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PART B

Part B

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Begins : 15/6/88
Ends : 18/11/88

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P0 - CH | NL | 0560.
Pt. B.

Chancellor's (Lawson) Papers:
The Single European Market and
Fiscal Harmonisation: The United
Kingdom Approach.

DD's : 25 Years

[Signature]

26/4/96

P0 - CH | NL | 0560.
Pt. B.



the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
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15 JUN 1988

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EC MERGER CONTROL REGULATION

At its meeting on 28 April, OD(E) invited me to report on progress in discussions on an EC Merger Control Regulation, before the Internal Market Council next discussed the issue. The Council is due to consider this subject on 22 June.

Against the background of our general reservation of principle, officials have explored the scope for improvements to the regulation in the main areas where we have concerns. Our main concerns are:

- (i) Scope. A regulation should apply to a relatively small number of genuinely Community-wide mergers
- (ii) Interface with national controls. Within the scope of the regulation, we should seek so far as possible to avoid "double jeopardy" for firms. The Commission should therefore have exclusive jurisdiction (subject to further exploration of the scope for national prohibition on specific grounds or in specific sectors).
- (iii) Interface with Articles 85 and 86. Even outside the scope of the regulation, Commission powers under Articles 85 and 86 should be removed as part as far as possible.

Young
→
CH/EX
15/6



- (iv) Criteria for intervention. The Commission's powers to "authorise" mergers should be defined as narrowly as possible, with the emphasis on competition rather than "industrial strategy".

Some progress has been made on some of these issues; though there is a long way still to go before we can reach a considered assessment of the merits of the proposal. On scope, we have the support of approximately half the Member States for an increase in the thresholds, both for the overall size of merger caught, and for the size of de minimis exceptions. But a clear divergence of interest is beginning to emerge as between the larger Member States which have effective merger control systems of their own, and the rest, who are looking to a Community regulation as a means of protecting national firms from foreign takeover. On the scope for national prohibition, the Commission have stated that national states' competition laws must respect the primacy of EC law, but that this did not mean that Member States could not apply laws that laid down rules on other matters, eg. conditions for banking, or to deal with unfriendly takeovers, provided that these laws were in conformity with EC law. This issue is a key one for many Member States, and further discussion has been set aside for the future.

On other issues, discussion is at a very early stage. There is general agreement that below the threshold of the regulation, Commission powers under Articles 85 and 86 should be minimised; the French in particular attach importance to this. There are legal limits to this process - a regulation cannot disapply the Treaty. But it should be possible, given the political will on all sides, to reduce the effective application of Articles 85 and 86 to mergers. On the criteria for intervention, the French have challenged the philosophical basis of the Commission's draft, and oppose the concept of mergers being prohibited simply because they create or enhance a dominant position.

It is clear from this that it will be some considerable while before a proposal emerges which is clear enough on these key issues to enable us to take a decision of principle for or against a regulation. Our position should remain one of open-mindedness about the principle, combined with continued willingness to contribute constructively to discussions.

Our position at the Council meeting on 22 June should be to maintain our current line. It is premature for the Council to be asked to take firm decisions, either on the regulation as a



the department for Enterprise

whole or on any significant aspect of it. We should make clear that the various issues which are still subject to discussion are closely interrelated, and it is not possible to reach a firm position on any one of them until the shape of the regulation as a whole is clear.

It is possible that the Presidency will nevertheless put before the Council the three questions covered at COREPER, and ask for Member States' views on 1) the primacy of the EC regime over national controls; 2) the principle of compulsory pre-notification; and 3) the criteria for intervention. I propose that the UK delegate should make clear that we regard such questions as premature, and cannot take a firm position; but that he should indicate the nature of our concerns in very general terms, on the lines of the COREPER discussion.

Conrad
David

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FRAME ECONOMIC

INDIRECT TAX APPROXIMATION : MEETING OF THE HIGH LEVEL GROUP : 16
JUNE 1988

SUMMARY

1. LIST AGREED OF QUESTIONS REQUIRING POLITICAL CONSIDERATION. PRESIDENCY WILL PREPARE PAPER FOR PRESENTATION TO THE ECOFIN COUNCIL, POSSIBLY AS EARLY AS JULY. CLEAR EVIDENCE OF GROWING APPRECIATION BY SEVERAL MEMBER STATES OF BENEFITS OF A GRADUAL, INTERIM APPROACH TO LIBERALISATION OF TRADE.

DETAIL

2. THE PRESIDENCY EXPLAINED THAT THE PURPOSE OF THE MEETING WAS SIMPLY TO DRAW UP A LIST OF POLITICAL QUESTIONS TO BE PUT TO THE ECOFIN COUNCIL, NOT TO TRY TO ANSWER THEM. THE STARTING POINT WAS THE FOLLOWING LIST PREPARED BY THE PRESIDENCY:

- A) NEED FOR TAX APPROXIMATION (BOTH VAT AND EXCISE DUTIES) FOR THE COMPLETION OF THE INTERNAL MARKET.
- B) VAT
 - I) 2 RATE SYSTEM INCLUDING CLASSIFICATION OF GOODS AND ZERO RATES:
 - II) WIDTH OF TAX BANDS:
 - III) COMPLETION OF HARMONISATION OF THE VAT BASE:
 - IV) NEED FOR AND BASIC STRUCTURE OF THE PROPOSED CLEARING SYSTEM.
- C) EXCISE DUTIES:
 - I) VARIOUS APPROACHES TO HARMONISATION (COMMISSION'S PROPOSALS, EPC IDEAS, RATE BANDS, MINIMUM RATES):
 - II) POSSIBLE USE OF TAX STAMPS (BANDEROLES):
 - III) COMMUNITY MONITORING SYSTEM (EG LINKED BONDED WAREHOUSES).

3. THERE WERE TWO TOURS DE TABLE, THE FIRST ON VAT (THE QUESTIONS IN PARAGRAPH 2(A) AND B)), THE SECOND ON EXCISE DUTIES (PARAGRAPHS 2(A) AND (C)). MOST DELEGATIONS AGREED THE LIST COVERED MOST OF THE ESSENTIAL QUESTIONS, AND TENDED TO REPEAT WELL-KNOWN DIFFICULTIES. THE FOLLOWING RECORDS THE MAIN ADDITIONAL POINTS OF INTEREST.

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4. DENMARK CONSIDERED THAT THE QUESTION OF ALTERNATIVES TO TAX APPROXIMATION SHOULD BE ADDRESSED. IT WAS PREMATURE TO PUT THE VAT CLEARING SYSTEM TO MINISTERS SINCE FURTHER TECHNICAL DISCUSSION WAS NEEDED. ON EXCISES, THE PRESIDENCY'S LIST WAS PARTLY POLITICAL AND PARTLY TECHNICAL. BELGIUM AGREED THE CLEARING SYSTEM WAS NOT RIPE FOR THE COUNCIL, AND THE LINKED BONDED WAREHOUSE IDEAS REQUIRED MORE TECHNICAL STUDY.

5. THE UK SUGGESTED TWO ADDITIONAL QUESTIONS:

I) HOW THE COMPLETION OF THE INTERNAL MARKET MIGHT BE ACHIEVED IN THE ABSENCE OF TAX APPROXIMATION:

II) SHOULD HARMONISATION BE RESTRICTED TO ITEMS WHERE DISTORTION OF TRADE MIGHT ARISE.

WE WERE READY TO SUBMIT A PAPER EXPLAINING A POSSIBLE ALTERNATIVE TO THE COMMISSION'S OVERALL APPROACH, BASED ON LIBERALISATION OF TRADE AND THE PROGRESSIVE APPLICATION OF MARKET FORCES. COSTS OF OPERATING THE COMMISSION'S PROPOSED SYSTEM SHOULD BE ASSESSED, AND IT WAS QUESTIONABLE WHETHER MINISTERS COULD TAKE DECISIONS BEFORE THESE HAD BEEN ESTABLISHED. ON EXCISES, THE QUESTIONS ON BANDEROLES AND THE LINKED BONDED WAREHOUSE SYSTEM REQUIRED TECHNICAL STUDY BEFORE SUBMISSION TO MINISTERS.

6. PORTUGAL FELT MINISTERS SHOULD ADDRESS THE PRINCIPLE OF ALTERING THE SCOPE AND COVERAGE OF THE PROPOSED REDUCED VAT RATE BAND. EXCISE DUTIES IN GENERAL REQUIRED FURTHER TECHNICAL STUDY. ALIGNMENT OF DIRECT TAXES WOULD ALSO BE NEEDED.

7. THE NETHERLANDS SURPRISINGLY CONCEDED THE NEED TO STUDY ALTERNATIVES TO THE COMMISSION'S APPROACH. IT WOULD BE POSSIBLE TO TAKE PROGRESSIVE STEPS TOWARDS THE ULTIMATE OBJECTIVE OF ABOLISHING FRONTIERS, AND COULD TAKE THE FORM OF A STREAMLINED VERSION OF THE CURRENT BENELUX SYSTEM, E.G. A LICENSING OR AUTHORISATION SYSTEM ALLOWING TRADERS TO CROSS BORDERS WITHOUT CHECKS. UNDER PRESSURE FROM THE PRESIDENCY THE NETHERLANDS AGREED TO SUBMIT A PAPER, BUT INDICATED IT MIGHT TAKE SOME TIME. ON EXCISES, AN "INTERMEDIATE STAGE" WOULD ALSO BE NECESSARY IF THE DIFFICULTIES WITH THE COMMISSION'S PROPOSALS PROVED INSURMOUNTABLE. CONSIDERATION OF LINKED WAREHOUSES SHOULD BE DEFERRED UNTIL ANSWERS TO THE OTHER QUESTIONS WERE AGREED.

8. LUXEMBOURG SUPPORTED THE CONSIDERATION OF ALTERNATIVES. THE ZERO RATE NOTIFICATION SYSTEM HAD BEEN DISMISSED TOO HASTILY: IT MIGHT BE NECESSARY TO PROCEED ON A STEP-BY-STEP BASIS. HARMONISATION

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MIGHT BE NECESSARY ONLY WHERE THERE WAS A REAL RISK OF DISTORTION OF TRADE.

9. ITALY STRESSED THAT EVERYTHING IN THE PRESIDENCY LIST WOULD REQUIRE IN-DEPTH TECHNICAL STUDY BEFORE POLITICAL DECISIONS COULD BE TAKEN. THEY WERE NOT OPPOSED TO THE FURTHER STUDY OF ALTERNATIVES. THE QUESTION OF ZERO RATES NEEDED CAREFUL STUDY.

10. IRELAND REPEATED THE NEED FOR MINISTERS TO ADDRESS THE BUDGETARY IMPACT OF THE COMMISSION'S PROPOSALS ON CERTAIN MEMBER STATES. IT WAS PREMATURE FOR THE COUNCIL TO DISCUSS BANDEROLES AND LINKED WAREHOUSES.

11. FRANCE IN A RAMBLING CONTRIBUTION POSSIBLY INTENDED TO AVOID GIVING TOO MUCH AWAY, SUPPORTED THE NEED TO CONSIDER PRACTICAL WAYS AND MEANS OF FACILITATING TRADE. THE COSTS OF THE VAT CLEARING SYSTEM HAD ALSO TO BE ADDRESSED, SINCE THERE WAS A RISK THAT IT WOULD PROVE MORE BURDENSOME THAN THE EXISTING SYSTEM. MOST OF THE EXCISE ISSUES REQUIRED TECHNICAL STUDY: THE APPROPRIATE QUESTION FOR MINISTERS WAS THE ROLE OF NON-FISCAL POLICY CONSIDERATIONS (E.G. ENERGY, TRANSPORT AND HEALTH).

12. SPAIN SHARED OTHERS' VIEWS ON THE CLEARING SYSTEM. THE BUDGETARY AND ECONOMIC IMPLICATIONS OF THE EXCISE PROPOSALS MEANT THAT ALTERNATIVE APPROACHES HAD TO BE EXAMINED.

13. GREECE PRESSED FOR FURTHER TECHNICAL EVALUATION OF THE ISSUES, PARTICULARLY THE COSTS AND BENEFITS OF THE CLEARING SYSTEM, BANDEROLES AND LINKED WAREHOUSES, BEFORE MINISTERS COULD BE EXPECTED TO REACH DECISIONS. THEY ASKED WHETHER DIRECT TAXATION SHOULD ALSO BE CONSIDERED.

14. GERMANY STRESSED THE NEED TO DISTINGUISH BETWEEN 'VIABLE ALTERNATIVES' (OF WHICH THERE APPEARED TO BE NONE) AND 'INTERIM STAGES': THE LATTER REQUIRED POLITICAL DISCUSSION. THE FUNDAMENTAL QUESTION WAS THE (NEXT WORD UNDERLINED) EXTENT OF THE NEED FOR HARMONISATION: IT MIGHT BE NECESSARY TO TAKE SMALLER, INTERIM STEPS. THIS REQUIRED A POLITICAL STEER IN ADVANCE OF FURTHER TECHNICAL CONSIDERATION.

15. THE COMMISSION RESTATED THEIR VIEWS ON THE ACCEPTABILITY OF ALTERNATIVES AND THE TRANSITIONAL NATURE OF ZERO RATES. THEY RECOGNISED THE PARTICULAR DIFFICULTIES ASSOCIATED WITH EXCISE DUTIES BUT SUGGESTED THAT THE EXISTING DIVERSITY OF TREATMENT MERELY

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UNDERLINED THE NEED FOR HARMONISATION.

NEXT STEPS

16. THE PRESIDENCY AGREED TO ADD THE QUESTION OF ALTERNATIVE OR INTERIM SOLUTIONS TO THE LIST WHICH IT WOULD DRAW UP IN A PRESIDENCY PAPER FOR SUBMISSION TO THE ECOFIN COUNCIL. THOSE DELEGATIONS WHICH HAD SUGGESTED ALTERNATIVES WERE REQUESTED TO SUBMIT PAPERS AS SOON AS POSSIBLE. ON EXCISES IT WAS AGREED THAT THE QUESTIONS ON BANDEROLES AND THE LINKED WAREHOUSE SYSTEM SHOULD NOT BE PRESENTED TO MINISTERS. UNDER QUESTIONING FROM THE UK AND THE NETHERLANDS, THE PRESIDENCY AGREED TO GIVE MEMBER STATES A FEW DAYS TO COMMENT ON THE DRAFT LIST. IT WOULD THEN BE MADE AVAILABLE TO THE INCOMING GREEK PRESIDENCY DURING THE FIRST FEW DAYS OF JULY FOR ONWARD TRANSMISSION TO ECOFIN. THERE WAS A SHORT INCONCLUSIVE DISCUSSION WHETHER THE QUESTIONS COULD BE DISCUSSED AT THE JULY ECOFIN COUNCIL OR WHETHER THIS WOULD BE PREMATURE. THE COMMISSION PRESSED HARD FOR JULY, BUT THE PRESIDENCY DUMPED THE PROBLEM ON THE GREEKS.

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ADDITIONAL 1

FRAME

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- Paymaster General
- Financial Secretary
- Economic Secretary
- Sir Peter Middleton
- Sir Geoffrey Littler
- Mr Byatt
- Mr Scholar
- Mr Lankester
- Mr Culpin
- Mr R E G Allen
- Mr Gilhooly
- Mr Michie
- Mr Cropper
- Mr Painter, IR
- Mr McGivern, IR

*Thanks.
One or two
Comments over page.*

Chancellor

SINGLE EUROPEAN MARKET: TAX HARMONISATION

behind
1. The outcome of the high level ad hoc working party on 16 June is being reported by telegram. But briefly, the German Presidency did no more than establish the questions on VAT and excise harmonisation which Member States felt should be put to the Council for political answers. The Presidency will now prepare the questions: they wish to have the final version ready for issue in the first few days of July, when they hand the baton to the Greeks. The list of questions will therefore be issued as a Presidency paper; but it will be shown in draft to Member States, to allow for very quick comments.

2. The Germans have taken on board our point about the need to pose questions about alternatives to harmonisation. A number of delegations want questions asked about interim measures; this will have the effect of bringing the Benelux system onto the agenda, and you will be interested that the Dutch are preparing a scheme, on which they promised a paper, for special frontier facilitation of authorised traders. Minimum excise rates will also figure. There was some dissension as to how far costs of the VAT clearing house

Internal distribution:

Chairman	Mr Allen	Mr Walton
Mr Nash	Mr Knox	(UKREP)
Mr Wilmott	Mr Oxenford	

and the Commission's excise proposals should be considered. All agreed that further technical study was needed, but some felt that this could come later, while others (including me) felt that Ministers could not sensibly decide on the principles of harmonised systems without knowing their operational costs.

3. Some delegations felt that the question of direct as well as indirect taxation should be addressed.

4. We remain the only delegation to challenge directly the principle of harmonisation. But I detect in others mounting concern about the budgetary economic and social costs, together with a very widespread feeling that full harmonisation by 1992 was impossible and the time had come to search for interim measures of trade facilitation. Throughout the discussion, the French were un-Gallically woolly; we sense that they are preparing a change of direction but have not so far discovered what. Over all, I feel that things have moved a little further our way.

5. There was no clear view on whether the Presidency list of questions should be discussed at the 11 July ECOFIN. The Commission said they should; the Dutch said they shouldn't; and the Germans dumped the problem on the Greeks. We intend to lobby behind the scenes against a July discussion. It would be very ill-focussed and tend to repeat old attitudes. I also have in mind that during July we should finalise and issue the paper which you promised at the May informal ECOFIN, and on which we and the Treasury are working. That would allow the holiday period for its digestion, and there could then be a better prepared discussion at the informal September ECOFIN and/or at the next formal meeting in October.

What?
Why?

What about Denmark? Luxembourg? Transfunds?

Confirmed by tel. report.

PH

P JEFFERSON SMITH

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FROM: J M G TAYLOR

DATE: 17 JUNE 1988

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

MR JEFFERSON SMITH - C&E

cc Chief Secretary
Paymaster General
Financial Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Scholar
Mr Lankester
Mr R I G Allen
Mr Gilhooly
Mr Michie
Mr Cropper
Mr Painter - IR
Mr McGivern - IR

SINGLE EUROPEAN MARKET: TAX HARMONISATION

The Chancellor was grateful for your minute of 17 June.

2. He had one or two further questions. First, he has asked which delegations felt that the question of direct as well as indirect taxation should be addressed, and why (your paragraph 3). Second, he has noted your comment that we remain the only delegation to challenge directly the principle of harmonisation. He asked whether Denmark and Luxembourg indicated any support for us - they did at Travemunde.

(your para 4)

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

J M G TAYLOR

CONFIDENTIAL

FROM: P J CROPPER
DATE: 21 June 1988

CHANCELLOR

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Sir G Littler
Mr R Allen
Mr Mortimer
Mr Gieve
Mr Tyrie
Mr CallMr Unwin C&E
Mr Battishill IREUROPE 1992: AN OPPORTUNITY FOR ENTERPRISE

Lord Cockfield gave a splendidly uncompromising address, word-perfect without notes, at yesterday's IOD seminar.

Harmonisation. We in the Commission have deliberately moved away from harmonisation. We will only press harmonisation where and when it is needed. In any case harmonisation does not mean total uniformity. When people sing in harmony they do not all sing the same tune: they sing different tunes, which fit smoothly together. So let us speak of approximation.

Transparency. We believe in transparency in everything we do. Brussels is the most transparent and open bureaucracy in Europe. Nobody who has his information system properly organised need ever say that he is out of touch with what is happening in Brussels.

1992. In 1985 this sounded a long way off. By the end of 1988 we will be half-way there. Time is passing: people will soon have to ask themselves whether they are going to be left behind. By the end of 1988, the Commission will have tabled 90 per cent of all the proposals needed for creation of the Single Market.

Single Market. You have to do the whole job. Everything hangs together; particularly the abolition of frontiers and frontier controls. You can't just do bits of the plan. This will enable you to garner the benefits of free competition. In particular, a single market in defence procurement offers enormous scope. Soldiers' socks can be bought by open tender in international competition, even if tanks are at present more tricky. The requisite Directives have now been tabled: there are great opportunities for some contractors.

Banking. We have, in place, all the Directives needed for a single market in banking.

USA is a single market, with a single currency and a single language. The Commission cannot give Europe a single language. But it will have a single market by 1992. We must now get to work on the single currency.

The Single Currency. This will be reached by the following stages:-


1. A European banking system.
2. Liberalisation of capital movements.
3. Extension of EMS to all member States.
4. Creation of European central bank.
5. Conversion of the ECU into a single European currency.

We must have a single currency as soon as possible after 1992.

Taxation of Enterprises. Initially Lord Cockfield had thought that harmonisation of the taxation of enterprises could come much later. But considerable pressure is now

growing up from industry. The more you remove the obvious barriers, the more you become aware of the less obvious ones. The Commission will be publishing a major paper later this year.

Leaving it to the market. Lord Cockfield was asked why we could not leave markets to sort out disparities in tax rates across frontiers. Taking VAT as an example Lord Cockfield said that you must first bring VAT rates close enough that timid Finance Ministers will be prepared to abolish frontiers and frontier controls. Only then would it be safe to leave markets to get on with the job of removing remaining disparities - in so far as they were any longer a serious problem.



P J CROPPER

DATE: 24 JUNE 1988



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 Mr Gilhooly
 Mr Michie
 Mr Cropper
 Mr Painter, IR
 Mr McGivern, IR

CHANCELLOR

SINGLE EUROPEAN MARKET: TAX HARMONISATION

In answer to your further questions on the working party's discussions of 16 June (Mr Taylor's note of 17 June), it was Greece, Luxembourg and Portugal who suggested that direct taxation should also be considered. Their reasoning was not too clear but seems to centre on the belief that differing direct tax rates have an equal or greater distortive effect on competition than do indirect tax rates. Although they did not indicate this at the meeting, the Presidency is proposing to include reference to direct taxation in its list of questions for submission to the Council.

Odd

2. Denmark and Luxembourg indeed made it clear that they saw great problems with the Commission's approach and agreed on the need to consider alternatives; but whilst their reservations undoubtedly go sufficiently deep as to preclude any likelihood of their agreeing to the Commission's proposals, they nevertheless stopped short of a bald statement of rejection in principle.

P JEFFERSON SMITH

Internal distribution: CPS Mr Wilmott Mr Knox
 Mr Nash Mr Allen Mr Oxenford
 Mr Walton, UKREP



FROM: J M G TAYLOR
DATE: 28 June 1988

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

MR JEFFERSON SMITH (C&E)

cc Mr Unwin - C&E

SINGLE EUROPEAN MARKET: TAX HARMONISATION

The Chancellor was grateful for your note of 24 June.

A handwritten signature, likely of J M G Taylor, located below the typed name.


J M G TAYLOR

PERSONAL AND CONFIDENTIAL

FROM: A G TYRIE

DATE: 13 JULY 1988

CHANCELLOR



cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Mr Cropper
Mr Call

EURO-ELECTION STEERING COMMITTEE

This unwieldy troupe met today under Geoffrey Howe's chairmanship. A few points may be of interest:

- i. A mid-term Campaign Guide is being worked up which will contain material relevant to both the Council Elections in May and the Euro-Elections five weeks later.
- ii. The European Information Campaign (one of the more absurd ways to waste money that I have come across) is, apparently, already in its third and final phase. The first phase was designed to inform party Euro fanatics (as Christopher Prout put it). The second phase which has just drawn to a close, was designed to inform party activists who are not Euro fanatics. The third phase, which will begin shortly, will be aimed at all those who voted Conservative in 1987 culminating in an 'information week' in mid-September.
- iii. A somewhat less unwieldy sub-committee has been set up to do the work of producing various publications and to prepare a draft of the manifesto. A preliminary idea is to produce a pamphlet with alternate pages of 'achievements so far' and 'agenda for the next five years.'



A G TYRIE



[Handwritten signature]

FROM: MISS M P WALLACE

DATE: 15 July 1988

MR TYRIE

EURO-ELECTION STEERING COMMITTEE

The Chancellor was most grateful for your minute of 13 July.

*Why no signature?
pl watch out!*

MOIRA WALLACE

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*Spencer
Intern*

FRAME ECONOMIC

YOUR TELNO 416 : EC MERGER CONTROL REGULATION

1. THE FOLLOWING ARE OUR PRELIMINARY ANSWERS TO THE QUESTIONS IN PARA 4 OF TUR BASED ON DISCUSSIONS WITH THE FEDERAL ECONOMICS MINISTRY AND OUR BANKING CONTACTS IN FRANKFURT.

2. A. BARRIERS TO HOSTILE TAKE-OVERS.

- PERHAPS BECAUSE THERE HAS NEVER BEEN A SUCCESSFUL HOSTILE TAKE-OVER IN THE FRG, THE FEDERAL GOVERNMENT HAS NOT ARMED ITSELF WITH POWERS TO STOP MERGERS ON NATIONAL INTEREST GROUNDS. UNDER THE ANTI-CARTEL LAW, THE FEDERAL CARTEL OFFICE IS ONLY EMPOWERED TO BLOCK TAKE-OVERS ON COMPETITION GROUNDS. IF THE FEDERAL CARTEL OFFICE RECOMMENDS THAT A MERGER SHOULD BE STOPPED ON COMPETITION GROUNDS, ITS DECISION CAN BE OVERRULED BY THE FEDERAL ECONOMICS MINISTER. BUT THIS SYSTEM DOES NOT WORK THE OTHER WAY ROUND. IF THE FEDERAL CARTEL OFFICE DECIDES TO ALLOW A MERGER ON COMPETITION GROUNDS, THE FEDERAL ECONOMICS MINISTER CANNOT BLOCK IT ON NATIONAL INTEREST GROUNDS. ACCORDING TO THE FEDERAL ECONOMICS MINISTRY, THERE ARE NO GOVERNMENT PLANS TO TAKE SUCH POWERS, AT LEAST FOR THE TIME BEING.

- THERE HAVE BEEN OCCASSIONS, HOWEVER, WHEN THE GOVERNMENT MAY HAVE INSPIRED A PURCHASE OF SHARES BY ONE OF THE BIG BANKS EG. DEUTSCHE BANK'S INVESTMENT IN DAIMLER BENZ. WHEN THE FLICK TAKE CAME ON THE MARKET, DEUTSCHE BANK TOOK A 25 PER CENT HOLDING TO KEEP THE IRANIANS OUT.

- ALTHOUGH THE FEDERAL GOVERNMENT HAS GRADUALLY DIVESTED ITSELF OF SOME OF ITS INDUSTRIAL SHARE-HOLDINGS (EG. VW AND VEBA), IT STILL RETAINS SUBSTANTIAL SHAREHOLDINGS AND HENCE PARTIAL CONTROL IN A NUMBER OF LISTED COMPANIES SO DO THE LAENDER GOVERNMENTS WHO HAAVE NO INTENTION OF GIVING UP THEIR INDUSTRIAL SHAREHOLDINGS.

- SHAREHOLDINGS OF MORE THAN 25 PER CENT IN ANOTHER COMPANY HAVE TO

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BE DISCLOSED TO THE FEDERAL CARTEL OFFICE (UNDER GERMAN COMPANY LAW, A 75 PER CENT MAJORITY IS REQUIRED FOR A NUMBER OF DECISIONS, WHICH MEANS THAT A SHAREHOLDER WITH OVER 25 PER CENT HAS A POWER OF VETO). FOLLOWING PRESSURE FROM THE GERMAN MONOPOLIES COMMISSION, THE BIG PRIVATE BANKS HAVE ALSO STARTED TO DISCLOSE MORE OF THEIR INDUSTRIAL SHAREHOLDINGS IN THEIR ANNUAL REPORTS. BUT OTHERWISE LITTLE INFORMATION IS AVIALABLE ABOUT THE OWNERSHIP OF SHARES. THERE IS NO SHAREHOLDER REGISTER OF GERMAN COMPANIES.

- IN THE MID-1970S A NUMBER OF MAJOR COMPANIES INCLUDING MANNESMANN, BAYER AND BASF, MOVED TO PROTECT THEMSELVES FROM HOSTILE TAKE-OVER BIDS BY MIDDLE EASTERN INTERESTS BY INTRODUCING RESTRICTIONS ON SHAREHOLDERS VOTING RIGHTS IN THEIR ARTICLES OF ASSOCIATION (USUALLY LIMITING VOTING RIGHTS TO 5 OR 10 PER CENT). MORE RECENTLY, A NUMBER OF OTHER COMPANIES HAVE FOLLOWED SUIT INCLUDING DEUTSCHE BABCOCK, VEBA AND FELDMUEHLE NOBEL (SEE BELOW).

- MUTUALLY SUPPORTIVE CROSS-HOLDINGS BETWEEN ALLIED COMPANIES PREVENTING OUTSIDE PURCHASE ARE ALSO WIDESPREAD EG. MUNICH RE (THE WORLD'S LARGEST RE-INSURANCE COMPANY) AND ALLIANZ (EUROPE'S LARGEST INSURANCE COMPANY) EACH HAVE A 25 PER CENT STAKE IN THE OTHER.

- EVEN SOME OF THE LARGEST LISTED COMPANIES ARE STILL CONTROLLED BY FAMILY INTERESTS EG. BMW, PORSCHE, NIXDORF AND HENKEL. WHEN THE ORIGINAL PROPRIETORS DO NOT HAVE LARGE STAKES, THE BIG BANKS OFTEN DO. CRITICISM IN RECENT YEARS HAS MADE THE BANKS SENSITIVE ABOUT THEIR SHAREHOLDINGS AND THERE HAVE BEEN SOME MODEST SIGNS OF REDUCTIONS. BUT THE BIG THREE BANKS STILL HAVE VERY SUBSTANTIAL INDUSTRIAL SHAREHOLDINGS. COMPANIES. DEUTSCHE BANK, FOR EXAMPLE, OWNS 28.5 PER CENT OF DAIMLER BENZ, 35 PER CENT OF HOLZMANN AND 25 PER CENT OF KARSTADT.

- SHARES IN PUBLIC LIMITED COMPANIES ARE NEARLY ALL IN BEARER FORM AND ARE DEPOSITED WITH THE BANKS. MOST SHAREHOLDERS ALSO GIVE THEIR PROXY VOTING RIGHTS TO THE BANKS. THIS MEANS THAT ONE OR TWO BIG BANKS WILL OFTEN ACT AS GUARDIAN FOR MORE THAN HALF OF A COMPANY'S EQUITY. A HOSTILE TAKEOVER BID WHICH THE BANKS DISAPPROVED OF COULD THEREFORE BE UNDERMINED IN THE WORDING OF A CIRCULAR TO THEIR SHAREHOLDERS (WHO RARELY IGNORE THE BANKS' ADVICE).

- THERE IS A VOLUNTARY TAKE-OVER CODE BASED ON RECOMMENDATIONS ISSUED BY THE STOCK EXCHANGE COMMISSION AND PUBLISHED BY THE FEDERAL FINANCE MINISTRY IN JANUARY 1979. THIS CODE IS DESIGNED TO PREVENT INSIDER DEALING IN THE SHARES OF THE TARGET COMPANY IN THE PERIOD

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BEFORE THE BID IS FORMALLY ANNOUNCED AND TO ENSURE THAT THE SHARE-HOLDERS IN THE TARGET COMPANY ARE GIVEN SUFFICIENT INFORMATION ABOUT THE BID AND SUFFICIENT TIME TO CONSIDER IT. BIDDERS ARE OBLIGED TO DISCLOSE THEIR DIRECT AND INDIRECT SHAREHOLDINGS IN THE TARGET COMPANY.

- AT THE END OF 1987 ONLY 474 GERMAN COMPANIES OUT OF APPROXIMATELY 2,150 PUBLIC LIMITED COMPANIES (AKTIENGESELLSCHAFTEN) WERE PUBLICLY QUOTED ON THE STOCK EXCHANGE AND THUS POTENTIALLY VULNERABLE TO A HOSTILE TAKE-OVER BID. THE NUMBER HAS HARDLY RISEN SINCE 1975. THIS IS PARTLY BECAUSE OF THE STRINGENT DISCLOSURE REQUIREMENTS ASSOCIATED WITH OFFICIAL LISTING.

- THERE IS STILL A STRONG RESISTANCE AMONG GERMAN BANKERS AND INDUSTRIALISTS TO THE CONCEPT OF HOSTILE TAKE-OVERS. INDUSTRIALISTS ARE CONCERNED THAT THE THREAT OF HOSTILE TAKE-OVERS WOULD DEPRIVE THEM OF THE FREEDOM TO THINK AND INVEST LONG TERM. THE TRADES UNIONS ARE ALSO OPPOSED TO THE INTRODUCTION OF HOSTILE TAKE-OVERS FOR FEAR OF JOB LOSSES, PARTICULARLY IF A FOREIGN COMPANY IS INVOLVED.

- FRIENDLY MERGERS OFTEN OCCUR BUT THEY ARE USUALLY QUIETLY NEGOTIATED. THERE IS A GENERAL ASSUMPTION THAT BECAUSE OF THE PROXY VOTING RIGHTS EXERCISED BY THE BANKS AND THEIR READINESS TO ACT IN CONCERT, IT IS NOT WORTH LAUNCHING A HOSTILE TAKE-OVER BID. SO STRONGLY IS THIS ASSUMPTION HELD THAT IT HAS SELDOM BEEN THOUGHT WORTHWHILE TO TEST IT.

- RAISING FINANCE COULD ALSO BE A PROBLEM FOR A DOMESTIC BIDDER SINCE THE POWER OF PATRONAGE ENJOYED BY THE THREE BIG BANKS IS SUCH THAT OTHER BANKS WOULD HESITATE TO SUPPORT A CONTESTED BID FOR FEAR OF OSTRACISM BY THE REST OF THE FINANCIAL COMMUNITY. ON THE OTHER HAND, MANY GERMAN COMPANIES REMAIN EXTREMELY UNDER-VALUED IN THE EQUITY MARKET AND THIS HIDDEN VALUE HAS ATTRACTED PLENTY OF INTEREST FROM POTENTIAL FOREIGN BIDDERS EG. THE SWISS FINANCIER WERNER REY.

- THE GERMAN SYSTEM OF CO-DETERMINATION WHEREBY EMPLOYEE REPRESENTATIVES OCCUPY 33 PER CENT OR 50 PER CENT OF THE SEATS ON THE SUPERVISORY BOARD (DEPENDING ON THE SIZE OF THE COMPANY) IS OFTEN CITED BY GERMAN BANKS AS A MAJOR REASON FOR THE LACK OF HOSTILE TAKE-OVER BIDS BY FOREIGN COMPANIES. IN THEIR VIEW, POTENTIAL FOREIGN BIDDERS WOULD BE DETERRED BY THE REQUIREMENT TO CONSULT EMPLOYEE REPRESENTATIVES ON ALL ASPECTS OF COMPANY POLICY, INCLUDING MANPOWER REDUCTIONS, AND BY THE VERY SEVERE LIMITATIONS THIS SYSTEM IMPOSES ON MANAGEMENT'S ABILITY TO CLOSE FACTORIES AND

UNDERTAKE OTHER RESTRUCTURING MEASURES.

- ANOTHER OBSTACLE TO HOSTILE TAKE-OVERS IN THE FRG IS THE FACT THAT CONTROL DOES NOT COME WITH OWNERSHIP. UNDER THE GERMAN TWO-TIER BOARD SYSTEM, THE MANAGEMENT BOARD IS APPOINTED BY THE SUPERVISORY BOARD, WHOSE MEMBERS ARE ELECTED BY SHAREHOLDERS FOR A PERIOD OF FOUR YEARS AND CAN ONLY BE REMOVED AT THE AGM BY 75 PER CENT OF THE VOTES CAST. CONSEQUENTLY IT MAY BE SEVERAL YEARS BEFORE ENOUGH NEW MEMBERS HAVE BEEN INSERTED INTO THE SUPERVISORY BOARD TO ASSERT CONTROL OVER THE MANAGEMENT BOARD AND THUS THE POLICY OF THE COMPANY.

- THE BIG GERMAN BANKS ARE HEAVILY REPRESENTED ON THE SUPERVISORY BOARDS OF THE LARGER INDUSTRIAL COMPANIES AND SEE IT AS THEIR ROLE TO SUPPORT MANAGEMENT. ACCORDING TO THE MONOPOLIES COMMISSION, IN 1984 THE DEUTSCHE BANK HAD 39 SEATS ON THE SUPERVISORY BOARDS OF THE TOP 100 GERMAN COMPANIES, THE DRESDNER HAD 22 AND THE COMMERZBANK 15. NEARLY ALL GERMAN COMPANIES HAVE A QUOTE HOUSE BANK UNQUOTE ON WHICH THEY RELY NOT ONLY FOR ORDINARY COMMERCIAL BANKING SERVICES BUT ALSO FOR LONG-TERM ADVICE ON CORPORATE STRATEGY.

3. B. IT IS DIFFICULT TO RANK THESE BARRIERS IN PRECISE ORDER OF IMPORTANCE, BUT THE MAIN BARRIERS UNDOUBTEDLY INCLUDE:

- THE POWER OF THE BANKS, MAINLY EXERCISED THROUGH THE SYSTEM OF PROXY VOTING:
- RESTRICTIONS ON SHAREHOLDERS' VOTING RIGHTS:
- LIMITED NUMBER OF LISTED COMPANIES:
- THE TWO-TIER BOARD SYSTEM:
- (WHERE FOREIGN BIDS ARE CONCERNED) THE SYSTEM OF CO-DETERMINATION.

4. C. THERE ARE NO SIGNS OF ANY IMMEDIATE STRUCTURAL CHANGE IN GERMAN SHARE OWNERSHIP. INDEED, THE RECENT TREND TO INTRODUCE RESTRICTIONS ON SHAREHOLDERS' VOTING RIGHTS HAS TENDED TO INCREASE THE BARRIERS TO HOSTILE TAKE-OVERS. AN ARTICLE IN THIS WEEK'S DIE ZEIT POINTED OUT THAT THIS TREND RUNS COUNTER TO THE NEED FOR MORE CROSS-BORDER MERGERS AND ACQUISITIONS IN THE RUN UP TO 1992. THE FEDERAL GOVERNMENT COULD HARDLY PUT PRESSURE ON THE FRENCH GOVERNMENT TO ALLOW SIEMENS TO ACQUIRE A SHAREHOLDING IN A FRENCH TELECOMMUNICATIONS COMPANY IF, AT THE SAME TIME, FRENCH COMPANIES WERE UNABLE TO BID FOR GERMAN COMPANIES. THE ARTICLE ALSO POINTS OUT THAT GERMAN COMPANIES AND SHAREHOLDERS ARE PAYING A PENALTY FOR THE ABSENCE OF STOCK MARKET PRESSURE.

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5.D. RECENT UNSUCCESSFUL HOSTILE TAKE-OVER BIDS INCLUDE:

A) AN ATTEMPT BY THE TWO GRANDSONS OF FRIEDRICH FLICK TO TAKE OVER FELDMUEHLE NOBEL, WHICH WAS FORMERLY PART OF THE FLICK EMPIRE. THEIR BID WAS DEFEATED BY A RAPID RISE IN SHARE PRICES ONCE THE BID WAS ANNOUNCED AND AN ANNOUNCEMENT BY THE MANAGEMENT BOARD THAT THEY INTENDED TO INTRODUCE A 5 PERCENT LIMIT ON SHAREHOLDERS' VOTING RIGHTS AT THE AGM ON 12 JULY. ON 13 JUNE, THE FLICK BROTHERS ANNOUNCED THAT THEY WERE RETIRING FROM THE SCENE.

B) AN ATTEMPT BY THE MUNICH-BASED FILM AND TELEVISION ENTREPRENEUR LEO KIRCH TO WREST CONTROL OF THE AXEL SPRINGER PUBLISHEING COMPANY FROM SPRINGER'S WIDOW AND OTHER MEMBERS OF THE FAMILY. KIRCH WAS DEFEATED WHEN THE BURDA BROTHERS, THE OTHER LARGE SHAREHOLDING TO THE SPRINGER HEIRS GIVING THEM A 52 PERCENT STAKE IN THE COMPANY, BUT HAS SUCCEEDED NEVERTHELESS IN BUILDING UP A 25 PERCENT BLOCKING MINORITY. (THIS CASE IS NOW SUBJECT TO AN INSIDER DEALING INVESTIGATION BECAUSE OF SUSPICION THAT NEWS OF THE BURDA BROTHERS' DECISION TO SELL THEIR SHARES TO THE SPRINGER FAMILY LEAKED OUT PREMATURELY.)

6. E. THE MAIN FORM OF DEFENCE USED BY TARGET COMPANIES HAS BEEN THE INTRODUCTION OF RESTRICTIONS ON VOTING RIGHTS.

7. F AND G. 474 COMPANIES ARE LISTED ON THE FRG'S EIGHT STOCK EXCHANGES WITH A NOMINAL VALUE OF DM 56 BILLION AND A MARKET VALUE OF DM 332 BILLION. THE STOCK MARKET VALUE OF SHARES IN GERMAN COMPANIES AMOUNTS TO 16.5 PERCENT OF GDP.

8. FURTHER INFORMATION WILL FOLLOW BY BAG.

MALLABY

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TO PRIORITY FCO
TELNO 263
OF 181505Z JULY 88
INFO ROUTINE UKREP BRUSSELS, OTHER EC POSTS

FRAME ECONOMIC

YOUR TELNO 416 TO BONN: EC MERGER CONTROL REGULATION

SUMMARY

1. LUXEMBOURG WELCOMES FOREIGN INVESTMENT AND MOST MAJOR CONCERNS HERE ALREADY HAVE SUBSTANTIAL NON-LUXEMBOURG PARTICIPATION. THERE IS LITTLE MONOPOLY/MERGER LEGISLATION AND THE GOVERNMENT'S FORMAL POWERS OF INTERVENTION ARE DESIGNED TO PROTECT LUXEMBOURG'S REPUTATION AND INTEGRITY AS A FINANCIAL AND BUSINESS CENTRE. HOWEVER, THE GOVERNMENT CAN EXERT CONSIDERABLE INFLUENCE IN CERTAIN FIELDS THROUGH THE REGULATORY AUTHORITIES (ESPECIALLY IN THE FINANCIAL SECTOR THROUGH THE LUXEMBOURG MONETARY INSTITUTE) AND THROUGH GOVERNMENT REPRESENTATION ON THE BOARDS OF KEY COMPANIES.

DETAIL

2. MERGER LEGISLATION WAS INTRODUCED IN SEPTEMBER LAST YEAR BUT THIS IS LIMITED TO PROCEDURAL MATTERS SUCH AS PRESENTATION OF ACCOUNTS TO SHAREHOLDERS BEFORE A MERGER CAN PROCEED AND EVALUATION OF SHARES.

3. A COMMISSION ON RESTRICTIVE PRACTICES (ESTABLISHED IN JUNE 1972) HAS POWERS SIMILAR TO THOSE IN EC DIRECTIVE OF 1985/86. THE COMMISSION GATHERS AT THE BEHEST OF MINISTER OF ECONOMY AND HAS MET ABOUT ONCE A YEAR. IN THEORY, THE COMMISSION COULD EXAMINE A POTENTIAL MONOPOLY SITUATION BUT, AS FAR AS WE CAN DISCOVER, THIS HAS NEVER HAPPENED.

4. INFORMAL MEANS OF INFLUENCE ARE MORE DIFFICULT TO PIN DOWN BUT THEY CERTAINLY EXIST. IN THE CASE OF A BANK, THE INSTITUT MONETAIRE LUXEMBOURGEOIS (IML) COULD WITHHOLD AN OPERATING LICENCE FROM A CONCERN JUDGED BY IML TO BE INEXPERIENCED OR OTHERWISE UNSUITABLE. THE INSURANCE COMMISSIONER TOLD ME THAT WHEN GUARDIAN ROYAL EXCHANGE BOUGHT INTO LE FOYER (ONE OF LUXEMBOURG'S TWO MAJOR INSURANCE COMPANIES), HE REACHED AGREEMENT WITH BOTH SIDES THAT THE FORMER'S STAKE SHOULD NOT EXCEED 40%. SOMETHING SIMILAR SEEMS TO HAVE HAPPENED WHEN A BELGIAN CONCERN TOOK AN INTEREST IN THE BANQUE INTERNATIONALE DE LUXEMBOURG.

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5. SOME KEY COMPANIES (EG CLT, SES, ARBED, LUXAIR) HAVE A SPECIAL STATUTORY BASE WITH GOVERNMENT SHAREHOLDERS. IN SES (THE COMPANY PLANNING TO LAUNCH THE ASTRA SATELLITE) THE GOVERNMENT SHAREHOLDERS HAVE ENHANCED VOTING POWERS. WITHOUT FURTHER INVESTIGATION WE CANNOT SAY WHETHER THIS IS A BLOCKING STAKE OR HOW WIDESPREAD SUCH PRACTICE IS. THE MAJOR LUXEMBOURG BANKS ARE ALSO INVOLVED IN MOST BIG VENTURES HERE AND THE GOVERNMENT CAN USUALLY COUNT ON THEIR COOPERATION.
6. IT IS EASY TO OBTAIN A LISTING ON THE LUXEMBOURG STOCK EXCHANGE. THERE IS NO EQUIVALENT OF LONDON'S QUOTE YELLOW BOOK UNQUOTE. SECRECY RULES APPLY TO SHARE OWNERSHIP.
7. WE KNOW OF NO RECENT EXAMPLES OF CONTENTIOUS TAKE OVERS. IT IS, HOWEVER, EASY TO OPEN A HOLDING COMPANY HERE AND LOCAL ACCOUNTANTS BELIEVE LUXEMBOURG MIGHT WELL BE USED AS A BASE FROM WHICH TO LAUNCH PREDATORY FORAYS INTO OTHER PLACES.

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MR COLLIS, D/TRANSPORT
MR MARTIN, D/TRANSPORT

MR M T R SMITH,
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FCO TELNO 416 OF 11 JULY.

GREECE: MERGER CONTROL REGULATION.

1. THE MAIN BARRIER TO HOSTILE TAKEOVERS IN GREECE IS THAT MOST COMPANIES HERE ARE CONTROLLED BY INDIVIDUALS OR SMALL FAMILY GROUPS. THE PROPORTION OF GREEK COMPANIES LISTED ON THE STOCK EXCHANGE IS SMALL AND EVEN AMONG SUCH COMPANIES FAMILY MAJORITY SHAREHOLDINGS ARE COMMON. APART FROM THE 'SOCIALISATION' OF VARIOUS COMPANIES BY THE PASOK GOVERNMENT WHEN IT FIRST ASSUMED POWER THERE IS NO RECORD OF A HOSTILE TAKEOVER EVER HAVING BEEN ATTEMPTED IN GREECE.
2. THE GOVERNMENT HAS NO FORMAL POWER TO OBSTRUCT A HOSTILE TAKEOVER. HOWEVER, THE PASOK GOVERNMENT HAS INTERVENED ON THREE OCCASIONS SINCE 1981 TO BLOCK TAKEOVERS. TWO OF THESE OCCASIONS INVOLVED AGREED TAKEOVERS BY A FOREIGN COMPANY AND THE GOVERNMENT'S INTERVENTION WAS PROMPTED BY GREEK COMPETITORS OF THE TARGET COMPANY. ALTHOUGH IT HAS NO LEGAL FOUNDATION, THE GOVERNMENT CAN APPEAL TO THE 'NATIONAL INTEREST' IN SUCH CASES AND THEREBY SUCCESSFULLY TAP THE HOSTILITY OF FOREIGN CAPITAL WHICH MANY GREEKS STILL FEEL: THE GOVERNMENT CAN THEN USE ITS CONTROL OVER THE BANKING AND FINANCIAL SYSTEMS, THE TAX AUTHORITIES AND THE CUSTOMS TO OBSTRUCT A FOREIGN BID. THUS WHEN THE US GROUP AMI RECENTLY ACQUIRED A MAJORITY OF THE UNLISTED COMPANY OWNING ATHENS' MAJOR PRIVATE HOSPITAL THE GOVERNMENT REACTED TO ACCUSATIONS OF TAX EVASION FROM A GREEK COMPETITOR (AND MINORITY SHAREHOLDER) BY IMPOSING ITS OWN BOARD FOR 6 MONTHS WHILE THE BOOKS ARE EXAMINED.
3. SINCE THE GOVERNMENT HAS NO FORMAL POWERS IN THIS AREA IT DOES NOT CONTEMPLATE STEPS TO REDUCE THEM. LIBERALISATION OF THE BANKING AND INSURANCE MARKETS, HOWEVER, WILL REMOVE SOME OF THE GOVERNMENT'S LEVERS OF INFLUENCE.
4. 120 COMPANIES ARE LISTED ON THE ATHENS STOCK EXCHANGE. THEIR TOTAL VALUATION IS DRACHMAS 570 BILLION. THE RATIO OF THIS FIGURE TO

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GDP IS 1-8.5.

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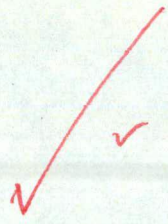
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YOUR TELNO 416 TO BONN: EC MERGER CONTROL REGULATION

1. PORTUGAL IS PERHAPS A UNIQUE CASE IN THAT SINCE THE 1974 REVOLUTION, BECAUSE OF THE HIGH LEVEL OF NATIONALISATIONS AND THE WEAKNESS OF THE ECONOMY, THERE HAS UNTIL VERY RECENTLY BEEN LITTLE OR NO INTEREST IN TAKEOVERS OR MERGERS, AND NO FORMAL CONTROL. THE STOCK EXCHANGE WAS CLOSED TO FOREIGNERS UNTIL 1985 AND STRICT FOREIGN EXCHANGE CONTROL HAS MADE TAKEOVERS BY FOREIGN COMPANIES DIFFICULT.
2. THE PICTURE HAS CHANGED DRAMATICALLY SINCE EC ACCESSION AND THERE IS A GROWING INTEREST IN PORTUGUESE COMPANIES FROM FOREIGN COMPANIES. TAKEOVERS HAVE OCCURED AND HAVE OFTEN BEEN DEMONSTRABLY BENEFICIAL TO THE PORTUGUESE COMPANY: SUCH WAS THE CASE OF A FAILING GLASS MANUFACTURER WHICH WAS TAKEN OVER IN 1986 BY A FRENCH GLASS COMPANY AND GIVEN THE CAPITAL INJECTION IT NEEDED TO MODERNISE.
3. HOSTILE OR UNWANTED TAKEOVER BIDS ARE LIKELY TO COME UP AGAINST THE STRONG RESISTANCE OF THE FAMILY OLIGARCHY THAT CONTROLS MOST PRIVATE COMPANIES. SUCH WAS THE CASE IN THE FAILED BID BY A BRITISH CONTROLLED WOOD-PULP COMPANY THAT WANTED TO INVEST IN A LONG-ESTABLISHED PORCELAIN COMPANY IN ORDER TO DIVERSIFY.
4. THE SMALL AND MEDIUM BUSINESS INSTITUTE, IAPMEI, HAS BEEN GIVEN THE RESPONSIBILITY OF DRAWING UP A FRAMEWORK OF CONTROL FOR MERGERS AND ACQUISITIONS. WE ARE HOPING TO CALL ON THEM LATER THIS WEEK.

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Inland Revenue

Policy Division
Somerset House

FROM: M A JOHNS

DATE: 19 JULY 1988

1. MR PAINTER

*Pl. see note at end.**JH 20.7.**Ch.**Agree lines**(para 11)?**OK. H 20/7*

2. CHANCELLOR OF THE EXCHEQUER

EUROPEAN COMMISSION MOVES TO COMBAT TAX EVASION

1. You may recall that the French succeeded in including in the Directive on Capital Liberalisation a provision requiring the Commission to make proposals for "eliminating or reducing risks of distortion, tax evasion and tax avoidance linked to the diversity of national systems for the taxation of savings and for controlling the application of these systems". This arose out of the French fear (shared by one or two other member states) that removal of exchange controls would open the floodgates to tax evasion. The Commission has to produce proposals by the end of this year and the Council to take a position on them by 30 June 1989 though you successfully inserted a statement making clear that unanimity was needed for any tax provision.

cc	Chief Secretary	Chairman
	Financial Secretary	Mr Isaac
	Paymaster General	Mr Painter
	Economic Secretary	Mr Beighton
	Sir P Middleton	Mr Houghton
	Sir G Littler	Mr McGivern
	Mr Byatt	Mr Corlett
	Mr Lankester	Mr Johns
	Mr Scholar	Mr Shepherd
	Mr Culpin	Mr O'Connor
	Mrs Lomax	Mr Sullivan
	Mr Peretz	PS/IR
	Mr Gilhooly	
	Miss O'Mara	
	Mr Ilett	
	Mr Cropper	
	Mr Tyrie	

2. This note seeks your authority for low-key consultations with the banks to strengthen our ammunition to resist any proposals for harmonisation in this area. And it invites your approval of the line to take in response to a request from the French for bilateral discussions.

3. The Commission could use the reference in the directive as a peg on which to hang a number of proposals for harmonising tax on savings - the provision is very wide. But our impression is that they are looking for something fairly minimal to satisfy the French. The key issues which are likely to be explored are:

- a. introduction of a common or minimum level of withholding tax on flows of interest between Member States
- b. introduction of generalised provisions for financial institutions to provide information to other EC fiscs about interest payments and other forms of investment income paid to residents of EC countries.
- c. a possible further candidate is introduction of a common or minimum level of withholding tax on flows of dividends between Member States and possibly third countries but so far they have suggested the need is less here.

4. The line we have been developing is

- a. Exchange controls are not essential to prevent tax avoidance or evasion. We have no evidence that removing controls in the UK was the cause of any significant change in the level of avoidance or evasion.
- b. The proposals represent an unacceptable reduction in the UK's freedom of action in tax matters (the sovereignty argument).

- c. They would ^{be} ineffective so long as non EC countries did not impose withholding taxes: tax evaders could move funds to those countries.
- d. They create serious practical difficulties and could drive financial business out of the EC (and London in particular) to the benefit of offshore tax havens.
- e. In particular, imposing a withholding tax on flows of interest would cause severe disruption to the inter-bank market; and in the case of dividends, would be inconsistent with the present system of corporation tax in the UK where the tax credit is sufficient to meet the shareholder's basic rate liability without the need for a withholding tax. And depending on the detailed proposals, a withholding tax on interest and dividends could create a lot of complaint from multinational companies if the lower rates provided for in UK double tax treaties were to be overridden.
- f. Even if the proposal were restricted to income paid to individuals, the issuing of Eurobonds and possibly their trading would move offshore if EC rules imposed a withholding tax on all bond interest and foreign deposits could be driven away if deposit interest faced such a tax.
- g. Though some difficulties could be reduced by specific exemptions and by allowing flows to non Community countries to be paid gross, the distinctions would be difficult to define and operate.
- h. The introduction of a withholding tax on dividends as a mechanism to combat evasion on cross border flows of savings would inevitably reopen the whole question of harmonisation of corporation taxes. (We expect that the Commission will return to this when they come to update the original 1975 draft directive on CT rates and structures as they plan to do if they decide to proceed with the preliminary draft directive on the business tax base.) The UK would find it

very hard to agree to centrally imposed harmonisation of this kind. *And you have made your position clear. H.*

- i. While we do not like any of the options, greater exchange of information is probably the least objectionable provided it does not drive financial business offshore and can be organised in a way which does not create a large amount of additional unproductive work on the UK Revenue or an unacceptable burden on UK banks who would see it as yet another government requirement overriding customer confidentiality.

5. In order to make our arguments, particularly those at e. and f., more effective we need to get a fuller picture of the likely damage to the London financial markets from a withholding tax or a generalised information power. The Treasury and the Bank of England are looking into the implications of this but we ought in addition to tap the views of the private sector. We think, in the first instance at least, the British Bankers Association are the best body to consult. They have a specifically UK orientation, they have a wide range of experience in different financial markets and they have a knowledgeable tax committee. We also have the advantage that they wrote to Brian Houghton here with a copy for information of a paper they had written on the subject for the European Banking Federation. This would provide us a low key basis for consultation. We might also speak to the British Merchant Banking and Securities Houses Association and to The Securities Association. We would involve Treasury and Bank of England officials in the discussions.

6. We would be grateful for your authority to approach them, to explain that the UK line is as in paragraph 4 above and to invite them to comment and in particular to provide whatever hard evidence they can of risks to financial markets and of practical problems. We could also explore with them the practicalities and effect on business of restricting any withholding tax or information requirement to EC residents only.

7. At the same time the French have made an approach through our embassy in Paris for expert bilateral discussions on the issue. The Cabinet Office and Foreign Office made it very clear that there were serious difficulties for the UK in any harmonisation in this area. The French stressed that they had serious difficulties in not making any change - their new government did not want to reduce taxes on capital compared with those on earned income (in fact they are reintroducing a wealth tax) so they would have difficulty in reducing taxes on investment income. While their taxes remained high there would be an unacceptable incentive to evade taxes. They recognised there was potential for differences between the two countries but thought with careful management it could avoid becoming a difficult bilateral issue. The suggestion was therefore raised of detailed talks between experts.

8. It was not clear from these discussions what exactly they wanted. They talked at a high level of generality but some of what they said implied they wanted harmonisation of rates of tax on savings as well as withholding tax or information powers. If so they are going well beyond past discussions: the Commission, as Mr McGivern said in his notes of 16 and 28 June, have said they have no plans to harmonise personal tax rates. And clearly any such move would be highly controversial. But this may not have been what the French intended.

9. It would seem hard to refuse to talk to the French to give them factual information about our system and clarify the practical implications of withholding taxes and information powers. And it might help to increase our understanding of their worries (in particular whether they are seeking to harmonise tax on savings) and get over to them our problems. On the other hand, we clearly should not get into a negotiating situation. It is quite likely that other EC countries besides ourselves will have difficulties with the French proposals and we may have no need to give ground at all.

10. If you are content we would suggest that we agree to the French request for talks but only on the basis of explaining how our system works and clarifying the practical implications of changes. In those talks we would try to get over the practical difficulties for the inter bank market, intra group flows, Eurobonds and deposit markets (and any others identified by the BBA). The best occasion seems to be to add Inland Revenue representation to the Anglo-French Treasury talks which will probably be taking place in early October. The French have asked in advance for a summary of our rules. If you agree, we do not think we could refuse this.

11. I would therefore be grateful if you would confirm

- a. that you are content with the line we are taking (para 4).
- b. that you are content for us to talk to the BBA and other City bodies on the lines set out in para 6.
- c. that you are content for us to talk to the French on the lines set out in para 10.

M. Scofield
 J A M A JOHNS

We are getting conflicting - and obscure - signals about what the French are seeking at this stage. The Commission (Mr. Fitcher) still thinks that they would be satisfied with something pretty minimal, (albeit in the Dutch holiday tax area) while our Embassy think they are pitching their claims higher and wider for a degree of personal tax harmonisation. I am reasonably confident that our opposite numbers in Paris understand the UK approach and, in particular the implications for us of a harmonised multilateral tax on domestic income. But the proposed clarifications discussion would help to establish our position.

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YOUR TELNO 416 TO BONN: EC MERGER CONTROL - BELGIUM

SUMMARY

1. EXISTING MERGER CONTROL LEGISLATION INEFFECTIVE. DRAFT SHAREHOLDING DISCLOSURE LAW INSPIRED BY EC PROPOSALS, THOUGH STRICTER. SHOULD BE IN FORCE BY END 1988. AUTHORISED CAPITAL AND WHITE KNIGHTS ARE PRESENTLY FAVOURED DEFENCE MECHANISMS AGAINST HOSTILE BIDDERS. TOUGHER MERGER CONTROL LEGISLATION IN PREPARATION.

DETAIL

TAKEOVER LAW

2. BELGIUM HAS LITTLE OR NO EFFECTIVE LEGISLATION TO PREVENT HOSTILE TAKEOVERS. SINCE 1964 TAKEOVER BIDS HAVE BEEN SUBJECT TO THE APPROVAL OF THE BANKING COMMISSION, THE FINANCIAL WATCHDOG ORGANISATION SET UP IN 1935 TO REGULATE BANKING PRACTICES. BECAUSE THE REGULATIONS WERE PRIMARILY PROCEDURAL THEY PROVED INEFFECTIVE AGAINST THE HOSTILE BID MADE BY CARLO DE BENEDETTI'S FRENCH COMPANY, CERUS, FOR CONTROL OF THE SOCIETE GENERALE DE BELGIQUE (SGB), BELGIUM'S LEADING HOLDING COMPANY. THE ABSENCE OF LEGISLATION ON SHAREHOLDING DISCLOSURES ALLOWED DE BENEDETTI TO ACQUIRE ANONYMOUSLY AN 18.6% STAKE IN THE SGB, BEFORE HE MADE A BID FOR A FURTHER 15%.

3. FOLLOWING A TAKEOVER THREAT TO BELGIUM'S LEADING OIL COMPANY, PETROFINA, IN THE LATE SIXTIES, THE LEGISLATION WAS TIGHTENED UP REQUIRING ALL FOREIGN TAKEOVER BIDS TO RECEIVE PRIOR AUTHORISATION FROM THE MINISTER OF FINANCE. THIS FELL FOUL OF THE

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TREATY OF ROME AND HAD TO BE AMENDED TO EXCLUDE BIDS FROM WITHIN THE EC. IT DID NOT, THEREFORE, APPLY IN CERUS'S CASE. THE 1970 ECONOMIC EXPANSION LAW INCLUDED THE REQUIREMENT FOR A COMPANY OR INDIVIDUAL SELLING ONE THIRD OR MORE OF A COMPANY'S SHARE CAPITAL WHERE TOTAL ASSETS AMOUNT TO 100 MILLION BF (POUNDS 1.6 MILLION AP) OR MORE, TO NOTIFY IN ADVANCE THE FINANCE AND ECONOMIC AFFAIRS MINISTERS AS WELL AS THE PRESIDENT OF THE APPROPORATE REGIONAL GOVERNMENT. SINCE CERUS WAS ACQUIRING, NOT SELLING, THIS LAW DID NOT APPLY EITHER.

4. DRAFT LEGISLATION ON SHARE DISCLOSURE (ORIGINALLY TABLED BY FINANCE MINISTER EYSKENS IN JULY 1987 WHEN RUMOURS FIRST CIRCULATED OF A POSSIBLE BID FOR THE SGB), HAS BEEN AGREED WITHIN THE GOVERNMENT AND WILL BE SUBMITTED TO PARLIAMENT BY THE END OF THE YEAR. THE NEW LAW WHICH GOES MUCH FURTHER THAN THE ORIGINAL EYSKENS DRAFT IN THE LIGHT OF THE SGB EXPERIENCE WILL REQUIRE A SHAREHOLDER IN A BELGIAN COMPANY LISTED ON ANY EC STOCK EXCHANGE TO DISCLOSE THE SHAREHOLDING ONCE IT REACHES 5% AND FOR EVERY 5% INCREASE THEREAFTER. THE SHAREHOLDER MUST INFORM THE COMPANY AND THE BANKING COMMISSION WITHIN 48 HOURS OF THE SHARE ACQUISITION: THE COMPANY MUST MAKE PUBLIC THE SHARE ACQUISITION WITHIN THE FOLLOWING 24 HOURS UNLESS GIVEN SPECIAL DISPENSATION BY THE BANKING COMMISSION TO WITHOLD THE INFORMATION ON GROUNDS OF PUBLIC INTEREST OR QUOTE GRAVE PREJUDICE UNQUOTE TO THE COMPANY. THE LAW WILL ALSO APPLY TO THE SALE OF SHARES AMOUNTING TO 5% OR MORE. COMPANIES WILL BE ABLE TO INSIST ON DISCLOSURE AT 3% IF STATED IN THE ARTICLES OF ASSOCIATION. EXISTING SHAREHOLDINGS OF 5% OR MORE WILL ALSO HAVE TO BE DISCLOSED ONCE THE LEGISLATION COMES INTO FORCE. FAILURE TO COMPLY COULD LEAD TO IMPRISONMENT OF BETWEEN ONE MONTH TO A YEAR AND/OR HEFTY FINES. FURTHER DETAILS WILL FOLLOW ONCE THE TEXTS ARE AVAILABLE.

EXISTING BARRIERS (PARA 2 OF YOUR TUR)

5. THE GOVERNMENT HAS AS YET NO LEGAL POWER TO PREVENT A MERGER. POLITICAL PRESSURE IS ITS ONLY WEAPON. UNDER BELGIAN COMPANY LAW THE MINISTER OF FINANCE MAY REJECT A PUBLIC TAKEOVER BID MADE BY A NON-EC PUBLIC OR PRIVATE CORPORATION (PARA 2 REFERS). THIS HAS HAPPENED ONCE IN THE LAST TWENTY YEARS. IT IS CERTAINLY UNLIKELY THAT THE GOVERNMENT WOULD ALLOW A STRATEGIC INDUSTRY E.G. THE ENERGY SECTOR, TO FALL INTO UNFRIENDLY HANDS, BUT IT IS HARD TO PIN DOWN THE METHODS BY WHICH THEY WOULD PREVENT IT. IN THE CASE OF THE SGB THE THEN MINISTER OF ECONOMIC AFFAIRS (MAYSTADT)

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WANTED REASSURANCE THAT DE BENEDETTI WOULD NOT SELL OFF THE SGB'S ASSETS IN THE ENERGY SECTOR, BUT HE WOULD NOT IN FACT HAVE HAD ANY LEGAL BASE ON WHICH TO CHALLENGE DE BENEDETTI HAD HE GAINED CONTROL AND NOT KEPT HIS WORD.

6. THERE IS NO PROVISION IN THE CURRENT DRAFT LEGISLATION TO GIVE THE GOVERNMENT SPECIFIC POWERS TO PREVENT HOSTILE TAKEOVERS IN PARTICULAR SECTORS BUT IT WILL HAVE THE POWER UNDER FUTURE LEGISLATION ON MERGER CONTROL (PARA 14 REFERS) TO DETERMINE THE CONDITION FOR TAKEOVERS.

RESTRICTIONS ON SHARE OWNERSHIP OR VOTING RIGHTS

7. THE ISSUE OF BEARER SHARES IS COMMON PRACTICE IN BELGIUM PRIMARILY FOR TAX REASONS. SINCE NO REGISTRATION OF OWNERSHIP IS REQUIRED THERE IS NO WAY OF DISCOVERING SHAREHOLDERS' IDENTITIES. SOME STOCK MARKET ANALYSTS THINK THAT THIS PRACTICE WILL RENDER MUCH OF THE PROPOSED LEGISLATION ON SHAREHOLDING DISCLOSURES INEFFECTIVE.

8. CONVERTIBLE BONDS OR BONDS WITH WARRANTS ARE CURRENTLY THE FAVOURED DEVICES FOR COMPANIES STRENGTHENING THEIR STABLE SHAREHOLDINGS. RECENT EXAMPLES INCLUDE GR/INNO/BM (SUPERMARKET CHAIN): TRACTEBEL (ENGINEERING AND ELECTRICITY) AND UCB (CHEMICALS). THE BONDS HAVE BEEN ISSUED TO FRIENDLY SHAREHOLDERS FOR CONVERSION AT A FIXED PRICE WITHIN A GIVEN PERIOD. THE BANKING COMMISSION ENVISAGES THAT COMPANIES WILL BE FORCED TO FOREGO THE FIXED PRICE ELEMENT IN CONVERTIBLE BONDS OR WARRANTS WHICH PRIVILEGES THE EXISTING SHAREHOLDER AND HANDICAPS ANY POTENTIAL BIDDER. STOCK OPTION PLANS ARE AVAILABLE TO COMPANY EMPLOYEES IN SOME CASES. COMPANIES MAY BLOCK THE SALE OF SHARES PURCHASED WITHIN THIS SCHEME FOR A PERIOD OF 2 TO 3 YEARS.

9. THERE IS NO LEGAL RESTRICTION ON VOTING RIGHTS OTHER THAN THAT ATTACHED TO THE TYPE OF SHARE PURCHASED (IE. ORDINARY OR 'A' ORDINARY). BELGIAN UNIT TRUSTS MAY NOT USE THE SHARES THEY HOLD ON BEHALF OF INVESTORS TO VOTE. THERE IS, HOWEVER, NOTHING TO PREVENT THEM FROM SELLING THE SHARES.

10. CROSS-HOLDINGS ARE A COMMON FEATURE IN THE BELGIAN CORPORATE SECTOR. OF THE TOP 50 BELGIAN COMPANIES (IN MARKET VALUATION TERMS) LISTED ON THE BRUSSELS STOCK EXCHANGE OVER 40 ARE

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INTERLINKED, IN MANY CASES THROUGH A TIGHTLY-KNIT NETWORK OF CLOSE FAMILY CONNECTIONS. ONE GROUP COMPRISING THE BANQUE BRUXELLES LAMBERT (BBL): COBEPA (THE BELGIAN HOLDING COMPANY OF BANQUE PARIBAS), GB/INNO/BM, GROUPE BRUXELLES LAMBERT (GBL-HOLDING) AND ROYALE BELGE (INSURANCE) ARE EITHER DIRECTLY OR INDIRECTLY LINKED THROUGH NO LESS THAN 17 COMPANIES. FAMILY HOLDINGS ARE OFTEN IMPORTANT VIZ. BEKAERT = 50%: DELHAIZE (SUPERMARKET CHAIN) = 40%: SOFINA (FINANCE AND ENGINEERING) = 48%: SOLVAY (CHEMICALS) = 25%: TABACOFINA = 10%: AG (INSURANCE) = 8%: GBL = 2%.

11. PROXY-VOTING MAY BE USED FOR A SINGLE AGM OR EGM, BUT NOT AS A GENERAL RULE.

OTHER DEFENCE MECHANISMS

12. CAPITAL INCREASES AUTHORISED BY EITHER THE SHAREHOLDERS OR THE BOARD, AS LAID DOWN IN THE ARTICLES OF ASSOCIATION, HAVE BEEN USED WIDELY IN RECENT MONTHS BY TARGET OR POTENTIAL TARGET COMPANIES. THE SGB USED ITS AUTHORISED CAPITAL TO ISSUE 12 MILLION NEW SHARES TO FRIENDLY SHAREHOLDERS IN AN ATTEMPT TO DILUTE CERUS'S STAKE. TRACTEBEL, GB/INNO/BM AND UCB HAVE ALL RESORTED TO THE SAME DEFENCE MECHANISM.

13. OTHER POPULAR DEFENCE MECHANISMS INCLUDE WHITE KNIGHTS USED BY BOTH BELGIAN INSURANCE COMPANIES (ROYALE BELGE AND ASSUBEL) AGAINST, IN ROYALE BELGE'S CASE, THE FRENCH INSURANCE COMPANY, AXA, AND IN ASSUBEL'S CASE, THE BELGIAN INSURANCE COMPANY, AG. ASSUBEL ALSO APPLIED AN AGREEMENT CLAUSE IN THEIR ARTICLES OF ASSOCIATION REQUIRING THE BOARD AND SHAREHOLDERS TO APPROVE THE PARTICIPATION OF ANY POTENTIAL SHAREHOLDER. ASSUBEL WAS ABLE TO REJECT AG'S TAKEOVER BID BY USING THIS CLAUSE. THE BANKING COMMISSION HAS SUGGESTED THAT THE FUTURE LEGISLATION ON PERMITTED DEFENCE MECHANISMS WILL MAKE IT MANDATORY FOR ANY COMPANY APPLYING AN AGREEMENT CLAUSE TO FIND AN ALTERNATIVE PREFERRED BIDDER WITHIN A LIMITED PERIOD OF TIME (EG 1 MONTH).

MERGER CONTROLS

14. MERGER CONTROL LEGISLATION TO COMPLEMENT THE SHARE DISCLOSURE REGULATIONS IS CURRENTLY BEING DRAFTED. IT WILL PROVIDE FOR POWERS OF ENFORCEMENT TO BE CONFERRED ON THE BANKING COMMISSION

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AND THE COMMERCIAL COURT, SET OUT THE CONDITIONS UNDER WHICH TAKEOVER BIDS MAY BE MADE AND DEFINE PERMITTED DEFENSIVE MECHANISMS (POISON PILLS).

BRUSSELS STOCK EXCHANGE

15. APPROXIMATELY 200 BELGIAN AND 150 FOREIGN COMPANIES ARE LISTED ON THE BRUSSELS BOURSE (LISTS OF NAMES FOLLOWS BY BAG). TOTAL STOCK MARKET VALUATION AT THE END OF 1987 WAS EQUIVALENT TO 26% OF GNP COMPARED TO 30% IN 1986.

16. CASE STUDIES OF IMPORTANT RECENT TAKEOVERS (SUCCESSFUL AND UNSUCCESSFUL) FOLLOW BY FAX. THESE WILL INCLUDE: CERUS/SGB: AXA/ROYALE BELGE: AG/ASSUBEL: SUCHARD/COTE D'OR AND GBL AND TRACTEBEL/CONTIBEL (IC.GAS).

CONCLUSION

17. THE ORIGINAL DRAFT BILL ON SHARE DISCLOSURE WAS INSPIRED BY THE EC PROPOSALS FOR DISCLOSURE AT 10% OF SHARE CAPITAL. THE BELGIAN GOVERNMENT DECIDED TO REDUCE THE LEVEL TO 5% FOLLOWING CERUS'S BID FOR THE SGB AND FEARS THAT OTHER BELGIAN COMPANIES MIGHT BECOME EASY TAKEOVER TARGETS. IN DRAWING UP MERGER CONTROL LEGISLATION THE BELGIANS HAVE SAID THAT THEY WILL TAKE THEIR LEAD FROM FRENCH AND UK PRACTICES, IN PARTICULAR THE CITY CODE. THE GOVERNMENT HOPE TO INTRODUCE THE LEGISLATION AS EARLY AS POSSIBLE.

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MR NEWMAN, DTI
DR HOWE, OFT
MR HOBROUGH, MAFF
MR COLLIS, D/TRANSPORT
MR MARTIN, D/TRANSPORT
MR M T R SMITH,
(BANK OF ENGLAND)

MR LEWIS, BANK OF ENGLAND
MR ARTHUR, FCO
MR KEEFE, FCO
MR WYNN-OWEN, HMT
MR J ALTY, CABINET OFFICE
MR S SCHLAROFF, DEN
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*A note, psc, on Law A-G
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TELNO 722
OF 201349Z JULY 88
INFO ROUTINE EC POSTS

FRAME ECONOMIC
YOUR TELNO 416 TO BONN: EC MERGER CONTROL REGULATION

SUMMARY

1. HOSTILE TAKEOVERS A NOVELTY, RELATIVELY SPEAKING, IN FRANCE. THE RULES ARE STILL EVOLVING AND NOT ALWAYS PREDICTABLE, BUT IT IS BECOMING EASIER TO MOUNT HOSTILE BIDS. A PREDATOR FACES SEVERAL HURDLES BUT CAN GET OVER THEM AND WIN. MARKET CAPITALISATION WAS DOLLARS 154 BILLION, OR 21.1 PERCENT OF GDP, AT THE END OF 1987.

DETAIL

2. HOSTILE TAKEOVER BIDS HAVE NOT BEEN A MAJOR FEATURE OF THE FRENCH ECONOMY UNTIL RECENTLY. IN 1969 THERE WAS A CELEBRATED RUSSE FOR CONTROL OF ST GOBAIN, BUT THERE WAS LITTLE HOSTILE TAKEOVER ACTIVITY IN THE 70S AND IN THE LAST 10 YEARS ONLY SOME 30 HOSTILE BIDS ARE RECKONED TO HAVE BEEN MADE. IT IS ONLY THIS YEAR THAT THERE HAS BEEN A CHANGE OF PACE, WITH GRAND MET CONTESTING SEAGRAM'S ULTIMATELY SUCCESSFUL BID FOR MARTELL, SCHNEINDER BIDDING FOR TELEMECANIQUE, BOLLORE FOR RHINE-RHONE, AND THORN FOR HOLOPHANE.

3. WITH HOSTILE TAKEOVERS A RELATIVE NOVELTY, THE RULES OF THE GAME ARE STILL EVOLVING AND CANNOT BE PREDICATED AS CONFIDENTLY AS IN LONDON OR NEW YORK. THE FRENCH AUTHORITIES ACCEPT THAT TAKEOVERS ARE AN INEVITABLE FEATURE OF SOPHISTICATED FINANCIAL MARKETS AND CAN PLAY A USEFUL ROLE IN BRINGING ABOUT ECONOMIC RESTRUCTURING. AS A RESULT, IT IS PROBABLY BECOMING EASIER TO MOUNT A HOSTILE TAKEOVER IN FRANCE THAN IT HAS BEEN IN THE PAST. BUT THERE IS AN UNPREDICTABILITY ABOUT OFFICIAL ATTITUDES AND A SUSPICION THAT THE AUTHORITIES WOULD BE TEMPTED TO STOP A HOSTILE TAKEOVER THEY DID NOT LIKE (EG IF IT AMOUNTED TO ASSET STRIPPING) OR TO IMPOSE MORE GENERAL CONSTRAINTS IF THERE WERE AN UPSURGE IN TAKEOVER ACTIVITY THAT WAS, FOR EXAMPLE, JUDGED TO HAVE DAMAGING SOCIAL CONSEQUENCES.

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INVOLVED: SEE THE PAPERS IN FCO/DTI ON THE PEARSON/LES ECHOS CASE FOR PROBLEMS THAT CAN ARISE IN A SENSITIVE SECTOR LIKE THE PRESS EVEN IN AN UNCONTESTED PURCHASE)

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A) MARTEL WENT ULTIMATELY TO SEAGRAMS AS THE HIGHEST BIDDER, BUT THE EARLY ATTEMPT BY BOTH PARTIES TO FREEZE GRAND MET OUT OF THE RUNNING BY CONCLUDING A SALE OFF BUT BOURSE FELL FOUL OF THE FRENCH AUTHORITIES - AFTER LOBBYING BY GRAND MIST AND BY US ON THEIR BEHALF.

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6. DECEMBER 1987 FIGURES FOR BOURSE LISTINGS ARE:

I. OFFICIAL LIST

- MONTHLY SETTLEMENT (FORWARD MARKET)

FRENCH STOCKS:	183
FOREIGN STOCKS:	67
TOTAL:	250

- COMPTANT (CASH MARKET)

FRENCH STOCKS:	453
FOREIGN STOCKS:	126
TOTAL:	579

II. SECOND MARKET

FRENCH STOCKS:	258
FOREIGN STOCKS:	5
TOTAL:	263

GRAND TOTAL 1092

7. DECEMBER 87 MARKET CAPITALISATION WAS DOLLARS 154 BILLION, WHICH REPRESENTED 21.2 PERCENT OF GDP (FURTHER DETAILS ON THE PARIS BOURSE ARE IN DOCUMENTS ATTACHED TO GUCKIANS'S LETTER OF 21 JUNE TO SMITH, FINANCIAL SERVICES DIVISION, DTI)

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FROM: J M G TAYLOR

DATE: 22 July 1988

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

MR JOHNS IR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr Scholar
Mr Culpin
Mrs Lomax
Mr Peretz
Mr Gilhooly
Miss O'Mara
Mr Ilett
Mr Cropper
Mr Tyrie
Mr Battishill IR
Mr Isaac IR
Mr Painter IR
PS/IR

EUROPEAN COMMISSION MOVES TO COMBAT TAX EVASION

The Chancellor has seen your minute of 19 July. He is content to proceed on the basis you propose.

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

J M G TAYLOR

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See above
27/7

FROM: J M G TAYLOR

DATE: 22 July 1988

MR WYNN OWEN

cc PS/Financial Secretary
Sir G Littler
Mr Lankester
Mr Monck
Mr R I G Allen
Mr Burgner

EC MERGER CONTROL REGULATION

... The Chancellor has seen Paris Telno 722 (attached).

2. He would be grateful for advice on how the effectiveness of points A to G in paragraph 4 of this telegram would be affected were a Community Mergers Directive to become law (and perhaps to what extent they are already circumscribed by Articles 85 and 86).

JTG

J M G TAYLOR

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FM PARIS
TO IMMEDIATE FCO
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INFO ROUTINE EC POSTS

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TOTAL:	263

GRAND TOTAL 1092

7. DECEMBER 87 MARKET CAPITALISATION WAS DOLLARS 154 BILLION, WHICH REPRESENTED 21.2 PERCENT OF GDP (FURTHER DETAILS ON THE PARIS BOURSE ARE IN DOCUMENTS ATTACHED TO GUCKIANS'S LETTER OF 21 JUNE TO SMITH, FINANCIAL SERVICES DIVISION, DTI)

GREENSTOCK

YYYY



[oops] →

John Grenford
2019 5028
PRHA: 5023

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

FROM: P JEFFERSON SMITH
DATE: 24 August 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Paymaster General
Financial Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Scholar
Mr Lankester
Mr Culpin
Mr R I G Allen
Mr Riley
Mr Gilhooly
Mr Gieve
Miss Simpson
Mr Cropper
Mr Pratt (Tsy Solr)
Miss Wheldon (Tsy Solr)

(L) content with paper
2) draft to F sec
3) letter to ECOFIN colleagues?
And what about contacting
Rommeliotis (could not Geoff
deal?), and press-release
suggestion?

mpw 25/8

THE MARKET-BASED APPROACH TO 1992

PAPER FOR ECOFIN

As I indicated in my note of 12 August, the draft of your paper for the September informal ECOFIN has been amended in the light of the Law Officers' advice and some helpful presentational points suggested by Sir David Hannay. It has been circulated to officials in interested Departments, but as it is your paper, we have not sought clearance from them. I attach a copy of the revised paper.

Internal Circulation:	CPS	Mr Allen
	Mr P V H Smith	Mr Kent
	Mr Nash	Mr Cockerell
	Mr Wilmott	Mr Fotherby
	Mr Fryett	Mr Knox
	Mr Nissen	

2. I should mention briefly a few points about the revised draft.

(i) The Law Officers' advice. As mentioned in my note of 12 August, to be consistent with the Law Officers' advice, the paper now lays slightly less stress on the ability of market forces to affect indirect tax rates through cross-border shopping. It also accepts the need for a degree of harmonisation of legislation necessary to achieve the internal market, while rejecting any harmonisation of indirect tax rates.

(ii) Fiscal competence. Paragraph 6 of the draft states that "The Single European Act did not involve the surrender of fiscal competence by Member States", which reflects the Attorney General's advice. I should mention, however, that both the Treasury Solicitor and UKREP have expressed strong reservations about its inclusion, believing it to be provocative and controversial. Certainly there are dangers in its inclusion, with considerable scope for argument as to the degree of fiscal competence surrendered, or not surrendered, under the Act. But it is a valid point, important to our case, and is consistent with the Attorney General's advice. We recommend its inclusion.

(iii) The Economic Secretary's comments. We have (we hope) taken on board all the Economic Secretary's comments - except in relation to making reference to the position in the USA. Because Lord Cockfield has a ready riposte to the UK drawing on the parallel between our market based approach and the US position, UKREP have suggested that it would be advisable not to give him an easy point for e.g. a press release. Mention of the USA might better be made during your oral presentation of the paper.

(iv) VAT postponed accounting. This has been given somewhat greater prominence (paragraph 18). Since it is highly unlikely that it would be acceptable to all other Member States the risk of having to make the change (with its £1.6 bn or so PSBR cost if implemented in a single step) seems remote. But it is a key part of a policy of shifting away

from frontier controls whilst retaining the destination principle and not harmonising rates. Are you content for it to be given this high-profile treatment?

3. Cabinet Office have suggested that, although the paper is your paper, it nevertheless represents an important aspect of general UK policy towards the Single Market and that you should therefore write to Sir Geoffrey Howe and appropriate colleagues, including the Prime Minister, seeking consent to the paper. We concur with this - not least because of the risk that the advantages of achieving the Single Market package as a whole may be seen by some Ministerial colleagues as outweighing the particular problems of indirect taxation. It is also advisable for the Attorney-General to cast his eye over the paper to ensure that it is consistent with his advice.

[No Irish! - shd be a minute. We will have redone when we have yr views]

4. I attach a letter to Sir Geoffrey Howe. Timing, and logistical constraints mean that it is in final form rather than draft. I should explain. In order for your ECOFIN colleagues to have had a reasonable time to consider your paper before the informal meeting on 17/18 September, you need to send it to them at the latest on Monday 5 September. In order to give your Ministerial colleagues some time to see the paper before then, you really need to write to Sir Geoffrey Howe immediately after the Bank Holiday. I regret this compressed timetable - which largely stems from the timing of the Law Officers' advice. But they ought to be able to respond quickly because officials have already seen the paper in draft.

5. I am also attaching a draft letter for you to send to your ECOFIN colleagues, M. Delors and Lord Cockfield. It has been cleared with FCO officials. UKREP suggest that, as a matter of protocol, it would be advisable for you to contact Mr Roumeliotis, to obtain his approval for discussion of your paper at September's meeting. Greek officials have already indicated that there will be no difficulty. Alternatively, it would probably suffice for Sir Geoffrey Littler to contact his opposite number.

[I can send PP.]

Yes

BRIEFING AND PUBLICITY

6. We are also arranging for copies of your paper and briefing material to be sent to the appropriate UK embassies so that they can do what they can to get the message across. At the same time we are asking them to let us know in good time the host country's attitude to the tax approximation issue and, in particular, to your paper.

7. But although the paper is for your ECOFIN colleagues, there is also a question of whether it should be released publicly, and if so, when and to whom. We see two reasons why it would be advisable to give the paper a public release. The positive reason is to give the UK's alternative, market-based approach a fair wind in the media. The negative reason is that the paper will almost certainly be leaked anyway and it would be preferable to avoid being put on the defensive. As a courtesy to your ECOFIN colleagues we consider that we should delay releasing the paper until 48 hours after you have written to them, but we should then give it something of a boost with the media. We would propose sending it, inter alia, to the Chairmen of the House of Commons European Legislation and Treasury and Civil Service Committees, Parliamentary libraries and to MEPs. We suggest also briefing the UK press and European correspondents in Brussels.

8. It would be most helpful if you could let us know whether these arrangements are acceptable.

PH

P JEFFERSON SMITH

*24 hrs
from
you*



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

The Rt Hon Sir Geoffrey Howe QC MP
Secretary of State for Foreign and Commonwealth Affairs
Foreign and Commonwealth Office
Downing Street
London SW1A 2AL

August 1988

At the informal May meeting of ECOFIN I promised to circulate to my EC colleagues a paper setting out the UK alternative approach to future indirect taxation in the Single Market, based on market forces. My intention was to show that the rigid and centralized Commission approach, which would involve highly unwelcome changes to our indirect taxation system - notably abolishing VAT zero rating - is not the sole route to achieving the Single Market. Indeed, as the paper explains, a market-based approach is more likely to reflect changing economic circumstances while at the same time providing for the progressive elimination of fiscal frontiers without any need for centrally-determined indirect tax rates.

I attach a copy of my paper which has been discussed by officials, and which I propose to send to my EC colleagues, M Delors and Lord Cockfield on 5 September. I intend to press strongly the approach set out in the paper at the informal ECOFIN on 17/18 September. I also propose to release the paper ~~on 7 September~~ in order to get some positive media coverage before ECOFIN - and before the Commission's predictable reaction.

In view of the tight timescale I would be glad to have your early consent to the approach which I propose to adopt. I am copying this to the Prime Minister, members of OD(E), Kenneth Clarke, Paul Channon and Sir Robin Butler.

NIGEL LAWSON

Shank thereafter

TAXATION IN THE SINGLE MARKET : A MARKET-BASED APPROACH

Introduction

1. The Commission have put forward proposals for approximation of indirect taxes. The aim is to achieve the completion of the Single Market in 1992. This paper sets out how the Community's objectives might be achieved, with fewer obstacles to agreement among Member States, by releasing market forces.

2. The market-based approach put forward here proposes a progressive reduction of frontier controls, including the introduction of postponed VAT accounting for imports, and an easing of restrictions on cross-border shopping. These measures, which are desirable in their own right as a contribution to completion of the Single Market, should be implemented without formal approximation of indirect tax rates. They would achieve through the operation of market forces within a framework of deregulation those rates and structures of indirect taxes that are suited to the completion of the Single Market. But neither the Commission's approach nor the market-based approach is suitable in the case of alcohol and tobacco, where individual Member States should be free to adopt such controls as are deemed necessary for ~~social and~~ health policy reasons.

The present system

3. The system currently in use in the Community for indirect taxes on trade between Member States is based on the Destination Principle: ie exports are relieved of tax, imports are charged at the tax rates of the importing country. Exporters to any market thus face the same tax rate as that market's domestic suppliers. There is no distortion of competition between foreign and domestic suppliers.

4. In order to implement this system and ensure that tax revenue accrues in the country where the goods are consumed, appropriate fiscal controls are required. These include restrictions on the quantities of tax-paid (as well as tax-free) goods which

Individuals can bring from one Member State to another. The level of controls applied, and whether they are applied at the frontier or inland, differs considerably between Member States. Controls also exist for many other purposes - for example to prevent drug or arms smuggling, to protect public or animal health, or to operate licensing or quota arrangements.

5. The present system imposes costs on those who trade or travel between Member States. In this context it is important to note that inland controls impose costs just as frontier controls do. The Commission's recent study on the "Economics of 1992" - the Cecchini Report - suggests that the cost of all border controls currently amounts to 8-9 bn ECU: 1.7 - 1.9% of the value of intra-EC trade, or 0.25% of Community GDP. The UK experience is that only a quarter to a half of these costs (about 0.1% of GDP) are associated with fiscal controls. Furthermore, border costs vary substantially between Member States: the Cecchini figures suggest that they may vary by more than 5 times, with the lowest costs around half the average.

The Single Market

6. Article 8A of the EEC Treaty provides that the internal market should be established by the end of 1992; and defines the internal market as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty". Article 99 of the Treaty provides that the Council will adopt harmonisation measures for indirect tax "to the extent that such harmonisation is necessary to ensure the establishment and functioning of the internal market within the time laid down in Article 8A". The Single European Act did not involve the surrender of fiscal competence by Member States and the Treaty leaves to the Council a considerable measure of discretion as to the fiscal implications of the creation of the single market. It does not imply that tax approximation is the sole route to achieving the internal market. Removal of internal frontiers consistent with other Treaty provisions is the essential goal.

7. According to the Brussels European Council of March 1985, the purpose of creating a Single Market is to create a more favourable environment for stimulating enterprise, competition and trade. In the words of the Padoa-Schioppa report, the intention is to improve the efficiency of resource allocation in the Community. Businesses should be able to compete in all Member States on an equal footing. Key elements in the creation of the Single Market are:

- reducing to a minimum the costs and other impediments to trade arising from different national regimes and measures;
- making markets more competitive, by deregulation and the elimination of unnecessary restrictions and constraints on production and consumption.

8. Recent developments in many Western economies demonstrate the benefits which result from deregulation, from freeing markets and from dismantling barriers and controls; and underline the importance of the speedy completion of the internal market. It is by releasing, not constraining, market forces that soundly-based economic growth will be achieved. The desirability of this approach is now widely accepted by the major industrial countries, and Community policies must be seen in this wider context.

9. The more competitive economy which will result from completing the Single Market will tend to mean closer alignment of prices of particular goods and services, both between and within Member States. But the pattern of relative prices and the allocation of resources will be determined by the market through the competitive process. It is this process which will enhance economic efficiency in the European economy.

10. Similarly, the more competitive Community economy will tend to mean ~~closer alignment of~~ ^{(that) towards a convergence} tax rates. But it no more follows that the Community needs to dictate tax rates centrally than that it needs to dictate prices. Market forces can, as a general rule, bring about a sufficient degree of convergence for the completion of the internal market.

The Commission's proposals

11. The Commission propose a formal system of indirect tax approximation, covering both VAT and excise duties, with tax rates or bands set by Community law. The proposals are presented as essential to completion of the Single Market, but in certain important respects are quite contrary to the philosophy underlying it. Although the Commission's 1985 White Paper recognised the potential role of market forces - "Market forces will themselves create pressures to achieve a degree of tax approximation" (paragraph 186) - the approach is essentially dirigiste rather than market-based, so involving undesirable costs and rigidities. Such an approach is unlikely to ensure that tax rates adequately reflect evolving market conditions and preferences.

12. The Cecchini Report did not separately identify the costs associated with present fiscal controls, and nor did it consider the costs of the Commission's proposals. A proper comparison is impossible at this stage, not least because more detail is required from the Commission on the administrative details of their proposals, especially the VAT clearing house and the linked bonded warehouse scheme. But despite a lack of information, there are no firm grounds for believing that the cost of the proposed arrangements would be less than could be achieved by simplifying the present system.

13. A satisfactory clearing house system, satisfying the criteria set out by the EPC, has yet to be devised. But because of its inherent complexity, and inevitable concerns about the revenue at risk, the associated costs are likely to be substantial. The linked bonded warehouse scheme for excises would also impose costs, and would even appear to impose restrictions on the passage of goods between Member States which do not exist at present. The Commission (and Cecchini) assume that non-fiscal barriers will be abolished by 1992, taking no account of the need to maintain preventive controls against, for example, drugs and firearms smuggling (consistent with Article 36 of the EEC Treaty and the Declaration on Articles 13-19 of the Single European Act).

. As regards the present system, the UK believes that average costs savings of around 50% could be achieved if the costs of frontier barriers were reduced to those of the "cheapest" Member States; in some cases the reduction could be over 80%. In view of this it is far from clear that the costs of the Commission's proposals would be less than could be achieved under the present system.*

15. The Commission's proposals are wide-ranging and of potentially great significance. They have implications - in many cases substantial implications - for a range of important national policy areas, including economic, social, health, fiscal and budgetary, transport, environment, energy. For some Member States the tax approximation proposals involve large and relatively sudden changes with potentially unwelcome consequences (many of which the Cecchini Report did not take into account). When the benefits and disadvantages of the proposals are considered, the overall balance will differ for each Member State, but certainly in some ~~(if not in many)~~ it is likely to be unfavourable.

16. Even more fundamentally, the arrangements implicit in the Commission's approach are unlikely to be consistent with the objective of deregulation and greater competition. Inevitably indirect tax rates would be set in a way which took insufficient and belated account of changing conditions and priorities. Any structure which requires unanimous agreement to alter tax bands or structures is unlikely to be sufficiently responsive to the needs of change. Rates would be brought closer together than they are under the current system, but probably at levels which took insufficient account of priorities in Member States and conditions in world and Community markets. The ~~potential~~ ^{theoretical} benefits of greater harmonisation would be outweighed by significant costs.

* As the EPC Opinion of 30 June put it: "there clearly exists a further considerable potential for saving, independently of tax harmonisation."

market-based approach

17. The Commission see their proposals as essential to completion of the Single Market, and in particular to the dismantling of border controls. However the UK Government believes that this latter objective can be achieved more directly, without approximating rates of indirect taxes along the lines proposed. The harmonisation measures which should be taken are those which will reduce controls and enhance competition in the Community in order to complete the Single Market; this will allow increased scope for market forces to influence indirect taxes. This approach recognises that continued reliance on a system based on the destination principle permits free and fair competition in national markets. It allows Member States freedom to set indirect tax rates according to national circumstances and priorities. At the same time it recognises that competitive pressure will in fact lead to greater convergence. The main elements of the market-based approach are set out below.

18. The first element is a substantial reduction in frontier controls on intra-Community trade, to the minimum consistent with maintaining the Destination Principle. A major contribution could be made by the introduction of postponed VAT accounting for imports, so that traders no longer have to account for and pay VAT at the frontier. This would yield immediate practical benefits in terms of reduced trader costs, and could be implemented well before the end of 1992. The UK *has always made it clear that it* would be willing to reintroduce such a system as part of a Community-wide move in this direction.

19. Other measures which should be considered include: greater moves towards controls based on internal, audit-type procedures; greater use of information technology; and substantial modification of the Community Transit system. The initial goal would be to reduce controls between all Member States to no more than the level currently in operation within Benelux, with active consideration being given to schemes which could reduce these controls still further. The UK is already moving in this direction by preparing two new schemes for faster clearance at frontiers and the greater use of periodic submission of VAT and statistical data.

20. The second major element is the enhancement of market forces in the context of individual travel between Member States. The present restrictions on cross-border shopping are designed to police the indirect tax system, but have the effect of restricting shoppers' freedom to take advantage of price differences between Member States, the bulk of which arise for reasons other than differences in indirect tax rates. Restrictions on the quantity of goods which individuals can take (tax-paid) from one Member State to another should be substantially and progressively relaxed, with the ultimate aim that they should be completely eliminated (but see paragraph 24 below). Whatever the size of the initial steps, by the end of 1992 they should be sufficient to ensure an important role for market forces - in the shape of cross-border shopping - in areas where tax rates are far apart. In these circumstances tax free allowances would ultimately be abolished.

21. These reductions in trading costs and increases in travellers' allowances would increase the competitive pressure on Member States when setting indirect tax rates. Countries with high tax rates would tend to lose revenue as their nationals shopped in other Member States, and would face greater competition from overseas producers; and conversely for low tax rates. Governments would have to choose a pattern of indirect tax rates which struck a balance between these competitive pressures and national preferences.

22. This market-based approach would be very much in keeping with the microeconomic policies increasingly being pursued in the major industrial countries, with the focus on deregulation and competition. It provides a much better guarantee than the Commission's proposals that indirect tax rates and structures will suit the circumstances of 1992 and beyond, rather than those of 1988. The pressures on tax rates would in general be downwards, providing an essential antidote to the in built pressures for increased public expenditure and taxation. In contrast, the Commission's proposals would mean additional regulation and a diminished role for the market; there would be no countervailing downward pressure on tax rates.

23. The market-based approach does not mean an immediate abandonment of the principle that goods bear the indirect taxes in force in the country where they are sold or resold. Any sudden change from this principle to a free-for-all would have large and potentially damaging implications for many Member States. These and other practical considerations indicate that frontier barriers cannot be removed in one go; a gradual approach will be needed.

Alcohol and tobacco

24. Whichever approach is adopted, alcohol and tobacco must be treated as special cases because of the serious ~~social and~~ health risks associated with excessive consumption of these products. Neither the market-based approach nor the Commission's approach would be appropriate. Allowing market forces completely unfettered sway, with greater (and ultimately unrestricted) access to cheap supplies, would be a retrograde step. Alcohol and especially tobacco are central targets in the Community's Europe against cancer campaign. At the moment there are very marked divergencies between member States' taxation of these products. The EPC report recognised that harmonisation would cause great difficulties in this area and thus recommended caution. Furthermore, any harmonisation should not force individual Member States to adopt significantly lower tax rates than they would ideally wish to impose for ~~social and~~ health reasons. Accordingly the UK considers it essential either that there should be effective restrictions in this area, or that high minimum duty rates should be set.

Conclusion

25. This paper has outlined an alternative, market-based approach to harmonisation of indirect taxation, in keeping with both the philosophy underlying the Single Market and the wider international climate of deregulation and competition. The key feature of this approach is that market forces would affect decisions by governments as well as the private sector of the European economy, ensuring flexibility of taxes in the face of changing circumstances. The UK Government considers that the Commission's approach is not the only one compatible with Article 99 of the

neatly nor the best means of setting rates of indirect taxes for the Community in a competitive world economy.

26. The alternative approach to harmonisation is intended to avoid major difficulties and adjustment costs. It is designed to provide a relatively smooth path to progressive further reduction of controls (especially through the increasing use of information technology) with the ultimate aim of removing frontier formalities. It is intended to develop in parallel with the increasing integration of the Single Market through providing increasing scope for market forces to influence tax rates rather than attempting to apply rigid, centrally-dictated indirect tax rates, which is premature, unnecessary and probably inappropriate. There should now be a concerted effort by all Member States and the Commission to devise a programme of action which will produce tangible results by the end of 1992.



FROM: MISS M P WALLACE

DATE: 26 August 1988

MR JEFFERSON SMITH - C&E

cc Chief Secretary
 Paymaster General
 Financial Secretary
 Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Byatt
 Mr Scholar
 Mr Lankester
 Mr Culpin
 Mr R I G Allen
 Mr Riley
 Mr Gilhooly
 Mr Gieve
 Miss Simpson
 Mr Cropper
 Mr Pratt (Tsy Solr)
 Miss Wheldon (Tsy Solr)

PS/C&E

Mr P V H Smith

Mr Nash

Mr Wilmott

Mr Fryett

Mr Nissen

Mr Allen

Mr Kent

Mr Cockerell

Mr Fotherby

Mr Knox

THE MARKET-BASED APPROACH TO 1992

The Chancellor was most grateful for your minutes of 12 and 24 August. He had only small changes to the draft paper, which I passed on by phone to Richard Allen. For the record, they are:

- (i) in para 2, final line, delete "social and";
- (ii) in para 10, second line, delete "mean closer alignment" and replace with "lead towards a convergence";



- (iii) in para 15, last sentence, delete words in brackets;
- (iv) in para 16, final sentence, replace "potential" with "theoretical";
- (v) in para 18, final sentence, amend to read: "The UK has always made it clear that it would be willing to reintroduce....";
- (vi) in para 24, first sentence and penultimate sentence, delete "social and".

3. There are two other points I ought to record. First, the Chancellor thought that it would suffice for Sir G Littler to contact his Greek opposite number, rather than the Chancellor speaking to Mr Roumeliotis personally. And on the question of press releasing the ECOFIN paper, the Chancellor thought that it would not be necessary to wait 48 hours after ECOFIN circulation - he thought 24 hours would suffice, if that timing was more propitious. But he would like to wait until nearer the time before settling the precise day of the press release. (Accordingly, he has amended the draft to the Foreign Secretary to the less specific on this point.)

4. Once I have a revised version of the paper, I shall sign off the minute to the Foreign Secretary on the Chancellor's behalf.

A handwritten signature in cursive script, appearing to read "Moira Wallace".

MOIRA WALLACE



BF 219 [box]

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

FOREIGN SECRETARY

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I attach a copy of my paper which has been discussed by officials, and which I propose to send to my EC colleagues, M Delors and Lord Cockfield on 5 September. I intend to press strongly the approach set out in the paper at the informal ECOFIN on 17/18 September. I also propose to release the paper shortly thereafter in order to get some positive media coverage before ECOFIN - and before the Commission's predictable reaction.

In view of the tight timescale I would be glad to have your early consent to the approach which I propose to adopt. I am copying this to the Prime Minister, members of OD(E), Kenneth Clarke, Paul Channon and Sir Robin Butler.

"shortly thereafter"
= shortly after 5 sept,
(of course)

Muir Wallace
PP [N.L.]
30 August 1988
(Approved by the Chancellor
and signed in his absence.)

TAXATION IN THE SINGLE MARKET : A MARKET-BASED APPROACH

Introduction

1. The Commission have put forward proposals for approximation of indirect taxes. The aim is to achieve the completion of the Single Market in 1992. This paper sets out how the Community's objectives might be achieved, with fewer obstacles to agreement among Member States, by releasing market forces.

2. The market-based approach put forward here proposes a progressive reduction of frontier controls, including the introduction of postponed VAT accounting for imports, and an easing of restrictions on cross-border shopping. These measures, which are desirable in their own right as a contribution to completion of the Single Market, should be implemented without formal approximation of indirect tax rates. They would achieve through the operation of market forces within a framework of deregulation those rates and structures of indirect taxes that are suited to the completion of the Single Market. But neither the Commission's approach nor the market-based approach is suitable in the case of alcohol and tobacco, where individual Member States should be free to adopt such controls as are deemed necessary for health policy reasons.

The present system

3. The system currently in use in the Community for indirect taxes on trade between Member States is based on the Destination Principle: ie exports are relieved of tax, imports are charged at the tax rates of the importing country. Exporters to any market thus face the same tax rate as that market's domestic suppliers. There is no distortion of competition between foreign and domestic suppliers.

4. In order to implement this system and ensure that tax revenue accrues in the country where the goods are consumed, appropriate fiscal controls are required. These include restrictions on the quantities of tax-paid (as well as tax-free) goods which

individuals can bring from one Member State to another. The level of controls applied, and whether they are applied at the frontier or inland, differs considerably between Member States. Controls also exist for many other purposes - for example to prevent drug or arms smuggling, to protect public or animal health, or to operate licensing or quota arrangements.

5. The present system imposes costs on those who trade or travel between Member States. In this context it is important to note that inland controls impose costs just as frontier controls do. The Commission's recent study on the "Economics of 1992" - the Cecchini Report - suggests that the cost of all border controls currently amounts to 8-9 bn ECU: 1.7 - 1.9% of the value of intra-EC trade, or 0.25% of Community GDP. The UK experience is that only a quarter to a half of these costs (about 0.1% of GDP) are associated with fiscal controls. Furthermore, border costs vary substantially between Member States: the Cecchini figures suggest that they may vary by more than 5 times, with the lowest costs around half the average.

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9. The more competitive economy which will result from completing the Single Market will tend to mean closer alignment of prices of particular goods and services, both between and within Member States. But the pattern of relative prices and the allocation of resources will be determined by the market through the competitive process. It is this process which will enhance economic efficiency in the European economy.

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12. The Cecchini Report did not separately identify the costs associated with present fiscal controls, and nor did it consider the costs of the Commission's proposals. A proper comparison is impossible at this stage, not least because more detail is required from the Commission on the administrative details of their proposals, especially the VAT clearing house and the linked bonded warehouse scheme. But despite a lack of information, there are no firm grounds for believing that the cost of the proposed arrangements would be less than could be achieved by simplifying the present system.

13. A satisfactory clearing house system, satisfying the criteria set out by the EPC, has yet to be devised. But because of its inherent complexity, and inevitable concerns about the revenue at risk, the associated costs are likely to be substantial. The linked bonded warehouse scheme for excises would also impose costs, and would even appear to impose restrictions on the passage of goods between Member States which do not exist at present. The Commission (and Cecchini) assume that non-fiscal barriers will be abolished by 1992, taking no account of the need to maintain preventive controls against, for example, drugs and firearms smuggling (consistent with Article 36 of the EEC Treaty and the Declaration on Articles 13-19 of the Single European Act).

4. As regards the present system, the UK believes that average costs savings of around 50% could be achieved if the costs of frontier barriers were reduced to those of the "cheapest" Member States; in some cases the reduction could be over 80%. In view of this it is far from clear that the costs of the Commission's proposals would be less than could be achieved under the present system.*

15. The Commission's proposals are wide-ranging and of potentially great significance. They have implications - in many cases substantial implications - for a range of important national policy areas, including economic, social, health, fiscal and budgetary, transport, environment, energy. For some Member States the tax approximation proposals involve large and relatively sudden changes with potentially unwelcome consequences (many of which the Cecchini Report did not take into account). When the benefits and disadvantages of the proposals are considered, the overall balance will differ for each Member State, but certainly in some it is likely to be unfavourable.

16. Even more fundamentally, the arrangements implicit in the Commission's approach are unlikely to be consistent with the objective of deregulation and greater competition. Inevitably indirect tax rates would be set in a way which took insufficient and belated account of changing conditions and priorities. Any structure which requires unanimous agreement to alter tax bands or structures is unlikely to be sufficiently responsive to the needs of change. Rates would be brought closer together than they are under the current system, but probably at levels which took insufficient account of priorities in Member States and conditions in world and Community markets. The theoretical benefits of greater harmonisation would be outweighed by significant costs.

* As the EPC Opinion of 30 June put it: "there clearly exists a further considerable potential for saving, independently of tax harmonisation."

A market-based approach

17. The Commission see their proposals as essential to completion of the Single Market, and in particular to the dismantling of border controls. However the UK Government believes that this latter objective can be achieved more directly, without approximating rates of indirect taxes along the lines proposed. The harmonisation measures which should be taken are those which will reduce controls and enhance competition in the Community in order to complete the Single Market; this will allow increased scope for market forces to influence indirect taxes. This approach recognises that continued reliance on a system based on the destination principle permits free and fair competition in national markets. It allows Member States freedom to set indirect tax rates according to national circumstances and priorities. At the same time it recognises that competitive pressure will in fact lead to greater convergence. The main elements of the market-based approach are set out below.

18. The first element is a substantial reduction in frontier controls on intra-Community trade, to the minimum consistent with maintaining the Destination Principle. A major contribution could be made by the introduction of postponed VAT accounting for imports, so that traders no longer have to account for and pay VAT at the frontier. This would yield immediate practical benefits in terms of reduced trader costs, and could be implemented well before the end of 1992. The UK has always made it clear that would be willing to reintroduce such a system as part of a Community-wide move in this direction.

19. Other measures which should be considered include: greater moves towards controls based on internal, audit-type procedures; greater use of information technology; and substantial modification of the Community Transit system. The initial goal would be to reduce controls between all Member States to no more than the level currently in operation within Benelux, with active consideration being given to schemes which could reduce these controls still further. The UK is already moving in this

direction by preparing two new schemes for faster clearance at frontiers and the greater use of periodic submission of VAT and statistical data.

20. The second major element is the enhancement of market forces in the context of individual travel between Member States. The present restrictions on cross-border shopping are designed to police the indirect tax system, but have the effect of restricting shoppers' freedom to take advantage of price differences between Member States, the bulk of which arise for reasons other than differences in indirect tax rates. Restrictions on the quantity of goods which individuals can take (tax-paid) from one Member State to another should be substantially and progressively relaxed, with the ultimate aim that they should be completely eliminated (but see paragraph 24 below). Whatever the size of the initial steps, by the end of 1992 they should be sufficient to ensure an important role for market forces - in the shape of cross-border shopping - in areas where tax rates are far apart. In these circumstances tax free allowances would ultimately be abolished.

21. These reductions in trading costs and increases in travellers' allowances would increase the competitive pressure on Member States when setting indirect tax rates. Countries with high tax rates would tend to lose revenue as their nationals shopped in other Member States, and would face greater competition from overseas producers; and conversely for low tax rates. Governments would have to choose a pattern of indirect tax rates which struck a balance between these competitive pressures and national preferences.

22. This market-based approach would be very much in keeping with the microeconomic policies increasingly being pursued in the major industrial countries, with the focus on deregulation and competition. It provides a much better guarantee than the Commission's proposals that indirect tax rates and structures will suit the circumstances of 1992 and beyond, rather than those of 1988. The pressures on tax rates would in general be downwards, providing an essential antidote to the in built pressures for

increased public expenditure and taxation. In contrast, the Commission's proposals would mean additional regulation and a diminished role for the market; there would be no countervailing downward pressure on tax rates.

23. The market-based approach does not mean an immediate abandonment of the principle that goods bear the indirect taxes in force in the country where they are sold or resold. Any sudden change from this principle to a free-for-all would have large and potentially damaging implications for many Member States. These and other practical considerations indicate that frontier barriers cannot be removed in one go; a gradual approach will be needed.

Alcohol and tobacco

24. Whichever approach is adopted, alcohol and tobacco must be treated as special cases because of the serious health risks associated with excessive consumption of these products. Neither the market-based approach nor the Commission's approach would be appropriate. Allowing market forces completely unfettered sway, with greater (and ultimately unrestricted) access to cheap supplies, would be a retrograde step. Alcohol and especially tobacco are central targets in the Community's Europe against cancer campaign. At the moment there are very marked divergencies between member States' taxation of these products. The EPC report recognised that harmonisation would cause great difficulties in this area and thus recommended caution. Furthermore, any harmonisation should not force individual Member States to adopt significantly lower tax rates than they would ideally wish to impose for health reasons. Accordingly the UK considers it essential either that there should be effective restrictions in this area, or that high minimum duty rates should be set.

Conclusion

25. This paper has outlined an alternative, market-based approach to harmonisation of indirect taxation, in keeping with both the philosophy underlying the Single Market and the wider international climate of deregulation and competition. The key feature of this approach is that market forces would affect decisions by governments as well as the private sector of the European economy,

ensuring flexibility of taxes in the face of changing circumstances. The UK Government considers that the Commission's approach is not the only one compatible with Article 99 of the Treaty nor the best means of setting rates of indirect taxes for the Community in a competitive world economy.

26. The alternative approach to harmonisation is intended to avoid major difficulties and adjustment costs. It is designed to provide a relatively smooth path to progressive further reduction of controls (especially through the increasing use of information technology) with the ultimate aim of removing frontier formalities. It is intended to develop in parallel with the increasing integration of the Single Market through providing increasing scope for market forces to influence tax rates rather than attempting to apply rigid, centrally-dictated indirect tax rates, which is premature, unnecessary and probably inappropriate. There should now be a concerted effort by all Member States and the Commission to devise a programme of action which will produce tangible results by the end of 1992.

cc Chief Secretary
Paymaster General
Financial Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Scholar
Mr Lankester
Mr Culpin
Mr R I G Allen
Mr Riley
Mr Gilhooly
Mr Gieve
Miss Simpson
Mr Cropper
Mr Pratt (Tsy Solr)
Miss Wheldon (Tsy Solr)

PS/C&E
Mr P V H Smith
Mr Nash
Mr Wilmott
Mr Fryett
Mr Nissen
Mr Allen
Mr Kent
Mr Cockerell
Mr Fotherby
Mr Knox



ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

1 September 1988

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H.M. Treasury
Parliament Street
LONDON
SW1

PS/CBE, Mr P.M. SMITH,
Mr NASH, Mr WILMOTT,
Mr FRYETT, Mr NISSEN,
Mr ALLEN, Mr KENT,
Mr COCKERELL,
Mr FOTHERBY, Mr KNOX.

CH/EXCHEQUER	
REC.	05SEP1988
ACTION	Mr JEFFERSON-SMITH
COPIES TO	CST, FST, PMG, EST, SIC P. MIDDLETON, SIR G. LITZLER, Mr BRATT, Mr SCHOLAR, Mr LANKESTER, Mr CALLAN, Mr FIELE, Mr R.I.G. ALLEN, Mr RILEY, Mr GILHOOLY, MISS SIMPSON, Mr CROPPER, Mr PRATT (T.SOL.), MISS LINDON (T.SOL.)

Quardlipal:

TAXATION IN THE SINGLE MARKET : A MARKET-BASED APPROACH

Thank you for sending me a copy of your minute to Geoffrey Howe dated 30th August.

I have a couple of comments on the text of your paper.

In paragraph 6 of the paper you make the point that the Single European Act did not involve the Member States giving up sovereignty in the area of indirect taxation. I have no doubt this is right, but from a legal point of view it is a statement which requires careful explanation given that Article 99 clearly provides a degree of competence to the Community. The statement does not seem necessary to your argument at this point in the paper, but could provide an opening for the Commission which seems bound, in any event, to be hostile to the thrust of the paper. I advise ommitting it.

I noted three points in the paper where concessions are impliedly made to the Commission's point of view. In paragraph 10, the final sentence suggests that some degree of convergence of tax rates is necessary. The use of the word "immediate" in the first sentence of paragraph 23 suggests that the destination principle may eventually have to be abandoned. The final sentence of paragraph 25 accepts that the Commission's proposals could form one route to the single market. Is it wise to make these concessions at this relatively early stage in the negotiating process?



- 2 -

I am otherwise entirely content.

I am copying this letter to the recipients of your minute.

G. Munro.
A. Chisholm

check an letter
Monday

Mike

Phew!
This poses no problems
I assume we'll get
final version by
mail, so wdn't
bother actioning
it.

FACSIMILE TRANSMISSION

To: Moira Wallace

SECRETARY OF STATE'S
PRIVATE OFFICE

DEPARTMENT OF TRADE AND INDUSTRY
1 Victoria Street
LONDON
SW1H 0ET

TELEPHONE
01-215-5422
FAX NUMBER
01-215-5468

From: pp. Gareth Jones
Date: 02/09/88

NUMBER OF PAGES TO FOLLOW 2

RECEIVED BY _____

DATE _____

DRAFT

Addressed to:

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

File No. *Assume*

Copies to:
Prime Minister
Members of OD(E)
Kenneth Clarke
Paul Channon
Sir Robin Butler
plus as minute.

Originated by:
Other activity
(Initials and date)

Seen by:
(Initials and date)

Enclosures:

Type for signature of

(Initials and date)

DEPARTMENT OF TRADE AND INDUSTRY

In David Young's absence, I am responding to your letter of 30 August to Geoffrey Howe enclosing your paper on Taxation in the Single Market for the ECOFIN Council.

I very much welcome this paper which sets out the market forces approach in a clear and persuasive way. It should allow us to take the offensive on this issue, both in the Community and domestically, to show that we have proposals which are more realistic, less burdensome and, indeed, more radical than those of the Commission. It is also extremely useful in the context of developing our position on frontier controls.

Whenever DTI Ministers speak at Single Market conferences or seminars, one of the first questions asked is about the government's approach to tax approximation. Your paper will now give us the opportunity to win the intellectual argument in the UK media and in the European Parliament, as well as with other Member States and perhaps even the Commission. I strongly welcome, therefore, your intention to make the paper widely available in the UK. We will

(CONTINUE TYPING HERE)

File No.

certainly want to use it, and draw on it, in our contacts with business - through David Young's Single Market advisory groups and more widely. It would, I think, be useful if you could circulate speaking notes on which we can all draw in putting over the proposals in a positive light. When I was in Strasbourg in July, I was struck by the hostility of EDG MEPs to our line on this issue and I am sure that careful lobbying of British MEPs will pay dividends.

It will not, of course, be easy to persuade other Member States of the merits of our approach: we may be in for quite a long haul, in which a process of continued lobbying will be necessary. The main focus of this will of course be your ECOFIN colleagues. But I think it would be useful if other Ministers with frequent contacts with their EC counterparts could take any opportunity going to explain our proposals. For example, I hope you would agree that over lunch at the next Internal Market Council in October, I should - without instigating a debate - set out our approach and explain how it fits in with the overall approach to the Single Market.

I am copying this letter to the recipients of yours.

check as letter
mandatory

Mike

Phew!
This poses no problems
I assume we'll get
final version by
mail, so won't
bother actioning
it.

FACSIMILE TRANSMISSION

To: Moira Wallace

SECRETARY OF STATE'S
PRIVATE OFFICE

TELEPHONE

DEPARTMENT OF TRADE AND INDUSTRY
1 Victoria Street
LONDON
SW1H 0ET

01-215-5422

FAX NUMBER

01-215-5468

From: pp Gareth Jones

Date: 02/09/88

NUMBER OF PAGES TO FOLLOW 2

RECEIVED BY _____

DATE _____

DRAFT

File No.

Addressed to:

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

Copies to:
Prime Minister
Members of OD(E)
Kenneth Clarke
Paul Channon
Sir Robin Butler
plus as minute.

Originated by:
(Initials and date)

Seen by:
(Initials and date)

Enclosures:

Type for signature of

.....
(Initials and date)

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(CONTINUE TYPING HERE)

File No.

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I am copying this letter to the recipients of yours.



DEPARTMENT OF HEALTH AND SOCIAL SECURITY

Richmond House, 79 Whitehall, London SW1A 2NS

Telephone 01-210 3000

From the Secretary of State for ~~Social Services~~ Health

RESTRICTED

Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON SW1P 3AG

2 September 1988

CH/EXCHEQUER	
REC.	02 SEP 1988
ACTION	MR JEFFERSON SMITH CTE
COPIES TO	CST, PMG, PST, EST, SER P MIDDLETON, SER G LITTLE, MR OTT, MR SCHOLAR, MR LANCASTER, MR CULPIN, MR BIG ALLEN, MR RILEY, MR GILHOOLY, MR GIEWE, MISS SIMPSON, MR CROPPER, MR PRATT (T.SOL),

MISS WHELDON (T. SOL)
P. S/CTE, MR PUGH SMITH,
MR WASH, MR WELMOTT,
MR FRYETT, MR JESSEN,
MR ALLEN, MR KEAT, MR HICK,
MR COCKERALL, MR FERRARDY

CTE {

Dear Chancellor,

TAXATION IN THE SINGLE MARKET: A MARKET-BASED APPROACH

Thank you for sending me a copy of your minute of 30 August to Geoffrey Howe and of the paper which it covered.

I fully agree with your line. I was particularly glad to see the firm position taken in paragraph 24 of the paper on the health consequences of harmonising excise duties on alcohol and tobacco products. I am sure it is right to defend that position very strongly.

I am copying this to those to whom you sent your minute.

*Yours sincerely,
G M Pocher*

KENNETH CLARKE
(Approved by the Secretary of State and signed in his absence)



FCS/88/151

CH/EXCHEQUER	
REC.	02 SEP 1988
ACTION	Mr Jefferson Smith C+E
COPIES TO	CST, PMG, FOT, EST SIR P. MIDDLETON Sir G. LITTLE Mr Byatt Mr Scholar Mr Lancaster Mr Culpin Mr R.F.G. Allen MR RILEY MR Gilthorpe MR GIERE Miss Simpson MR Chappier

✓
2/9

CH/EXCHEQUER	
REC.	02 SEP 1988
ACTION	Mr R.F.G. ALLEN
COPIES TO	PS/EST SIR P. MIDDLETON SIR G. LITTLE MR LANCASTER MR MOUNTFIELD MR H.P. EVANS MR MERCER MR PARKINSON

CHANCELLOR OF THE EXCHEQUER

MR Pratt Tsy/BOLF

Miss Wheldon (Tsy SOL)
PS/C+E MR DVH Smith MR Nash MR Wilmott MR Fryett
MR Missen MR Allen MR Kent MR Cokerell MR Fotherby } C+E
MR Knox

1. Thank you for your minute of 30 August, enclosing the paper which you propose to circulate to ECOFIN colleagues on the market-based approach to indirect taxation.

2. I think the paper has come out well. It makes some telling criticisms of the Commission proposals but these are balanced by practical and positive suggestions on the dismantling of border controls. This should set the tone for a broad-based discussion of tax approximation at your informal ECOFIN meeting later this month.

3. I support the idea of a press release on the paper. But it will of course be important to ensure that it reaches your ECOFIN colleagues first!

4. I am copying this minute to the Prime Minister, members of OD(E), Kenneth Clarke, Paul Channon and Sir Robin Butler.

(GEOFFREY HOWE)

Ch/see also 2 other
action folders
tucked inside

FROM: MISS M P WALLACE
DATE: 2 SEPTEMBER 1988

CHANCELLOR *this one*
[phee!] mpw
TAXATION IN THE SINGLE MARKET: UK PAPER

cc Mr Gieve (personal)
N&A @ [unclear]

OD(E) circulation of your paper has thrown up little in the way of substantive comment. But reactions ^(behind) from the Attorney General and the Foreign Secretary require decisions.

2. The Attorney General's letter has points of substance on the paper. Customs' advice is as follows:

- (i) ✓ if the Attorney General thinks it provocative (although strictly correct) to say that the SEA did not involve the surrender of Member States' fiscal competence, then perhaps it is better to drop it.
- (ii) X Customs feel that the reference to "a sufficient degree of convergence for the completion of the internal market" does indeed suggest that some degree of convergence is necessary - but they feel this is an implicit element of our position, and should stand.
- (iii) ✓ they agree with the Attorney General's comment that the word "an immediate" in paragraph 23 are ambiguous, and they would accept his amendment.
- (iv) ✓ Again, Customs feel that the sentence the Attorney General highlights in paragraph 25 is also merely a statement of fact, and does not involve any tactical concession.

If you could let us know whether you agree with Customs recommendations, then we will have the final version faxed first thing on Monday morning to reach ECOFIN desks on Monday. Covering letters to your colleagues are in a signature folder for your signature, *in this box*.

3. The Foreign Secretary's response makes a reference to the need to ensure that your colleagues have actually received the paper before you go ahead with the press release. The minute is no more specific than that, but I have spoken to Jon Ker who has rather stronger feelings about it. He thinks our fear of Commission leaks is misplaced. He thinks that the lower orders in the Commission recognise that this is Cockfield's baby, and wouldn't dare leak, or react to it publicly. Instead Lord C will spend a couple of days writing his "point by point rebuttal". Jon thinks that this will allow time for other Finance Ministers to read your paper, and their officials' comments on it, in isolation, before the Cockfield reply issues. (Jon thinks the whole manoeuvre would go even more smoothly if Hannay were to "slip up" and fail to deliver the paper to Cockfield until the Tuesday!) The thing Jon is afraid of is that by press releasing in a hurry we get an angry ^{hurried} and bitter response from the Commission, and sour the reception of our paper in other finance ministries. His preferred approach is to delay release of the paper until Monday 12 September - although he conceded that from a "press management" point of view you might prefer Friday 9 September. I undertook to pass on his thoughts to you and John Gieve.

*I agree with
 Customs advice re pts (i), (iii) & (iv),
 but with A-G re (ii). Per am
 accounts. Re para 3, para (9 Sept)
 looks to be but, but I will
 discuss with Mr Gieve.
 M..*

Mpw.
 MOIRA WALLACE



Jo23
Jo24

ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

1 September 1988

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H.M. Treasury
Parliament Street
LONDON
SW1

Quarantined:

TAXATION IN THE SINGLE MARKET : A MARKET-BASED APPROACH

Thank you for sending me a copy of your minute to Geoffrey Howe dated 30th August.

I have a couple of comments on the text of your paper.

In paragraph 6 of the paper you make the point that the Single European Act did not involve the Member States giving up sovereignty in the area of indirect taxation. I have no doubt this is right, but from a legal point of view it is a statement which requires careful explanation given that Article 99 clearly provides a degree of competence to the Community. The statement does not seem necessary to your argument at this point in the paper, but could provide an opening for the Commission which seems bound, in any event, to be hostile to the thrust of the paper. I advise omitting it. ✓

omit

I noted three points in the paper where concessions are impliedly made to the Commission's point of view. In paragraph 10, the final sentence suggests that some degree of convergence of tax rates is necessary. The use of the word "immediate" in the first sentence of paragraph 23 suggests that the destination principle may eventually have to be abandoned. The final sentence of paragraph 25 accepts that the Commission's proposals could form one route to the single market. Is it wise to make these concessions at this relatively early stage in the negotiating process?

*Statement
of Rev*

CONFIDENTIAL



- 2 -

I am otherwise entirely content.

I am copying this letter to the recipients of your minute.

G. Munro
John



Jo23
Jo24

ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

1 September 1988

Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H.M. Treasury
Parliament Street
LONDON
SW1

Handwritten:

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WLS ✓
omit
dn
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*Statement
of fact*

CONFIDENTIAL



- 2 -

I am otherwise entirely content.

I am copying this letter to the recipients of your minute.

G. Curzon
Admiral

ppp

1992

- committed to single mkt
but - tax approx not needed. - agree AHGcom
- can't say how by mkt
(note) Jones will like
CHANCELLOR *1991/1992*
of allowances not till after 1992.

FROM: JOHN GIEVE
DATE: 2 SEPTEMBER 1988

cc
Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr R I G Allen
Mr Riley
Mr Gilhooly
Mr Cropper
Mr Tyrie
PS/C&E
Mr Jefferson Smith
Mr R Allen C&E
Mr Hammond C&E

*Thank you for your letter
I am glad to hear
I have spoken to what
you want who
agrees to the brief
I am grateful for
your interest in
this*

TAXATION IN THE SINGLE MARKET: PRESS RELEASE

We discussed the best way to release your ECOFIN paper to the press. After further discussions with Mr Unwin and others, I think the best approach may be to put out a press release with the whole paper attached on the 12 o'clock run on Tuesday morning; but to give it under embargo on Monday evening to a selected group of journalists who would also be invited to a press briefing at mid day on Tuesday.

2. I attach a draft press release, which is drawn largely from a draft by Mr Allen in Customs. I think our main line is that this is a positive and constructive attempt to set out an alternative and more practical way to achieving the single market in 1992. Our aim will be to avoid the accusation that it is a wrecking manoeuvre.

3. Mr Unwin has agreed to take the press briefing. I will also be present and I think it would be sensible for someone from EC division to be present to answer wider questions on 1992, the ECOFIN agenda etc. I attach a list of people who might be invited. I think it is probably worth inviting PA (who will get the story out to many of the regional papers). I am not convinced that TV or radio will be interested but there is no harm in

CONFIDENTIAL

asking. The other optional invitations are those for the Daily Mail, Daily Express, and Today. While they should be supportive of the general line, there is a risk that they will go over the top in a way that is unhelpful in ECOFIN itself. My inclination is to leave them off the list but I would welcome your views.

4. In addition to our briefing of the economics correspondents, UKREP will need to field enquires from the Brussels brigade.

J. Gieve

JOHN GIEVE

Times
Financial Times
Independent
Guardian
Daily Telegraph
? ~~Daily Mail~~
? ~~Daily Express~~
? ~~Today~~
Wall Street Journal
Economist
Taxation
? Reuters
? PA
? ~~BBC TV~~
BBC Radio
? ~~ITN~~
Financial World Tonight

David Smith
Philip Stephens
Steve Levinson
Chris Huhne/Peter Rodgers
Anne Segall
~~City editor~~
~~" "~~
~~" "~~
Peter Norman
Clive Crook
Malcolm Gunn
Jonathan Lynn
Larry Elliott
~~John Cole~~
Dominic Harrod
~~Peter Allen~~
John Roberts.

DRAFT PRESS RELEASE

TAXATION IN THE SINGLE MARKET: A MARKET-BASED APPROACH

In a paper sent to Finance Ministers' in other EC countries this week, the Chancellor of the Exchequer sets out a market-based approach to achieving the single market in 1992, which would avoid the many difficulties of the Commission's proposals for indirect tax harmonisation.

2. Commenting on the paper today, the Chancellor said:-

"We are determined to see the completion of the single market in Europe in 1992. Like other Member States, however, we are unhappy with the Commission's proposals for harmonizing indirect taxes. Not only would this require every Member State to make changes to its tax regime (eg abolition of VAT zero rating) but it would mean additional regulation and bureaucracy to ensure a fair allocation of revenues between Member States.

I am convinced there is a better way which builds on market forces and deregulation and my paper sets out in detail how this could work.

It involves substantial reductions in border controls (while retaining necessary checks for drugs and terrorists) and ~~large~~ ^{Progressive} increases ⁱⁿ ~~and eventual abolition of~~ the "tax paid" allowances that people can bring back from other Member

typ1.u1/ln/tls/press9.2.9

with ~~out~~ *no actual addition of any limit at all.*

States, (There will need to be special arrangements for alcohol and tobacco for health reasons).

I have sent the paper to my colleagues in the Community and look forward to discussing it with them in Crete later this month." *For the discussion see the letter at the ECOM Council*

BACKGROUND NOTE

1. The European Commission published its detailed ~~package of~~ proposals in August 1987. In order to remove fiscal controls at frontiers between Member States, the Commission proposed that VAT should be charged on goods and services traded between Member States (at present such supplies are zero rated as exports). To ensure that revenue continued to accrue, as now, in the Member State where the goods or services were finally consumed, the Commission suggested a VAT "clearing house" system and, for goods subject to excise duties, a linked bonded warehouse system. In order to minimise abuse and distortion to trade, the Commission proposed that VAT rates should be "approximated" and excise duty rates harmonised. For VAT, two rate bands were proposed: a standard rate of 14 to 20 per cent and a reduced rate of 4 to 9 per cent. For excise duties, the Commission proposed the complete harmonisation of duty rates based roughly on the average of existing rates in the EC.
2. Consideration of the Commission's proposals falls to the Economic and Financial Affairs Council (ECOFIN). During initial discussions on 16 November 1987, ECOFIN referred the proposals to its Economic Policy Committee (EPC) for economic analysis. EPC produced an interim report in April this year and a final 'opinion' in June. Both the interim report and the final opinion failed to give a clear endorsement to the

Commission's approach, but instead highlighted the many problem areas associated with tax approximation.

3. At an informal meeting of ECOFIN in May this year, the Chancellor agreed to prepare a paper setting out the UK's proposals for an alternate approach to the completion of the internal market. This is the paper which he has now sent to his ECOFIN colleagues *for discussion at the informal ECOFIN meeting in Crete on ~~the~~ 17 September.*

CONFIDENTIAL

1. ACSA
2. PMP

FROM: JOHN GIEVE
DATE: 2 SEPTEMBER 1988

CHANCELLOR

cc

- Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir P Middleton
- Sir G Littler
- Mr Byatt
- Mr Lankester
- Mr R I G Allen
- Mr Riley
- Mr Gilhooly
- Mr Cropper
- Mr Tyrie
- PS/C&E
- Mr Jefferson Smith
- Mr R Allen C&E
- Mr Hammond C&E

cc **PPS**
 Mr Lankester
 Mr R Allen (C&E)
 Mr Parkinson

Mr Gieve

I would be inclined to make the point about
 about as known in the second paragraph of
 question for the third (the attached manuscript
 amendments). This might help avoid awkward
 questions: most travellers use their tax paid
 allowance for their own products. RA. 5/9

TAXATION IN THE SINGLE MARKET: PRESS RELEASE

We discussed the best way to release your ECOFIN paper to the press. After further discussions with Mr Unwin and others, I think the best approach may be to put out a press release with the whole paper attached on the 12 o'clock run on Tuesday morning; but to give it under embargo on Monday evening to a selected group of journalists who would also be invited to a press briefing at mid day on Tuesday.

2. I attach a draft press release, which is drawn largely from a draft by Mr Allen in Customs. I think our main line is that this is a positive and constructive attempt to set out an alternative and more practical way to achieving the single market in 1992. Our aim will be to avoid the accusation that it is a wrecking manoeuvre.

3. Mr Unwin has agreed to take the press briefing. I will also be present and I think it would be sensible for someone from EC division to be present to answer wider questions on 1992, the ECOFIN agenda etc. I attach a list of people who might be invited. I think it is probably worth inviting PA (who will get the story out to many of the regional papers). I am not convinced that TV or radio will be interested but there is no harm in

2/9

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asking. The other optional invitations are those for the Daily Mail, Daily Express, and Today. While they should be supportive of the general line, there is a risk that they will go over the top in a way that is unhelpful in ECOFIN itself. My inclination is to leave them off the list but I would welcome your views.

4. In addition to our briefing of the economics correspondents, UKREP will need to field enquires from the Brussels brigade.

J. Gieve

JOHN GIEVE

Times
Financial Times
Independent
Guardian
Daily Telegraph
Daily Mail
Daily Express
Today
Wall Street Journal
Economist
Taxation
Reuters
PA
BBC TV
BBC Radio
ITN
Financial World Tonight

David Smith
Philip Stephens
Steve Levinson
Chris Huhne/Peter Rodgers
Anne Segall
City editor
" "
" "
Peter Norman
Clive Crook
Malcolm Gunn
Jonathan Lynn
Larry Elliott
John Cole
Dominic Harrod
Peter Allen
John Roberts.

DRAFT PRESS RELEASE

TAXATION IN THE SINGLE MARKET: A MARKET-BASED APPROACH

In a paper sent to Finance Ministers' in other EC countries this week, the Chancellor of the Exchequer sets out a market-based approach to achieving the single market in 1992, which would avoid the many difficulties of the Commission's proposals for indirect tax harmonisation.

2. Commenting on the paper today, the Chancellor said:-

"We are determined to see the completion of the single market in Europe in 1992. Like ^{(?) must} other Member States, however, we are unhappy with the Commission's proposals for harmonizing indirect taxes. Not only would this require every Member State to make changes to its tax regime (eg abolition of VAT zero rating) but it would mean additional regulation and bureaucracy to ensure a fair allocation of revenues between Member States.

- though specific arrangements would need to apply to alcohol and tobacco, for health reasons -

I am convinced there is a better way which builds on market forces and deregulation and my paper sets out in detail how this could work.

It involves substantial reductions in border controls (while retaining necessary checks for drugs and terrorists) and ^{progressive} ~~large~~ increases and ~~eventual abolition~~ ⁱⁿ of the "tax paid" allowances that people can bring back from other Member

[Ch's amendment]

typ1.u1/ln/tls/press9.2.9

with the eventual abolition of any limit at all.

States/ ~~(There will need to be special arrangements for alcohol and tobacco for health reasons).~~

I have sent the paper to my colleagues in the Community and look forward to discussing it with them in Crete later this month."

BACKGROUND NOTE

1. The European Commission published its detailed ~~package of~~ proposals in August 1987. In order to remove fiscal controls at frontiers between Member States, the Commission proposed that VAT should be charged on goods and services traded between Member States (at present such supplies are zero rated as exports). To ensure that revenue continued to accrue, as now, in the Member State where the goods or services were finally consumed, the Commission suggested a VAT "clearing house" system and, for goods subject to excise duties, a linked bonded warehouse system. In order to minimise abuse and distortion to trade, the Commission proposed that VAT rates should be "approximated" and excise duty rates harmonised. For VAT, two rate bands were proposed: a standard rate of 14 to 20 per cent and a reduced rate of 4 to 9 per cent. For excise duties, the Commission proposed the complete harmonisation of duty rates based roughly on the average of existing rates in the EC.
2. Consideration of the Commission's proposals falls to the Economic and Financial Affairs Council (ECOFIN). During initial discussions on 16 November 1987, ECOFIN referred the proposals to its Economic Policy Committee (EPC) for economic analysis. EPC produced an interim report in April this year and a final 'opinion' in June. Both the interim report and the final opinion failed to give a clear endorsement to the

Commission's approach, but instead highlighted the many problem areas associated with tax approximation.

3. At an informal meeting of ECOFIN in May this year, the Chancellor agreed to prepare a paper setting out the UK's proposals for an alternate approach to the completion of the internal market. This is the paper which he has now sent to his ECOFIN colleagues *for discussion at the informal ECOFIN meeting in Crete on ~~the~~ 17 September.*

dti

the department for Enterprise

mp

The Hon. Francis Maude MP
Parliamentary Under Secretary of State for
Corporate Affairs

CONFIDENTIAL

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

**Department of
Trade and Industry**

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

CH/EXCHEQUER	
REC.	6 SEP 1988
ACTION	Mr JEFFERSON - SMITH - CUE
COPIES	EST, FST, PMG, EST
TO	Sir P. MIDDLETON, Sir G. UTTER, Mr BYATT, Mr SCHOLAR, Mr LANKESTER, Mr CULPIN, Mr R. G. ALLEN, Mr RILEY, Mr GILHOBY, Mr GIEVE, Miss SIMPSON, Mr CROPPER, Mr PRATT (T.SOL), Miss WHELDON (T.SOL), P.S./CUE, Mr P.V.H. SMITH, Mr NASH, Mr WILMOTT, Mr FRYETT, Mr NISSEN, Mr ALLEN, Mr KENT, Mr COCKERELL, Mr FOTHERBY, Mr KNOX. } CUE

✓ 6/9

Direct line
Our ref
Your ref
Date

215 4417

5 September 1988

Dear Chancellor,

In David Young's absence, I am responding to your letter of 30 August to Geoffrey Howe enclosing your paper on Taxation in the Single Market for the ECOFIN Council.

I very much welcome this paper which sets out the market forces approach in a clear and persuasive way. It should allow us to take the offensive on this issue, both in the Community and domestically, to show that we have proposals which are more realistic, less burdensome and, indeed, more radical than those of the Commission.

Whenever DTI Ministers speak at Single Market conferences or seminars, one of the first questions asked is about the government's approach to tax approximation. We have needed ammunition to win the intellectual argument in the UK media and in the European Parliament, as well as with other Member States and perhaps even the Commission. I strongly welcome, therefore, your intention to make the paper widely available in the UK. We will certainly want to use it in our contacts with business. It would, I think, be useful if you could circulate speaking notes on which we can all draw in putting over the proposals. When I was in Strasbourg in July, I was struck by the hostility of EDG MEPs to our line on this issue and I am sure that careful lobbying of British MEPs will pay dividends.

It will not, of course, be easy to persuade other Member States of the merits of our approach: we may be in for quite a long haul, in which a process of continued lobbying will be necessary. The main focus of this will of course be your ECOFIN colleagues. But it would be useful if other Ministers could take any opportunity going to explain our proposals to their EC counterparts. I hope you would agree that over lunch

JCIADJ



2

at the next Internal Market Council in October, I should -
without instigating a debate - set out our approach and explain
how it fits in with the overall approach to the Single Market.

I am copying this letter to the recipients of yours.

*Yours sincerely
Chris North*

FRANCIS MAUDE

(Approved by the Minister and signed in his absence)



FROM: A C S ALLAN

DATE: 5 September 1988

MR GIEVE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr R I G Allen
Mr Riley
Mr Gilhooley
Mr Cropper
Mr Tyrie

PS/C&E

Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr P R H Allen - C&E
Mr Hammond - C&E

TAXATION IN THE SINGLE MARKET: PRESS RELEASE

The Chancellor was grateful for your minute of 2 September and the attached draft press release. He is also most grateful to Mr Unwin for agreeing to take the press briefing.

2. The Foreign Office have expressed the strong view that we should ensure that other Finance Ministers have actually received the paper before it is press-released here; they believe the fear of Commission leaks is misplaced. In the light of this, the Chancellor feels that we should aim to release the paper on Friday, 9 September. But if there are any signs that the paper is leaking in Brussels or elsewhere, we should be ready to push the release out before then.

3. The Chancellor had a few comments on the draft press-release:

- (i) in the third paragraph, amend "large increase and eventual abolition of the tax-paid allowances" to "progressive increases in the tax-paid allowances", and

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add at the end of the sentence (after "Member States")
"with the eventual abolition of any limit at all".

- (ii) amend the final paragraph to read "I have sent the paper to my colleagues in the Community for the discussion which we are scheduled to have at the informal ECOFIN later this month."

A handwritten signature in dark ink, appearing to read "A C S Allan".

A C S ALLAN

FROM: JOHN GIEVE
DATE: 5 SEPTEMBER 1988

MR A C S ALLAN

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Sir G Littler
- Mr Byatt
- Mr Lankester
- Mr R I G Allen
- Mr Riley
- Mr Gilhooly
- Mr Cropper
- Mr Tyrie
- PS/C&E)
- Mr Unwin)
- Mr Jefferson Smith) C&E
- Mr P R H Allen)
- Mr Hammond)

*OK with
out the two
changes*

u
*I refer original to
RIGA's amendments, tho'
don't feel v strong*

AA

(to stick the 1982 paper would be a Herko)

I attach a revised draft of the press release. It now takes account of your comments and also of a suggestion from Mr Lankester and Mr Allen that the reference to tobacco and alcohol should be brought forward rather than appearing in brackets at the end of the penultimate paragraph.

2. Subject to any further comments, we will get these printed up for release on ~~Thursday~~ or, if we hear that the story has leaked beforehand or that Lord Cockfield is on the verge of making a response, on Wednesday.

John Gieve

JOHN GIEVE

6 September 1988

TAXATION IN THE SINGLE MARKET: A MARKET-BASED APPROACH

In a paper sent to Finance Ministers' in other EC countries this week, the Chancellor of the Exchequer sets out a market-based approach to achieving the single market in 1992, which would avoid the many difficulties of the Commission's proposals for indirect tax harmonisation.

2. Commenting on the paper today, the Chancellor said:-

"We are determined to see the completion of the single market in Europe in 1992. Like most other Member States, however, we are unhappy with the Commission's proposals for harmonizing indirect taxes. Not only would this require every Member State to make changes to its tax regime (eg abolition of VAT zero rating) but it would mean additional regulation and bureaucracy to ensure a fair allocation of revenues between Member States.

I am convinced there is a better way which builds on market forces and deregulation, though separate arrangements would need to apply to alcohol and tobacco, for health reasons - and my paper sets out in detail how this could work. ~~It includes~~

In recognition of health cons. studies, the proposals include special arrangements for alcohol and tobacco.

In essence this alternative approach

It involves substantial reductions in border controls (while retaining necessary checks for drugs and terrorists) and progressive increases in the "tax paid" allowances that people can bring back from other Member States, with the eventual abolition of any limit at all. *Special arrangements*

I have sent the paper to my colleagues in the Community for the discussion which we are scheduled to have at the informal ECOFIN later this month."

Commis meeting

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG

74/88

Note to Editors

The European Commission published its detailed proposals in August 1987. In order to remove fiscal controls at frontiers between Member States, the Commission proposed that VAT should be charged on goods and services traded between Member States (at present such supplies are zero rated as exports). To ensure that revenue continued to accrue, as now, in the Member State where the goods or services were finally consumed, the Commission suggested a VAT "clearing house" system and, for goods subject to excise duties, a linked bonded warehouse system. In order to minimise abuse and distortion to trade, the Commission proposed that VAT rates should be "approximated" and excise duty rates harmonised. For VAT, two rate bands were proposed: a standard rate of 14 to 20 per cent and a reduced rate of 4 to 9 per cent. For excise duties, the Commission proposed the complete harmonisation of duty rates based roughly on the average of existing rates in the EC.

2. Consideration of the Commission's proposals falls to the Economic and Financial Affairs Council (ECOFIN). During initial discussions on 16 November 1987, ECOFIN referred the proposals to its Economic Policy Committee (EPC) for economic analysis. EPC produced an interim report in April this year and a final 'opinion' in June. Both the interim report and the final opinion failed to give a clear endorsement to the Commission's approach, but instead highlighted the many problem areas associated with tax approximation.

3. At an informal meeting of ECOFIN in May this year, the Chancellor agreed to prepare a paper setting out the UK's proposals for an alternate approach to the completion of the internal market. This is the paper which he has now sent to his ECOFIN colleagues for discussion at the informal ECOFIN meeting in Crete on 17 September.



FROM: A C S ALLAN
DATE: 6 September 1988

psyp

MR GIEVE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr R I G Allen
Mr Riley
Mr Gilhooly
Mr Cropper
Mr Tyrie

PS/C&E
Mr Unwin - C&E
Mr Jefferson Smith - C&E
Mr P R H Allen - C&E
Mr Hammond - C&E

TAXATION IN THE SINGLE MARKET: PRESS RELEASE

The Chancellor has seen your minute to me of 5 September. He is content that the press release should be issued on Thursday, unless the story leaks earlier.

2. He had a few further changes to the draft:
- (i) amend the second paragraph of his comments to read "I am convinced there is a better way which builds on market forces and deregulation and my paper sets out in detail how this could work. In recognition of health considerations, the proposals include special arrangements for alcohol and tobacco;
 - (ii) begin the third paragraph "In essence this alternative approach involves substantial reductions...", and add a comma after Member States in the penultimate line;



(iii) in the final paragraph, refer to "the informal ECOFIN
~~COUNCIL~~ meeting".
Council

A handwritten signature in black ink, appearing to read "A C S Allan".

A C S ALLAN



pl folder

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

*Thank - letter
for paper*

FROM : THE CHAIRMAN

DATE : 7 September 1988

CHANCELLOR OF THE EXCHEQUER

TAXATION IN THE SINGLE MARKET : A MARKET-BASED APPROACH

Following your communication to fellow Finance Ministers, I have sent a copy of your ECOFIN paper to fellow Heads of Customs Administrations with some appropriate lobbying prose. You may like to know that my French colleague has already told me on the telephone that, apart from problems on postponed VAT accounting, he is very much in accord with the paper's approach and will commend it to his Finance Minister before the informal ECOFIN meeting.

2. This is encouraging. Although this does not guarantee French support, it is a good start; and our position on postponed VAT is, of course, a strong one - if our colleagues cannot accept it, tant pis; we have shown our willing.

J B UNWIN

cc Paymaster General
Economic Secretary
Sir P Middleton
Sir G Littler

Mr Jefferson Smith
Mr Nash
Mr Wilmott
Mr Allen



FROM: MISS M P WALLACE

DATE: 9 September 1988

MR UNWIN C&E

cc Paymaster General
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Jefferson Smith
Mr Nash
Mr Wilmott
Mr Allen

TAXATION IN THE SINGLE MARKET: A MARKET-BASED APPROACH

The Chancellor was grateful for your minute of 7 September. He found your report of your French colleagues' reaction most interesting - indeed surprising.

A handwritten signature in dark ink, appearing to read 'Moira Wallace'.

MOIRA WALLACE

RIGA
note

PS / Chancellor



This has now been rightly mentioned
by developments in Cote, and
subsequently, and I wonder whether it
will be worth inserting an additional
paragraph, as indicated, after para 4 2

CHANCELLOR OF THE EXCHEQUER

to speaking NAs. Attention, to find
para to be amended.

RA.
22/9

Board Room
H M Customs and Excise
New King's Beam House
22 Upper Ground
London SE1 9PJ
Telephone: 01-620 1313
01 382 5011

FROM: P JEFFERSON SMITH
DATE: 21 September 1988

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Scholar
Mr R I G Allen
Mr Gilhooly
Mr Riley

EC: INDIRECT TAXATION AND FRONTIER CONTROLS - UK ALTERNATIVE APPROACH

Replying to your letter of 5 September in which you circulated your ECOFIN paper to Ministerial colleagues, Mr Maude asked you to circulate speaking notes on the UK's alternative approach for use by colleagues in putting over our proposals.

2. I attach a draft reply for you to send to Lord Young. I am also attaching a draft of the speaking notes; subject to your views we propose to clear them interdepartmentally at official level.

3. As far as Mr Maude's other points are concerned, we see no objection to him setting out the UK approach at the next Internal Market Council. On lobbying British MEPs, the Economic Secretary

Internal Distribution:	CPS	Mr Allen	Mr Oxenford
	Mr Nash	Mr Kent	
	Mr Wilmott	Mr Kncx	

22/9

has written to the leaders of the British EDG and Labour Groups and to Ben Patterson, enclosing a copy of your ECOFIN paper, and we shall be considering further with other Departments how best to follow this up.

C Carmington
(for)

P JEFFERSON SMITH

DRAFT LETTER to Lord Young,
 Secretary of State for Trade and Industry

Francis Maude wrote to me on your behalf on 5 September, giving some helpful comments about the paper on Taxation in the Single Market, which I circulated to the informal ECOFIN in Crete.

I agree that it would be useful for Ministers to have speaking notes on the UK's alternative approach for use in putting the proposals across. I have set this in hand, and have asked my officials to clear the notes in draft with interested departments.

I also agree that it would be helpful if you were to set out our approach at the next Internal Market Council in October.

As for lobbying British MEPs, I am asking officials to consider, in consultation with appropriate officials in other Departments, how this might be most effectively done.

NIGEL LAWSON

Sugg.
amb.
ment.

SPEAKING NOTE ON CHANCELLOR'S ALTERNATIVE STRATEGY

- 1) Government is committed to completion of internal market as defined in the Treaty; but does not regard fiscal harmonisation as necessary to achieve this.
- 2) Centrally imposed tax approximation would take insufficient account of changing conditions, needs and social and other priorities in Member States. The Commission's proposals (e.g. the VAT clearing house) are potentially more burdensome for businesses than what could be achieved under proposed UK approach.
- 3) Present system of relieving exports of tax and imposing tax on imports results in no distortions of competition between foreign and domestic supplies.
- 4) As Prime Minister made clear in Bruges speech, UK objective is deregulation and trade facilitation through reduced government intervention to reduce business costs and create greater incentives to trade within the Single Market - not greater and more detailed regulation from centre. To this end, Chancellor put forward a paper to his Council colleagues outlining UK's suggested alternative approach.
- 5) ^{The UK} ~~This~~ approach is based on providing scope for market forces to influence indirect tax rates to the extent necessary for the Single Market while concentrating on the early reduction of barriers to movement of people and goods.
- 6) The main elements of this approach are:
 - (i) Substantial and early reductions in border formalities for Community goods and people, while retaining the necessary controls against drugs and terrorism, as provided for in the Treaty;

* The Chancellor's paper was well received by his colleagues, he opened up debate and focused attention on the flaws in the Commission's approach. As a result, his Commission has agreed to review its proposals, taking representations from Member States.

- (ii) Controls on commercial transactions increasingly to take place inland at traders' premises as an element in normal internal controls, rather than at the frontier; aim is progressive elimination of frontier formalities.
 - (iii) Large and progressive increases in "tax paid" allowances on goods that people can bring back, from other Member States (although smaller increases or high minimum rates for alcohol and tobacco, for health reasons). Aim is eventually no limit at all on tax paid goods (other than alcohol and tobacco) and consequent abolition of related frontier checks.
- 7) This approach has the advantages that it does not require Member States to make what in many cases could be large and highly unwelcome changes in tax rates with damaging consequences for national economic, social, health or other policies. Nor does it set tax rates at average levels which may not be appropriate for the circumstances of 1993, but would be very difficult to change.
 - 8) It does not imply that market forces should be given a totally free rein. The UK accepts that this could cause problems for Member States with high indirect tax rates. We are content to see this element phased in according to a timetable agreed by all Member States.
 - 9) The main aim of the UK approach is to concentrate on practical and achievable reductions in fiscal and other frontier barriers. The UK has not abandoned the aim of eliminating frontier controls as envisaged in the Single European Act.
 - 10) But we believe that this should be approached with the intention of minimising disruption to the national policies of Member States. If this involves some compromise on timing or extent, we believe that this is preferable to an uncompromising approach which risks failing to make any progress.

11) ECOFIN discussions show that whatever differences there may be between Member States on how to achieve the single market, the prospects for implementing anything as radical as the Commission's proposals' by the end of 1992 are minimal. UK is pressing for early action on practical steps to be taken to ensure that real progress towards eliminating fiscal controls is made by 1993.

12) So, the UK is not putting forward its alternative approach as an unalterable blueprint. Our intention is to open up the debate so that achievable policies can be fully considered in the Community. We welcome the contributions of other Member States and of the Community institutions to making real and early progress to the Single Market in this difficult area.



Ch.
 Content to write as proposed?
 RIGA has suggested an addition to the draft speaking notes, which I have flagged - content with this? And with arrangements for clearance?
 Don't think this is really good, but I suppose
 Mr with stroke no
 pompous.
 So OK
 (without RIGA addition).

Board Room
 H M Customs and Excise
 New King's Beam House
 22 Upper Ground
 London SE1 9PJ
 Telephone: 01-620 1313
 01 382 5011

FROM: P JEFFERSON SMITH
 DATE: 21 September 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Byatt
 Mr Scholar
 Mr R I G Allen
 Mr Gilhooly
 Mr Riley

EC: INDIRECT TAXATION AND FRONTIER CONTROLS - UK ALTERNATIVE APPROACH

Replying to your letter of 5 September in which you circulated your ECOFIN paper to Ministerial colleagues, Mr Maude asked you to circulate speaking notes on the UK's alternative approach for use by colleagues in putting over our proposals.

2. I attach a draft reply for you to send to Lord Young. I am also attaching a draft of the speaking notes; subject to your views we propose to clear them interdepartmentally at official level.

3. As far as Mr Maude's other points are concerned, we see no objection to him setting out the UK approach at the next Internal Market Council. On lobbying British MEPs, the Economic Secretary

Internal Distribution: CPS Mr Allen Mr Oxenford
 Mr Nash Mr Kent
 Mr Wilmott Mr Knox

has written to the leaders of the British EDG and Labour Groups and to Ben Patterson, enclosing a copy of your ECOFIN paper, and we shall be considering further with other Departments how best to follow this up.

C Carrington
(for)

P JEFFERSON SMITH

Pse type for Lord Young

DRAFT LETTER to Lord Young,
Secretary of State for Trade and Industry

Francis Maude wrote to me on your behalf on 5 September, giving some helpful comments about the paper on Taxation in the Single Market, which I circulated to the informal ECOFIN in Crete.

I agree that it would be useful for Ministers to have speaking notes on the UK's alternative approach for use in putting the proposals across. I have set this in hand, and have asked my officials to clear the notes in draft with interested departments.

I also agree that it would be helpful if ^{Francis}you were to set out our approach at the next Internal Market Council in October.

As for lobbying British MEPs, I am asking officials to consider, in consultation with appropriate officials in other Departments, how this might be most effectively done.

NIGEL LAWSON

SPEAKING NOTE ON CHANCELLOR'S ALTERNATIVE STRATEGY

- 1) Government is committed to completion of internal market as defined in the Treaty; but does not regard fiscal harmonisation as necessary to achieve this.
- 2) Centrally imposed tax approximation would take insufficient account of changing conditions, needs and social and other priorities in Member States. The Commission's proposals (e.g. the VAT clearing house) are potentially ~~more~~ more burdensome for businesses than what could be achieved under proposed UK approach.
- 3) Present system of relieving exports of tax and imposing tax on imports results in no distortions of competition between foreign and domestic supplies.
- 4) As Prime Minister made clear in Bruges speech, UK objective is deregulation and trade facilitation through reduced government intervention to reduce business costs and create greater incentives to trade within the Single Market - not greater and more detailed regulation from centre. To this end, Chancellor put forward a paper to his Council colleagues outlining UK's suggested alternative approach.
- 5) This approach is based on ~~providing scope for~~ ^{allowing} market forces to influence indirect tax rates to the extent necessary for the Single Market while concentrating on the early reduction of barriers to movement of people and goods.
- 6) The main elements of this approach are:
 - (i) Substantial and early reductions in border formalities for Community goods and people, while retaining the necessary controls against drugs and terrorism, as provided for in the Treaty;

(ii) Controls on commercial transactions increasingly to take place inland at traders' premises as an element in normal internal controls, rather than at the frontier; aim is progressive elimination of frontier formalities.

(iii) Large and progressive increases in "tax paid" allowances on goods that people can bring back, from other Member States (although smaller increases or high minimum rates for alcohol and tobacco, for health reasons). Aim is eventually no limit at all on tax paid goods (other than alcohol and tobacco) and consequent abolition of related frontier checks.

7) This approach has the advantages that it does not require Member States to make what in many cases could be large and highly unwelcome changes in tax rates with damaging consequences for national economic, social, health or other policies. Nor does it set tax rates at average levels which may not be appropriate for the circumstances of 1993, but would be very difficult to change.

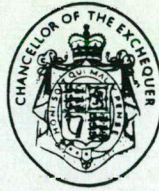
8) It does not imply that market forces should ^{immediately} be given a totally free rein. The UK accepts that this could cause problems for Member States with high indirect tax rates. We are content to see this element phased in according to a timetable agreed by all Member States.

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10) But we believe that this should be approached with the intention of minimising disruption to the national policies of Member States. If this involves some compromise on timing or extent, we believe that this is preferable to an uncompromising approach which risks failing to make any progress.

- 11) ECOFIN discussions show that whatever differences there may be between Member States on how to achieve the single market, the prospects for implementing anything as radical as the Commission's proposals' by the end of 1992 are minimal. UK is pressing for early action on practical steps to be taken to ensure that real progress towards eliminating fiscal controls is made by 1993.
- 12) So, the UK is not putting forward its alternative approach as an unalterable blueprint. Our intention is to open up the debate so that achievable policies can be fully considered in the Community. We welcome the contributions of other Member States and of the Community institutions to making real and early progress to the Single Market in this difficult area.

CC CST, PMG, EST,
Sir P. ADDLETON, Sir G. LITZLER,
Mr BIATT, Mr SCHOLAR,
Mr R.I.G. ALLEN, Mr GILHOOLY,
Mr RILEY, PS/C&E,
Mr JEFFERSON SMITH - C&E.



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

23 September 1988

The Rt Hon Lord Young of Graffham
Secretary of State for Trade
and Industry
1 Victoria Street
London SW1

Dear Secretary of State

Francis Maude wrote to me on your behalf on 5 September, giving some helpful comments about the paper on Taxation in the Single Market, which I circulated to the informal ECOFIN in Crete.

I agree that it would be useful for Ministers to have speaking notes on the UK's alternative approach for use in putting the proposals across. I have set this in hand, and have asked my officials to clear the notes in draft with interested departments.

I also agree that it would be helpful if Francis were to set out our approach at the next Internal Market Council in October.

As for lobbying British MEPs, I am asking officials to consider, in consultation with appropriate officials in other Departments, how this might be most effectively done.

*Yours sincerely
Nigel Lawson*

pp.

NIGEL LAWSON

[Approved by the Chancellor and signed in his absence]



Inland Revenue

CONFIDENTIAL

Savings and
Investment Division
Somerset House

Ang

FROM : B O'CONNOR
30 September 1988

1. MR CORLETT
2. CHANCELLOR

seen in draft

[Copy in to Ch]

EC TAX HARMONISATION : WITHHOLDING TAX ON SAVINGS

1. You have asked (Mr Taylor's minute 22 September) about what positive fall-back proposals we could make on this issue, which would be more attractive than those of the French and the Commission.

BACKGROUND

2. The Capital Movements Directive agreed at the EcoFin Council in June requires the Commission to submit to the Council by the end of this year "proposals aimed at eliminating or reducing risks of distortion, tax evasion and tax avoidance linked to the diversity of national systems for the taxation of savings and for controlling the application of these systems". The Council is required to take a position on these proposals by June 1989.

cc. Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr R I G Allen
Mr Culpin
Mrs Lomax
Mr Peretz
Mr Gilhooly
Miss G Noble
Mr C Riley
Mr A Sharples
Miss O'Mara
Mr Ilett
Mr Cropper
Mr Tyrie
Mr Bostock - UKREP
Mr Arrowsmith) B of E
Mr Hewitt

Chairman
Mr Isaac
Mr Painter
Mr Beighton
Mr Corlett
Mr Houghton
Mr McGivern
Mr Johns
Mr Shepherd
Mr Sullivan
Mr Davenport
Mr Orhial
Mr Alpe
Mr O'Connor
PS/IR

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3. The Commissioners primarily concerned - Delors and Lord Cockfield - are determined that the Commission should meet this timetable. Present indications (from the Delors and Cockfield cabinets) are that the Commission are more likely than not to propose some sort of minimum withholding tax on interest paid to EC residents, perhaps coupled with new or extended arrangements for Member States' fiscal authorities to obtain information about deposits in other Member States by their residents. But there is as yet no decision on the broad lines of the Commission's proposal: still less on the detailed issues involved in any proposal for a withholding tax.

4. The French remain the principal advocates of Community legislative action, fearing apparently both a loss of revenue and a degree of fiscal injustice between those who place their savings in France and those who place them elsewhere. The French government appears not yet to have defined a precise negotiating position; but seems likely to be a strong advocate of a withholding tax (as urged in the recent semi official Lebeque report).

IMPOSITION OF A WITHHOLDING TAX

5. It is widely recognised (including by the Commission) that imposing a withholding tax on interest paid will tend to drive business elsewhere: our own policies reflect this fact. Some interest paid from the UK to non-residents is paid net, but the trend has been to increase the attraction of London by extending the categories of individuals who can be paid gross - depositors in banks and building societies, holders of certain gilts, eurobond investors etc. Furthermore, the majority of our double taxation agreements with EC members specify a nil rate of withholding on interest, including the French agreement which was renegotiated as recently as 1986.

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6. To impose a withholding tax now would be to reverse this general policy. We have discussed this with the Treasury and the Bank. Our starting point is that, as a minimum, we should want exemption for eurobonds, interbank lending, wholesale money generally, corporate investment and investment by residents of non-member States. But Treasury officials are less concerned about a tax which was imposed on non-residents' deposits of up to a modest size - perhaps £50,000, the limit up to which UK individual investors in building societies and banks are subject to composite rate tax. At present interest paid by building societies and banks to non-residents is paid gross. But interest paid by other deposit-takers (including local authorities) to non-residents is paid net after deduction of basic rate tax.

7. Three points arise on this.

First, it is not clear whether this would satisfy the French wish to discourage "medium size savers" from shifting their savings within the Community. They may have rather bigger fish in mind. There would be a particular presentational problem in excluding large investors for the French Socialist Government.

Second, it is unclear how effective the tax would be, certainly for investors determined to avoid tax. Discounts, for example, cannot be caught. Nor could investment in the Channel Islands.

Third, it is not clear what the Commission or the French envisage should happen to the network of bilateral treaties among member States. The UK has treaties with each of the other eleven members. In the cases of Denmark, France, Germany, Greece, Ireland, Luxembourg and Netherlands, interest is exempt from tax in the source country. The rates with the other members are Belgium 15 per cent, Portugal 10 per cent, Spain 12 per cent and Italy 10 per cent (not yet ratified). In the case of France the rate was reduced from 10 per cent to nil as recently as 1986 to

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take account of various fiscal problems connected with the financing of the Channel tunnel. It would of course be possible to renegotiate these treaties. But any change in the interest articles could affect the overall balance and might therefore also involve changes to other articles. Moreover any increase in the tax charged on interest, apart from possibly driving investment out of the UK would adversely affect UK investment in other member States.

INFORMATION POWERS

8. If the French want to collect full tax liability at the marginal rate from their wealthier residents once they are allowed to invest abroad, then full provision of information by banks anywhere in the EC is logically the policy which should be espoused. Earlier rounds of discussion have however indicated widespread opposition among Member States, on banking secrecy grounds, to a general cross-reporting obligation on banks. There are also substantial practical difficulties in any such information exchange regime (whether it takes the form of bulk provision of information or requests for information about individual cases).

9. One less far-reaching possibility is to generalise the Danish scheme. In that, Danish taxpayers placing deposits abroad will be obliged to require that the deposit-taker will provide the Danish tax authorities with information about the account. There would be no sanction against banks that do not comply. All responsibility will rest with the Danish taxpayer. Such a regime, if generalised, would create administrative work for banks and might drive away business while being of limited value in dealing with evasion. Nevertheless, it is preferable to more far-reaching options both for us and, subject to further thoughts, the BBA.

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10. Another possibility is to build on the 1977 Mutual Assistance Directive. We know that the Commission are considering this as one possible way forward; and have convened a meeting of fiscal administrations in mid-October to discuss the subject. This Directive provides for three types of information exchange:

- spontaneous, where one tax authority finds out something it thinks will interest another,
- consultations leading towards bilateral bulk exchanges,
- exchanges of information, on request, about a specific taxpayer.

11. This is a sensitive area for the UK. Arguably, we have failed to change our information powers to meet the existing Directive requirements, let alone anything further the Commission might propose. (The deficiency here is that our formal powers only bite where there is a UK tax interest. If we have no tax interest in a foreigner, we have no power to seek information about him - as the Directive requires - solely to help a foreign tax authority.) Commission proposals for greater disclosure of banking information are likely to cause trouble for Member States with strong bank secrecy laws.

12. The British Bankers' Association, who we have consulted with your agreement, were initially divided as to whether a bulk information regime would be more or less administratively onerous than information requests about a particular taxpayer. They are considering their position further and are due to report back to us by 10 October.

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VIEWS OF OTHER MEMBER STATES

13. The indications are that Germany will support the general concept of a withholding tax. They have just introduced a new interest withholding tax of 10 per cent to take effect on 1 January 1989. The details are shown in the Annex. We do not know whether the Germans will seek to renegotiate our double taxation treaty.

14. We have no firm information about the likely approach of other States, but we shall be making informal contact and will report further.

LATEST DEVELOPMENT

15. The Delors Cabinet has now suggested a meeting with UK officials at the beginning of next week. A Revenue/Treasury team has agreed to attend. Subject to your views, we do not intend to mention any of these fall-back possibilities but simply to draw the Commission's attention to the wide implications of this issue particularly those aspects which we are likely to find most difficult such as wholesale flows and any exchange of information which would involve additional work for the Revenue or would be unacceptable to our banks. Are you content for us to hold a discussion on this basis?



B O'CONNOR

FEDERAL REPUBLIC OF GERMANY: NEW WITHHOLDING TAX ON INTEREST

The new withholding tax on interest was introduced by the Tax Reform Law 1990 which has been passed by the Federal Parliament and signed by the President on 25 July 1988.

Whereas most of the reforms are to take effect from 1 January 1990, the new interest withholding tax comes into effect on 1 January 1989.

Details:

1. The rate is 10%.
2. The following interest is subject to the withholding tax:-
 - a. Interest from deposits with resident banks and savings institutions (savings banks, building societies etc) including resident branches of foreign institutions.
 - b. Interest from bonds and debt instruments.
 - c. Distribution from investment funds.
3. The tax is not withheld on interest paid to churches, charitable organisations, political parties, pension funds etc.
4. Certain types of interest are exempt, including:-
 - a. Interest on savings deposits with statutory term of notice.
 - b. Interest on giro accounts with rate up to 0.5%.
 - c. Interest on foreign securities.
5. The tax withheld is creditable against the taxpayer's final liability.
6. If a taxpayer normally pays no income tax due to his low income, he can obtain a "non-assessment certificate" from his tax office, which authorises the bank etc to pay the interest without deduction of tax.

DW 12.9.88

[Sources: BMF publ of 15.4.88; Frankfurter Allgemeine 27.8.88, 6.9.88]

DRAFT

Pr type

Lyn Parker, Esq. PS / Foreign Secretary
em

The Rt Hon Geoffrey Howe QC MP

TAXATION IN THE SINGLE MARKET: SPEAKING NOTES ON UK APPROACH

~~My officials have prepared~~ speaking notes on the UK's alternative approach to taxation in the Single Market, for use by Ministers in putting the proposals across. have been prepared

I attach a copy of the notes, which have been cleared in draft with interested departments; I am also copying them to ^{other Private Secretaries to} ~~other ODE~~ Ministers.

JMG T—

~~NIGEL LAWSON~~

P— S—



H.M. CUSTOMS AND EXCISE
 DEPARTMENTAL PLANNING UNIT
 NEW KING'S BEAM HOUSE, 22 UPPER GROUND
 LONDON SG1 9PJ
 01-620 1313

ppp pe

PRH ALLEN CIE ✓

FROM: J K OXENFORD

DATE: 31 OCTOBER 1988

1. MR ALLEN
2. CHANCELLOR

IRA 31/10/88

Ch. Content to write as proposal (perhaps a PS letter would be better). The speaking notes are as you agreed earlier. or 2/11 yk - as PS letter - pkr.

TAXATION IN THE SINGLE MARKET: SPEAKING NOTES FOR MINISTERS ON THE UK ALTERNATIVE APPROACH

I attach the final version of the speaking notes, which have been cleared with interested departments and incorporate your comments. They have already been made available to the Parliamentary Under Secretary of State for Corporate Affairs (Mr Maude) for use at the Internal Market Council; but as they are also intended for general use, you will wish to circulate them more widely.

2. We suggest circulation to ODE Ministers, as those most likely to be called upon to put the proposals across. A draft covering letter is attached.

John Oxenford

J K OXENFORD

-
- Circulation: PS/Chief Secretary
 PS/Paymaster General
 PS/Financial Secretary
 PS/Economic Secretary
 Sir P Middleton
 Sir G Littler
 Mr Byatt
 Mr R I G Allen
 Mr Culpin
 Mr Cropper
 Mr Parker - Cab. Off.
- cps *Mr Unwin - CIE*
 Mr Jefferson Smith - *CIE*
 Mr Nash
 Mr Wilmott
 Mr Cockerell
 Mr Kent
 Mr Gaw
 Mr Allen (2nd copy)
 Mr Knox



[Handwritten signature]

Treasury Chambers, Parliament Street, SW1P 3AG

01-270 3000

3 November 1988

Lyn Parker Esq
PS/Foreign Secretary
Downing Street
London SW1A 2AL

[Handwritten signature: Lyn Parker]

TAXATION IN THE SINGLE MARKET: SPEAKING NOTES ON UK APPROACH

Speaking notes on the UK's alternative approach to taxation in the Single Market have been prepared for use by Ministers in putting the proposals across.

... I attach a copy of the notes, which have been cleared in draft with interested departments; I am also copying them to other Private Secretaries to OD(E) Ministers.

[Handwritten signature]
[Handwritten signature]
J M G TAYLOR
Private Secretary

- cc. PS/CST
- PS/PMG
- PS/FST
- PS/EST
- SR P Middleton
- SR G LITTLE
- MR BUETT
- MR RIG ALLEN
- MR CULPIN
- MR CROPPER
- MR Parker - c/o
- MR UNWIN
- MR J-Smith.

SPEAKING NOTE ON CHANCELLOR'S ALTERNATIVE STRATEGY

- 1) Government is committed to completion of internal market as defined in the Treaty; but does not regard fiscal harmonisation as necessary to achieve this.
- 2) Centrally imposed tax approximation would take insufficient account of changing conditions, needs and social and other priorities in Member States. The Commission's proposals (e.g. the VAT clearing house) are potentially more burdensome for businesses than what could be achieved under proposed UK approach.
- 3) Present system of relieving exports of tax and imposing tax on imports results in no distortions of competition between foreign and domestic supplies.
- 4) As Prime Minister made clear in Bruges speech, UK objective is deregulation and trade facilitation through reduced government intervention to reduce business costs and create greater incentives to trade within the Single Market - not greater and more detailed regulation from centre. To this end, Chancellor put forward a paper to his Council colleagues outlining UK's suggested alternative approach.
- 5) This approach is based on allowing market forces to influence indirect tax rates to the extent necessary for the Single Market while concentrating on the early reduction of barriers to movement of people and goods.
- 6) The main elements of this approach are:
 - (i) Substantial and early reductions in border formalities for Community goods and people, while retaining the necessary controls against drugs and terrorism, as provided for in the Treaty;

- (ii) Controls on commercial transactions increasingly to take place inland at traders' premises as an element in normal internal controls, rather than at the frontier; aim is progressive elimination of frontier formalities.
- (iii) Large and progressive increases in "tax paid" allowances on goods that people can bring back, from other Member States (although smaller increases or high minimum rates for alcohol and tobacco, for health reasons). Aim is eventually no limit at all on tax paid goods (other than alcohol and tobacco) and consequent abolition of related frontier checks.
- 7) This approach has the advantages that it does not require Member States to make what in many cases could be large and highly unwelcome changes in tax rates with damaging consequences for national economic, social, health or other policies. Nor does it set tax rates at average levels which may not be appropriate for the circumstances of 1993, but would be very difficult to change.
- 8) It does not imply that market forces should immediately be given a totally free rein. The UK accepts that this could cause problems for Member States with high indirect tax rates. We are content to see this element phased in according to a timetable agreed by all Member States.
- 9) The main aim of the UK approach is to concentrate on practical and achievable reductions in fiscal and other frontier barriers. The UK has not abandoned the aim of eliminating frontier controls as envisaged in the Single European Act.
- 10) But we believe that this should be approached with the intention of minimising disruption to the national policies of Member States. If this involves some compromise on timing or extent, we believe that this is preferable to an uncompromising approach which risks failing to make any progress.

- 11) ECOFIN discussions show that whatever differences there may be between Member States on how to achieve the single market, the prospects for implementing anything as radical as the Commission's proposals' by the end of 1992 are minimal. UK is pressing for early action on practical steps to be taken to ensure that real progress towards eliminating fiscal controls is made by 1993.

- 12) So, the UK is not putting forward its alternative approach as an unalterable blueprint. Our intention is to open up the debate so that achievable policies can be fully considered in the Community. We welcome the contributions of other Member States and of the Community institutions to making real and early progress to the Single Market in this difficult area.



FROM: A C S ALLAN

DATE: 3 November 1988

MR BYATT

cc PS/Economic Secretary
 Sir P Middleton
 Sir T Burns
 Sir G Littler
 Mr Monck
 Mr Lankester
 Mr R I G Allen
 Mr Burgner
 Mrs Lomax
 Mr Spackman
 Mr Meyrick
 Mr Tyrie
 PS/C&E

COST OF NON-EUROPE

The Chancellor attention has been drawn to the sixteen volume set of papers on Research on the "Cost of Non-Europe", published by the EC Commission. (What is the relationship between this and the Cecchini Report?) He wonders what your views on this work are. In particular, do we agree with the findings? The facts and figures will no doubt be used by the Commission to justify all sorts of proposals.

2. The Chancellor has noted the very detailed listing of the technical barriers in each country for each industry (see, for example, the attached extract* on Technical Barriers to Imports of Wood Working Machines into France). The Chancellor feels this must be useful ammunition for us, both in arguing specific cases and in making the general point that these sorts of technical barriers are of far greater importance than more theoretical concerns such as those about tax approximation. He would be interested in your comments.

(* from Volume 6)

ACSA

A C S ALLAN

5. Removing technical barriers

The existing divergences of the national regulations were described in section 3, whereby these divergences only create problems for imports into France.

According to the type of wood-working machine, the costs for additional protective facilities in France amount to approximately 1,200-1,400 ECU. These additional costs raise the price per machine, however, it must be taken into account that these additional regulations apply to all suppliers, even the French, i.e. they are tendentially competitively neutral (upwards trend of economy of scale curve).

The question of competitive neutrality must be considered under the aspect of formal requirement. Formal requirements apply to e.g. particular drawing formats, which frequently mean that existing plans cannot be used and must be revised. Sectional drawings, details on material and other information is required for the many details concerning the machine. A complete piece-list in French must also be drawn up.

The level of the testing fees for a machine i.e. type of machine, amounts to between 300 and 800 ECU. When evaluating the testing fees it must be taken into account that

- a special test is required for each deviation in machines of one and the same type, e.g. in the working width, output or numbers of aggregates
- correspondingly high costs are incurred for the transport of the machines to the testing centre in France

- in the case of bulky machines or the examination of a large number of prototypes, considerable travel and accomodation expenses of the French examiners must be borne by the manufacturers of each country
- costs are again incurred by the frequently prescribed repeat tests.

The testing duration itself is between six months and one year. In the other countries, Italy, UK, FRG, the test duration extends to 2-3 months only. The consequences of the French regulations are as follows:

- on the issuing of the decree, foreign suppliers had to carry out adaption investment in order to meet the French requirements
- manufacturers of special machines are more greatly subjected to testing procedures than the manufacturers of standard machines (no type variety)
- the safety regulations caused a general rise in the price level in France - the level of the price rise depends on the kind of machine
 - in the case of special machines, the price rise corresponds to the costs of the protective hood and the testing costs
 - in the case of standard machines the price rise is less than proportionate the value of the machine.

- drawing up piece lists in French
- drawing up circuit diagrams in French
- producing detail drawings

Depending on the export activity to France, the respondent firms stated that on average, one employee must be engaged for 50-100 of his time on these tasks; this corresponds to additional expenditure of approximately 15-30,000 ECU p.a., regardless of the number of models involved.

In order to quantify the consequences of harmonization, the following premise must be assumed:

- the average plant manufacturers approximately 150 wood-working machines p.a.
- approximately 10 % of production is exported to France
- the average price of the machines amounts to 10-15,00 ECU (smaller single and multi-spindle machines)

The following additional costs thus result:

Alternative A: 15,000 ECU for personnel costs:
 number of exported machines
 (approx. 15) = 1,000 ECU

Alternative B: 30,000 ECU for personnel costs %.
 15 = 2,000 ECU

Related to the value of the machine this results in a scale of 6.6 % to 20 % max. According to the interviews the average ratio amounted to 7-10 %. The firms react to the French decrees in varying manners:

- some foreign suppliers did not carry out adaption investment with the consequence that no machines are exported to France
- in so far as it was accepted, manufacturers of special machines passed on the full cost of the price rise to the customer
- Italian manufacturers carried out product improvements and concentrated on exporting smaller, standardised machines to France
- German manufacturers primarily supply CNC controlled machines with automatic feeding of the workpiece, i.e. this new technique takes the safety aspect into account
- there are no noteworthy British exports to the French market

Taking the described state of affairs into account, the following direct costs of a non-realised internal market will arise:

the case of a rise in average job size to approximately 30-40 units, this results in cost reduction of 11.5 mio. ECU x 3-5 % = 0.5-0.9 ECU.

Harmonization of the technical regulations at a "non-French level" could lead to an expansion of production, particularly for the Italian manufacturers. This expansion would be at the cost of French manufacturers, i.e. the number of French manufacturers (currently approximately 6 firms) would be reduced. The initial basis for further observation is the French production volume, which amounted to 17.5 mio. ECU in 1986. Taking into account the well-known economies of scale in mechanical engineering of approximately 3.5 % in the case of a rise in average job size to approximately 30-40 units, this results in cost reduction of 17.5 mio. ECU x 3-5 % = 0.5-0.9 mio. ECU.

COST OF
NON EUROPE

FROM: I C R BYATT
DATE: 18 November 1988

per

CHANCELLOR

cc PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Monck
Mr Lankester
Mr R I G Allen
Mr Burgner
Mrs Lomax
Mr Spackman
Mr Riley
Mr Meyrick
Mr Tyrie
Ms Symes

*Thanks
in the
the next system
affairs*

PS/Customs & Excise

COST OF NON-EUROPE

You asked (Mr Allen's note of 3 November) how the 16 volumes of research papers recently published by the EC Commission relate to the Cecchini Report and whether we agreed with the findings. You also asked about the relative importance of technical barriers and tax approximation.

2. The papers make available the background research undertaken by the Commission as part of the single market. These volumes are 5800 pages long. They contain a great deal of illustrative material on the costs of non-Europe, but are not well designed to provide precise answers to questions such as, which forms of trade barrier are most significant, which industries are most protected, or which countries impose highest barriers. However the material does generally support the estimates in the Cecchini Report that about 2½% average cost reduction could be obtained from:

AA

	<u>% of GDP</u>
- border control savings	.25
- eliminating multiple national standards	1.75
- reduced costs of public procurement	.50

~~1~~ Within the total, multiple technical standards and regulations were thought to be 7 times as costly as border controls and only a proportion of the latter are accounted for by the costs of fiscal checks at frontiers to deal with variations in tax rates.

3. We think the above estimate of the possible static savings to be broadly defensible. We have slightly more reservations about the full achievability of the Commission's estimates on the dynamic gains from economies of scale, restructuring of trade and increased competition which they put at a further 2-4% of Community GDP. We also doubt that the gains will come through quite as quickly as the 1% a year that the Commission suggest. I enclose a copy (top copy only) of the paper which Mr Meyrick sent to the Economic Secretary on these figures in July.

4. Whether or not these savings are achieved will, I believe, depend to a considerable extent on whether the steps towards 1992 take the form of deregulation and reduction of controls or by bureaucratic harmonisation of regulations.

5. We are undertaking some further work to estimate the possible gain to the UK from the single market looking at the main sectors and industries expected to be most affected.

~~6~~ It appears from the studies that reductions in technical barriers are of much greater importance than tax approximation. The Commission, with help from research institutions in member states (CBI in the UK) asked 11,000 firms for views about how much trade barriers cost them and which were more important. The replies indicated that on average firms thought trade barriers could be reduced at a saving of about 2% of total costs and total sales to all markets could be boosted by about 5% in the absence of those barriers. The barriers which they thought to be most important were:

Table 1
General barriers thought important

	% of firms think this is an important barrier
Differences in technical regulation and standards	51
Administrative barriers (excessive customs formalities)	51
Physical frontier delays and costs	45
Implementation and explanation of Community land (too costly and tales too long)	37
Capital market and exchange restrictions	36
Freight transport regulations raising transport costs	36
Restrictions in open procurement for government contracts	35
Differences in VAT and sales taxes	35
Other barriers	9

Source: Commission Basic Findings Volume 3

7. Differences in national standards and regulations were reported to be an important source of costs in the following industries:

Table 2
Differences in National Technical Standards and Regulations

	% of firms think this an important barrier
Motor vehicle and parts manufacturing	68
Electrical engineering	66
Mechanical engineering	63
Chemical industry	60
Manufacturing of non metallic mineral products	56
Other transport equipment	55
Leather and leather goods processing	51

Source: Commission Basic Findings Vol 3 table 6B1

8. The Commission's studies do readily show which countries impose effective technical barriers. Firms often report the barriers they face in other countries rather than their own. Detailed case studies are given in volume 6 of technical regulations. While these case studies give clear examples of the costs of arbitrary technical regulations (as for example in the French restrictions on wood working electrical machinery to which you referred), there is no easy way of quantifying the costs in different countries. Table 3 gives a broad indication of the extent to which different countries impose these costs.

Table 3
Costly Technical Regulations in Different Countries

	UK	France	Germany	Italy
Dishwashers	X	N	N	N
Electrical lifts	N	N	N	N
Weighing equipment	P	P	X	X
Woodworking machinery	N	P	N	N
Fire protection products	X	X	X	X
Foodstuffs	X	P	X	P
Pharmaceuticals	X	X	X	X
Automobiles	P	P	X	P
Building material	N	P	X	N
Telecoms equipment	N	X	P	X

Key: P = highly protective regulations
 X = costly regulations
 N = neutral regulations

9. It is clear from the above table and indeed from other studies that the UK is far from being squeaky clean on technical barriers to trade. For example when it comes to cars we are not thought to be better than the French or the Italians. Nevertheless our restrictions have been substantially reduced over the last few years. E(CP) and the Secretary of State for Trade are continuing to root out areas where costly barriers can be eliminated. We are, therefore, in a good position to press other Community Member States to focus energy on the attack on non tariff barriers (from outside the Community as well as in it) and on reducing administrative costs.

TB

I C R BYATT