrie

PROSPECTS FOR THE BRADY PLAN: CEPR MEETING

1. There was a lunch time CEPR meeting today at which Professor Daniel Cohen spelt out his views on the Brady plan including some lessons on the secondary debt market. I took the chair, without expressing any views myself.

2. There was no press handout, but there is a discussion paper entitled "Debt Relief and Secondary Market Discount" and there may be some press reporting tomorrow.

3. Cohen made two points of interest:

(i) In his view, the key "to an efficient rescheduling process is a clear commitment from the lenders that the flow of resources they will ask the debtor to transfer will reflect the secondary market discount." In other words, Cohen wants the lenders, acting together, to agree that there should be a reduced flow of resources from the debtors - in the hope that this will stimulate a larger share of investment in output in debtor countries - which takes the form of lower interest payments. He did not manage to explain quite why the banks should accept this.

(ii) Cohen contrasted the average price in secondary markets with what he called the "marginal price", which he defined as the value of an extra dollar of, say,

Brazilian debt to a bank. He claimed that this marginal value for the major debtors was actually zero, since Brazil and other debtors have such a major debt overhang. The moral, he thought, was that such countries should not waste resources buying back their own debt. Most of the audience found this analysis unclear/unconvincing.

HPE

H P EVANS

FROM: H G WALSH (IF1)
DATE: 9 May 1989
EXT: 4680

CHANCELLOR

cc: Economic Secretary
Mr Wicks
Mr Lankester
Mr Evans
Mr Mountfield
Mr Lazar

pp. 17.

GUYANA

We have been asked to convey the attached letter from Finance Minister Wilson of Canada, thanking you for your support in the Guyana Support Group operation which has now been brought to a successful conclusion. The Canadians have of course put an enormous administrative effort into filling the financing gap, and the UK has played a full role. It is now up to Guyana to show the same follow through with the programme (despite domestic difficulties) that Canada showed in raising the finance.

2. This letter provides an opportunity obliquely to make the point that bilateral associations should not be the determinant of chairmanship of Support Groups.

3. A draft reply is attached for you to send to Mr Wilson.

H.w.

H G WALSH

DRAFT LETTER

FROM: CHANCELLOR
TO: THE RIGHT HONOURABLE MICHAEL H WILSON
MINISTER OF FINANCE
CANADA

GUYANA

Thank you for your letter of 3 May about the Support Group for Guyana.

It was of course largely owing to your extraordinary efforts and determination, and to that of your Special Envoy Marcel Masse, that the Guyana Support Group was able to reach a successful conclusion in a worthwhile cause. This however is only the beginning: it is vital that Guyana should stick to its reform programme despite considerable domestic difficulties.

I am glad that you emphasised in your letter that the Guyana case has been an instance of the international financial community co-operating in an effort whose economic importance is multilateral. It goes well beyond the individual country concerned and its bilateral relationships. By making a major effort we have been able to help Guyana, but there is still a long way to go in eliminating arrears at the Fund.

Copies of this letter go to the recipients of yours.

Minister of Finance



Ministre des Finances

MAY - 3 1989

The Right Honourable Nigel Lawson
Chancellor of the Exchequer
H.M. Treasury
Parliament Street
London, SW1P 3AG
UNITED KINGDOM

My dear Colleague:

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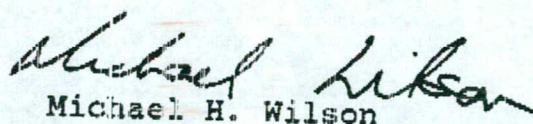
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I am confident that the donors and creditors which have participated in the Support Group recognize that the importance of this exercise goes beyond Guyana. I think we have all learned some valuable lessons from this first application of the intensified collaborative approach. The process has been long and not without its share of difficulties. Perhaps the most valuable lesson which we take away from this first Support Group exercise is that it has underscored the willingness of the international community to make special efforts to help cooperating countries with overdue obligations not only to normalize their relations with the international financial institutions and other creditors but also to provide extraordinary financial support to solid programmes of growth-oriented adjustment.

In closing, I would like to acknowledge the excellent collaboration that has been demonstrated by your officials throughout this initiative. I trust that you will convey my appreciation to all those who have endeavoured to ensure the success of this undertaking. I am also writing to Messrs. Amato, Bérégovoy, Brady, Murayama and Waigel.

Yours sincerely,


Michael H. Wilson

89-05-12 16:27

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9224

1126 05/12 04979668 SMCD5287.0007
OCRA6138

ATTN RT.HON. NIGEL LAWSON
ATTN CHANCEELOR OF THE EXCHEQUER
ATTN H.M. TREASURY
ATTN LONDON (UNITED KINGDOM)

Put

CH/EXCHEQUER	
REC.	12 MAY 1989
ACTION	Mr H.P. EVANS
COPIES TO	Mr WICKS
	Mr LANKESTER
	Mr MOUNTFIELD
	Mr WALSH

✓ 12/5

.REFNO: OCRA6138

12 MAY 1989

DEAR MR. MINISTER:

YOU WILL RECALL THAT ON DECEMBER 9, 1988, WE INFORMED YOU OF THE ESTABLISHMENT OF A SUPPORT GROUP FOR GUYANA UNDER THE CHAIRMANSHIP OF CANADA. THE GROUP, WHICH WAS ESTABLISHED IN THE FRAMEWORK OF THE INTENSIFIED COLLABORATIVE APPROACH TO THE PROBLEM OF ARREARS, COMPLEMENTED THE SIGNIFICANT WORK OF THE BANK-CHAired CONSULTATIVE GROUP ON GUYANA TOWARD SECURING THE FINANCING ARRANGEMENTS THAT WOULD ASSIST GUYANA IN RESUMING ECONOMIC GROWTH, SETTling ITS ARREARS TO THE FUND, THE WORLD BANK AND THE CARIBBEAN DEVELOPMENT BANK, AND RE-ESTABLISHING NORMAL FINANCIAL RELATIONS WITH OTHER CREDITORS.

WE ARE NOW PLEASED TO INFORM YOU THAT IN LATE APRIL 1989, MR. MARCEL MASSE, THE CHAIRMAN OF THE SUPPORT GROUP, ADVISED US THAT THE FINANCING ARRANGEMENTS FOR GUYANA HAD BEEN CONCLUDED. ALSO, ON APRIL 28, 1989 THE EXECUTIVE BOARD OF THE FUND ENDORSED GUYANA'S 1989 ECONOMIC PROGRAM AND AGREED TO ITS MONITORING BY THE FUND. THE GUYANESE AUTHORITIES HAD STARTED TO IMPLEMENT

THIS PROGRAM ON MARCH 31, 1989. THE EXECUTIVE BOARD ALSO ENDORSED THE INTENTION OF THE FUND'S MANAGEMENT SUBSEQUENTLY TO RECOMMEND APPROVAL OF THE USE BY GUYANA OF THE FUND'S RESOURCES SUBJECT TO SATISFACTORY PERFORMANCE UNDER THE FUND-MONITORED PROGRAM AND THE NORMAL CONDITIONS PERTAINING TO SUCH USE.

A BANK MISSION IS NOW IN GUYANA CONDUCTING PRELIMINARY DISCUSSIONS ON A POSSIBLE STRUCTURAL ADJUSTMENT CREDIT FROM IDA.

AS YOU ARE AWARE, GUYANA IS THE FIRST CASE IN WHICH
WE PURSUED THE INTENSIFIED COLLABORATIVE APPROACH.
THEREFORE, THE SUCCESS THAT HAS BEEN ACHIEVED IS OF
PARTICULAR IMPORTANCE FOR THE INTERNATIONAL FINANCIAL
COMMUNITY AND FOR OTHER MEMBER COUNTRIES IN ARREARS THAT
ARE CONSIDERING UNDERTAKING ECONOMIC REFORMS IN THE
FRAMEWORK OF THE COLLABORATIVE APPROACH. WE THANK YOU FOR
YOUR ASSISTANCE, WHICH WAS CRUCIAL TO THIS SUCCESS.

AS INDICATED IN MR. MASSE'S REPORT, ALTHOUGH THE
FINANCING PLAN HAS BEEN CONCLUDED SOME TASKS REMAIN TO BE
FINALIZED. IN PARTICULAR, FURTHER WORK IS NEEDED TO HELP
ENSURE AN APPROPRIATE PHASING AND TIMELY DISBURSEMENT OF
THE AGREED CONTRIBUTIONS DURING 1989 AND TO MINIMIZE THE
USE OF GUYANA'S SCARCE INTERNATIONAL RESERVES IN THE
FOURTH QUARTER. WE ARE CONFIDENT THAT WE WILL CONTINUE TO
HAVE YOUR SUPPORT IN SOLVING THESE REMAINING PROBLEMS. ON
OUR PART, WE WILL NOT SPARE OUR EFFORTS TO ASSIST THE
AUTHORITIES IN THE IMPLEMENTATION OF THEIR ECONOMIC
PROGRAM.

BARBER CONABLE
PRESIDENT, IBRD

MICHEL CAMDESSUS
MANAGING DIRECTOR, IMF

=05121122

NNNN
64111 IMF UW
*
262405 TRSY G



Mr Brown

Ant. 12/5

Foreign and Commonwealth Office

CONFIDENTIAL

London SW1A 2AH

EXCHEQUER	
REC.	12 MAY 1989
ACTION	<i>Mr R.I.G. ALLEN</i>
DEPS	<i>PS TEST</i>
TO	<i>SC P MIDDLETON</i> <i>S. T. BURNS, MR WICKS,</i> <i>MR LANKESTER,</i> <i>MR MOUNTFIELD, MR ILETT,</i> <i>MR EVANS, MR MEDLIS, P.J.R. PS/CHE.</i>

12/5 12 May 1989

See Charles.

Call by M. Santer, Luxembourg Prime Minister: 15 May

M. Santer will be calling on the Prime Minister for half an hour at his request. He will be accompanied by the Luxembourg Ambassador, M. Jean Wagner, and M. Alphonse Berns, the Director of International Economic Affairs at the MFA. Our Ambassador in Luxembourg, Mrs Campbell, will also be present. M. Santer is also seeing the Foreign Secretary, the Chancellor of the Exchequer, Mr Renton and Mr Maude (a programme is enclosed). The Prime Minister last met M. Santer at the independence celebrations in Luxembourg on 18 April. Their last full bilateral was on 21 September 1988 in Luxembourg. A personality note is enclosed.

This is an important visit for Santer, coming just before the national elections (on 18 June). It is not at all certain that Santer's Christian Social Party will remain as the major coalition partner. But the result is unlikely to affect UK interests since there is close to a consensus between the three main parties on the issues of most concern to us.

Santer's main aims (and ours) will be to discuss EC tax issues, which are of major importance to Luxembourg and on which we largely agree. But it will also be a useful opportunity to tackle him on SNF.

Luxembourg opposes in principle any administered indirect tax approximation, accepting that market forces will bring about whatever changes in tax rates may be required once fiscal frontiers are dismantled. But they also have strong practical objections, driven by concern not to lose the cross-border trade currently attracted by low Luxembourg tax rates. The Prime Minister will wish to welcome Luxembourg's approach, and to note the encouraging signs of flexibility and open-mindedness on the part of the Commission and most other member states.

Luxembourg is also firmly opposed to the Commission's proposal for a withholding tax on interest. They see it as a major threat to their financial sector (in which the UK is a major partner with new banks such as Lloyds and TSB continuing to open in Luxembourg). We have made clear our fundamental objections: the Commission's proposal is unnecessary, would not work and would damage financial markets, as was demonstrated by the German experience with their domestic

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withholding tax, now abolished. The Prime Minister may wish to stress the importance of continued UK-Luxembourg cooperation on this.

Luxembourg has reservations about the Delors Report recommendation for early work on institutional change. Santer told our Ambassador last month that he believed it was too soon to talk about Treaty amendment. The Prime Minister may wish to reiterate our own opposition to Treaty change whilst emphasising the practical measures on which we believe work should now be carried forward by ECOFIN and the Committee of Central Bank Governors.

The Luxembourgers are in the middle of the NATO pack on SNF. They agree that there should be no third zero and that decisions on a follow-on to LANCE should be taken in two stages: authorisation of research and development now; and a decision on whether to produce and deploy in 1990/91. But they also believe that, although there should be no question of SNF negotiations at this stage, they are inevitable in due course; they should be considered in 1990/91 in the light of progress in other arms control talks. The Prime Minister may wish to explain our objections to SNF negotiations and the risk of ending up with a third zero. Up to date short range nuclear missiles will continue to be an essential element of NATO's strategy of flexible response irrespective of progress in other arms control fora.

Santer may raise President Mitterrand's audio-visual initiative and the proposed September Conference on High Definition Television (HDTV), to which Council of Europe members and probably some Eastern European countries are being invited. Luxembourg, as a broadcasting centre, favours cooperation between European programme makers; but is likely to agree with us that the emphasis should be on industry-led co-operation, avoiding government subsidies or fiscal incentives. This is another field in which the UK is a major partner. UK firms have bought over half of the Channels on Luxembourg's Astra broadcasting satellite.

I am copying this letter to Alex Allan (HMT) and Trevor Woolley (Cabinet Office).

Jani,
Stephen Wall
(J S Wall)
Private Secretary

C D Powell Esq
10 Downing Street

CONFIDENTIAL

VISIT BY M SANTER, PRIME MINISTER OF LUXEMBOURG: 15 MAY

PROGRAMME

- 1000 Arrive Gatwick
- 1230 Working lunch with the Foreign Secretary (full Luxembourg delegation, HMA Luxembourg, Sir J Fretwell, Mr Kerr, PS, Mr Blunt (WED))
- 1415 Call on Mr Renton, Home Office (Ambassador, M Zimmer, M Bausch)
- 1500 Call on Mr Maude, DTI (Ambassador, M Berns, M Mersch)
- 1545 Call on Chancellor of the Exchequer at No 11 (Ambassador, M Bausch, M Mersch)
- 1630-1700 Call on Prime Minister (Ambassador, Mr Berns)
- 1900 Depart Gatwick

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SANTER, JACQUES

Minister of State (Prime Minister), Minister of Finance, of National Development and of the Posts, Telecommunications and Information Technology. (Christian Social).

Born 1937. Educated in Strasbourg and Paris (Doctorate in Law). Worked as lawyer at the Luxembourg Court of Appeal for 4 years before going into politics. Member of the Chamber of Deputies since 1974. Member of the European Parliament from 1974-79. Appointed Minister of Labour, Social Security and Finance 1979. He led the PCS election campaign in 1984 and was invited to form a government where the Christian Social Party again gained the highest number of seats.

A devout Catholic, who retains a strong interest in social and labour affairs. He is able and friendly and has established himself in the eyes of British and other European Ministers. Though a strong performer on EC matters he has distanced himself and his country from the integrationists. Keenly interested in TV/Satellite questions. Played an important neutral role during the Luxembourg Presidency on IGC but achieved little as Chairman of Ecofin.

Speaks English but prefers French. COI visitor (1973).

CONFIDENTIAL

LUXEMBOURG ECONOMY

As a small open economy, Luxembourg has benefited greatly from the sustained expansion of its larger neighbours. Like them, it is now experiencing increasing inflation.

Population (1987): 370,000. GDP (1987, at PPPs): \$5.5 billion

GDP per capita (1987): \$14,700 (UK: \$12,300)

Per cent change on year earlier	1987	1988	1989
GDP	2.0	3.0*	2.8**
Fixed Investment	3.5	4.5*	3.5**
Consumer Price Inflation	0	1.5	2.7 (Feb)
Surplus on current transactions (per cent GDP)	**38	39*	36**
Unemployment (per cent)	1.7	1.6	1.4 (Jan)

* Estimate

** Forecast

Source: OECD except *** EC

Policy Issues

- Restructuring of economy, to reduce reliance on steel, has been a major priority since first oil shock of 1974, and has been generally successful. This has freed resources for the service sector which provides roughly 60 per cent of GDP. Steel now accounts for under 8 per cent of employment compared with 17 per cent in 1970.

- Fiscal policy. Public sector debt is tiny and the public sector is roughly in financial balance. The Budget for FY1989 includes further reductions in taxation on companies and individuals, aided by buoyant revenue. The Railway system still absorbs a large annual subsidy and pensions will place an increasing demand on public expenditure.

- Inflation has been rising. Luxembourg's small size and very open economy leaves no scope for independent monetary policy.

- The open-ness of the Luxembourg economy means that it is particularly influenced by other countries' tax and regulatory regime. Exports of services, largely financial and communications services, make up roughly 80 per cent of Luxembourg's exports. As host to Eurobond market, Luxembourg was one of the recipients of additional German capital following the announcement of the short-lived German withholding tax. The authorities hope that overseas residents will increasingly take jobs in Luxembourg and so reduce any inflationary pressure from the tight domestic policy market.

PRIME MINISTER OF LUXEMBOURG**MEETING WITH CHANCELLOR OF THE EXCHEQUER - 15 MAY****SUBJECT: TAX APPROXIMATION****OBJECTIVE:**

7 To impress upon Mr Santer the need to reach agreement as quickly as possible on proposals which would achieve the abolition of fiscal frontier controls by means acceptable to all Member States. An approach along UK lines offers the best prospect of realistic progress by 1993.

POINTS TO MAKE:

- i. Welcome Luxembourg support for the view that tax approximation is unacceptable and unnecessary for completion of Single Market; also welcome support given to UK approach.
- ii. Becoming increasingly clear that the many practical difficulties inherent in Commission's proposals mean agreement on them would not be reached by 1992 - if at all;
- iii. Welcome flexibility and recognition by Commission of the difficulties with their proposals. UK strongly supports abolition of fiscal frontier controls. Important to make progress now - based on realistic, practical measures.

BACKGROUND

Luxembourg's views

Luxembourg derives considerable revenue benefits from its system of low indirect tax rates, and would therefore be adversely affected by the Commission's proposals. The standard rate of VAT is currently 12 percent, with reduced rates of 3 and 4 percent. The proposals for alcohol and tobacco would cause serious difficulties as Luxembourg uses the lower prices of these items to stimulate cross-border shopping. Under the proposals, duty on spirits would rise by about 45 percent; on table wine by about 25 percent and on beer by about 230 percent.

Luxembourg shares considerable common ground with UK in opposing the Commission's proposals. At COREPER in February, it joined the UK and Denmark in rejecting the need for tax approximation and at a recent excise working group, it argued that fiscal frontiers can be removed without approximation.

Present position

On 10 April 1989, at a plenary session of the European Parliament in Strasbourg, Madame Scrivener, the Commissioner responsible for fiscal harmonisation, indicated that the Commission accepted that its proposal for a VAT clearing house was unlikely to achieve unanimity by 1993. But the Commission still consider that approximation of VAT rates is necessary. She conceded that full harmonisation of excise duty rates is not feasible; and appeared to accept the need for a solution to cater for the continuation of UK zero rating in the long term. She also appeared to countenance retention of high excise duty rates on alcohol and tobacco, on health and social grounds; and showed willingness to examine alternative proposals.

Madame Scrivener indicated that she would be putting revised proposals to her fellow Commissioners in May. Discussion can be expected at either the informal May ECOFIN or the June ECOFIN, depending on the Commission's timetable. It is anticipated that the proposals - and alternatives put forward by other Member States - will then be examined in detail, possibly by a high level group of experts drawn from the member states. There is no real prospect of further progress until the Commission's revised ideas have been received and discussed.

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CHANCELLOR'S MEETING WITH LUXEMBOURG FINANCE MINISTER

SUMMARY

1. POOS CONFIRMS LUXEMBOURG POSITIONS ON WITHHOLDING TAX AND BANKING RECIPROCITY. HE INDICATES, ON A PERSONAL BASIS, CAUTION ABOUT TOO-RAPID IMPLEMENTATION OF DELORS REPORT CONCLUSIONS.

DETAIL

2. THE CHANCELLOR HAD A BILATERAL MEETING WITH THE LUXEMBOURG ECONOMICS MINISTER, POOS, BEFORE THE ECOFIN LUNCH TODAY. THREE ISSUES WERE DISCUSSED: WITHHOLDING TAX, THE DELORS REPORT AND BANKING RECIPROCITY.

WITHHOLDING TAX

3. POOS SAID THAT THE LUXEMBOURG AND UK POSITIONS WERE SIMILAR. (THE CHANCELLOR AGREED). THE QUESTION WAS WHETHER TO REMIT THE PROPOSAL AGAIN TO THE AD HOC GROUP, OR TO SEEK TO KILL IT OFF IMMEDIATELY.

4. THE CHANCELLOR DOUBTED THAT IT WOULD BE POSSIBLE TO END DISCUSSIONS NOW. THERE WOULD BE FURTHER CONSIDERATION OF BOTH THE WITHHOLDING TAX AND THE EXCHANGE OF INFORMATION BETWEEN FISCS. THE UK POSITION ON THIS, OR ANY, WITHHOLDING TAX WAS CLEAR: IT WOULD NOT ACHIEVE THE ENDS FOR WHICH IT WAS PROMOTED, AND IT WOULD DAMAGE THE COMMUNITY AS A WHOLE. POOS AGREED WITH THIS ANALYSIS. LUXEMBOURG WOULD CONTINUE TO OPPOSE THE PROPOSALS REGARDLESS OF THE OUTCOME OF THE ELECTION IN JUNE.

DELORS REPORT

5. POOS SAID THAT LUXEMBOURG'S REPRESENTATIVE ON THE DELORS GROUP HAD ACCEPTED THE FINAL DRAFT OF THE REPORT, INCLUDING ITS PROPOSAL

THAT FURTHER DEVELOPMENTS SHOULD TAKE PLACE IN THREE STAGES. THE POINT OF INTEREST WAS WHEN DISCUSSION OF TREATY AMENDMENT SHOULD BEGIN. SPEAKING PERSONALLY, HE THOUGHT THIS SHOULD NOT BE UNTIL AFTER 1992. IT WAS TOO EARLY TO START SUCH A DISCUSSION NOW.

6. THE CHANCELLOR SAID THE INSTITUTIONAL PROBLEM WAS A REAL ONE. IT WAS MOST UNFORTUNATE THAT THE REPORT HAD RECOMMENDED THAT PREPARATORY WORK ON TREATY CHANGE SHOULD BEGIN IMMEDIATELY. POOS SAID THAT IT MIGHT BE POSSIBLE TO MUSTER A MAJORITY IN MADRID IN FAVOUR OF STARTING WORK IMMEDIATELY. BUT THIS WOULD SIMPLY CREATE AN IMPASSE. THE TREATY WAS A CONSTITUTIONAL DOCUMENT. IT COULD NOT BE AMENDED EVERY YEAR OR TWO.

fairly helpful

RECIPROCITY

7. THE CHANCELLOR SAID THAT THE LATEST DRAFT TEXT WAS A CONSIDERABLE IMPROVEMENT ON THE ORIGINAL. FURTHER CHANGES WERE NECESSARY BUT, IF PEOPLE WERE PREPARED TO BE FLEXIBLE, HE FORESAW AGREEMENT BEFORE LONG.

8. POOS SAID THAT LUXEMBOURG COULD NOT ACCEPT THAT THE COMMISSION SHOULD HAVE THE POWER TO DECIDE ON RETALIATION AS PROPOSED IN ARTICLE 5 OF THE REVISED PROPOSAL. THIS MEANT THAT THE COMMISSION MIGHT BLOCK AUTHORISATIONS AND ACQUISITIONS. LUXEMBOURG WAS ALSO CONCERNED THAT, IF ADOPTED, THE PROPOSAL MIGHT ENCOURAGE SIMILAR PROPOSALS TO DEAL WITH INWARD INDUSTRIAL INVESTMENT.

9. THE CHANCELLOR SAID WE SHARED THE VIEW THAT ANY EVENTUAL RETALIATORY ACTION SHOULD BE IN THE HANDS OF THE COUNCIL, NOT THE COMMISSION. ACTION OF THIS SORT SHOULD ONLY BE TAKEN IF IT WAS ABSOLUTELY ESSENTIAL AND IF IT WERE THOUGHT LIKELY TO BE EFFECTIVE. THAT WAS A POLITICAL DECISION. WE OUGHT TO BE ABLE TO SECURE A CHANGE IN THE TEXT ALONG THESE LINES. WE ALSO AGREED THAT RECIPROCITY OVER INDUSTRIAL INVESTMENT REGULATIONS WAS COMPLETELY UNACCEPTABLE. BUT THERE WAS NO TREATY BASE, AND IT DID NOT SEEM A REALISTIC POSSIBILITY.

CAMPBELL

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CONFIDENTIAL

FROM: SUSIE SYMES (EC1)
DATE: 12 MAY 1989
X 4441

CHANCELLOR

cc PS/Paymaster General
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Wicks
Mr Lankester
Mr R I G Allen
Mr Mountfield
Mr Ilett
Mr Melliss

PS/Inland Revenue
PS/Customs and Excise

MEETING WITH M SANTER, 15 MAY

(HMA Lnx'bg) You are seeing M Santer, the Prime Minister of Luxembourg, at 3.45 at No.11 on Monday, 15 May. The Paymaster General, Juliette Campbell and Richard Allen will attend.

2. M Santer will be accompanied by Jean Wagner (Luxembourg Ambassador in London), Jean-Jacques Kasel (Political Director) and Romain Bausch (Counsellor, Ministry of Finance).

3. The Prime Minister will be seeing M Santer later that Monday afternoon.

4. The Private Secretary letter attached covers EC monetary and tax issues to be covered in your meeting. I attach a note from IF2 on the Luxembourg Economy, and some more detailed briefing on fiscal frontiers provided by Customs and Excise.

5. M Santer might want to discuss banking and reciprocity, which I expect M Solchaga to raise over lunch at next week's informal ECOFIN on 19-21 May (although not on the formal programme). The UK has welcomed as a constructive move the Commission's revised proposals for a reciprocity provision in the second directive. But points of difficulty remain, and following the ECOFIN discussion on 17 April we have continued to press - in particular - that use of any reciprocity provision should be under Council control. Luxembourg agree; indeed only France is still supporting the Commission on this aspect.

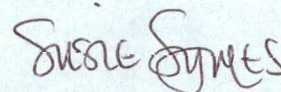
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6. You might stress that despite the progress made on reciprocity, and our enthusiasm to achieve the single market in financial services, the UK could not agree to adopt the directive until our concerns on other provisions have been addressed. There is no need to discuss these concerns in detail. But if raised, you could say that our concerns include points to be discussed in COREPER later in the week:

a. the circumstances in which secret banking supervision information can be passed on to other parties, on which we believe that harmonisation of widely differing laws is impracticable and unnecessary at this stage: better to leave as a matter for national laws, with each national supervisory authority having a right of veto over onward dissemination, of information it has provided, by the authority in another member state. [The UK wants a wide range of 'gateways', as in the Banking Act.]

b. absolute levels for initial and continuing capital, which we think it unnecessary to harmonise: the thing that matters is to harmonise minimum requirements for capital in relation to risk - the solvency ratio derived from the Basle Convergence agreement. [Luxembourg tends to disagree.] There are also a number of technical and other points which need to be got right.

7 I am also attaching the reporting telegram on your meeting with M Poos in Luxembourg last month. A personality note on M. Santer is annexed to the private secretary letter



SUSIE SYMES

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[Handwritten signature]

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

16 May 1989

Richard Gozney Esq
PS/Secretary of State
Foreign and Commonwealth Office
Downing Street
LONDON
SW1A 2AL

cc PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Wicks
Mr Lankester
Mr R I G Allen
Mr Mountfield
Mr Ilett
Mr Melliss
Ms Symes

PS/IR
PS/C&E

Dear Richard

CHANCELLOR'S MEETING WITH LUXEMBOURG PRIME MINISTER

M. Jacques Santer, the Prime Minister of Luxembourg, called on the Chancellor yesterday afternoon. He was accompanied by Luxembourg officials; the Paymaster General, Mr R I G Allen (Treasury), and HM Ambassador Luxembourg were also present.

The Chancellor, opening the discussion, noted that on a wide range of EC issues, our two countries' positions were very close. It was important that this should continue to be so.

Delors Report

Santer said that Luxembourg was a small country, which was already linked monetarily to Belgium. Luxembourg therefore supported the principles of EMU, with all the consequences which followed from that. But progress towards this goal must be very cautious. Delors was right to divide the process into three stages. These should be taken in a pragmatic, realistic way, building on the system as it existed at present. Luxembourg was not in favour of calling an Inter-Governmental Conference (IGC) at this stage. It was one thing to call an IGC by majority; it was quite another to seek to reach agreement, by unanimity, at that IGC.

The Chancellor said that it was wise not to seek to have an IGC at this stage. There seemed to be a misunderstanding, in some quarters, that because the UK had agreed to the Single European Act, it would also agree to anything which might arise from that. In fact, the position was exactly the reverse. The Single European Act was itself a major undertaking, beyond which we were not prepared to go. Completion of the single market was an enormous job, and the Community should not be distracted from



that. There was, in any case, no way in which it would be possible to get a new Treaty accepted by the House.

The Chancellor agreed that we should see how far co-operation could be improved within the framework of the existing Treaty. Much of the material in Delors' first stage could be useful here - though we could not accept the proposition that embarking on that first stage meant accepting the whole process. The Chancellor commented that, despite Luxembourg's monetary union with Belgium, the Delors proposals would nonetheless cause Luxembourg difficulties since they envisaged imposing wholly new centralised budgetary controls on Member States.

Santer asked whether this meant that the Chancellor doubted that there would be any progress at this weekend's informal ECOFIN meeting. The Chancellor said he would be interested to hear what others had to say. If there were agreement to focus only on the first stage, some progress might be possible. But if others wished to go any further than this, there would be no progress. Santer said that, unlike the UK, Luxembourg could agree to embarking on all three stages in the report. Luxembourg also agreed, however, that action should be focused on what was practicable.

One of Santer's officials asked whether it was not necessary to have budgetary co-ordination between countries if there were monetary co-ordination between them. The Chancellor said that all that was required was an agreement not to monetise budgetary deficits, and that Member States would not be bailed out of their budgetary difficulties. Delors, however, thought that you also needed control from the centre, and intervention through regional policy. This raised a further question: how would this great accretion of economic power in the centre be made accountable? But we did not think it wise to go down this road in the first place.

Santer asked whether our wish to focus on closer co-operation within the existing framework included UK membership of the ERM. The Chancellor said that our position was clear: we would join when the time was ripe.

Withholding tax

Santer said that it was now clear that the original Commission proposal could not be followed through. It was, in any event, not a necessary condition for capital liberalisation. The Chancellor noted that this was no accident - we had had to press hard for this in ECOFIN, last year. The Chancellor said that the focus of debate might well shift towards greater exchanges of information between fiscal authorities. Santer said that Luxembourg could not go as far as the Second Draft Directive on the exchange of information, though the Mutual Assistance Directive would be acceptable. The Chancellor said we could also accept the Mutual Assistance Directive, though it would be very difficult to go further than that.

Indirect tax

Santer said the Commission would need to come up with new proposals on indirect tax harmonisation. He understood that the Commission was likely to propose a minimum rate of VAT at 15 per cent, a lower range of 4-9 per cent, and continuing zero rates as a transitory derogation. This would not be enough of a revision from the earlier proposals for Luxembourg: for example, the bureaucratic clearing house mechanism was still in play. The Chancellor said that we could not accept the clearing house mechanism either. Nor could we accept that maintenance of zero rates could only be a transitory derogation. But in any event, none of this was necessary for the abolition of fiscal frontiers, as our own papers had demonstrated. Moreover, there was no possibility of approximating excise duties. The Chancellor said that we awaited the Commission's proposals. But if they were as close to the old proposals as Santer's information implied, there was no chance of any agreement on them. Santer agreed.

I am copying this letter to Charles Powell (No.10), and Paul Tucker (Bank).

Yours ever

J M G Taylor

J M G TAYLOR
Private Secretary

From: T P Lankester
Date: 17 May 1989

CHANCELLOR

cc

Economic Secretary
Sir P Middleton
Mr N Wicks
Mr Peretz
Mr R I G Allen
Mr Bottrill
Mr Walsh

Mr Isaac - IR
Mr J Kerr - FCO
Mr Lavelle - CO

ANGLO/FRENCH TALKS

We had our six-monthly talks with the French Treasury yesterday. In addition to an exchange on the UK and French economies, we discussed the following topics.

International Debt

2. The French challenged our view that there should be no additionality of IFI lending in support of debt reduction. They argued that substantial additional funds were needed if the "arithmetic was to work" and if a substantial reduction in debt was to be achieved (which they thought politically and economically necessary). We spoke on standard lines emphasising that we did not wish to see a further transfer of risk from the private to the public sectors and that, while we were willing to see modest amounts of IFI money being used in support of debt reduction, the latter should come about largely as a result of negotiations between the debtors and creditors. The proposal that the IMF might in certain circumstances lend into a financing gap should help this process along - insofar as it would put pressure on the banks to reach agreement or suffer a build up of arrears. We suggested that it would be a mistake to hurry individual negotiations such as Mexico too fast: in order to achieve sizeable debt reductions, a period of some disorder might be needed.

3. The French listened politely but seemed unimpressed by our arguments, although they professed to agree with our concern about transfer of risk. They remain clearly in the American camp.

4. We also presented our paper on Burden Sharing with particular reference to ensuring that in future the Paris Club does not make an excessive contribution. As guardians of the Paris Club, they seemed more interested in this and promised to give it careful study. The paper will be circulated to the Paris Club for discussion at its next meeting.

Delors Report

5. My French opposite number (in what was clearly a carefully considered statement) said that the UK could very well face a choice in Paris in December: either we would commit ourselves to joining the ERM, or else France would lead the others to a separate monetary treaty. We of course refused to be drawn on how we would react to such a choice though we made clear that we would deplore a parting of the ways. The French said that the Italians and the Spaniards were very close to them in their thinking and that the Spaniards might well announce a firm date for joining the ERM at Madrid. (Our own reporting from Madrid, incidentally, does not by any means support this as a certainty: Spanish officials have serious reservations about early participation in the ERM, though these may be outweighed by political pressure.)

Taxation of Savings

6. The French more or less admitted that the withholding tax is dead. They proposed instead that we should now all focus on information powers and they said they were working up a proposal involving a further strengthening of the draft proposal already on the table. We were unable to elicit what precisely this was, but said we would look at whatever they came up with. (It seemed to be some variant of the Option 3 put forward in a recent note by Mr Isaac to you.)

Indirect Taxation

7. We noted encouraging movement from the Commission in the direction which we had been working for. We remained firmly opposed to centrally imposed VAT harmonisation, but we were keen to see progress on the new system of tax collection and rebate that would be required if fiscal frontiers were to be eliminated. The French seemed rather unsighted on latest Commission thinking, but said that any permanent acceptance of zero rates would be very difficult for them. We made clear that a merely transitional arrangement would not be good enough for us.

Reweighting of the ECU

8. The French said it would take some time to reach agreement on this. We made it clear that we favoured an early decision but there was no way we would go along with recent proposals put forward by the French. We warned that, in the absence of agreement, the existing weightings would have to continue.

E. K. Davies

PP T P LANKESTER



10 DOWNING STREET

From the Private Secretary

CH/EXCHEQUER	
REC.	18 MAY 1989
ACTION	Mr Bottrill
COPIES TO	PS/EST MR NICKS MR LANCHESTER MR H.P. EVANS MR MOUNTFIELD MR WALSH
18 May, 1989.	

Dear Bob,

PRIME MINISTER'S MEETING WITH THE PRESIDENT OF THE INTER-AMERICAN BANK

The Prime Minister had a good talk this morning with Senor Iglesias, whom she thought rather good news.

Sr. Iglesias was cheerfully pessimistic about the prospects in Latin America. The past decade had been very difficult: the outlook was not much better. There were some bright spots: Chile, his own country Uruguay, and Bolivia - not long ago a joke country but now applying Thatcherite policies. He also mentioned with approval new legislation on private investment in Mexico, which represented an important breakthrough. The problems of Latin America were poor public administration, together with economic and social fatigue. Sr. Iglesias and the Prime Minister vyed with each other in gloomy predictions about Argentina.

Turning to the affairs of the Inter-American Development Bank, Sr. Iglesias said that he was not so much running a bank as a hospital. He saw his role as helping countries to change their policies and modernise their ideas. He was also keen to develop lending to support environmental policies. The Prime Minister expressed sympathy for Sr. Iglesias' problems. He had to deal with countries who wanted to borrow money but did not want to repay it or pay interest on it.

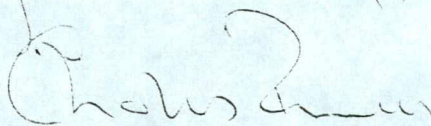
The Prime Minister asked Sr. Iglesias' views on the debt situation. Sr. Iglesias said that he was trying to discourage Latin American governments from being fixated on debt. There was a tendency to believe that solving the debt problem would solve all problems, which was simply not true. Look at Peru, which had failed to pay anything on its debt for five years, but was in worse shape than ever. The essential step towards overcoming debt problems was the adoption of sound domestic economic policies. Among other things, this would help attract

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capital back into the country, a crucial factor in a country like Venezuela, where capital held by Venezuelans outside the country was twice the amount of overseas debt. He was also a believer in the step by step approach. The Prime Minister cautioned against trying to transfer the burden of commercial debt onto the taxpayers' shoulders.

I am copying of this letter to Alex Allan (HM Treasury), Neil Thornton (Department of Trade and Industry) and Myles Wickstead (Overseas Development Administration).

Yours sincerely,


C.D. POWELL

R.N. Peirce, Esq.,
Foreign and Commonwealth Office.

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FROM: J M G TAYLOR

DATE: 22 May 1989

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

MR LANKESTER

cc PS/Economic Secretary
Sir P Middleton
Mr N Wicks
Mr Peretz
Mr R I G Allen
Mr Bottrill
Mr Walsh

Mr Isaac IR
Mr J Kerr FCO
Mr Lavelle CO

ANGLO/FRENCH TALKS

The Chancellor was grateful for your note of 17 May.

A handwritten signature in the bottom right area of the page.

J M G TAYLOR