

Mr Fforde
•Mr Coleby
The GPS
The DGPS

Attached is the Minute to the
Chancellor on limiting bulldog
issues referred to in my note
for record of 29 June 1982.

Ian Plenderleith
30 June 1982

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H M Treasury

Parliament Street London SW1P 3AG

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Mr. M. J. Bullough
Apropos my conversation
yesterday, the note by
perfect shows the proposed

breach of EC regulations which
is worrying him. Defence
briefing B on that would be
very helpful ahead of the Monday
meeting - and also, if possible, on the claim

in 4 (b) I Plenderleith Esq of this letter that
the need Bank of England issues quences in
Japan and Threadneedle Street LONDON
EC2 Germany are run by the banks

without any official intervention/control: that may
be the form, but the substance is surely that
they are effectively run by the authorities' close control?

Copies to Mr. Lockhart
LS/6 Mr. George
Mr. Walker
Mr. Hill
Mr. Curre
Mr. Ware

24 June 1982

Dear John

J 25/6

THE BULLDOG MARKET

When we spoke on the telephone this morning we provisionally
arranged a meeting for 4.30 pm on Monday in my office, to which
you and other recipients of this letter are invited.

2. I am copying to you with this letter, with apologies for not
having done so earlier, the submission we put to Treasury Ministers
yesterday about a possible limit on sterling bond issues by overseas
companies and Governments. This follows your letter to me of
16 June, and some further discussion in the context of the planned
monetary statement. Although I have not yet seen anything in writing,
I believe the Chancellor is content. I hope that this will give you
sufficient cover for the time being to act to damp any sudden
excessive overseas interest in sterling issues. But you will see
that it proposes further consideration between you and us about the
case for a more formal limitation, and the form such a limit should
take. That is the purpose of my meeting on Monday.

3. I think my note to the Chancellor (which I fear shows all the
signs of having been prepared in some haste) acts to some degree
as a commentary on most of the points raised in your letter of
16 June. But to summarise very briefly:-

(a) In the Treasury we are not inclined to accept that
there are any very strong general arguments for a limit
on overseas sterling issues either in terms of the exchange
rate or "crowding out"/impact on sterling interest rates.
If there were they would amount to a general case for
reimposing exchange controls.

(b) There are in any case difficult presentational
aspects internationally, and also domestically given the
Government's general policy on international capital flows
and exchange controls.

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(c) But we do accept it would be embarrassing if the first or main result of the clarification of tax treatment for deep discounted bonds was a rush of issues by US companies in the sterling market. And more generally we accept there is a case on market management grounds for maintaining a limited and orderly queue of overseas sterling borrowers - if anything perhaps leaning in a more restrictive direction (as the Japanese and Germans).

4. You said you were now giving thought to revised written guidance for the new issue market to supplement that previously issued by the Bank. If you agree, I would like at my meeting to run through the various options for what that might say, and more generally for our future public stance towards the bulldog market. As I see it the main options are as follows:-

(a) A limit (not necessarily quantified) on all overseas sterling issues (possibly extending to the Euro-sterling market also) explicitly imposed by the Treasury and policed by the Bank under the Control of Borrowing Order.

(b) Continuation of the arrangements you have operated hitherto to limit issues by informal means through the new issue queue - with consultation between us if you felt we had reached a point at which you could no longer limit overseas issues to the level you would like by reference to the dangers of market congestion. We would then consider between us of what if any action to take.

(c) As (b), but with a presumption that we would allow the volume of overseas sterling issues gradually to increase as it became clear that the market could cope.

(d) An arrangement to parallel those operated in Japan and Germany under which overseas issues are restricted, but, so far as the formalities are concerned, not by the authorities but by the market itself. (I am attaching an internal note about a recent OECD meeting at which, as you see, the Japanese representatives firmly denied any official responsibility for their restrictions, and described how they worked). An alternative would be an arrangement in which the Bank, again so far as the formalities are concerned, took it on itself to control the market on behalf of market participants.

5. I hope that Juliet Wheldon (Treasury Solicitor) will be able to advise us about which of these options would require formal notification under EC Directives. I am attaching a note by Mark Perfect here setting out the position as we currently see it.

6. Copies go to Juliet Wheldon, and to Andrew Turnbull and Peter Sedgwick in the Treasury.

Yours ever
David

D L C PERETZ

We have never operated thus. The queue rests on COBO and is not an 'informal' arrangement.

FROM: DAVID PERETZ

DATE: 23 June 1982

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (R)
Sir D Wass
Mr Burns
Sir K Couzens
Sir W Ryrie
Mr Littler
Mr Middleton
Mr Lavelle Mr Kemp
Mr Monck Mr Moore
Mr Britton
Mr Robson
Mr Sedgwick
Mr Turnbull *cc M. Hall*
Mr Bailey
Mr Perfect
Mr Ridley

MONETARY PACKAGE: A LIMIT ON BULLDOG ISSUES?

The Bank believe that after Friday's statement they could face many enquiries about the possibility of American companies issuing deep-discounted sterling stock in London. They also foresee a pick up in interest in sterling issues by foreign governments now that Falklands uncertainties are out of the way. They have suggested there should be a formal limit on overseas sterling bond issues ("bulldogs"), and that if necessary they should go public. They would like to have Ministerial backing for this. A further possibility would be to include a sentence about this in this week's Parliamentary Answer on the monetary package, or to indicate the policy in background briefing. This note advises against going public at any rate at this stage, and the Bank are not pressing us to do so. While we consider the case for and against a public limit more carefully we suggest that the Bank be given cover to continue as hitherto to seek to limit the volume of overseas sterling issues by informal means, through the new issue queue.

Background

2. Up to now, as you know, the Bank have operated an informal limit of around £100 million a month on new bulldog issues through

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their queuing arrangements. In practice interest by borrowers has been modest, and the average volume of issues has been well below that limit. The specific point arising from Friday's announcement is that US corporate borrowers may be interested in taking advantage of the lifting of the embargo on zero and low-coupon bonds. Because US companies enjoy taxation of such bonds on an accruals basis they might find the UK market more attractive than UK companies.

3. If demand does pick up the Bank believe that sooner or later they will either have to allow a greater volume of issues, or to lay down a more explicit limit. In the latter case they would expect appeals to Ministers, both in private, for example by sovereign borrowers like the French or the World Bank who are denied early access to the market, and in public.

A possible sentence for the Parliamentary Answer

4. Were we all agreed that an explicit limit was the right course there would be a case for saying so in the text of this week's Parliamentary Answer:-

(i) In that context it would be clear that the limit was not being imposed because of concern about the exchange rate - but because of worries about overseas borrowers in the bond market crowding out potential domestic corporate borrowers.

(ii) It would also provide some presentational reinforcement to the rather thin line at present on measures to encourage corporate borrowing - though that would risk putting more weight on the point than it would bear.

(iii) The Government might be exposed to criticism if it turned out that the most immediately obvious result of measures designed to ease access by UK companies to the sterling bond market was a rush of interest by overseas corporate or sovereign issues, and the existing informal queue was inadequate to contain it.

The case against

5. The case for some kind of limit on overseas sterling issues would have to be:-

(a) There may be something in the argument that foreign sterling issues crowd out domestic ones, or raise domestic sterling interest rates. Capital markets are not perfect; and the domestic capital market's capacity to absorb new bond issues may be limited in the short run. But any upward impact on interest rates could in principle be offset by selling less gilts, which in the circumstances should be possible without adverse monetary effects. And there is also the argument that foreign sterling bond issues could encourage domestic issues through a demonstration effect.

(b) Similarly it is possible that there could be some minor support for the exchange rate from limiting issues by those overseas borrowers likely to sell the sterling proceeds for foreign currencies (not always the case). But the flows on this account are of course pretty small in relation to total capital outflows.

6. Neither of these points is very compelling; indeed if accepted they would amount to a general case in favour of exchange controls. Like other controls on capital flows, a limit that acted as a real constraint would be easy enough to get around. It might give a boost to the Euro-sterling market; or lead to a rise, for example, in direct placements with UK institutions (since the limit would apply to market issues). There is nothing to prevent UK funds buying issues made by overseas companies and governments in New York and elsewhere. The best case for a limit is that it helps secure the orderly development of the sterling new issue market.

7. For this reason we have been happy to have an informal limit on new issues operated by the Bank, with the market's tacit agreement.

The official stance has been that this is intended to ensure the market's orderly development, not to discriminate against foreign borrowers.

8. Presentation of an explicit limit on foreign borrowings would be altogether more awkward.

(i) There is always a risk it would be seen by some as the first move back towards more general imposition of exchange controls - definitely counter-productive for the exchange rate.

(ii) Even if we could avoid that, it is hard to make any general case for a limit on crowding out grounds without contradicting the line we have always taken on other capital outflows, and by implication making a case for restricting them also. For example in your paper to the NEDC last year we said that portfolio outflows have not been at the expense of institutional flows to UK companies, have had little if any impact on interest rates, and have indeed benefitted UK investment rather than the reverse. (In practice the share of institutional money going to companies has not fallen; overseas investment by the institutions has been at the expense of investment in gilts).

(iii) We are fairly sure also that a straightforward official restriction of the kind proposed by the Bank would require us to enter a formal reservation under the OECD code of liberalisation of capital movements; and also to notify and obtain (negative) clearance from the EC Commission under Community Directives on Capital Movements.

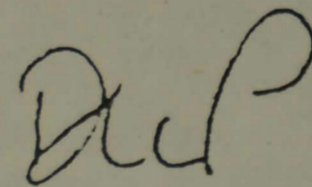
Recommendation

9. For all these reasons we would like to take time to consider policy on this more carefully together with the Bank. One possibility

I would like to explore in detail is that of devising arrangements similar to those operated by the Germans and Japanese. In both cases they do in practice limit foreign access to their domestic capital markets, but do so in ways that avoid having any limit openly imposed by the authorities. In effect they have restrictions administered, so far as the formalities are concerned, by market participants; the authorities only play a role behind the scenes. A second option would be to wait and see if foreign interest in the bulldog market does pick up before deciding if any action is necessary. A third would be to decide only to operate the limit to the extent justified by the preservation of an orderly and healthy market, and hence to permit a gradually expanding level of overseas issues if the market seems able to cope.

10. If in the end we did decide to go for a public limit we should be able to refer back to this week's measures for some time to come. Meanwhile we recommend against making an early decision on whether to do so, or including anything in this week's statement. If very strong pressure develops next week we might have to think again or at any rate accelerate our further consultations with the Bank. For the time being, however, we recommend that the Bank be authorised to operate as firmly as they need on the same basis as hitherto - that is informally through the operation of their queue to preserve orderly market conditions.

11. The general lines of this submission have been agreed with HF and FEU.



D L C PERETZ

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EMP F/3

FROM: R M PERFECT

DATE: 24 June 1982

MR PERETZ

cc Miss J Wheldon - T.Sol

A LIMIT ON BULLDOGS

You asked me to check the EC position with Treasury Solicitor.

Is it a restriction?

2. Issues or placings of securities of a foreign undertaking on a domestic capital market appear on List C of the capital movements directive. The UK is required to authorize capital movements on List C between member states unless this imperils an economic objective. If it does threaten an economic aim we are free to reintroduce a restriction operative when the Directive came into force in the UK. The Commission would however examine us and may recommend the restriction be abolished.

New or old?

3. If the restriction was not in force when the Directive came into force it would fall under Article 6 which requires us to endeavour not to ^{re-}introduce it. If we failed in our endeavours we would need a derogation from our commitments. Derogations are available under Article 73 (disturbance to the functioning of the capital markets) or Articles 108 or 109 (balance of payments problems). While Article 73 appears more suitable to me it has never been used so we would have no precedents to follow and the Commission might try to take a hard line to dissuade others. Which ever Article we use we either have to discuss and agree the restriction before introducing it or claim that we face a crisis. Neither option is attractive and we should try to show that we did indeed have such a restriction in the early 1970's when the Directive came into force in the UK.

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4. The legal basis for the restriction would be the Control of Borrowing Order. This requires potential issuers to seek Bank permission before making issues greater than £3 million. The criteria to use when deciding on permissions are for the Bank and Treasury to determine. The restriction would be a discriminatory change in those criteria. The Control of Borrowing Order was in place in the 1970's and had any non-resident been given permission under Section 8 of the Exchange Control Act 1947 to issue sterling bonds in London (which they were not, Bank of England Notice EC10 refers) then permission under the Control of Borrowing Order would also have been needed. We can reasonably argue that this permission would not have been given and that the envisaged restriction should consequently be regarded as the reintroduction of a control rather than a new restriction.

Notifying the Commission

5. Miss Wheldon's preliminary view is that the wording of Article 3 does not require us to notify the Commission before reintroducing a List C restriction. She is double-checking this view against previous advice. I agree. Nonetheless as a matter of flattery I would recommend trying to notify the Commission (and the OECD Secretariat) on the day of any announcement or as soon thereafter as possible. This should maximise the chances of a smooth ride from these bodies. I have prepared dummy letters to these bodies which can be adapted to any scheme we may introduce.

R. M. Perfect

R M PERFECT

FROM: R. H. HARRIS
DATE: 21 June 1982



NOTE FOR THE RECORD

cc Mr Feretz ✓ Mr Turnbull (para 10)
Mr Bottrill (para 3-4)
Mr Boote (para 10)
Mr Field DOI (para 12-15)
Mrs Helps D/Trade (para 20)
Mr Malley " (para 22)
Miss Winship " (para 19)
Mr R Baker (OECD UKDEL)
Mr M Tate o.r. (OECD UKDEL)

OECD: CAPITAL MOVEMENTS AND INVISIBLE TRANSACTIONS
COMMITTEE (CMIT)

Richard Baker (OECD UKdel) and I attended the CMIT meeting beginning Tuesday 15 June.

Recent developments

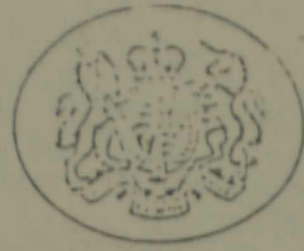
2. The Secretariat recalled instructions in the communique from the Ministerial Council to strengthen the OECD treatment of international investment and trade in services. (ref DAF(INV)(82) 19).

Recent measures (ref Working document 1/146)

3. Japan The Japanese delegation explained that the total size of yen denominated bond issues was not decided by the Ministry of Finance. It was decided and administered by underwriters. Japanese investors were unfamiliar with foreign issues and there was a limit to the number that they could digest. New issues had been stopped between Nov 1980 and Jan 1981. More attention was now paid to the amount the market could stomach. The Ministry of Finance prepared a biannual forecast that was discussed by the underwriters in the presence of Min.Fin. A total of 16 billion yen bond issues were expected Jan-May 1982.

4. On loans, these were decided by banks, though the Min Fin were concerned because of the exchange rate effect and because banks were large subscribers to Government bond issues. During consultations the Min Fin had expressed hopes but never issued instructions. Press reports to the contrary were false, unjustified and completely mistaken. The Finnish, USA delegates and others expressed concern about Min Fin involvement with frustrations to the capital market but after Japanese explanations that Min Fin not expressing view on individual bond/loan decisions

2/16



protesting
and / that Min Fin shouldn't be prohibited from expressing
desires or hopes in view of importance of loans/bonds the
Chairman concluded that if Japan felt there were any
misunderstandings CMIT had provided an opportunity to explain.

5. Sweden The 1916 Natural Resources Act controlling foreign
investment had been revised but practice remained the same. The
largest crispbread firm had recently gone Swiss as a result.

6. Switzerland Reports of a Eurofranc (Swiss)/^{issue}were not quite
right. The World Bank had been allowed to raise a bond issue
nominally expressed in dollars but with value fixed and repayable
in Swiss francs, at the World Bank's discretion. The Swiss
National Bank was not likely to offer such terms to others.

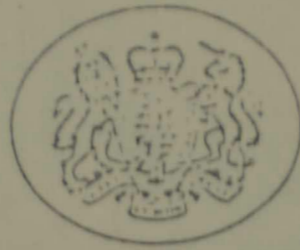
7. France confirmed that the share of French francs in ECU
lending did not count as foreign currency lending.

8. Italy confirmed the press reports under reference of a
reduction in leads and lags permissible on trade payments. France
queried whether this affected the Italian position under the code
and wished to pursue bilaterally with the Secretariat.

9. Japan noted that Japanese banks opposed foreign issues of
certificates of deposit and other commercial paper because they
feared it would lead to domestic issues and undermine reliance on
bank loans. Min Fin had hoped etc. but unfortunately. However
now that tax problems were resolved Min Fin expected zero coupon
bond sales to resume shortly.

10. United Kingdom recalled Japan challenge on Nomara case at
previous session and spoke to Gents letter of 27 April. Japan
asked about the criteria for acceptance as a bank/deposit taker.
I explained that these were set out in Schedule II of the Banking
Act 1979 and undertook to provide Japan with a copy. Finland had
read these and wondered if any clarification was available.

∟ The Bank produce an annual report on their supervisory activities
that may suffice - I will follow up_7.



Recent French exchange control measures DAF/INV/82.21

11. France confirmed the report was accurate. Gold transactions were formally anonymous, so residential status was irrelevant. Now that anonymity removed this area had not been satisfactorily clarified. USA noted that these controls were becoming long-term while UK wondered if supervision of gifts to non-residents did not impede such transfers. Explicitly did not suggest advertising in Le Figaro to find out.

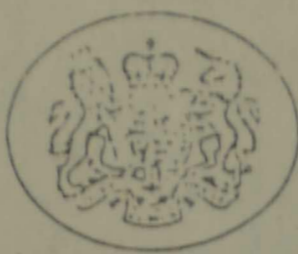
Inward direct investment DAF/INV/82/17

12. The Secretariat noted that the Ministerial Council had asked the responsible committees (CMIT and CIME) to take work on liberalising capital movements forward. The draft paper suggested has some elements of the right of establishment might be included in the liberalisation obligations of the Capital Movements Code.

13. The Scandinavians, led by Finland, said they were opposed on practical grounds and also in principle. The Code did not guarantee establishment and hence did not guarantee associated transactions. This was the old egg and hen problem (sic).

14. Others felt that CMIT was bound to make some proposals on liberalising rights of establishment since Ministers had asked for them. The problem was how to define the gap between the Code and the Decision on National Treatment and suggest how to plug it. In discussion it was made clear that the 1961 decision adopting the Code made it clear that right of establishment was not necessarily entailed by the Codes but nor was it explicitly ruled out, and indeed in some areas it had been explicitly included eg insurance under the Invisibles Code. All agreed that if the Codes were extended to cover rights of establishment all would have a chance to lodge reservations.

15. In conclusion it was agreed the paper under reference should be revised to reflect the reservations of the minority. Baker (UK) noted that the Finns already had a reservation on



direct investment that explicitly noted their reservations on rights of establishment. He hoped they would reconsider their position and trick the rest of us into the open.

16 Norway (DAF/INV/82.10)

On second reading, Norway noted that the fact that oil revenues were paid in Norwegian currency made for monetary expansion. Recent court cases on tax and exchange control evasion had heightened public concerns and a Parliamentary paper 1977/78 No.27 suggested company ownership structures should not be unnecessarily complicated. Paper to be cleared by written procedure.

17 New Zealand

On first reading, New Zealand explained that the balance of payments remained tight. Gas developments were expected to provide 50 per cent of energy requirements by 1985 and it might then be possible to liberalise. But at present the current account deficit was 6-7 per cent of GDP. The exchange rate was targeted bearing in mind expected relative inflation rates. New Zealand was happy to accept inflows but there was no queue to get in. Official financing had to cover the current account deficit and any private capital outflows.

18. Questioned on the exchange rate New Zealand thought that dollar/EMS movements affected individual exporters more than their weighted exchange rate target. On direct investment Austria felt the New Zealand attitude was too nationalistic and would have preferred overseas investment to have been stopped if it hurt the New Zealanders rather than allowed if it benefitted them. The Committee sought to encourage New Zealand to limit its reservations, notably on real estate needed for health purposes, and wanted to recommend the New Zealand authorities to liberalise in this area. New Zealand thought this might add to its workload so Richard Baker (UK) suggested the Committee invite the New Zealanders to reflect on whether they could liberalise further and this was acceptable.



Films (DAF/INV/82.16)

19. The Secretariat noted it was 4 years since CMIT had examined films. In 1970-71 CMIT had included videos in the definition of films and the Secretariat now wanted to cover all new forms of telecommunications and data transmission processes. The Secretariat suggested setting up a group of experts on films. Their first task might be to define the field they could cover. Holland suggested the existing group on information processing be consulted UKDEL OECD to check ICPP contact⁷. Despite Japan's (disbelieved) protest that it had no experts on films CMIT felt the best way to proceed was to invite advice from experts as envisaged in the paper under reference.

Insurance

20. Jamar (Holland) reported on Insurance/CMIT subgroup work. A new text had passed the insurance committee and would come to CMIT in October. But no common ground had been found on taxation of insurance and advice from the fiscal affairs committee might be needed. For example 7 countries took account of reciprocity in taxing insurance while others did not.

Maritime Committee

21. Work on competition policy, access to different types of trade and subsidies continued.

Tourism

22. A questionnaire had been issued and replies were due back in July. The limit on tourist allowances in G1 of the Invisibles Code had clearly been overtaken by inflation and needed revising.

Future work

23. The next meeting was fixed for October 5-7 with 16-17 December also pencilled in. Australia and the USA and Spain will be examined at these meetings. The film experts meeting might be fixed for October 28-29.

R. M. Perfect

R M PERFECT