PO-CH/NL/0838
PARTA

Chel
Lawson

PART A

CONFIDENTIAL

(Circulate under cover and
notify REGISTRY of movement)

PO -CH /NL/~~0118~~
0838

PART A

MEETING OF THE EUROPEAN
COMMUNITY (EC) ECONOMIC
AND FINANCE COUNCIL
(ECOFIN), 18 NOVEMBER
1985, BRUSSELS

PO -CH /NL/~~0118~~ 0838
PART A

Begins: 6/11/85
Ends: 18/11/85

DD: 25 years

5/9/95

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

C, I feel sure line in para 6 is still the best course. Content for Bryce to work this up for ECOFIN?

FROM: B H KNOX

DATE: 6 November 1985

CHANCELLOR

Ok. I will need a Monger/Schiller paper on X, which can emphasise the overall tax & fiscal (inc PX) policy. N.

RWO 13/11

cc: MST
Mr Lavelle
Mr A Edwards
Mr Monger
Mr Hopkinson
Mr Cropper
Mr H Davies

ECOFIN: TAX HARMONISATION

Mr Wynn Owen's minute of 31 October to Mr Lavelle asked for a note on where we stood in relation to Lord Cockfield's remark at the last ECOFIN that no alternative had yet been produced to his plans for achieving a single market. This submission examines the handling of alternatives and goes on to seek your endorsement of the general line to be taken in briefing for the next ECOFIN on 18 November.

Alternatives to Tax Harmonisation

2. Although it is true that no Member State has put forward an alternative, it is unlikely that Lord Cockfield is actively seeking one: his words have a certain rhetorical ring to them. It is in any case far from clear that this is the right time for any alternatives to be tabled.

/3. You have

Internal distribution:

CPS
Mr Godfrey
Mr Wilmott
Mr Cockerell
Mr Bone

attached at Such

3. You have seen Mr Wilmott's submission of 22 October, Annex B of which pointed to VAT postponed accounting, the elimination of statistics and the increased computerisation of customs operations as the best means of reducing frontier delays. Of these the first is expensive, the second improbable and the third not likely to be a practical proposition for some years to come. In any case they are all concerned with the reduction as opposed to abolition of frontier controls. Lord Cockfield rests his case for the internal market on a 'Europe sans frontières' and (if other much more important frontier formalities relating to drugs, plant and animal health, CAP, statistics etc, were to be removed) for that a large measure of tax harmonisation would also probably be necessary. Our alternative approach would ~~be~~ for a Europe with frontiers (albeit easier to cross than at present) which as it happens would not require further harmonisation.

4. However, to say so at this point would be to risk (a) prejudicing the UK aims on higher priority parts of the White Paper and (b) incurring the odium of breaking up the internal market initiative (or perhaps even giving greater impetus to the notion of other Member States progressing on a faster track). It would be preferable tactically to wait until debate had departed the arena of rhetoric and had entered the realm of the art of the possible before tabling any more modest ambitions which we might have in mind.

Approach to November ECOFIN

5. So if the UK is not to show its hand at the next ECOFIN what stance are we to adopt? There is a perfectly respectable line to be taken which is both practical and respectful of the philosophy of the internal market but which leads inexorably to the sort of studies which should demonstrate clearly to most Member States the immense difficulties posed by tax harmonisation.

/6. In telegraphese

6. In telegraphese the line goes as follows :-

(a) UK endorses many of Commission's plans for completing internal market, looks forward to rapid progress on high priority matters identified at Milan; ready to study practical ways of cutting trade obstacles.

But (b) Indirect tax harmonisation (not a Milan priority) raises wider issues barely touched upon in the White Paper, such as effects on Member States' freedom to adjust their economic and fiscal policies, on national revenues, on regional economies/industries and social policies. As politicians (this is to be a 'political' discussion) Finance Ministers cannot possibly take on trust what is little more than the White Paper's declaration of faith. Indirect tax harmonisation was referred to the ECOFIN Council to examine 'on the basis of the White Paper any measures which might be necessary for the achievement of the objective of a single market ... '. ECOFIN would be failing in its duty if it did not call for deepest consideration of all the implications.

Therefore (c) This means proper studies of all possible approaches to tax problems associated with internal market: the assessment of current distortions and delays and other means of minimising them: the necessity for tax approximation and the practicality of any proposed measures. Rigorous cost/benefit approach required. Only after this can sensible decisions of principle be arrived at.

Conclusion

7. I should be grateful if you would signify your agreement to this being the UK line to be taken at ECOFIN. We can then set in hand suitable briefing.

Bryce Knox

B H KNOX

770/53

FROM: G W MONGER
DATE: 14 November 1985

MR SCHOLAR

cc Mr Lavelle
Mr Edwards
Miss Sinclair
Mr Romanski

Mr Knox, C&E

ECOFIN: TAX HARMONISATION

You saw Mr Wynn Owen's minute of today asking if you and I could expand the first few lines of 2(b) in the Ecofin brief on fiscal harmonisation.

2. I attach a quick draft which spells out some extra points both on wider fiscal policy and on indirect taxes. Have you any comment or addition? There is no reference to public expenditure, which was mentioned in the minute from the Chancellor's office, but I cannot immediately see how this is relevant, except as one of the elements in fiscal policy generally, the first item on the attached redraft.

G W MONGER

CONFIDENTIAL

FROM: R G LAVELLE
DATE: 15 November 1985

CHANCELLOR

STOLTENBERG

You may like to have a short aide memoire of ground it could be useful to cover tomorrow, and a modest dossier of background papers.

(i) IGC: Monetary Amendment

2. Stoltenberg is coming to discuss the monetary amendment area and you will spend most of the time on this. You will have your own views on tactics. But your central objective will be to clarify what Stoltenberg regards as the most minimal amendment that will meet French/German political needs. You will wish to explain our objections to any EMU reference. And you will want to explain why it is important to make sufficient progress on Monday to keep the issue evidently under Finance Ministers' control. The only safe course will be to have a text virtually agreed by the time of the December Council.

3. Included in the dossier below are:

- your minute to the Prime Minister
- Mr Fitchew's brief for ECOFIN
- a note, as requested this afternoon, on what EMU means.

(ii) IGC: Other

4. You need not spend time on other IGC topics (which indeed have yet to be discussed by Ministers collectively in the UK). In general the number of topics to be put to the December Council is contracting quite satisfactorily. Both German and UK Treasury interests in such issues as retaining unanimity over tax issues, and firm financial control in 'new' areas (such as technology) ought to be met.

CONFIDENTIAL

CONFIDENTIAL

5. Included in the dossier below are:

- an overview telegram by Hannay
- the telegram mentioned by Hannay summarising German views
- a fuller note on early German ideas on the Parliament

(iii) <u>ECOFIN: Other agenda items</u>

6. You may like to compare notes on some of the other ECOFIN items.

7. On <u>Greece</u>, Tietmayer will presumably report the position after the Monetary Committee. The Germans have so far been among the toughest critics of the Greek measures. It looks as if the Commission have driven a reasonably firm bargain on the coverage and period of the import deposit scheme and the Greeks' inability to introduce VAT on 1 January (they must pay their dues anyway). It remains to be seen what will be proposed on Community* borrowing. We will not oppose in principle but will want conditions, perhaps linking release of tranches to performance.

*...mar ...ggests ½ becu M...

8. On <u>tax approximation</u>, you will ask Stoltenberg to take the lead, given the obvious constraints on your leading the pack against Lord Cockfield. Our view is that indirect tax harmonisation raises issues scarcely touched on in the White Paper - national freedom to adjust economic and fiscal policies, and profound social issues as well. We will say all this but preferably not first.

9. The <u>Annual Report</u> is, as you commented earlier, a curate's egg. We may need to douse down references to boosting demand and infrastructure spending. On the whole it does not look too troublesome: rather more tiresome for the Germans than us.

10. The item on <u>Euratom loans</u> is there at the German request. We are already commited to agreement to raising the lending limit from 2 to 3 becu. We gather Bangeman has said there is no energy objection. Perhaps Stoltenberg can explain his anxieties . Obviously we can express sympathy: but we cannot change our line.

11. You may like to mention that over lunch you had in mind

CONFIDENTIAL

to say something about unitary taxation and about tin. The dossier below includes the speaking notes prepared on each topic.

(iv) The Community Budget

12. We think it would be useful to try and stiffen the Germans up a little on the Budget, where Tietmayer has shown signs of wobbling. A note by Mr Edwards is attached. The Germans seem to be running scared of the Parliament. We see major dangers in committing ourselves to exceeding the maximum rate provisions as an opening tactic in negotiations with the Parliament.

(v) Net Balances

13. It would be very helpful if Stoltenberg could be reminded to raise this subject at the ECOFIN lunch. So far the Commission have, reluctantly, given only limited information about their own position to national government - and nothing about the total impact of the budget on member states. This is ludicrous. A note by Mr Edwards is attached. (in Stoltenberg folder)

(vi) The wider scene

14. Sir G Littler has reported today on his discussions in Paris this week - the prospects for US interest rates, reflections on the Plaza Agreement, evolving responses to the Baker initiative and possible dates for a further G5 Ministerial meeting in the new year.

RL

R G LAVELLE

CONFIDENTIAL

FROM: JANET BARBER
DATE: 15 NOVEMBER 1985

1. MR LAVELLE ✓ M

2. CHANCELLOR

GBT MILAN TEXT

What is happening to the White paper?

ECOFIN 18 NOVEMBER

You are due to attend ECOFIN on 18 November. Sir Geoffrey Littler, Mr Lavelle and Mr Culpin will be in support. Mr Byatt will attend as Chairman of the Economic Policy Committee, for item 2(d). Mr Knox, Customs and Excise, will attend for items 2(c) and 2(g). The Council begins at 11.00am in the Charlemagne Building, 170 Rue de la Loi, Brussels.

2. There are six substantive items on the agenda:

- (a) preparation of economic and monetary items liable to be raised at the next meeting of the European Council.
- (b) measures taken by the Greek Government.
- (c) removal of fiscal barriers
- (d) the annual economic report
- (e) Euratom loans
- (f) (possibly) the unit trusts Directives

In addition, you wish to raise the following yourself:

- (g) VAT exemption limit - with Lord Cockfield and M Delors
- (h) unitary tax - generally, over lunch
- (i) the tin market - also generally over lunch

Further items which might be raised in the margins:

- (j) Spain's EC Budget position in 1986
- (k) export credits: the ecu Commercial Interest Reference Rate (CIRR)
- (l) member states'net balances.

ECONOMIC AND MONETARY ITEMS FOR THE EUROPEAN COUNCIL

3. The major item to be discussed under this heading is the Delors proposal for the amendment of the monetary provisions of the Treaty of Rome. This is covered in Brief A1 (which Mr Fitchew is also submitting separately). The discussion will be in restricted session - that is, Minister plus Permanent Representative plus one.

4. Your line to take is as set out in your minute to the Prime Minister of yesterday's date.

5. Also under this heading, the Commission may make an oral statement on economic matters to be raised at the European Council "to introduce a policy debate". Apart from the annual economic report, which is on this agenda separately, it is not entirely clear what this could be about. But it may be about the Commission's ideas on a Community programme for infrastructure investment. We think that the Commission may be considering, amongst other things, a new Community borrowing and lending

facility just for infrastructure. Our view is that this would be unnecessary. This subject is covered in Brief A2. Given the rest of the agenda, there may be little time for much discussion. (If infrastructure is not raised under this heading, it might be raised in the discussion on the annual economic report.)

MEASURES TAKEN BY THE GREEK GOVERNMENT

6. This is covered in Brief B

7. The central issue is a loan to Greece under the Community Loan Mechanism (CLM), and the conditions which should be attached to it. It seems that the Commission and Greece have reached agreement on a possible package. However, under the terms of the Treaty and the CLM Decision, the Monetary Committee have to be consulted before the Commission puts their proposal to the Council. The Monetary Committee is therefore meeting on Sunday evening. Sir Geoffrey Littler will attend, and will provide supplementary briefing in the light of the outcome of that meeting.

REMOVAL OF FISCAL BARRIERS

8. This is covered in Brief C. The line to take in the original Customs Brief is augmented by Mr Monger's note of 14 November, which is attached to Brief C.

9. At ECOFIN on 28 October, it was agreed that there would be a substantive political debate on this subject at this ECOFIN. The UK's longer term objective is to avoid commitment to tax approximation, and to hinder substantive progress on it, without prejudicing progress on the more important aspects of the internal market. Brief C suggests that you call for a detailed consideration of all the implications of tax and the single market, before decisions of principle are taken. This would include looking at all possible options for getting round tax problems associated with the internal market.

??

THE ANNUAL ECONOMIC REPORT

*too bulky - I have it with me.

10. This is covered in Brief D. A copy of the annual economic report is attached*(top copy, and for Sir Geoffrey Littler, Mr Lavelle, Mr Culpin only).

11. The report was discussed at the October ECOFIN, and will be taken again at the December ECOFIN, when we expect it to be formally adopted by the Council. There should be no question of formal adoption at this Council. The report is on the agenda this time at the request of the Dutch, so that Mr Ruding can air some difficulties he has with it.

12. Our general attitude to the report is that it is broadly welcome, but that we would not necessarily agree with every word in it. Brief D gives the important points to make. Attached to Brief D, as general background, is a set of tables giving statistics on the economic situation in the EC, US and Japan.

EURATOM LOANS

13. This is covered in Brief E.

14. Almost a year ago, the Commission proposed an increase in the Euratom lending ceiling from 2000 million ecu to 3000 million ecu. Earlier in the year, we and all other member states agreed this. At the time, however, Germany placed a Parliamentary reserve on

the increase, which has not been removed. The matter is on this ECOFIN agenda at their request.

15. It is not clear what the German problem is. We think that they might want to express worries about the Commission's general borrowing and lending ambitions apart from Euratom, and we can probably support them on this. However, we do not want to withdraw our agreement to the increase in the Euratom lending ceiling.

UCITS (UNIT TRUSTS) DIRECTIVE

16. This is covered in Brief F. It is a "possible" item.

17. At the October ECOFIN, the UCITS ("undertakings for collective investment in transferable securities") Directive, and the associated capital movements Directive, were agreed subject to a Danish waiting reserve. The Danes will probably be asked if they can lift their reserve. You should express our firm support for the package agreed last month.

VAT EXEMPTION LIMIT

18. This is covered in Brief G.

19. You may wish to raise this, in the margins of the meeting, with Lord Cockfield and, if possible, M Delors. The objectives are to give our views on the Commission idea of a common threshold at a fairly low level, and to dissuade the Commission from pursuing the infraction proceedings currently hanging over us.

UNITARY TAX

20. The relevant material for this item is contained in Mr Fawcett's minute of 14 November to Mr Wynn Owen. The final version of a speaking note, to explain recent developments to ECOFIN, was attached to Mr Fawcett's note to the Financial Secretary of today's date, and is reproduced in Brief H.

Useless minute – see Brief H which is stripped down version.

THE TIN MARKET

21. Briefing on this will be provided separately by Mr Lavelle. The aim is to request EC colleagues' co-operation in an orderly run-down of the tin market. Brief I

SPAIN'S EC BUDGET POSITION IN 1986

22. This is covered in Brief J.

23. The Spanish Finance Minister has sought a meeting with you on this in the margins of ECOFIN. He is worried that Spain will be a net contributor to the Community Budget in 1986. Your objective is to calm his fears without making a commitment to an addition to the Draft Budget for enlargement.

THE ECU CIRR

24. This is covered in Brief K.

25. The Italians were threatening to raise this issue at this ECOFIN, but they have now accepted that it is too soon for a proper discussion. Nevertheless, the matter could still be mentioned in the margins. If so, your aim is to discourage substantive discussion until the December ECOFIN, after the working group will have made further progress on the technical aspects.

MEMBER STATES' NET BALANCES

26. We hope that the Germans will raise over lunch the issue of the Commission's failure to provide figures on Member States' net balances in respect of the Community Budget. You should support them in suitably strong terms. The background is given in Mr Lavelle's separate note of today's date. Brief L (last page)

OTHER MATTERS

27. Some "A" items (ie items not requiring discussion) will probably be taken at the beginning of the meeting, but as yet we have not received a list of these.

28. Personality notes are not attached - I have these - top copy only.

29. Copies of this briefing go to those on the attached list.

Janet Barber

JANET BARBER
EC1

1496/002

ECOFIN COUNCIL, 18 NOVEMBER

BRIEF A1

INTER-GOVERNMENTAL CONFERENCE : MONETARY PROVISION OF THE TREATY

References :- Articles 103-109 of Treaty of Rome (Annex A)
Delors' amendment to Article 107 (Annex B)

OBJECTIVES

(a) [If possible] to persuade the Council that no amendments should be made to the monetary provisions of the Treaty.

(b) (Fallback, if isolated in opposing all amendments) :-

(i) to secure rejection and preferably withdrawal of Delors' amendment and, in particular, of the EMCF voting provision discriminating against non-ERM members;

(ii) to make it clear that a Treaty reference to Economic and Monetary Union (EMU) is politically unacceptable;

(iii) to underline legal risks of a Treaty reference to EMS, but to leave open possibility of a minimal reference, provided that :-

- the independence of Member States' exchange rate policies is explicitly safeguarded;

- no legal obligation to join the ERM is created;

- the French and others accept stronger obligations on removing exchange controls.

(c) to reserve any follow-up either before or after the European Council for ECOFIN Ministers and Monetary Committee.

You will need to intervene.

Importance of monetary policy
Success of the EMS (Rambouillet 1984)

Line to Take

(i) Amendment to monetary provisions of the Treaty - whether ARticle 107 or elsewhere - unnecessary and risky. Technically unnecessary, because EMS and the ERM have worked satisfactorily and flexibly on basis of Central Bank Governors' agreement. Risky, because any reference to EMS in the Treaty will have formal legal consequences eg for the respective competences of Community institutions and central banks. Could also make further gradual development of EMS (such as in last December's package) more rather than less difficult, because Community Article 235 legislation and therefore European Parliament will be involved.

(ii) We should concentrate on practical decisions. Removal of exchange controls to create a unified financial market in Europe and removal of barriers to the private use of the ECU;

(iii) ~~Delors'~~ Commission draft (prompted by pressure of Commission) is unacceptable. Brings wide range of decisions, including ECU settlement provisions, under Article 235. Is full of general and ambiguous language, eg on tasks and autonomy of EMCF, opening up wide area for legal interpretation. Proposal in paragraph 3 of text to deprive non-ERM Members of their votes in the EMCF (of which they are shareholders) ~~politically unacceptable;~~ ~~astonished~~ surprised that Commission should have put forward such a divisive proposal.

(iv) Must warn colleagues of political dangers of suggesting a Treaty reference to EMU. No UK agreement to this will be possible ~~[at European Council]~~.

(v) ~~(as appropriate)~~ UK takes Treaty commitments very seriously. Not prepared to write in the Treaty objectives - even ultimate ones - which are nowhere defined and which we cannot know whether we will be able to perform. EMU goes well beyond irrevocable locking of exchange rates and establishing a Community Central Bank. Could only make sense if accompanied by fiscal union and single Community Finance Ministry. ~~And that requires~~ political union. Danger (as in 1972) of Community entering into unrealistic commitments which outside world will not take seriously. Main purpose of IGC should be to bring Treaty up to date and enable practical progress to be made where it is now blocked, eg on internal market, environment, technology. Utopian ideals of EMU quite inappropriate to rest of the exercise.

(vi) Our understanding is that even a minimal reference in Treaty to EMS will bring the system within the ambit of Article 235 legislation with implications for existing division of competences and Central Bank independence. ~~Is that~~ what colleagues want?

(vii) [If appropriate]. Recognise strength of colleagues' views that there should be at least a symbolic reference to EMS - probably in Article 107. Ready to give this further consideration subject to three conditions. First, would have to have M. Delors' assurance that his amendment would not be put to European Council. Second, ~~to balance any~~ Treaty ~~reference to EMS must also~~ strengthen the provisions in the Treaty relating to freedom of capital movement, (for example by limiting the duration of protective measures under Articles 108 and 73); [and include a reference to the status of the ECU]. Third, any reference to EMS in Article 107 must meet the following requirements :-

- it must explicitly safeguard the independent responsibility of Member States' for exchange rate policy;

- there must be no legal obligation implicit or explicit to participate in the exchange rate mechanism;

- the implications for Community competence must be kept to a minimum.

1496/003

BACKGROUND

1. The background is contained in Sir Geoffrey Littler's record of the Monetary Committee meeting and in your minute to the Prime Minister (both attached below at Annex C).

2. Our latest information is that both the French and Germans are working on possible Treaty amendments, referring to both EMU and EMS. (You should press Herr Stoltenberg hard to drop any reference to EMU).

3. We recommend you to avoid getting into any negotiation on texts at ECOFIN. This should be remitted to the Monetary Committee for further work, if necessary before the 2nd December European Council (and preferably in the presence of the Council Legal Service). Annex D below, however, contains a first shot at an "acceptable" amendment to Article 107, meeting the requirements in the Line to Take.

Capital Movements

4. Annex E below sets out our ideas for strengthening the Treaty provisions on freedom of capital movement. Again there should be no need to deploy this in detail.

5. Whether to propose a Treaty reference to the status of the ECU - to embarrass the Germans - is a matter for tactical judgement on Monday. It should not be pressed too hard.

V. important

Annex A

regulation or administrative action in Member States as directly affect the establishment or functioning of the common market.

The Assembly and the Economic and Social Committee shall be consulted in the case of directives whose implementation would, in one or more Member States, involve the amendment of legislation.

Article 101

Where the Commission finds that a difference between the provisions laid down by law, regulation or administrative action in Member States is distorting the conditions of competition in the common market and that the resultant distortion needs to be eliminated, it shall consult the Member States concerned.

If such consultation does not result in an agreement eliminating the distortion in question, the Council shall, on a proposal from the Commission, acting unanimously during the first stage and by a qualified majority thereafter, issue the necessary directives. The Commission and the Council may take any other appropriate measures provided for in this Treaty.

Article 102

1. Where there is reason to fear that the adoption or amendment of a provision laid down by law, regulation or administrative action may cause distortion within the meaning of Article 101, a Member State desiring to proceed therewith shall consult the Commission. After consulting the Member States, the Commission shall recommend to the States concerned such measures as may be appropriate to avoid the distortion in question.

2. If a State desiring to introduce or amend its own provisions does not comply with the recommendation addressed to it by the Commission, other Member States shall not be required, in pursuance of Article 101, to amend their own provisions in order to eliminate such distortion. If the Member State which has ignored the recommendation of the Commission causes distortion detrimental only to itself, the provisions of Article 101 shall not apply.

TITLE II—ECONOMIC POLICY

CHAPTER 1—CONJUNCTURAL POLICY

Article 103

1. Member States shall regard their conjunctural policies as a matter of common concern. They shall consult each other and the Commission on the measures to be taken in the light of the prevailing circumstances.

2. Without prejudice to any other procedures provided for in this Treaty, the Council may, acting unanimously on a proposal from the Commission, decide upon the measures appropriate to the situation.

3. Acting by a qualified majority on a proposal from the Commission, the Council shall, where required, issue any directives needed to give effect to the measures decided upon under paragraph 2.

4. The procedures provided for in this Article shall also apply if any difficulty should arise in the supply of certain products.

CHAPTER 2—BALANCE OF PAYMENTS

ARTICLE 104

Each Member State shall pursue the economic policy needed to ensure the equilibrium of its overall balance of payments and to maintain confidence in its currency, while taking care to ensure a high level of employment and a stable level of prices.

ARTICLE 105

1. In order to facilitate attainment of the objectives set out in Article 104, Member States shall coordinate their economic policies. They shall for this purpose provide for cooperation between their appropriate administrative departments and between their central banks.

The Commission shall submit to the Council recommendations on how to achieve such cooperation.

2. In order to promote coordination of the policies of Member States in the monetary field to the full extent needed for the functioning of the common market, a Monetary Committee with advisory status is hereby set up. It shall have the following tasks:

- to keep under review the monetary and financial situation of the Member States and of the Community and the general payments system of the Member States and to report regularly thereon to the Council and to the Commission;
- to deliver opinions at the request of the Council or of the Commission or on its own initiative, for submission to these institutions.

The Member States and the Commission shall each appoint two members of the Monetary Committee.

ARTICLE 106

1. Each Member State undertakes to authorise, in the currency of the Member State in which the creditor or the beneficiary resides, any payments connected with the movements of goods, services or capital, and any transfers of capital and earnings, to the extent that the movement of goods, services, capital and persons between Member States has been liberalised pursuant to this Treaty.

The Member States declare their readiness to undertake the liberalisation of payments beyond the extent provided in the preceding subparagraph, in so far as their economic situation in general and the state of their balance of payments in particular so permit.

2. In so far as movements of goods, services, and capital are limited only by restrictions on payments connected therewith, these restrictions shall be progressively abolished by applying, *mutatis mutandis*, the provisions of the Chapters relating to the abolition of quantitative restrictions, to the liberalisation of services and to the free movement of capital.

3. Member States undertake not to introduce between themselves any new restrictions on transfers connected with the invisible transactions listed in Annex III to this Treaty.

The progressive abolition of existing restrictions shall be effected in accordance with the provisions of Articles 63 to 65, in so far as such abolition is not governed by the provisions contained in paragraphs 1 and 2 or by the Chapter relating to the free movement of capital.

4. If need be, Member States shall consult each other on the measures to be taken to enable the payments and transfers mentioned in this Article to be effected; such measures shall not prejudice the attainment of the objectives set out in this Chapter.

Article 107

1. Each Member State shall treat its policy with regard to rates of exchange as a matter of common concern.

2. If a Member State makes an alteration in its rate of exchange which is inconsistent with the objectives set out in Article 104 and which seriously distorts conditions of competition, the Commission may, after consulting the Monetary Committee, authorise other Member States to take for a strictly limited period the necessary measures, the conditions and details of which it shall determine, in order to counter the consequences of such alteration.

Article 108

1. Where a Member State is in difficulties or is seriously threatened with difficulties as regards its balance of payments either as a result of an overall disequilibrium in its balance of payments, or as a result of the type of currency at its disposal, and where such difficulties are liable in particular to jeopardise the functioning of the common market or the progressive implementation of the common commercial policy, the Commission shall immediately investigate the position of the State in question and the action which, making use of all the means at its disposal, that State has taken or may take in accordance with the provisions of Article 104. The Commission shall state what measures it recommends the State concerned to take.

If the action taken by a Member State and the measures suggested by the Commission do not prove sufficient to overcome the difficulties which have arisen or which threaten, the Commission shall, after consulting the Monetary Committee, recommend to the Council the granting of mutual assistance and appropriate methods therefor.

The Commission shall keep the Council regularly informed of the situation and of how it is developing.

CHANCELLOR OF THE EXCHEQUER

C.

Robert Culpin and I will be at No 11 in time for a 7am departure.

Focus on brief A1. Stoltenberg will doubtless have cast more light on this.

The tin note (Brief I) may need changing in the light of developments.

__Bilaterals__ likely with:

1) Lord Cockfield - on VAT Exemption limit;

2) M. Delors - "

3) Mr Catalan (Spain) - on Spains 1986 EC Budget position.

Worth remembering that Anglo-French Summit is going on at the same time elsewhere.

Ro 15/11

2. The Council, acting by a qualified majority, shall grant such mutual assistance; it shall adopt directives or decisions laying down the conditions and details of such assistance, which may take such forms as:

(*a*) a concerted approach to or within any other international organisations to which Member States may have recourse;

(*b*) measures needed to avoid deflection of trade where the State which is in difficulties maintains or reintroduces quantitative restrictions against third countries;

(*c*) the granting of limited credits by other Member States, subject to their agreement.

During the transitional period, mutual assistance may also take the form of special reductions in customs duties or enlargements of quotas in order to facilitate an increase in imports from the State which is in difficulties, subject to the agreement of the States by which such measures would have to be taken.

3. If the mutual assistance recommended by the Commission is not granted by the Council or if the mutual assistance granted and the measures taken are insufficient, the Commission shall authorise the State which is in difficulties to take protective measures, the conditions and details of which the Commission shall determine.

Such authorisation may be revoked and such conditions and details may be changed by the Council acting by a qualified majority.

Article 109

1. Where a sudden crisis in the balance of payments occurs and a decision within the meaning of Article 108 (2) is not immediately taken, the Member State concerned may, as a precaution, take the necessary protective measures. Such measures must cause the least possible disturbance in the functioning of the common market and must not be wider in scope than is strictly necessary to remedy the sudden difficulties which have arisen.

2. The Commission and the other Member States shall be informed of such protective measures not later than when they enter into force. The Commission may recommend to the Council the granting of mutual assistance under Article 108.

3. After the Commission has delivered an opinion and the Monetary Committee has been consulted, the Council may, acting by a qualified majority, decide that the State concerned shall amend, suspend or abolish the protective measures referred to above.

CHAPTER 3—COMMERCIAL POLICY

Article 110

By establishing a customs union between themselves Member States aim to contribute, in the common interest, to the harmonious development of world

Annex B.

Brussels, 5 November 1985
II/582/85-EN

[illegible] LB

(1) Explicit reference to EMU

(2) Reaffirm EMU - by EMS & other means

(3) EMCF [illegible] the EMS

(4) Delete the independence [illegible] UK

MONETARY PROVISION

Article 107 is completed as follows :

1. Member State shall treat its policy with regard to rates of exchange as a matter of common concern and shall cooperate in the framework of the EMS.

   The EMS aims to contribute to a better stability within and outside of the Community.

   The EMS includes a mecanism of exchange rates and interventions for Community currencies in which participate those Member States which be able to assume the obligations flowing therefrom. The European currency unit (ECU) is the foundation of the system : it is used in particular for the settlements between the monetary authorities of the Member States.

2. If a Member State makes an alteration in its rate of exchange which is inconsistent with the objectives set out in Article 104 and which seriously distorts conditions of competition, the Commission may, after consulting the Monetary Committee, authorise other Member States to take for a strictly limited period the necessary measures, the conditions and details of which it shall determine, in order to counter the consequences of such alteration.

3. The European Fund for Monetary Cooperation enjoys the autonomy necessary for the performance of its tasks. Its board of directors is composed of the Members of the Committee of Governors of Central Banks of the Member States and of a representative of the Commission. Decisions are taken unanimously by the representatives of Member States participating in the mechanism of exchange rates and interventions of the EMS.

4. The European Fund for Monetary Cooperation will be replaced, at the appropriate moment, by a European Monetary Fund which will enjoy institutional autonomy.

   To this end, on a proposal from the Commission and after consulting the European Parliament, the Council may, acting unanimously, lay down the appropriate provisions which it shall recommend to the Member States for adoption in accordance with their respective constitutional requirements.

CONFIDENTIAL

Annex C

MONETARY AMENDMENTS TO THE TREATY

The Monetary Committee met in Brussels in restricted session on Saturday, 9 November. Between 11 a.m. and 3.30 p.m. there was a discussion of the ideas for incorporating a "monetary dimension" in the E.C. Treaty. The Delors proposals for amendments to Article 107 were on the table (copy attached).

2. This report is divided into two parts. First a summary of the views expressed by each member who spoke and then an account of some conversations in the margin and suggestions according with them which were made by the Chairman, Tietmeyer.

Views of Members

3. The Chairman asked that at least one Committee member from each country should express his views on three questions:

(1) whether monetary amendments to the Treaty were necessary or desirable (and he added that the Committee should try to look at this from the technical point of view, as well as noting political positions);

(2) what did members think of the Delors proposals in this connection;

(3) were there alternatives which would be preferable.

Answers were offered by the following members and in the following order.

4. **RUSSO (Commission):**

(1) Yes. Amendments were being sought in four major areas: the internal market, technology, social services and the economic and monetary field. It would be damaging to omit the last. (He later added that, since the idea of monetary amendments was now under public discussion, a decision against them would be seen as a retreat).

(2) The essence of the Delors proposals was to embody four elements: to confirm the legitimacy of action taken on the EMS, ERM, ECU and EMCF; to state the target of the complete development of the EMCF; to assert the aim of exchange rate stability both inside and outside the Community; and to express the positive solidarity of participants in the ERM.

(3) No alternatives: the Commission thought the Delors proposals captured the essence of what was needed.

5. **SZASZ (Netherlands Central Bank):**

(1) Treaty amendment would be needed to establish Economic and Monetary Union (EMU) - but that was not at issue now. Treaty amendment would also be needed for the final stage of the EMS - but again that was not at issue now. We were not ready for anything that needed Treaty amendment in the monetary field, although he wished we were.

(2) The Delors draft involved major changes. Incorporating the EMS in the Treaty brought a wide range of decisions under Article 235 and provided no room for autonomous Central Banks (they would be superseded by the Council acting on Commission recommendations); in individual countries the law set tasks for Central Banks and this gave them a locus and autonomy in it; there were some important checks and balances between Governments and

Central Banks. The Delors draft neither spelled out tasks nor defined autonomy of the EMCF; and it ignored fiscal and other economic responsibilities and was therefore fundamentally unbalanced.

(3) We should concentrate on practical decisions, not on Treaty language.

6. **GLESKE (Bundesbank):**

(1) Entirely a political question.

(2) Strongly supported Szasz throughout, especially on the problems of competence and balance. He added two new points: paragraph 3 of the draft would be the first ever public recognition of a 2-tier Community and he thought this was undesirable; the treatment of the ECU was dangerous (his specific point proved to be partly a translation problem - the English text is stronger than the French - but he maintained his view that it was foolish to specify this kind of mechanism in a Treaty).

(3) No offers.

7. **SARCINELLI (Italian Treasury):**

(1) Politically impossible not to have monetary dimension.

(2) Delors amendments too detailed and too weak. Paragraph 3 (the 2-tier proposal) should be dropped. The draft should be more ambitious on rules, institutions and instruments. General objectives should go in the Preamble.

(3) Hoped the Luxembourg and other ideas could be combined.

8. **LEBEGUE (French Tresor):**

(1) A political necessity for the French government. Vital to take the rare opportunity of Treaty amendment now to incorporate the "acquis communautaire" in the monetary field. Failure to do so would be seen as a defeat.

(2) Delors had provided a good basis, but it could be improved. The architecture he would seek would begin with a descriptive passage in general terms on EMS, ERM, ECU, EMCF, then (going further than Delors) give a statement of the EMU objective and refer to some elements such as convergence, financial integration, and liberalisation of capital movements. He thought paragraph 3 "un peu brutal" in its formulation (he later made clear that he had no problem with the idea) and too much fuss was being made about problems of competence and decision-making, where the draft did not really change what existed already.

(3) Improve on Delors as he had indicated.

9. **LITTLER (UK):**

(1) Could see no technical need for amendment (and had not heard of any today). Lack of Treaty provisions had not prevented good progress so far, and their presence would not have helped. This would continue to be the case. He agreed with Szasz that full EMU or the final stage of EMS would need Treaty provisions; but when we reached that stage we could make them and would not be inhibited by whatever lapse of time from the previous date of Treaty amendments.

(2) The Delors draft was full of general and ambiguous language which would make a lawyer's paradise: on such

issues as Commission competence, autonomy, relations with non-EEC currencies and the IMF, and the nature of the ECU and consequent obligations. On paragraph 3 he thought there were good technical grounds for avoiding non-voting (but subscribing) shareholders; and it was a pity from the political point of view that it had been published.

(3) His preferred alternative would be no amendment.

10. **JANSON (Belgian Bank):**

(1) Desirable for political reasons.

(2) The Delors draft was inadequate and in some respects ambiguous: it could complicate future business.

(3) A better draft would focus on the EMU objective, not on mechanisms; the concept of convergence should be included; and reference to a future EMF must provide for its statutory independence from the Council.

11. **DOYLE (Irish Finance Ministry):**

(1) There was no need on technical grounds. We had made progress without specific Treaty assistance - or constraints: there had been advantage in being able to tackle our problems with total flexibility.

(2) The Delors draft was sloppy and unimaginative. Some of the points it specified could be inappropriate in a few years. And it was full of ambiguities which would cause difficulty, to which others had drawn attention.

(3) If there was a political imperative, he deplored the way it was being handled. To argue that, because the Treaty was only amended at 20/30 year intervals, we must now agree some complex drafting by 2 December was absurd. We should decide in principle what kind of provisions we wanted, and then undertake a thorough process of drafting with legal advice.

12. **LAGAILLETTE (Banque de France):**

(1) Suggested there was one technical argument in favour of Treaty provision: it would be seen as a move fostering stability, which was an objective for us all. (This was the only attempt in the whole discussion to state a positive technical argument).

13. **USSING (Danish Economics Ministry):**

(1) The EMS had developed well without Treaty provision. If amendments were needed elsewhere, it would be natural to cover monetary questions, although the IGC was not the right forum for this. The essential point was that any Treaty language should not change present monetary arrangements.

(2) The Delors draft did involve changes, including some that were contentious or of uncertain effect, and he opposed this.

(3) There should be minimal changes only; and he would be cautious at this stage about referring to EMU.

14. **DEMOS (Greek Finance Ministry):**

(1) He supported the principle of the proposed amendment.

(2) The drafting was too loose and vague and it contained specific proposals which needed more study.

(3) More discussion was needed.

15. **MULLER-ENDERS (German Finance Ministry):**
(1) On technical grounds there was no need for any Treaty amendment and it would be best to preserve the lack of Treaty constraint in the interests of flexibility.
(2) The Delors draft was unsatisfactory. For a document designed to be valid for 20 years or so before the next amendment it was absurd to specify intermediate stages in monetary development: for example, as we moved towards EMU the whole concept of balance of payments imbalances and their settlement between the member states would cease to have any validity. By focussing on monetary and ignoring fiscal and other areas, the draft was pathetically unbalanced. And the concept of a 2-tier Europe was not acceptable.
(3) If anything had to be included, he would like to try to express the EMU objective, but making it clearly subject to unanimous agreement when the time might be ripe.

16. **KIRSCH (Luxembourg):**
(1) Essential on political grounds.
(2) Delors text a good basis, but too descriptive in detail on the present mechanisms, and not strong enough on the objective of EMU.
(3) He would prefer a general statement of objectives in the preambular part of the Treaty. We should vet the drafting carefully to avoid risks of misinterpretation.

POSSIBLE WAYS FORWARD

17. In an opportunity just before the meeting I asked Tietmeyer privately what the German position was. He said he personally thought the whole idea of monetary amendments silly. But he went on to say with heavy earnestness that it was a matter of vital political importance to Mitterand that there should be progress in this area in the Treaty discussions. I interjected that it was of equal political importance to others to avoid presenting to their Parliaments nonsenses which those Parliaments might refuse to ratify, and he should be under no illusion about the potential lack of enthusiasm of the British Parliament, and about the way in which the resistance of the British Government would be fortified by worries over this.

18. Tietmeyer said he fully understood. The German Government was very close to us on substance. But he had been looking for some positive reconciliation. He then outlined the idea of using a strong reference to the objective of EMU (to satisfy the French) but governed by a clause making decisions on that subject to the unanimity rule or directly to votes by National Parliaments. I said that I would want to look at any such proposal critically and make sure it left no loophole for Commission lawyers to exploit, and Tietmeyer warmly agreed. Beyond that, I said it was as much a political matter for us as for others and I could not go further.

19. After the collection of views of members reported above, Tietmeyer said that a wide range of views had been expressed and he would like informally to explore possible common elements, of which he saw two:

- general agreement on the objective of EMU, qualified by the need for new Treaty changes or unanimous national decisions to make moves to it and by the understanding that the text must involve no juridical change in present Community practice or the position of Central Banks; and

- perhaps a willingness of all to undertake that they would seek, in their own national and independent policies, to move towards the conditions which would make EMU possible eventually; ?

and in the light of some immediate comments he then added:

- that member states would cooperate together in pursuing their independent policies (Dutch suggestion); and
- "within the context of the EMS" (responding to French insistence that a way must be found of mentioning EMS).

20. There seemed to me to be a hint of stage-management in the way in which this succession of ideas was developed. Tietmeyer discouraged discussion. Lebegue said it was an interesting basis but if Tietmeyer was reporting he should make clear that itdid not go as far as some would wish; I said that in that case he should also make clear that it went further than some thought necessary or even desirable.

21. Tietmeyer closed the discussion with a brief and broadly satisfactory outline of the report he would make to ECOFIN of the views expressed by Committee members.

Brussels, 5 November 1985
II/582/85-EN

monetary is

The EMS ~~provides~~ (not shall provide) a framework for this cooperation and aims to contribute to a zone of monetary stability with the Community.

MONETARY PROVISION

Article 107 is completed as follows :

(and cooperate)

1. Member State shall treat its policy with regard to rates of exchange as a matter of common concern, and shall cooperate in the framework of the EMS.

   Zone of monetary stability

   The EMS aims to contribute to a better stability within and outside of the Community.

   The EMS includes a mecanism of exchange rates and interventions for Community currencies in which participate those Member States which be able to assume the obligations flowing therefrom. The European currency unit (ECU) is the foundation of the system : it is used in particular for the settlements between the monetary authorities of the Member States.

2. If a Member State makes an alteration in its rate of exchange which is inconsistent with the objectives set out in Article 104 and which seriously distorts conditions of competition, the Commission may, after consulting the Monetary Committee, authorise other Member States to take for a strictly limited period the necessary measures, the conditions and details of which it shall determine, in order to counter the consequences of such alteration.

3. The European Fund for Monetary Cooperation enjoys the autonomy necessary for the performance of its tasks. Its board of directors is composed of the Members of the Committee of Governors of Central Banks of the Member States and of a representative of the Commission. Decisions are taken unanimously by the representatives of Member States participating in the mechanism of exchange rates and interventions of the EMS.

4. The European Fund for Monetary Cooperation will be replaced, at the appropriate moment, by a European Monetary Fund which will enjoy institutional autonomy.

   To this end, on a proposal from the Commission and after consulting the European Parliament, the Council may, acting unanimously, lay down the appropriate provisions which it shall recommend to the Member States for adoption in accordance with their respective constitutional requirements.

2332/6

CONFIDENTIAL

NOTE FOR THE RECORD

cc Sir G Littler
Mr Lavelle
Mr Fitchew
Mr Kelly
Mr Mortimer

MONETARY AMENDMENTS TO TREATY
DISCUSSION WITH MORAWITZ, 12 NOVEMBER

Finding myself next to Morawitz at the EIB lunch yesterday, I took the opportunity to question him about the likely evolution of the German position on monetary amendments to the Treaty.

2. Morawitz said that, almost without exception, German officials were strongly opposed to any monetary amendments to the Treaty. Stoltenberg was of the same persuasion and would argue his case strongly in the German Cabinet. However, Genscher at the Foreign Ministry and Bangeman at the Economics Ministry (who is likewise from the FDP) were strongly of the opposite persuasion. They would both like to see new monetary language in the Treaty. Morawitz had no doubt that, when it came to the point of decision, Kohl would accept the advice of Genscher and Bangeman and overrule Stoltenberg, partly for reasons of coalition politics and partly because his grasp of the issues at stake was limited.

3. Mr Morawitz said that he regretted this very much, as did almost all other officials in Bonn. He just hoped that Britain or some other member state would hold out against Treaty amendments in this area.

4. On substance, Morawitz said that the kind of amendment which the German Government was likely eventually to support would be one which enshrined in the Treaty the ultimate objective of economic and monetary union. This was what Tietmeyer had been examining informally with others in Bonn and elsewhere. Tietmeyer had been the brains behind the Werner report on economic and monetary union of some years ago and had a proprietary interest in the subject. The prevailing view in the departments

1603/10

ECOFIN 18 NOVEMBER

BRIEF A2

ECONOMIC ITEMS WHICH COULD BE RAISED AT THE EUROPEAN COUNCIL: THE COMMISSION'S IDEAS ON A COMMUNITY PROGRAMME FOR INFRASTRUCTURE INVESTMENT

OBJECTIVE

To listen to what the Commission has to say, to avoid implicit or explicit commitment to any extension of Commission action in this area, and to request that any Commission paper for the European Council be circulated to Finance Ministers in good time.

LINE TO TAKE

[If general discussion]	Infrastructure investment important, but only of benefit if justified by rates of return. Any expenditure from Community Budget must of course be subject to budget discipline.
[On possibility of new Community financing instrument]	Not at all convinced of need for new instrument. Private banking sector and EIB cater well for Community's infrastructure needs. Cannot ignore impact of additional Community borrowing on capital markets.
[On possibility of new guarantee system for infrastructure]	Do not see any advantages in national or Community guarantees for projects which would not otherwise go ahead. If projects have good rates of return, guarantees not required.

[On Commission paper for European Council]	If there is to be a paper for European Council, would be helpful if text could be circulated well in advance.
[Only if pressed on medium term transport infrastructure programme]	Should be left to Transport Ministers. Understand discussions are continuing in Brussels at official level.
[If pressed on New Community Instrument IV]	Are considering the Commission's proposals. Would want to see improvements in the management of the New Community Instrument before comtemplating an extension.

BACKGROUND

We think that the Commission will make an oral statement on economic items to be raised at the European Council "to introduce a policy debate". The content of this statement is anyone's guess, but the betting is that the Commission will outline its ideas on a Community programme for infrastructure investment.

2. In the annual economic report, the Commission outlines the benefits of a co-ordinated infrastructure strategy, with particular reference to transport, telecommunications and environmental protection. The report recommends that the Community should "facilitate the advancement of the projects, inter alia through the easing of administrative and fiscal conditions [and] through the development of its own financial instruments."

3. At the moment, Community support for infrastructure is through:

(a) the Community Budget, mainly projects part financed by the Regional Fund, and a fairly small experimental support programme for transport infrastructure.

(b) the Community's borrowing and lending instruments principally the European Investment Bank, but also the New Community Instrument and, for energy projects, Euratom. Under these instruments, the EIB/Commission borrow on the capital markets, and on-lend for investment projects.

There is currently on the table a more ambitious medium term transport infrastructure programme (a Commission proposal), but this is bogged down in discussion at working level in Brussels. This could involve both Budget Finance and Community lending. If there is to be an programme, we would prefer the latter rather than the former, but decisions on this are a long way off, and at this stage we would presume that any associated lending would be absorbed within the EIB's activity.

4. It is known, however, that the Commission are currently conducting a study on the scope for Community action on infrastructure, which presumeably relates directly to the recommendation in the annual economic report. It is this which they may decide to outline to the Council. We understand that the Commission is commissioning a study by outside consultants (Telesis) which would:

(i) identify large infrastructure projects of Community interest CFL?

(ii) identify the best administrative framework for such projects

(iii) look at the possible contribution of the Community's financing instruments.

On (iii), we think that the Commission are considering a new borrowing/lending instrument purely for infrastructure, and/or a guarantee system for infrastructure projects. This impression is strengthened by the fact that the current Commission proposal for extending the New Community Instrument (NCI III is approaching exhaustion, and there is a draft Council Decision for a new NCI IV) excludes infrastructure. (Discussion on the NCI IV proposal will begin in Brussels very shortly). Also, some of the proposals for Treaty amendment being put forward in the Inter Governmental Conference also refer - somewhat ominously - to the Commission's borrowing and lending powers.

5. We would not wish to support the introduction of a new Community borrowing/lending instrument. There seems little need for it, given the EIB and the (conventional) NCI. Account must be taken of the impact of additional Community borrowing on the capital markets. Nor would we favour any schemes of national of Community guarantees for risky investments which might not otherwise be carried out.

(6. In fact, we would favour abolition of the NCI. There is little need for this, given the EIB, and the Commission have managed to make a loss on it in recent years. But getting rid of it is probably not possible, given its role in Integrated Mediterranean Programmes.)

7. So, if the Commission's remarks get as far as suggesting a new Community infrastructure borrowing/lending instrument, you should indicate scepticism as in the line to take. You should find that the Germans and the Dutch have similar views.

8. More generally, if there is general discussion, it cannot be said too often that infrastructure projects must be justified in terms of rates of return, and (if appropriate) any Community Budget expenditure must be subject to Budget Discipline.

9. Finally, The Commission are in the habit of producing a paper on the economic situation immediately before the European Council, so that there is not time to digest it. Whether they will produce a paper for this Council is not clear. But we suggest you ask that any paper for the Council be circulated well in advance.

CONFIDENTIAL

Sir G. Littler will bring you on the spot

ECOFIN 18 NOVEMBER: GREEK MEASURES BRIEF B

UK OBJECTIVE/LINE TO TAKE

This will have to be finalised after the Monetary Committee meeting on Sunday evening, when the Commission proposal on a CLM loan to Greece, and the conditions to be attached to it, will be discussed. But it will probably cover the following points:

(a) the size of loan, and its staging (perhaps in two tranches)
(b) rapid dismantling of the import deposit scheme
(c) (supporting others) a reduction in the higher rate of the import deposit scheme
(d) (also supporting others) a transfer of some items from the higher to the lower rate in the import deposit scheme
(e) limiting in some way the blocking or deferring of imports by the public sector
(f) the payment of own resources on a notional VAT basis, if Greece are permitted to postpone the introduction of VAT.

If a loan is agreed, you should request, at the end of the discussion, that the Monetary Committee should consider the terms and conditions of the Commission's borrowing, as they did for the French loan in 1983.

BACKGROUND

1.On 11 October, the Greek government announced a series of measures to improve Greece's economic position, and to deal with a balance of payments problem. The details of the measures are given in a letter from the Greek Minister for Economic Affairs to the Council - copy at Annex 1 to this brief. In addition, the Greeks are seeking to delay the introduction of VAT, and to extend restrictions on capital movements, beyond the end of this year. (Up to the end of this year, these derogations have been allowed as part of Greece's transitional accession to the Community). Some of the measures, particularly the import deposit scheme and the capital restrictions, come within Community competence. The import deposit scheme has been implemented under Article 109 of the Treaty of Rome, which allows member states to take protective measures if a sudden balance of payments crisis occurs. The extension of the capital restrictions (and the continuation of the import deposit scheme) would be under Article 108(3), which allows the Commission (subject to passive approval by the Council) to authorise protective measures if, after examination, other measures are deemed insufficient to meet the problem.

2. Greece indicated also that it expected consideration of "mutual assistance" from the Community, provided for under Article 108 in the event of balance of payments difficulties. The "assistance" would take the form of a loan under the Community Loan Mechanism (CLM). This involves the Commission borrowing on the capital market, on its own credit rating, and on-lending to Greece. There is enough room within the present CLM ceiling for the size of loan likely to be made to Greece. Any CLM loan would be subject to Greece taking the necessary domestic measures to correct its balance of payments problem. Before making a recommendation on

mutual assistance to the Council, the Commission must, under Article 108 and the Council Decision setting up the CLM, consult the Monetary Committee. A CLM loan requires Council unanimity.

3. A copy of Articles 108 and 109, and a copy of the CLM texts, are at Annex 2 to this brief.

4. The sort of package we might like to see would include the following:

(a) a loan of not more than 1000 mecu in two tranches, perhaps now and in January 1987, with the second tranche being conditional on a review of performance, and the setting of new targets for 1987.

(b) a specific time limit for phasing out the import deposit scheme not later than mid 1987, and a reduction in the maximum rate from 80% to 50% ideally now or, if not, during 1986.

(c) dropping of, or at least a time limit on, the Greek proposal for blocking or deferring imports by public sector agencies

(d) if there is a derogation to allow Greece to postpone the introduction of VAT, Greece should not benefit from this, but should pay own resources on a notional VAT basis.

5. The Monetary Committee first discussed the Greek measures on 25 October, and the Chairman, Herr Tietmeyer, made an oral statement to ECOFIN on 28 October - copy attached at Annex 3 to this brief. (The Monetary Committee was particularly concerned about the import deposit scheme.) Substantive discussion was expected at this ECOFIN.

6. Since the October ECOFIN, the Commission has been discussing the matter with the Greek government. We understand that Greece has now formally applied for a CLM loan, and that the Commission have reached agreement with Greece on a package of conditions for the loan. We are expecting a paper for the Monetary Committee meeting setting out the details. Meanwhile, we think that the proposed package includes the following (see UKREP telegram 3843 - Annex 4 to this brief):

(a) modifications to the import deposit scheme, with four items being transferred from the higher rate (80%) to the lower rate (40%).

(b) a start in dismantling the import deposit scheme in between six and twelve months time, with full dismantling after not more than 18 months

(c) Greek introduction of VAT on 1 January 1987, but for Greece to pay own resources in 1986 on a notional VAT basis.

(d) the opening up of the petroleum monopoly to other member states from 1 January 1986.

(e) continuation of the export subsidy scheme until 31 December 1986.

(f) extension of some capital restrictions for three years.

The Monetary Committee will meet on 17 November to discuss the Commission's proposals, and will report to ECOFIN. Sir Geoffrey Littler will attend the Monetary Committee meeting, and will give you supplementary briefing before ECOFIN.

7. The DTI have suggested that the line to take on the import

deposit scheme might be the following. The Commission package is a weak response, but it would be wrong for the UK to take the lead in attacking it. If, however, other member states attack it, or seek further modifications, the UK could press for, as appropriate:

(a) further tranfers from the higher to the lower rate, notably whisky, foodstuffs and confectionary, and all ceramics and tableware (instead of just ceramic tiles).
(b) a reduction in the higher rate, say to 60% (from 80%)
(c) dismantling of the scheme to begin in six months at the latest.

8. The reasons for requesting a Monetary Committee discussion of the terms of the Commission's borrowing for a CLM loan are as follows (not for use):

(a) to keep an eye on the Commission - they made rather a mess of the recent refinancing of the French loan.
(b) so that the Bank of England can make sure that the City gets a share of the business.

<u>Parliamentary Scrutiny</u>

7. It is possible, depending on the outcome of the Monetary Committee discussion, that the Council will want to agree on a CLM loan for Greece. A CLM loan requires a formal Council Decision. In general, Commission proposals for Council Decisions are subject to scrutiny by the UK Parliament, and should not be agreed by the UK until this process is complete. Therefore, we should strictly put a Parliamentary reserve on any loan proposal which is otherwise agreeable. However, until we receive the Commission's proposed Council Decision, we cannot be certain if it falls into the category of document subject to scrutiny. Moreover, it seems that the last proposal, for a CLM loan for France in 1973, was not submitted for Parliamentary scrutiny, perhaps because no proper documentation was ever received.

8. Therefore, if there is a Council Decision on a loan, and, for reasons of tactics, urgency or confidentiality, a Parliamentary reserve causes problems, it is probably worth the risk not putting on a reserve. In this event, we will try to persuade Cabinet Office that we should follow the France precedent. But a lot will depend on the documentation, and, if Cabinet Office cannot be so persuaded, it would be necessary for you to explain the adoption of the Decision in advance of scrutiny to the House. This would involve a letter to the Chairmen of the Scrutiny Committees, and, if the Committees requested it, a statement to the House.

770/54

C/ v. useful.

REDRAFT OF 2(b) OF BRIEF

Indirect tax harmonisation (not a Milan priority) raises issues barely touched upon in the White Paper, including:

- The effect on member States' fiscal policy. Some would suffer significant reductions in revenue from indirect tax, leading to more direct tax, a cut in expenditure, or higher deficits, all with major macro-economic implications.

- The effect on the balance between direct and indirect taxes. Member States would lose the flexibility to decide the right balance, and to adjust it. For example, some members want to reduce the burden of direct taxation so as to improve incentives and increase the freedom of the individual to decide how to spend his own income.

- The effect on regional and social policies. For example, changes in VAT coverage could have important implications in this area.

- The effect on industrial policy. For example, the level of duties on wine and beer is important to States producing them.

- The effect on the working of the market. We need to consider the relative importance of differences in tax in creating major distortions. There are other causes which may be more important. Which should have priority?

- The effect on traders. How great would be the extra burdens imposed on traders by the clearing house system proposed by the Commission? The Council are concerned to reduce the burdens on business.

- As politicians.....[as at present].

Therefore (c) This means proper studies of <u>all</u> possible approaches to tax problems associated with internal market: the assessment of current distortions and delays and other means of minimising them: the necessity for tax approximation and the practicality of any proposed measures. Rigorous cost/benefit approach required. Only after this can sensible decisions of principle be arrived at. which

must set out Commission proposals

<u>Lines to take</u>

[If Commission proposal for a standstill on VAT rates is raised] Not seen it. Therefore unable to comment in detail. This discussion dealing with the major issues of principle rather than individual proposals.

<u>Background</u>

This is to be a 'political' discussion on the issue of tax approximation, which Finance Ministers agreed (at the September ECOFIN) should be held as the start of substantive debate. At the October ECOFIN Lord Cockfield exhorted Member States to take the necessary decisions on tax early so that the internal market could be completed by 1992. (He has since put in a lot of propaganda work : a speech to European journalists on 4 November* was a scarcely veiled attack on UK resistance to parts of the White Paper; and on 7 November he announced a Commission proposal, not yet seen in print, for a standstill on VAT rate changes as a necessary starting point for essential approximation.*)

Few Member States are keen on tax approximation: indeed as far as we can tell only the Belgians really want to make progress. However, several seem likely to parade now a high-toned attitude of being generally in favour of working towards fiscal harmonisation, even if at a later stage difficulties appear insuperable. Only the Danes are likely to be open in their opposition. The Irish and Greeks may be prepared to suggest that further study is necessary before difficult issues of principle are decided.

*See attachments

ECOFIN, 18 NOVEMBER

SUBJECT: ANNUAL ECONOMIC REPORT BRIEF D

DOCUMENT: ANNUAL ECONOMIC REPORT 1985-86

UK Objectives

1. The Commission's Annual Economic Report for 1985-86 will be discussed at the request of the Dutch. There was a first exchange of views on the report at the October ECOFIN. Then should be no question of this meeting adopting the report; normally this is not done until the December meeting of ECOFIN.

Points to make

1. Annual Economic Report broadly welcome. Contains much that UK government agrees with. But all such documents likely also to contain ideas that are less welcome.

2. Regret that figures for growth and employment over period 1986-90 are present as objectives. Figures depend on particular economic model, may be on high side. Could raise expectations unnecessarily. Prefer to see figures as illustrative rather than as targets.

3. Not right that report calls for pledges by the social partners on incomes and labour market adjustments in exchange for actions by governments. Need to see action by social partners, especially lower real wage growth.

4. Would prefer more cautious line on calls for increased infrastructure investment. Must have due regard to rates of return and budgetary considerations.

5. But many positive points. Particularly welcome is continued emphasis on need for monetary policy to provide framework for stability by reducing inflation and stabilising exchange rates. Also agree with report's emphasis on moderation of real wage increases and greater flexibility in labour markets as necessary conditions for fall in unemployment.* Report's general tone that boosting demand would do more harm than good, lead to higher inflation, no long-term employment gain is right. But feel there might be tendency to demand boost rather than demand support in some parts of report.

* Look forward to discussion of Economic Policy Committee's report on labour market flexibility (should do this) at next Ecofin. (EPC Chairman referred to this report in his statement on annual report at October Ecofin.)

Background

1. The Annual Economic Report for 1985-86 has been adopted by the Commission and was published on 16 October. It is now sent to the Council for adoption. The Report was discussed at the October ECOFIN meeting, and is on the agenda for this meeting at the request of the Dutch. It is normally adopted at the December ECOFIN.

2. The Report comprises 186 pages, including a section devoted to the United Kindgom and similar sections devoted to the other member countries. It is a development of the themes of last year's Report. The principal aim remains to find a means of achieving "a substantial and durable improvement in the employment situation". There is more emphasis in this year's Report on ensuring total demand is sufficient by the relaxation of fiscal policy and on a cooperative strategy between "the Community, governments of member states and the social partners". However, there is a clear recognition that increasing demand alone is insufficient to bring about an increase in employment and that moderation of real wage increases is equally important. The Report generally makes it clear that while maintaining a sufficient amount of demand is desirable, providing a demand "boost" to the economy would not produce any long-term economic benefits, but the message is not as clear as we might wish in places.

3. The Report sets an objective of achieving output growth of 3½ per cent per annum over the next five years. This is slightly higher than the growth rate suggested for the Community by the Treasury's own latest assessment of world economic prospects. The Report suggests that such output growth, if accompanied by appropriate measures could lead to a 1½ per cent per annum increase in employment and a fall in the Community's unemployment rate from about 11 per cent now to 7 per cent by 1990. This seems optimistic.

4. The Report suggests a range of measures are required to achieve these objectives:

(i) Monetary policy conducted to reduce inflation further but to allow room for faster real growth.

(ii) Budgetary policies at a micro-economic level to favour employment creation. Tax cuts and infrastructural investment are mentioned specifically.

(iii) International policies to improve the freedom of trade and to mitigate the developing countries' debt problem.

(iv) Moderate increases in real wages.

(v) Initiatives to improve labour market flexibility.

(vi) Improved policies designed to open up the Community's internal market.

(vii) Greater investment in Europe's economic potential in the widest sense, eg through major transport projects and environmental investment.

There is little to quarrel with among these suggestions, although the government might want to place the emphasis in a different way from the Report.

5. Two themes run through the Report and are seen as crucial to the achievement of the stated objective. First, governments should ensure that macro-economic policies are providing enough demand in their economies. Germany is identified as the one country were domestic demand may be insufficient and fiscal policy could be relaxed. The UK is included with Denmark, France and the Netherlands in a group of countries which could find themselves with room to manoeuvre on fiscal policy in the near future. Second, co-operation between the social partners is regarded as vital in ensuring that growth is employment creating. This would be achieved by lower real wage increases and more labour flexibility.

6. The Dutch are known to be unhappy with some aspects of the report and they have insisted on it being discussed at this meeting. The Germans are certain to be critical of the suggestions that their economy has room to manoeuvre, eg by bringing forward to 1987 tax cuts planned for 1988.

7. The section on the UK is reasonably satisfactory. The Commission forecast is generally less optimistic than our own. They expect lower output growth in 1986 - real GDP to increase by 2 per cent, although they do expect "some slight improvement in the outlook for the unemployment count". They are also pessimistic about inflation saying that it will be "difficult to bring the annual inflation rate below 5 per cent on a lasting basis".

8. There are a number of supportive statements in the Report. The effect on the UK's competitiveness of rapidly rising unit wages costs is pointed out, the beneficial effects for employment of cutting income tax, especially by increasing tax thresholds, is recognised and the need for moderation in the growth of real wages is regarded as vitally important. There are also, however, some less welcome statements. In particular, the Commission are in favour of extra public expenditure on infrastructure investment. There is also strong encouragement for full membership of the EMS to be given further consideration.

9. We could argue for the deletion of the reference to "the removal of fiscal frontiers" from the summary at the end of III.3.1 on the internal market (page 84). This would be on the grounds that removal of fiscal frontiers (or tax harmonisation) was not

one of the internal markt priorities identified at the June European Council, whereas the other five items were. However, although we oppose tax harmonisation, we do not want to be seen to oppose it for fear of endangering progress on other aspects of the internal market.

10. Mr Byatt, in his capacity as Chairman of the EPC, made the attached statement on the report to the October ECOFIN meeting.

ECOFIN 18 NOVEMBER BRIEF E

EURATOM LOANS

Relevant document: Commission proposal for a Council Decision to increase the Euratom lending ceiling - attached.

UK OBJECTIVE

To listen to the German worries, and, if the Germans express anxiety over Commission plans for infrastructure and Community borrowing and lending, to offer support. If the Germans lift their reserve on inceasing the Euratom lending ceiling, to agree to the adoption of the Commission's proposal on this.

LINE TO TAKE

(If vote on Commission proposal)	Agree.
(If Germans voice objections to increase in lending ceiling)	Say nothing.
(If Germans air worries about Commission ideas on Community borrowing/lending for infrastructure)	(As appropriate) Agree that while infrastructure is important, projects must be justified by rates of return, and take account of budgetary considerations and bugetary discipline. Agree that there is no pressing need for new lending instrument - private banking sector and EIB cater well for Community's infrastructure needs.

(See also infrastructure brief A2)

BACKGROUND

1. The Euratom loan scheme was set up in 1977 by means of a Council Decision. Under the scheme, the Commission borrows on the international capital markets, and on-lends to member states to contribute to the financing of nuclear power stations. The European Investment Bank is responsible for administering Euratom loans: it examines loan applications in accordance with its normal banking practice using the same criteria as for its own resources loans. In addition, the EIB customarily co-finances the projects from its own resources, within the constraint that total Community finance should not exceed 50 per cent.

2. The current Euratom lending ceiling is 2000 million ecu, agreed in 1982. In December last year, the Commission issued a proposal for a Council Decision to increase the ceiling to 3000 million ecu. At that point, the Commission reported that 1800 million ecu of the present ceiling had been taken up, and that there were agreed loans not then made of a further 1100 million ecu. (The Commission operates an approved loans "pool" so that if a project drops out, another can take its place easily).

3. In January of this year, a Department of Energy Minister (Mr Goodlad) wrote to the Economic Secretary, seeking the Treasury's agreement to the Commission's proposal. The Department of Energy supported the Commission's general aim of encouraging nuclear power development to reduce Community dependence on imported oil. We saw no reason to oppose the Department of Energy on this. Although UK use of Euratom loans has been small (see paragraph 4 below), the Commission indicated at the time that they were prepared to consider floating rate dollar lending (instead of a fixed rate mixture of currencies) under Euratom, which could make the loans a little more attractive to UK public sector borrowers. The proposed increase in the lending ceiling has no UK public expenditure implications. Therefore, in February of this year, the Economic Secretary wrote to Mr Goodlad, saying that we would agree to the Commission's proposal.

4. As far as UK use of Euratom loans is concerned, by the end of 1984, only 44 million ecu had been taken up - part of total approved loan of 159 million ecu to the South of Scotland Electricity Board for Torness. As far as we can see, no Euratom money has ever been raised in the UK.

5. In March, Coreper discussed the Commission's proposal, and all member states agreed it. However, Germany placed a Parliamentary reserve on it. In the event, a Committee of the Bundestag gave an unfavourable opinion on the proposal, and no further progress has been made. The issue was discussed at the Energy Council on 11 November, where the German Minister said that there were no energy reasons for opposing the increase in the ceiling, but that the final decision on this was for ECOFIN. We agree that this matter is for ECOFIN, as it concerns Community borrowing and lending.

6. The issue is on the agenda of this ECOFIN at the Germans' request. We do not have any definite information on the reason for this. But we think that it may be tactical, to give the Germans a chance to air their worries at Commission ambitions in the borrowing and lending field. The Germans may have two specific

proposals in mind:

(a) the proposed extension of the New Community Instrument (NCI). Under the NCI, the Commission borrows on the international capital markets, and, through the EIB, on-lends to member states for infrastructure, energy and industry (particularly small and medium sized undertakings). The NCI is approved by the Council in installments. The current NCI is NCI III, but this is coming up to exhaustion, and there is a Commission proposal for a new NCI IV. Discussion on this will begin in Brussels at working level very shortly. The proposed NCI IV includes some new features which need to be probed, and, for the first time, excludes infrastructure.

(b) a new Community programme for infrastructure, which the Commission are known to be considering. The Commission may mention this at this ECOFIN under economic items likely to be raised at the European Council, and there is a separate brief. In summary, we think that the Commission is considering a new borrowing/lending instrument purely for infrastructure, and/or some sort of Community guarantee system for infrastructure projects.

7. We, like the Germans, would want to look very carefully at 6(b), and would not be in favour of a new borrowing/lending instrument. Our argument would be that the EIB covers the ground adequately on borrowing, and that there is no sense in national or Community guarantees for risky investments which would not otherwise be carried out. We would also probably favour abolition of the NCI. There is quite a lot of overlap with the EIB, and there have been problems in the management of NCI borrowing and lending which the EIB and the Commission are trying to sort out at the moment. But getting rid of the NCI this time, at least, is probably not possible because of its role in the new Integrated Mediterranean Programmes.

8. Therefore, it is suggested that you listen to what the Germans have to say, and, if appropriate, express sympathy for their worries over any grandiose new Commission plans. But you should not withdraw our agreement to the increase in the Euratom lending ceiling. If the Germans withdraw their reserve, the increase in the ceiling could be adopted at this ECOFIN (adoption requires unanimity). The necessary Parliamentary scrutiny procedures have been completed.

ANNUAL ECONOMIC REPORT 1985-86

STATEMENT BY THE CHAIRMAN OF THE
ECONOMIC POLICY COMMITTEE
TO OCTOBER ECOFIN

The EPC discussed the Annual Economic Report in draft. The Report has not changed in substance since then, although an introduction and summary has been added. EPC asked me to report their conclusions to Ecofin.

I. General Aspects

- The Committee welcomes the Report's basic approach and objectives. It sets out the elements of and conditions for more employment-creating growth and takes more account than earlier reports of dialogue and social acceptability.

- Although the Report contains a number of new elements, particularly the realisation and mutual co-ordination of various steps and measures to achieve more employment and growth, it can be regarded as a continuation or development of the strategy which the Member States are already following. It takes account of the outcome of the Committee's work on a variety of subjects such as profitability, labour costs, labour markets and employment and protectionism.

- With regard to the Report's presentation of the possible results of the proposed co-operative growth strategy, the Committee considers that these should be interpreted as illustrating the direction of a possible development, rather than as setting an objective - especially since the co-operative growth scenario assumes more favourable external conditions as compared with the baseline assumption.

II. The Various Elements of the Strategy

- Monetary Policy

The Committee shared the Commission's view that monetary policy should continue to promote domestic price stability and greater exchange rate stability.

- Profitability and Factor Prices

  There was agreement that a further increase in the profitability of capital was necessary for greater growth of investment and employment. Specific investment incentives would not be a good tool. In order to counter the tendency towards greater capital deepening and the shedding of labour, there is a need for change in the evolution of relative prices of labour and capital; labour costs should fall in relation to the rewards from new investment.

- Real Wages and Labour Market Flexibility

  The Committee confirmed the importance of a moderate evolution of real wages and greater labour market flexibility. It advocated that real wages per head should on average grow slower than the growth in productivity and that wage and salary structures be adjusted in order to correspond more closely to the level of skills and sectoral and regional requirements. The EPC has been studying labour market flexibility as part of its work on market flexibility and has sent a first report to Ecofin. This separate report underscores the importance which EPC attaches to the need to achieve greater flexibility in the labour market as a necessary condition for a return to full employment. I think this work is important and Ecofin might find it useful to discuss our report at a later meeting.

- The Role of Demand

  The Committee wishes to distinguish between a demand boost - where demand leads supply - and demand support where demand follows supply. An isolated demand boost would, as argued in the Annual Report, run the risk of becoming counter-productive and leading to accelerating inflation without contributing to a lasting increase in employment. But to be effective, increases in supply need to be paralleled by increases in real demand. Governments will want to assure economic agents that such increases will take place - generally through the working of markets. Where markets work effectively, a moderate evolution of wages, higher profitability and lower interest rates may, of themselves, trigger adequate demand for investment and employment. But this will not always happen and governments may find they have to take action to maintain levels of demand. There are problems of timing, as market processes will inevitably take time. Also much will depend on the circumstances in individual Member States.

- Budgetary Policy

  There was agreement that in considering demand support, the medium term consolidation objective should not be called into question. If public investment were used to provide support, profitability considerations should remain the main criterion. If tax cuts were used, regard should particularly be paid to their incentive effects on economic performance, and their contribution to a better evolution of relative factor prices as well as to their effect on demand.

- Co-operative Strategies

  Some members felt that in pursuing co-operative strategies, account should be taken of the need to promote flexibility and to strengthen the role of markets. In some cases this could involve strengthening the position of individuals against institutions. It would be counter-productive to add to the market power of dominant groups, especially, but not exclusively, in labour markets. Those with jobs may, by achieving excessive wages, damage the employment prospects of others.

- Action Step by Step

  (a) The Parallelism of Measures and Commitments

  Some members pointed out that their governments could not take measures solely on the basis of declarations of intent or commitments on the part of management and unions. They therefore argued that agreements should be equally binding for all. Pledge should be matched with pledge and action with action.

(b) The Time Dimension of Steps

There was agreement that any individual steps should be carried out within a medium term framework, but that a degree of flexibility should also be retained so that in each case an appropriate reaction to changing conditions would be possible. Longer term commitments might stand in the way of this. But there was a balance to be struck; flexibility should not affect credibility.

Conclusion

Finally, EPC is able to commend the broad approach set out in the Commission's Annual Report. All in all, the Report contains a clear message and a balanced presentation of the proposed strategy's elements and implications. It provides a good foundation for a fruitful dialogue with economic agents on the many elements necessary for an"employment creating adjustment phase" to be successful.

I C R BYATT

28 October 1985

INTERNATIONAL STATISTICS: COMMUNITY, US AND JAPAN

List of tables

INTERNATIONAL STATISTICS: COMMUNITY, US AND JAPAN

(Commission's latest forecasts, October 1985, unless stated otherwise)

1. Gross domestic product (per cent changes)

	1984	1985	1986
Belgium	1¾	2	1¾
Denmark	4	2¼	3¼
Germany	2½	2¼	3½
Greece	2½	2	1
France	1½	1¼	2
Ireland	4½	2½	2¼
Italy	2½	2¾	2¾
Luxembourg	3¼	1¾	1¼
Netherlands	1¾	2	2
UK	* 1¾ 2½	3½	2 3
EC	2¼	2¼	2½
USA	6¾	2¼	2½
Japan	5¾	4¾	4

2. Prices- consumers' expenditure deflator (per cent changes)

	1984	1985	1986
Belgium	6¼	5	3¼
Denmark	6½	4¼	1¾
Germany	2½	2	1½
Greece	21¼	19	12½
France	7¼	5¾	4
Ireland	8½	5¾	5¼
Italy	11	8½	6½
Luxembourg	6¾	3¾	3½
Netherlands	2½	2½	1
UK	5	5¼ 6	4¼
EC	6¼	5¼	4
USA	3¼	3¼	4½
Japan	2	1¾	2¼

3. Unemployment rate (per cent of civilian labour force)

	1984	1985	1986
Belgium	14½	13¾	13½
Denmark	10	9	8½
Germany	8½	8½	8
Greece	8	8¼	9
France	10	10¾	11
Ireland	16	17	17½
Italy	12	12½	13
Luxembourg	1¾	1¾	1½
Netherlands	14¼	13¼	13
UK	11¾	12	11¾
EC	10½	10¾	10¾
USA	7½	7¼	7¾
Japan	2¾	2½	2½

4. Three-month interest rates (per cent per annum)

	1984				1985			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Latest
Germany	6	6	6	6	6¼	5¾	5	5
France	12½	12½	11½	10¾	10½	10¼	9¾	9¼
Italy	17¾	17¼	17	17½	16¼	15½	14½	14¾
Netherlands	6	6	6¼	6	6¾	6¾	6¼	6¼
UK	9¼	9¼	11	10¼	13	12¾	11¾	11½
Major EC average	10	10	10	9¾	10¼	10	9	9
USA	9½	11	11½	9½	8¾	8	8	7¾
Japan	6¾	6¼	6¼	6¼	6¼	6¼	6¼	7

Source: Bank of England

5. Long term government bond yields (per cent per annum)

	1984				1985			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Latest
Germany	8¼	8¼	8	7½	7½	7¼	6¾	6¾
France	13	13	12½	11¼	11¼	11	10¾	10½
Italy	16¾	15½	15	15	13½	13¾	14	13¾
Netherlands	8¼	8¼	8¼	7½	7½	7½	7	7
UK	10¾	11½	11¾	11	11½	11¼	10¾	10½
Major EC average	11¼	11¼	11	10¼	10¼	10	9½	9½
USA	12	13¼	13	11¾	11½	11¼	10¼	10
Japan	7¼	7¼	7½	6¾	6¾	6¼	6¼	6¾

Source: Bank of England

6. Current account balances ($bn)

	1984	1985	1986
Belgium	0	¾	2¼
Denmark	1¾	-1¾	-1½
Germany	6¼	13	15
Greece	-1¼	-1¾	-1¾
France	-3¼	-2½	-3
Ireland	-1	-½	-½
Italy	-3	-6	-3½
Luxembourg	1¼	1¼	1½
Netherlands	5	5½	6½
UK	1¼	5 4¼	4 5½
EC	3¼	12½	19½
USA	-101	-126	-131
Japan	35	45	56

7. Effective exchange rates (1975 = 100)

	1984				1985			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Latest
Belgium	89.7	90.1	89.7	88.7	88.2	89.2	90.8	92.3
Germany	125.6	125.8	123.1	121.3	119.5	121.7	125.3	128.1
France	66.3	66.4	65.0	64.1	63.3	64.9	67.0	68.9
Italy	48.6	48.4	47.6	46.7	45.9	45.3	44.5	44.7
Netherlands	114.8	115.2	112.8	111.2	109.5	112.1	115.5	118.5
UK	81.7	79.8	78.0	75.1	72.1	78.9	82.1	80.0
US	129.0	130.2	138.0	141.7	150.0	145.8	138.3	129.1
Japan	157.2	158.7	154.9	156.5	154.5	155.3	157.8	176.8

Source: HMT

8. Relative wholesale prices for manufacturing (1980=100)[1]

	1975-1980	1983	1984	1985	
		Q1	Q1	Q1	Q2
Belgium	112.0	96.4	94.9	94.3	93.9
Denmark	100.8	110.3	113.7	114.6	114.8
Germany	113.5	94.9	92.4	91.2	90.6
France	93.0	112.6	117.6	121.6	122.8
Italy	84.8	122.7	131.2	137.7	139.8
Netherlands	107.8	99.0	99.0	97.3	97.2
UK	88.2	103.4	105.1	107.8	109.2
US	96.6	94.8	93.1	90.2	89.9
Japan	108.4	84.7	80.2	78.0	76.8

1 These indices are not a measure of real exchange rates. They are only relative prices and are not adjusted for exchange rate changes. Calculated relative to the thirteen largest industrial countries.

Source: IMF

9. **General Government fiscal deficits (per cent of GNP)**

	1984	1985	1986
Belgium	-10	-8 ½	-7 ½
Denmark	-4 ½	-3	- ¾
Germany	-2	-1 ¼	- ¾
Greece	-10	-12 ½	-10 ½
France	-2 ¾	-3 ¼	-3 ¼
Ireland	-10	-11 ½	-10 ½
Italy	-13 ½	-13 ½	-12 ¾
Luxembourg	1 ½	2	2
Netherlands	-6 ¼	-6	-6 ½
UK	-3 ¾	-3 ¼	-2 ¾
EC	-5 ½	-5 ¼	-4 ¾
USA[1]	-3 ¼	-3 ½	-2 ¾
Japan[1]	-3	-1 ½	- ½

10. **Money supply (change over previous period at annual rates)**

	1983		1984			
	H1	H2	H1	H2	Latest over[1] target base	Target range
Germany (CBM)	9 ½	5	4 ½	5	4 ¼ (Sept)	3-5
France (M2R)	9	10	9	8	7 ¼ (June)[2]	4-6
UK (MO)	7	6	5	6	3½(Oct)[2]	3-7
US (M1)	14	8	7 ½	4 ½	13 (Oct)	3-8
Japan (M2)	7	7 ½	8 ½	7 ½	8 ¼ (July)[2]	-

1 Target base varies. US M1 rebased in July to Q2 average and range widened.

2 Year on year

Source: OECD

November 1985

ECOFIN: 18 NOVEMBER 1985 BRIEF F

Draft directive on unit trusts (Undertakings for Collective Investment in Transferable Securities - UCITS)

UK Objectives

1. To secure agreement in principle of this directive (and the associated capital movements directive). It is expected that Denmark will be requested to withdraw the only remaining reserve. There should be no need for other interventions.

Points to make

2. UK strongly supports this proposal. We hope the residual Danish point will not upset this carefully constructed package.

Background

3. The UCITS directive will from 1 October 1989 allow a UCITS authorised in one Member State to market its units throughout the Community without the need for any further authorisation. It would need to comply only with local marketing rules and exchange controls. This will be a significant step forward in the removal of internal barriers. The associated capital movements directive will remove all exchange controls in respect of UCITS units, subject to any over-riding waivers given by the Commission under Article 108 of the Treaty. (France, Greece, Ireland and Italy presently benefit from such derogations.)

4. At the last meeting of ECOFIN all issues on the capital movements directive and all but one of the difficulties on the UCITS directive were resolved. Denmark maintained a waiting reserve (because of uncertainty over the application of the directive to some of its unit trusts). That point has now been resolved. However they now have a parliamentary scrutiny reserve because their Parliamentary Committee has questioned whether the directive will lead to tax evasion in Denmark (see paragraph 6 below). As that Committee meets again on Friday 15 November, this could clear the way for Denmark to lift its reserve at ECOFIN.

5. It is important that Denmark resolves its internal difficulties quickly. Many of the compromises agreed at last month's ECOFIN were expressed to be conditional on adoption of the directive before the end of the year.

6. Denmark has no difficulties with the substance of the directive and as the directive does not deal with taxation any action required to deal with the tax point would be for Denmark. (Ireland has in the past suggested that the taxation of UCITS should also be harmonised but, in the absence of any real support, has recently accepted that any attempt to harmonise tax should be dealt with separately.)

7. The Danish tax point appears to arise because Danish units are taxed more heavily than elsewhere in the Community. This, they say, could encourage Danish investors to buy units of other Member States unit trusts, which under the UCITS directive will be able to market freely in Denmark. In addition as such UCITS would not have to establish a presence in Denmark it might also be that the Danish tax authorities are worried that they will find it more difficult to collect duties due from the sale of units in Denmark and taxes due from Danish citizens in respect of dividends paid. UCITS based elsewhere will not necessarily be obliged to make reports to the Danish tax authorities. The answer is probably that there will need to be some adjustment of existing law and practices by the tax authorities in Denmark and in other Member States too. But that should not be a reason for delaying a much needed liberalisation of the internal market.

ECOFIN 18 NOVEMBER BRIEF H

UNITARY TAX : SHORT SPEAKING NOTE FOR THE CHANCELLOR TO USE AT ECOFIN

1. UK passed enabling legislation in July to retaliate against US if progress not made in dealing with unitary tax.

2. Hoped that California would put its own house in order in September but it didn't.

3. Pleased when US President said last week he would deal with unitary tax at federal level (legislation, tax treaties, amicus briefs).

4. UK undertaken not to trigger its legislation provided satisfactory progress made (legislation passed by end of 1986).

5. Also not to apply it to dividends paid on or before that date.

6. All this a big step forward.

BRIEF I

TIN

SPEAKING NOTE

The UK, as in the Industry Secretary's message to EC colleagues and at the ITC meeting before the weekend, has consistently urged ITA members to take the necessary steps to enable the ITC to meet its legal obligations. We are willing to do so, despite some uncertainty over the formal extent of those obligations (which will eventually need to be cleared up although this should not delay decisions). We are therefore interested in pursuing bankers packages which would promise bridging finance quickly.

Budgetary costs are as unwelcome to me as to anyone. What has happened clearly demonstrates the folly of arrangements which deliberately work against the market over long periods of time. We are not arguing for a new support price or the "rescue" of the ITA. Nor arguing from self interest in tin or dealing on the London Metal Exchange. Accept that the tin market might move from London.

But matters are urgent. I am thinking of the prospect of default. If obligations are not met, the consequence is likely to be collapse followed by legal processes against the ITC and Government. Whatever the outcome of the legal processes, the implications of default for the sovereign debt issue would be very serious.

Failure to honour ITC obligations promptly could risk establishing default as an acceptable solution to debt problems on a wider scale. This would complicate the settlement of current international debt problems about which we are all concerned. We must clearly avoid giving any excuse for default. Some countries in Latin America e.g. Peru just looking for an excuse. May also be consequences nearer home. Euro markets could react badly to perceived default on international obligations, whether or not cross default clauses triggered.

<u>Background</u>

On liabilities.......

<u>European Commission</u> Now taking a more constructive attitude.

<u>France, Greece and Demark</u> claim no liabilities beyond capital subscription.

<u>FRG</u> Some indications that now accept (privately) the need to meet ultra vires liabilities of buffer stock manager.

<u>Benelux</u> nearer to accepting the UK point of view. Dutch aware of implications of joint and several liability.

<u>Italy</u> wants both to rescue agreement and <u>not</u> to honor obligations.

<u>Ireland</u> not significant.

On continuing with the agreement......

all <u>except</u> Italy appear to wish to discontinue the intervention activities of the tin buffer stock.

SPANISH REQUEST FOR BILATERAL DISCUSSION

UK OBJECTIVE

To calm Spanish fears about their net budgetary position in 1986, without making a commitment to a specific addition to the Draft Budget to take account of enlargement.

LINE TO TAKE

Cannot prejudge the outcome of the second Budget Council. But axiomatic that the understandings reached with Spain and Portugal should be honoured in full, within whatever total budgetary appropriations are finally agreed. We accept that, if necessary, appropriations for Spain and Portugal should take priority over those for the present ten member states.

BACKGROUND

1. The head of the Spanish delegation to ECOFIN - probably Fernandez Ordonez, State Secretary for Economic Affairs - has asked to speak to you in the margins of the meeting. Officials have said that we will try to arrange a meeting during the day.

2. The Spaniards wish to discuss Spain's difficulties with the 1986 Budget. They are also trying to speak to the French, Germans and Dutch.

3. In the enlargement negotiations, the transitional period VAT/GNP Own Resources refund percentages for Spain and Portugal were chosen with the intention that, during the first few years of transition, Spain's net budgetary position in respect of the Community Budget would be broadly neutral. However, on the basis of the Preliminary Draft Budget and in the establishment of the Draft Budget, Spain has become worried, probably with some justification, that in 1986 they will be a net contributor to the Budget.

4. In setting the Draft Budget, the Council made the following statement:

> "The Council states that it is prepared to reconsider the appropriations entered against ERDF and the ESF at the second reading of the draft budget and to ensure on that occasion that the amounts necessary to comply with the commitments arising out of the accession negotiations in respect of the two new Member States are made available to the countries concerned, taking into account the repetition of the c/a and p/a entered in the 1985 budget for the Ten."

The Spanish Minister may remind you of this statement. The UK maintains that the Budget Council undertaking to reconsider the figures is without commitment.

11/142

ECOFIN 18 NOVEMBER BRIEF K

What on earth is CIRR? What is the [illegible]?

CIRR

UK Objectives

If raised in the margins, to encourage constructive discussion (and compromise) in the next working group meeting in preparation for ECOFIN in December. Avoid becoming embroiled in discussion of individual rates or margins: it should be the task of the working group to come up with an agreed line on technical matters.

Line to take

What is [illegible]

(i) Essential to achieve workable solution to the CIRR problem, and that will call for compromise between protagonists of, respectively, high and low margins. Need progress at working group level in advance of December ECOFIN.

(ii) May be possible to distinguish treatment of ECU CIRR from CIRRs for national currencies, but rate can only be settled in context of settlement of CIRR problem generally.

(iii) Can be no question of countries going their own way on CIRR rates. Survival of Consensus depends on individual countries adhering to rules even when have reservations about them. Breaking rules risks disintegration of the Consensus and an outbreak of export credit competition, reinforcing protectionist pressures everywhere.

Background

Under the OECD Consensus which regulates export credit competition, participants are permitted to offer official support for finance in low interest rate currencies (eg DM, Yen, Swiss franc and, in some markets, the US dollar) at rates based on a Commercial Interest Reference Rate (CIRR) which is meant to reflect market conditions. Currently CIRRs are in the main derived by adding various margins to the five year government bond rate (available, and transparent, in all markets) to transform it into a commercial rate available to first class borrowers. In the two years of the system's existence there has been constant controversy over individual rates which has now reached a point where the existing methodology, as well as the general level of current rates, is under question. In the forefront are the Italians and French who, more willing than the rest of the EC to subsidise their exports, wish to see lower rates. The Dutch and Germans, not wanting subsidy, take the opposite line. The UK stands somewhere in the middle: not wanting subsidy but wishing to ensure the system survives.

2. The ECU CIRR has been the focal point of the Italian case (they tend to use ECU more than others). They are currently arguing for a reduction in the rate and a change in methodology for the ECU CIRR and others. The UK along with the Dutch, and now the Commission, have argued that the ECU CIRR can only be dealt with in the context of a general CIRR settlement. This is largely for tactical reasons. A reduction for this CIRR in advance of a more general settlement would set a precedent for reductions in other rates with much greater financial and economic significance. The Italians claim greater urgency for the ECU because the rate was initially set for only 6 months, a period which expires at the end of December. A new rate could be set at the next OECD meeting in January. They have occasionally said that they are prepared effectively to set their own CIRR (and have been taken to task by the Commission on this because it would amount to a breach of the Consensus). The danger to the Consensus in individual countries going off on their own is considerable.

3. The Italians had threatened to bring the ECU CIRR to this ECOFIN but drew back at the last working group meeting when it became apparent that a discussion would not be fruitful. The subject is now to come before ECOFIN in December (as originally planned) to decide an EC negotiating mandate for the January OECD on CIRRs generally (including the ECU). In preparation for this the Commission has tabled a provisional proposal at working group level which builds on an earlier UK idea for determining CIRRs by a global margin over

government bond rates, so avoiding the currency by currency discussions which have proved so fruitless in the past. In its present form the proposal has some undesirable features including (as a negotiating gesture) too large a loophole for individual currencies to escape from the global approach. But it does offer a way out of the present morass. It may still founder, however, on the large discrepancy between the margin (perhaps around ½ per cent) desired by the Italians, French and Belgians and the higher margin (well above 1 per cent) the Germans and Dutch seem prepared to accept. We have long thought the Guilder and DM CIRRs to be too high and would be looking to the Dutch and Germans to move rather further than the French and Italians. But the UK itself will be seeking to retain a margin sufficiently high to avoid building in subsidy. There are, however, considerable uncertainties about what exactly is required to do this and some force in the French and Italian arguments that capital market developments are leading to a general reduction in margins. Our current proposal is 1% plus the 0.2% margin for official support. We may need to move down from this to secure agreement, given the overriding need to keep the system alive.

UNITARY TAX : SHORT SPEAKING NOTE FOR THE CHANCELLOR TO USE AT ECOFIN

1. UK passed enabling legislation in July to retaliate against US if progress not made in dealing with unitary tax.

2. Hoped that California would put its own house in order in September but it didn't.

3. Pleased when US President said last week he would deal with unitary tax at federal level (legislation, tax treaties, amicus briefs).

4. UK undertaken not to trigger its legislation provided satisfactory progress made (legislation passed by end of 1986).

5. Also not to apply it to dividends paid on or before that date.

6. All this a big step forward.

2332/9

1986 COMMUNITY BUDGET

We think that it would be most valuable for the Chancellor to underline with Stoltenberg, for transmission (we would hope) to Tietmeyer, the importance of finding a common line, with the French and the Dutch, on the 1986 budget, and a line which respects budget discipline.

2. Officials of all four countries are to meet in my room at the Treasury on Monday. The next Budget Council is on Tuesday 26 November.

3. The background is that the first Budget Council established a draft budget in which agricultural guarantee expenditure for the Ten was within the financial guideline and DNO expenditure was within the maximum rate. Regrettably, Tietmeyer hinted at the Council that Germany would be ready to go considerably further at the second Budget Council. The European Parliament voted yesterday to add no less than 2.1 becu to the budget, mainly on DNO expenditure.

4. In preliminary contacts with French and Dutch officials, we appear to have come close to agreeing that the most promising line at the next Budget Council will be:

- To reject any specific provision for the so-called "cost of the past" problem (or overhang of past commitments in the structural funds) as being a Commission device for expanding these funds at a massive rate;

- on the assumption that no qualified majority will be obtainable for sticking with the position established by the first Budget Council given the accession of Spain and Portugal, to work towards an outcome where DNO expenditure rises by the maximum rate plus the amounts needed for Spain and Portugal;

- to that end, to stick with the maximum rate increase plus the Parliament's statutory margin at the Council, and to make clear that there is no question that the understandings reached with Spain and Portugal must be honoured in full within that total, but to tell the Parliament that the Council is ready to discuss the possibility of scoring some of the enlargement expenditure as an addition to the maximum rate so as to lessen the impact on existing member states.

5. Preliminary contacts with the Germans suggests that they would prefer to make concessions sooner. They are much more daunted than we are by the European Parliament. It appears that they would prefer the Council to propose a new, slightly higher maximum rate and negotiate with the Parliament on that. On this approach, the Council would commit itself from the outset to exceeding the maximum rate provisions of the Treaty, and the bottom end of the subsequent negotiating bracket would be raised. There have also been some suggestions that the Germans may go along with some specific supplementary provision for the "cost of the past", despite the appalling precedent which this would set and the reduced scope which would remain within the VAT ceiling for adding to agricultural expenditure (benefiting German farmers) in extremis.

A J C EDWARDS

2332/9

NET BALANCES

We suggest that the Chancellor should ask Stoltenberg to confirm that he will raise the question of net balances at the ECOFIN lunch on Monday.

2. The background to this is:

- The Commission have declined since 1983 to provide any tables giving net balances for individual member states.

- The Germans have asked for these figures on several occasions, notably at the September Budget Council. The French as well as ourselves have supported.

- In response to this, the Commission (a) agreed to discuss the matter at the following ECOFIN if the Germans cared to raise it and (b) sent individual member states estimates of their own receipts from the Community budget of 1984 (but not of others' receipts). This was, of course, a mischievous move. We all know about our own receipts. What we want to know is the receipts of others.

- We have now had one informal and two formal ECOFINs since the September Budget Council and on each occasion the Germans have failed to raise the matter, though they appear to be as concerned as ever to obtain these figures.

3. In the view of officials it should remain an important objective for the UK to oblige the Commission to divulge this information, the Fontainebleau system notwithstanding. We want to be able to monitor the net transfers of resources through the budget to Italy, Greece, Spain, Portugal and Ireland, and to have some check on the traditional (but highly suspect) French claims that they will soon be as large net contributors as we are. We see no harm, either, in other member states seeing what enormous net contributions to the budget the UK is making, even after Fontainebleau. More generally, it is ludicrous that the Community should decide its policies (for example, on "cohesion" with the less prosperous member states) and its budgets without any systematic information on the total impact of the budget on individual member states.

4. As to tactics, the past history on the British budget problem, refunds and Fontainebleau is such that it is far more likely to be productive for other member states to propose, and the UK to support, on this matter, rather than vice versa. That is why we would like Stoltenberg to press the point (and incidentally to restore German credibility in so doing).

A J C EDWARDS

CONFIDENTIAL

FROM: G Littler

DATE: 18 November 1985

cc: Mr Lavelle
Mr Fitchew
Mr Bostock

Chancellor

ECOFIN: GREECE

1. The Commission will propose

- Acceptance of Greek Economic Policy Measures

- Acceptance of various derogations and deferments

- A loan financed by Community borrowing

After a meeting of the Monetary Committee from 10pm last night to 3 am this morning, there are comments on all three of these.

Economic Policy Measures

2. These are unchanged from the programme originally announced by Greece. In giving approval, the Commission have pushed the Greeks a little towards a slightly better inflation performance and a more closely defined monetary policy.

3. If there should be any argument, we should support the Commission, as recommended by the Monetary Committee.

Derogations and Deferments

4. The two important points are:

- the import deposit scheme

- the effect of deferring the introduction of VAT on the Greek budget contribution for 1986.

5. The Commission seem to have done a good and tough negotiation in which they have insisted that the 1986 budget contribution be based on a notional VAT (otherwise Greece would have benefitted by a lower contribution to the tune of 150 mecu at the expense of other members). They have a confidential agreement that Greece will begin to dismantle the import deposit scheme between six and twelve months from now, and phase it out completely in not more than eighteen months.

/6

CONFIDENTIAL

CONFIDENTIAL

6. It will be for the Budget Committee to settle details of the VAT budget arrangement. The monetary committee has asked the Commission to work in its 3-monthly review for a more rapid removal of the Import Deposit Scheme and to report regularly every six months to the Monetary Committee.

Proposed Loan

7. The Commission proposal will be for an amount of 1.75 becu, in two equal tranches (the first disbursed immediately; the second after one year, not before 1 January 1987, and dependent upon satisfactory performance) with an average repayment period of six years.

8. The form of loan avoids immediate budgetary charges on other Members, which is welcome. There are two points of possible difficulty:

(a) The Greeks want front-loading. The Monetary Committee was virtually unanimous (slight Italian hesitation) that equal tranches would be best, to ensure that there remains some leverage in the second tranche.

(b) All Monetary Committee members except Ireland and (?) Belgium felt that the proposed amount was over-generous, by comparison with the total amount of the facility (8 becu of which the French drawing has left 4.7 becu still available) by comparison with what would be available from the IMF for Greece (about 1.8 becu in the most unlikely event that the absolute maximum was accorded) and in relation to the financing need. The French made the neat proposal that, by the IMF analogy where about 80% of maximum would be allowed normally, and recognising that Community money should not be applied to buying out other creditors, we should abate the Commission proposal to about 1.4 becu. This will be reported by Tietmeyer, and I recommend you support it.

The IMF

9. The Greeks confirmed that there is no question of their applying for IMF lending as well. Some of my colleagues raised the question whether they should be encouraged to do so. I and eventually a majority argued that we must not either shelter behind the IMF, or try to unload obligations on to them, against Greek wishes, but that we should match the kind of approach the IMF themselves would adopt and not become a soft touch.

G Littler