PO-CH/NK/0728 PART A

3/3

CONFIDENTIAL

FROM: S P Judge

DATE: 14 January 1987

PS/CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Mr Cassell
Mr Scholar
Mr Cropper

PS/Customs & Excise

Thanks. Soon

VAT: STARTER No 6: SMALL WORKSHOPS

The Minister of State undertook (paragraph 31 of the Chevening note) to investigate whether the proposals on VAT avoidance might hinder the provision of small workshops.

Customs are convinced that the VAT reform will have no effect on property companies who build small workshops for start-up companies. At present, sales and long leases (over 21 years) are zero-rated, whereas short leases are exempt. The construction work done by builders for the developers is, at least at present, zero-rated. So the only possible problem area is with developers who do the building work themselves (ie buy bricks and pay wages) and then grant short, exempt, leases. Even here Customs think that the reform will not have any effect, as they are not allowed to deduct the input VAT on their bricks at present.

SPJ.

S P JUDGE
Private Secretary

SECRET

Enterprise measures

31. Although there was no case for a major enterprise package in this Budget, it would be helpful to have an analysis of the various proposals put forward by Lord Young and Mr Trippier. Help for pre-trading R&D did not look attractive, nor did the proposals for "chance in a lifetime". But the proposal for enterprise companies - or some related measure designed to encourage local investment in small businesses - seemed worth further study. The Financial Secretary agreed to look at this. The Minister of State would investigate whether the proposals on VAT avoidance might hinder the provision of small workshops, and if so what might be done to alleviate that.

BUDGET - SECRET

COPY NO. 2/33

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

From: P Jefferson Smith

Date: 14 January 1987

MINISTER OF STATE

cc Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Sir G Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr Sedgwick
Mr Scholar
Mr Odling-Smee
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey
Mr Battishill - IR
Mr Isaac - IR
Mr Painter - IR
Mr Graham
(Parl.Counsel)

JEFFERSON SMITH TO MST 14/1

CONSUMER CREDIT TAX

1. We asked for a meeting with you on Friday so that we could run over the basis of the intended consumer credit tax and check that we are on the right lines before going on to the next stage, which is to prepare instructions to Parliamentary Counsel. This note may serve as a basis for discussion: it sets out the points which we take as decided and sketches out the areas on which more work now falls to be done, and on which further detailed submissions will be made.

Internal Circulation:

CPS	Mr Butt	Mr Trevett
Mr Knox	Mr Howard	Mrs Boardman
Solicitor	Mr Wilmott	Mr Mier

Basis for the Tax

2. The tax is to be payable by persons offering interest-bearing credit to consumers. The rate of tax is to be 5% of the interest.

3. The charging provisions will have to define

(a) The persons liable to pay the tax.

(b) What is meant by consumer credit. Both these matters are best dealt with by casting the net widely, and then defining the classes of lending, lender or borrower which are to be exempt - see below.

(c) The term interest - to reduce avoidance we envisage a definition which will bring in any charge which is proportionate to the capital originally borrowed or outstanding; but it would exclude any non-proportionate charge e.g. a fixed arrangement or management fee.

(d) Territoriality - see below.

(e) The time the tax falls due - we think this should be the date at which the interest is payable. Collection would be quarterly in arrears.

Exemptions

4. There is a firm decision to exclude one type of consumer credit, and that is any mortgage to the extent that it is eligible for MIRAS relief. The other area where an exemption is definitely needed is for those transactions which are to be disregarded as de minimis. Most consumer credit is likely to be provided by a relatively small number of big firms, and on efficiency grounds we want to keep out of the tax net very small firms with low turnover, and any firms making only occasional loans. We think we need something like the VAT registration threshold, but are not in a position to advise what the relevant limits should be. These could best be fixed in the light of consultation after the Budget.

5. Other exemptions will be needed to ensure that the tax bites on commercial loans, but only on loans to consumers. Thus it will be necessary to exclude certain lenders, i.e. private individuals not

lending in a business capacity, and certain borrowers, i.e. businesses borrowing for the purpose of their businesses. (But for anti-avoidance and control reasons it would be desirable to tax any credit extended to businesses for the purpose of onward lending, unless those businesses are themselves registered for the purpose of the tax. Other exclusions may be desirable, e.g. all loans for car purchase.)

?? why

6. Some types of loan fall uncomfortably between the private and business sectors. A local authority mortgage is not a commercial loan properly speaking, but should probably be taxed (or relieved) in the same way as any other mortgage, for reasons of competition. Loans by friendly societies and credit unions may merit special treatment, but we must find out more about them. But perhaps the problem may best be considered in relation to charities, whether as lenders or borrowers. Charities may lend at low interest rates for social welfare purposes, or might even lend at normal commercial rates as a proper use of their funds if their foundation deeds permit it; they may run bank overdrafts or borrow in other ways. As lenders, they appear to have some of the characteristics which should make them taxable, though as borrowers they look more like consumers. We would like a steer on whether to exempt them as borrowers only, as both borrowers and lenders, or neither.

7. We propose no exemption of any sort in relation to any interest on credit card transactions. There seems no case for a de minimis limit, but this could be reconsidered if necessary in the light of representations between the Budget and the start date. If a credit card is used for any purpose, including a business transaction, interest on any outstanding balance should be caught by the tax. This is a practical proposal, to keep the tax as simple as possible and facilitate its early introduction. We believe that most business use of credit cards does not attract interest, the cards being used as charge cards; mainstream business borrowing is or can be financed by other means.

8. If we have a firm decision not to make any exemption for credit cards, and are able to indicate the broad principles of exemption in respect of other lending, there would be no need to have settled the exemption details before the Budget. Indeed it would be much better to allow scope for discussion, so that those with a good case for exemption can come forward and identify themselves. We therefore envisage that the Finance Bill should provide exemption for

(a) that part of any mortgage eligible for MIRAS;

(b) loans by registered businesses to other registered businesses;

(c) other loans to businesses for business purposes, but excluding credit card purchases, loans for onward lending, and probably loans for car purchase; relief to be subject to compliance with evidential and other conditions imposed for revenue control reasons;

(d) loans attracting interest payments in aggregate below levels to be specified by Treasury Order;

(e) any other circumstances to be prescribed by Treasury Order.

Territoriality

9. Broadly speaking, this should be a tax on consumer credit within the UK. Work is being done to define how this concept should work in practice, and it may be that a further Order-making power to adjust the tax at its (territorial) margins will be necessary. There is a problem over loans to UK residents by firms established offshore, on which we will develop proposals.

Timing of Introduction

10. The tax on credit cards is to come in first. The earliest start date is a date from which the card companies can increase their charges to borrowers, so as to recoup the tax, without being open to the charge of retrospection. We propose 1 May. This will certainly produce loud howls about lack of time to prepare, but no later date can be expected to remove this complaint while bringing in useful revenue in 1987/88. Because credit cards will be dealt with in

good

isolation, it will be necessary to define them. The essence, as we see it, is that production of the card enables the holder to make purchases of goods or services on credit, those purchases being charged to an account which is to be settled with the company which has issued the card. This will tax interest in respect of purchases by credit card, but not purchases using a shop account for which a card does not have to be produced; but tax will be payable only in respect of interest, and in consequence there will be no tax on purchases by charge card or credit card purchases not running into the interest bearing period.

11. Other taxable credit will be brought within the tax later. We propose going for a start date of 1 April 1988, but we think you should be prepared to be pushed back if valid reasons for delay are brought up during the passage of the Finance Bill.

Revenue

12. At the 5% rate, the revenue flow would be as follows

		£m	
	1987/88	1988/89	1989/90
Credit cards (1)	30	55	65
Other (2)	-	295	435

(1) From 1 May 1987

(2) From 1 April 1988

Enforcement

13. Enforcement powers will be needed. These include penalties against fraud or dishonesty and sanctions against failure to comply with registration provisions and for belated payment. The basic question is how far these should be modelled on the post Keith VAT provisions. The other major questions are whether as a further sanction credit debts to lenders who are in default to the Department should be unenforceable in the Courts; whether recovery powers might include personal liability of directors; whether legal disputes in

relation to this tax should be settled in the VAT Tribunals rather than in the High Court; and whether there should be special provision against offshore avoidance. All these matters will be the subject of a separate submission.

Management and Control

14. The legislation will have to put the tax under our care and management. The question is how much of the mechanical detail should be spelt out in the Finance Bill. Our view is, as little as possible: we would hope for powers to make regulations regarding registration for the tax, accounting and, where necessary to safeguard the revenue, giving security. Regulations would deal with such matters as payment of the tax quarterly in arrears. This will keep down the amount of material in the Finance Bill, but it would be desirable to expose the draft regulations at the same time as the Finance Bill was published, so that the credit card companies would know in detail, subject to passage of the Bill, what they would have to comply with from Royal Assent.

Cash and Manpower Resources

15. We would need a core of staff available immediately from the Budget to set up machinery for registering and accounting for the tax on credit cards. This would have to build up towards the end of the year, so that we could take on other lenders from 1 April 1988. There is a difficulty about being specific about numbers until we know what exemptions are to be made, particularly any de minimis limits. Cash provision will also be required not just for the manpower, but for related costs such as training and accommodation. This will involve a supplementary estimate and an increase in our approved manpower provision for 1987/88 and a further enhancement of our PES provision for 1988/89 and beyond. We are working on figures, and intend to consult with FP Division before making a further submission.

16. This may be the point to touch on information technology aspects. We have pointed out in earlier submissions that we do not really know how long a lead-in time the lending institutions will need, and of course we will need to adapt our own technology. We intend to base the accounting for the tax on existing hardware at the Betting Duty Control Centre at Manchester. But there will have to be some software adaptations, and for reasons of Budget security we do not think it is desirable to bring our computer experts into this work before the Budget. We reason, we hope not over-optimistically, that if the timescale is manageable by the lending institutions, it is also manageable by us.

Appropriate!

Next Steps

17. The next immediate step is to instruct Parliamentary Counsel, which will be done on the basis of a further submission to you, amplifying points in this paper. We hope to get this to you by the end of next week, for discussion and decision in the week following, with the aim of getting firm instructions to Counsel by the end of the month.

18. Material will be prepared for the FSBR, to meet the Treasury deadlines. We do not envisage much detail in the descriptive material, but the revenue figures will have to be firm.

19. On Budget Day, we would publish a leaflet aimed at the credit card companies explaining what would be taxable from 1 May and how they would be expected to account for that tax, subject to passage of the Finance Bill. On publication of the Finance Bill, there would be a similar leaflet in respect of all other credit, giving the framework of the tax, and indicating that much of the detail would be open to discussion with relevant trade associations, during the passage of the Bill.

P Jefferson Smith

3736/028

We must see that this doesn't happen again.

FROM: N J ILETT
DATE: 15 January 1987

PRINCIPAL PRIVATE SECRETARY

cc: PS/Economic Secretary
PS/Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Peretz
Mr Culpin
Mr M Hall
Mr Revolta
Mr Pickford
Mr M Richardson
Mr Wiseman
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Ch

Incredible that Lord Ch did not let anyone know. But in some ways not unhelpful to draw attention to debt not being painless. But could look odd to have "Gov't admits credit explosion"

AA

CONSUMER CREDIT: CREDIT EXPANSION, ARREARS AND DEBT ENFORCEMENT

You may like to know that the Lord Chancellor's Department is today publishing a consultative document on the reform of the procedure for the enforcement of debt. — press notice attached.

2. The consultative document forms part of the Lord Chancellor's Civil Justice Review, and is of no immediate interest to the Treasury, though there will be public expenditure considerations as and when the Lord Chancellor's deliberations lead to firm proposals for change. However, there is one immediate point of concern, namely the stark manner in which the Lord Chancellor's Department begin their paper with arguments about the expansion in consumer credit lending, the increase in default, and the causes of default (pages 1 and 2 of the (80 page) paper, attached below). If the Press pick this up, the Opposition may use it to support their arguments about the dangerous expansion of credit, socially undersirable lending etc.

3. The Lord Chancellor's Department evidently take a parochial view of this consultation document, which they describe as uncontentious. They did not consult the Treasury or the DTI in advance; indeed, we only got the press notice and the document itself last night after No.10 tipped us off.

4. The Lord Chancellor's Department tell me that so far press interest has come exclusively from legal specialists. If, however, the economic/popular press take this up I suggest the following defensive line:

(i) The ratio of personal debt to personal income has risen, but so have personal holdings of liquid assets, ie there has been a change in this country as in others in the way people manage their financial affairs;

(ii) We do not live in a paternalist society. Lenders and borrowers are free to take their own decisions;

(iii) While the Bank of England has made it clear that the growth in consumer lending is not at present a worry on prudential grounds, the Bank have equally emphasised that lenders need to pay close attention to the quality of their lending;

(iv) No evidence of lax monetary conditions.

5. We are looking at the figures which the Lord Chancellor's Department have quoted, which appear to be drawn from research by the National Consumer Council. If we come up with anything which improves the picture we will submit further advice.

N J ILETT

CHAPTER 1

DEBT ENFORCEMENT PROCEDURES

1. Claims for unpaid debts arising out of the supply of goods, services and credit make up the great majority of cases in the civil courts. In 1985 out of approximately 2.4 million cases started in the High Court (Queen's Bench Division) and County Courts, 2.1 million were debt claims for specified amounts of money.

Credit

2. More people are buying goods on credit. According to a recent study on the cause of debt [I], the proportion of consumer spending obtained on credit has risen from a quarter to a third of total expenditure. A wide variety of new sources, notably credit cards and budget accounts, have joined the traditional market of credit provided by hire-purchase and finance companies and lenders have broadened their policies so that credit is now easier to obtain. Banks and building societies, for example, are now more heavily involved in the provision of loans for consumer purchasing. In 1979 £5,000m was owed to UK banks by individuals other than house purchasers; in 1984 the figure was £15,000m[I].

Default

3. During the 1960s and 1970s the amount of hire-purchase and retail credit outstanding at the end of the year was less than the credit extended during the year. In other words, the public had repaid more than it had borrowed. This position has now been reversed. In 1984 the amount outstanding at the end of the year outstripped the new credit extended during the year by over £2,500 million. This is due to 2 factors:

I A background paper prepared by Gillian Parker of the University of York for the National Consumer Council's conference "Consumers in Debt" held in January 1986.

(i) more long-term credit is provided so that at the end of the year a smaller proportion of the debt has been repaid; and

(ii) more people are getting into arrears.

4. Notwithstanding current levels of unemployment credit is being made more widely available and this must be recognised as a major factor in the rising incidence of default. More specifically the National Consumer Council and Welsh Consumer Council in their report "Consumers and Debt" (1983) refer to three important factors as:-

(i) loss of income after contracting a debt;
(ii) financial mismanagement; and
(iii) family difficulties.

5. Recent studies on debt all point to the major areas as housing, fuel and the provision of consumer services. Thus:-

(i) The 1984 report of the Audit Commission estimated that over one million local authority tenants were in arrears with their rent.

(ii) 102,409 households in England and Wales had had their electricity supply disconnected because of non-payment in the year up to the end of June 1986.

(iii) In the same period 39,454 households had had their gas supply disconnected because of non-payment.

6. Two studies carried out for the Scottish Law Commission's review of diligence (enforcement)[II] indicate that a debtor is typically young, married with a family, in low paid manual work and subject to periods of unemployment.

II Adler, M and Wozniak, E (1981) "The origins and consequences of default: an examination of the impact of diligence". University of Edinburgh, Department of Social Administration.
Gregory, J and Monk, J (1981) "Survey of defenders in debt actions in Scotland". Research report for the Scottish Law Commission.

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DATE: 15 January 1987

PRINCIPAL PRIVATE SECRETARY

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Gregory, J and Monk, J (1981) "Survey of defenders in debt actions in Scotland". Research report for the Scottish Law Commission.

RC6.50

CONFIDENTIAL

Rw

FROM: CATHY RYDING

DATE: 15 January 1987

PS/MINISTER OF STATE

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir P Middleton
Mr Cassell
Mr Scholar
Mr Cropper
PS/C&E

VAT: STARTER NO.6: SMALL WORKSHOPS

The Chancellor was grateful for your minute of 14 January. He has commented "good".

CR

CATHY RYDING

LORD CHANCELLOR'S DEPARTMENT

PRESS NOTICE

Trevelyan House · 30 Great Peter Street · London · SW1P 2BY
Telephone: Direct lines 01-210 8512 or 8510

87/5

15 January 1987

Please Note Embargo

Not for publication or broadcast before

1530 hours Thursday 15 January 1987

DEBT ENFORCEMENT

LORD HAILSHAM PROPOSES CHANGES TO HELP BOTH CREDITORS AND DEBTORS

New measures to deal with "multiple debt": Closer Links with Advice Agencies

The majority of the two million or so claims which are brought in a year in the High Court and the County Courts in England and Wales are for unpaid debts arising out of the supply of goods, services and credit. In a consultation paper+ published today as part of the Civil Justice Review, the Lord Chancellor, Lord Hailsham of St Marylebone, puts forward a number of proposals aimed at improving the system for the recovery of debt and to make it more sensitive to the needs of both creditors and debtors.

A new study carried out for the Department by Touche Ross Management Consultants (also published today++) analyses the whole system for the recovery of debt and concludes that overall the system is working reasonably well. In particular, it dispels the myth that the County Court bailiffs are less effective than their High Court equivalents, the Sheriff's Officers.

The proposed changes include special measures to deal with "multiple debt" to reflect the needs of both parties (creditors and debtors) by:

* providing easier access to the court system for both parties;
* placing restrictions on the amount of future credit that multiple debtors may obtain; and
* placing restrictions on enforcement against debtors who have no means to pay.

+ Civil Justice Review. Consultation Paper No.5. Enforcement of Debt. Price £1.
++ Civil Justice Review. A Study of Debt Enforcement Procedures. Price £2.

Other changes include:

* all debt cases to start in the County Courts, to help unify the system and to relieve pressure on the High Court;

* closer links between the courts and the advice agencies;

* encouragement to settle claims outside the court system;

* improvements to design of court forms (now in hand).

SUMMARY OF THE STUDY

The study reveals a marked difference in the nature of County Court and High Court debt business. High Court claims are significantly larger, at £5,000 on average, and are mainly brought against business debtors. The average size of a County Court claim is £230, mainly brought against an individual.

The study shows that generally the system is working reasonably well. The main findings are as follows:-

On the positive side

The report dispels the myth that the County court bailiffs are less effective than their High Court equivalents, the Sheriff's Officers.

More than 60% of creditors are able to recover at least part of the debt, without undue cost and delay.

County Court creditors and debtors find court staff and Registrars helpful and informative. Few debtors have complaints about the bailiffs.

County Court creditors and debtors have little difficulty with the procedures and consider the court proceedings to be fair. On the other hand some 10-30% of litigants are still encountering problems.

On the negative side

Most creditors have no information about the financial status of the debtor either at the time of the original transaction or when they begin court proceedings.

A substantial minority of individual debtors are in low paid employment or are unemployed and find it hard to pay off their debts.

High Court litigants are noticeably less happy with the court system as a whole.

Although in most instances at least some payment in received, it remains the case that, a year after judgement, half the claims in the sample were still wholly or partly unpaid.

SUMMARY OF RECOMMENDATIONS

Cases to start in County Court

The paper recommends that debt business should remain part of the court system but suggests that all claims start in the County Court. Substantial cases would transfer to the High Court if they become contested and debts over £3,000 would be enforced by the High Court Sheriffs. At present there is no minimum monetary limit on cases that start in the High Court.

Pre-litigation action

A new pre-summons form is proposed which is designed to promote settlement of claims without the need for recourse to court action.

Enforcement Office

The case for a separate enforcement office to take over responsibility for enforcing civil debts is considered but rejected as involving greater cost and delay without, necessarily, a consequent improvement in the success rate.

In its place, improvements are proposed to the "administration order" (a form of mini-bankruptcy) to counter the problem of multiple debt. The paper recommends:

* the scope of the administration order be broadened to enable more applications to be made. At present only debtors who have a judgment entered against them may apply to the Court for its protection;

* no restriction on the amount of debt to be included in an order. At present the maximum debt that can be included in an application for an order is £5,000;

* a restriction on obtaining future credit or, where it is apparent that the debtor has no means to pay, a restriction on future enforcement;

* composition orders, which enable the court to reduce the amount of debt to be repaid, where appropriate, to be encouraged;

* creditors to be prevented from using pressure to secure payment to the detriment of other creditors who are taking part in the order.

Seizure and sale

The paper examines the arguments for and against the continuation of seizure and sale of the debtor's goods as a form of enforcement and comes down in favour of its retention but with the following modifications:

* improvements in the management and accountability of County Court bailiffs and High Court Sheriffs;

* enforcement by Sheriffs to be put on a modern statutory basis;

* the provisions which exempt certain property from seizure to be updated.

Advice Agencies

The paper recognises the valuable work which is being done by the voluntary advice agencies in the field of debt and recognises that closer links should be promoted between the courts and such agencies.

Responses to the Consultation Paper

Responses to the consultation paper are requested by 29 May 1987. They should be sent to Miss Frances Walker, Lord Chancellor's Department, Trevelyan House, 30 Great Peter Street, London, SW1P 2BY.

/Notes for Editors

Notes for Editors

1. The consultation paper records that in recent years both the provision of credit and credit default has risen sharply. These factors are reflected in the growth in the number of money claims dealt with by the courts in England and Wales. For example, in 1980 about 1.3 million summonses were issued for debt claims in the County Courts. By 1985 this figure had risen to about 2 million.

2. If judgment is entered for payment of the debt, the creditor may immediately proceed to enforce it. There are four main methods of enforcement, the most commonly used being "execution", i.e., the seizure and sale of the debtor's goods. Execution is carried out in the County Court by members of the court service; in the High Court by Under Sheriffs and Sheriff's Officers for whom the Lord Chancellor is not responsible. There are 285 County Courts employing 841 bailiffs. High Court cases are brought in the Royal Courts in London and at 134 District Registries of the High Court outside London. There are about 60 Under Sheriffs.

3. Other methods of enforcement are attachment of earnings, garnishee orders (usually attaching funds in a bank or building society) and charging orders (charging an interest in land or securities). In addition there are two procedures which are closely related to enforcement: the administration order, which is a means of clearing multiple debts by a series of pro-rata payments to all the creditors; and the oral examination procedure, whereby a creditor can question a debtor about the extent of his assets and liabilities. Particular categories of debt, e.g., rent and rates, can be enforced formally outside the High Court and County Courts but such methods are not included in the present study.

4. In February 1985 the Lord Chancellor set in hand a major review of the system of civil justice in England and Wales with the object of bringing about reforms which would cut the delays and complexity of civil litigation. Three consultation papers, on personal injuries litigation, small claims in the County Court and the Commercial Court have already been published and two further papers - on housing and general issues - will shortly be available. The Review is expected to be completed by the end of 1987. The appointment of Touche Ross Management consultants to carry out the study of debt cases was announced on 14 April 1986.

Press enquiries to Richard White, Lord Chancellor's Department; 01-210 8829.

BUDGET SECRET

COPY / OF 36

FROM: S P Judge

DATE: 15 January 1987

PPS

Can I have the [illegible] ws 1988 FBS - what wd it contain? ws [illegible]

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Sir Geoffrey Littler
Mr Cassell
Mr Monck
Mr A Wilson
Mr Sedgwick
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Mr Odling-Smee
Mr Peretz
Miss Sinclair
Mr Tlett
Miss Evans
Mr Cropper
Mr Tyrie
Mr Ross Goobey
PS/C&E (9 copies)
PS/IR (3 copies)
Mr Graham - Parly Counsel

PS/MST
To
PPS
15/1

CONSUMER CREDIT TAX

I attach a note of the meeting the Minister of State held today to discuss Mr Jefferson Smith's submission of 14 January. Due to our imminent departure to Brussels, I regret that I have not been able to discuss it, or this note, with him.

2. The tentative decisions taken were as follows. Paragraph numbers refer to the note of the meeting.

i. The general basis of the tax was agreed (paragraphs 2-4);

ii. it was agreed to tax all credit cards (paragraph 13);

iii. a general mechanism for granting exemptions was agreed (paragraph 14);

iv. it was agreed not to exempt charities, either as borrowers or lenders (paragraphs 16 and 17);

v. it was agreed to plan for the introduction of the main tax from 1 April 1988;

vi. "Keith"-type enforcement was preferred (paragraph 20);

vii. it was agreed that the tax on credit card interest would be due from the date the interest appeared on the statement (paragraph 24);

viii. it was agreed that the credit card tax would start on 15 August 1987.

3. The major items of work that have already been promised include:

i. further details of the **de minimis** exemptions (paragraph 5);

ii. a list of interest payments allowable against income tax (paragraph 7);

iii. an analysis of the implications of this tax for the operation of MIRAS (paragraph 8);

iv. a list of "problem" borrowers and lenders (paragraph 9); and

v. further work on territoriality (paragraph 18).

Deborah Francis.

pp. **S P JUDGE**
Private Secretary

MINISTER OF STATE TREASURY

NOTE OF A MEETING HELD AT 5.15PM ON 15 JANUARY 1987 AT HM TREASURY

Present: Minister of State
Mr Scholar
Mr Peretz
Miss Sinclair
Mr Ilett
Mr Cropper
Mr Ross Goobey

Mr Knox - C&E
Mr Jefferson Smith - C&E
Mr McLaughlin - C&E

Mr Painter - IR

NOTE OF MST MEETING 15/1

CONSUMER CREDIT TAX

1. The Minister of State apologised for the last minute change of time, which was caused by him having to go to Brussels on Friday. He worked through Mr Jefferson Smith's submission of 14 January.

Basis for the tax

2. The general principle is that **lenders** will be responsible for paying the tax on interest they charge - and passing it on in some way to the **borrower**, unless he can demonstrate that the credit concerned is exempted.

up to lenders

3. There was broad agreement that paragraph 3 of Mr Jefferson Smith's note was correct. Item 3(e) - when the tax falls due - is discussed further in the credit card context in paragraph 22 below.

4. Mr Ross Goobey, commenting on item 3(c) - excluding **non-proportionate** arrangements and management fees - wondered if this would encourage lenders to boost these fees and cut interest rates. But Mr Ilett thought bigger front end fees would not be popular with borrowers.

Exemptions

5. The Minister of State said that he agreed with the general proposition on **de minimis** exemptions (paragraph 4), and awaited further work.

6. Mr Painter explained that it would not be easy to exempt just the parts of mortgage loans that were eligible for interest relief (MIR). Not all lenders operated MIR at source (MIRAS) and so it was not enough just to exempt interest paid under MIRAS arrangements. Borrowers not using MIRAS would have to supply evidence (eg a tax coding) to the lender, indicating how much of their loan was both under £30,000 and for a qualifying purpose (ie extensions but not washing machines).

7. Mr Painter added that many other interest payments were allowable against tax - eg on loans used to finance employee buyouts. **He agreed** to provide a list of these. Mr Scholar said it was important that these income tax allowances were not converted into consumer credit tax exemptions. The Minister of State said this was a risky area, and would have to be watched carefully.

8. Mr Painter also pointed out that exempting loans that qualified for MIR would make any eventual abolition of MIR that much more difficult. Also, complicating the MIR and MIRAS systems would put considerable burdens on the Revenue and lending institutions. This would inevitably leave less effort remaining to crack down on abuses to the MIR system - believed to be costing £100 million in lost revenue.

9. Mr Jefferson Smith explained that in simple terms the tax would bite on loans from **commercial lenders** to **consumers**. But the first category would have to include competitors and proxies - eg local authority loans. The second might include charities - see paragraphs 16 and 17 below. He offered to provide a fuller list of such borrowers and lenders. The Minister of State agreed that, on anti-avoidance grounds, it would be desirable to tax credit extended to businesses for onward lending, unless those businesses are themselves registered for the purpose of the tax.

is this practicable ?

10. Mr Jefferson Smith clarified the reference to loans for car purchases in paragraph 6 of his note: they could be excluded from the exemption, ie taxed! This would apply irrespective

Good!

? of who was doing the lending. Mr Ross Goobey thought the motor industry lobby would make a lot of trouble about this.

11. Miss Sinclair wondered how the border between the commercial lenders and sole traders or unincorporated lenders would be policed. Mr Jefferson Smith admitted that there would be some leakage here, but that only small amounts of revenue were at stake. Mr Scholar said it was important not to antagonise Lord Young by placing an onerous compliance burden on small businesses.

12. The Minister of State wondered why an individual using a credit card for both business and personal spending should be taxed on the interest paid on business use. Mr Ilett thought that business use fell into either:

discuss

i. a large company issuing lots of cards to employees, probably required to repay the monthly bill in full, and therefore paying no interest.

ii. a greengrocer running a fruit van and a car, with two separate credit cards. Exempting one but not the other from the tax would create an obvious avoidance route.

13. Mr Jefferson Smith said that if the credit card tax was to happen during 1987 then no exemptions could be allowed. Prudent businesses only use them as charge cards and so were not liable for interest or tax.

✓ v expensive credit

14. Mr Jefferson Smith said that, subject to Parliamentary Counsel's views, he expected the Finance Bill clauses to follow the structure set out in paragraph 8 of his submission. When the Bill is published the Government should set out:

a. the exemptions that it definitely intends to make; and

b. a broad outline of the exemptions to be specified in detailed Regulations, following consultation.

It will be important to steer pressure groups towards b., to minimise the risk of exemptions being enshrined in primary legislation.

15. Mr Cropper lamented the passing of the days when the Finance Bill Committee would make changes of this kind, and was seen as the proper forum for so doing. Mr Ilett said that the difficulties in Committee might be eased if the general exemption principles were on the face of the Bill. But Miss Sinclair said that people would want to know soon if their loan was going to be taxable.

Charities

16. Mr Knox admitted that there were problems with not exempting charities as **lenders** - eg loans to injured soldiers who are trying to start a new life. The Minister of State thought that the post-Budget consultation period would ease this problem. It was certainly important not to exempt "bogus" charity lending.

So do companies!! Bad news under VAT for them!

17. The Minister of State pointed out that, in terms of the existing logic, charities were treated as consumers - they paid VAT and other Customs taxes. Borrowing for quasi-commercial activities - eg Christmas cards, disabled workshops, should be taxed. Hard cases would be typified by a church in financial difficulties with a bank overdraft. But granting exemptions here would just encourage further abuses. Mr Scholar suggested that "Consumer Credit Tax" was not a good name for a tax paid by (or, more strictly, passed on to) charities. The Minister of State recognised that we were creating a rod for our own backs by this position on charities, but thought that it could not be avoided.

?? ✓ diff

DISCUSS

Territoriality

18. The Minister of State looked forward to the further work on this. Mr Jefferson Smith said that there was a theoretical problem with lending organisations without a UK agent. But they would always be at risk from the next Budget, especially for long loans (the main offshore risk). Mr Ilett thought that the

significant start-up costs of extra-territorial credit would prove quite a deterrent.

Timing - main tax

19. The Minister of State agreed that we should aim for 1 April 1988, and recognised that this might be pushed back if there were a lot of problems with the Finance Bill. !?

Enforcement

20. The Minister of State agreed that a "Keith" approach was best, although there would be a series of entirely predictable rows. He favoured VAT tribunals. Mr Ilett expressed doubts, on prudential grounds, about the suggestion that if a lender is in default to the Department then it would not be able to enforce debts to it in the Courts.

Management control: cash and manpower

21. The Minister of State was content with paragraphs 14 and 15 of Mr Jefferson Smith's note, and approved of the new use for the Betting Duty Control Centre at Manchester. He agreed that Customs are right not to bring their computer experts in at this stage.

Credit cards

22. On the question of when the tax is due, three dates sprang to mind:

i. when interest charges appear on statements;

ii. the date by which minimum payments have to reach the lender; and

iii. when the minimum payment is actually received.

Mr Ilett pointed out that, because the minimum payment (usually 5 per cent of the amount outstanding) is always more than the interest payments (about 2 per cent of the amount outstanding), the tax can be deemed to be paid by the borrower when he makes his minimum payment.

23. It was generally agreed that, on prudential grounds, option iii. was not satisfactory.

24. From the point of view of the credit card companies, i. was probably easier for them to administer, but ii. gave them the best cashflow position. It was agreed, provisionally, that we should try i.

25. As to how the tax would appear on the credit card statements, Mr Jefferson Smith felt that this could be left up to companies. They could either increase interest rates from, say, 2 per cent to 2.1 per cent, or show a separate line. This would depend on how easily their software could be modified. Mr Ilett thought that DTI would prefer the latter, on consumer protection grounds.

26. The final issue discussed at the meeting was when this tax should start. It was envisaged that tax due in a 3-month period (however defined) would be payable to Customs one month after the end of the quarter. So if the tax was introduced on 1 May 1987, tax on interest payable during May, June and July would be payable to Customs on 1 September. Further tranches would come in on 1 December and 1 March. But this would involve an element of retrospection - the credit card companies would have to pass on during May, June and July a tax which they were not at that stage legally liable to pay to HMG. (The Provisional Collection of Taxes Act would not apply here).

27. Alternatively, if tax was due on interest payable after 15 August - certainly after Royal Assent - then the introduction of the tax would be greatly simplified. About £10 million of revenue would be lost in 1987-88. The Minister of State felt that this was the neatest way to introduce the tax.

Deborah Francis

p.p. **S P JUDGE**
Private Secretary

RA3.27

Prg

FROM: A C S ALLAN

DATE: 20 January 1987

MR ILETT

cc PS/Economic Secretary
PS/Sir P Middleton
Mr Cassell
Mrs Lomax
Mr Peretz
Mr Culpin
Mr M Hall
Mr Revolta
Mr Pickford
Mr M Richardson
Mr Wiseman
Mr Copper
Mr Ross Goobey
Mr Tyrie

CONSUMER CREDIT: CREDIT EXPANSION, ARREARS AND DEBT ENFORCEMENT

The Chancellor was grateful for your minute of 15 January about the Lord Chancellor's Department's consultative document. He feels we must make sure in the future that the Lord Chancellor's Department do not act alone, and do consult other departments in advance on issues of wider importance.

ACSA

A C S ALLAN

BUDGET - SECRET COPY NO. 2 /24

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

JEFFERSON SMITH To MST 22/1

From: P Jefferson Smith
Date: 22 January 1987

MINISTER OF STATE

cc PS/Chancellor
Mr Cassell
Mr Scholar
Mr Peretz
Mrs Lomax
Mr Ilett
Miss Sinclair
Mr Cropper
Mr Ross Goobey
Mr Painter (I/R)
Mr Graham
(Parly Counsel)

CONSUMER CREDIT TAX : SCOPE AND COVERAGE

1. At the Chancellor's overview meeting on 19 January, we were asked to provide a note on how we could exempt loans to charities whilst taxing lending by them. At that meeting it was recognised that it would also be necessary to consider the extent to which the tax should be applied to loans to or by other categories who are neither businesses nor individual consumers. You are to discuss these issues with us further on Friday in advance of our submitting to you detailed draft instructions to Parliamentary Counsel next week.

2. To date it has been decided that:

(a) The Finance Bill should set out the main reliefs, and provide scope for other, more detailed, provisions to be prescribed by Treasury Order following the post-Budget consultative exercise.

Internal Circulation:

CPS	Mr Butt	Mr Trevett	Mrs Smith
Mr Knox	Mr Howard	Mrs Boardman	Mr MacLachlan
Solicitor	Mr Wilmott	Mr Mier	

(b) The tax charge is to be accounted for by registered lenders, it being left to them how and to what extent to pass it on to individual borrowers. One important consequence of this is that, if the charge of tax depends on the status of the borrower or any matter within the borrower's control, such as the purpose of the loan, the lender must be able to get the necessary information at the time the interest is charged.

(c) There is to be a general relief for loans for business use (except in respect of credit cards).

(d) The tax should apply to all loans to individuals other than any:

(i) for business use; or

(ii) which attract income tax relief for use in the purchase or improvement of a main residence.

Prob right, but careful

(e) Loans <u>to</u> charities should be exempt; but loans <u>by</u> them should be treated on a par with loans by commercial lenders.

(f) Lenders should only be required to register if the total of their taxable business is above a de minimis limit to be prescribed by Order.

3. This note covers the implications of the decisions to date for the treatment of charities and for other private and public bodies which are neither mainstream businesses nor individuals; the extent of the exemption for business use; and the structure of the de minimis limit.

A. <u>Borrowers : the definition of "consumer"</u>

4. The first main issue is whether the right approach is to impose the tax basically on lending to all borrowers other than businesses, or to make its basis loans to individuals (other than for business use). This turns on whether borrowers who are neither businesses nor private individuals are to be inside or outside the tax. In the case

of VAT, the basic dividing line is drawn so as to allow only businesses to escape the burden of the tax by reclaiming VAT paid on purchases for business purposes. As a result, all non-business purchasers are treated as consumers, and have to bear the effects of the tax, unless any individual purchase benefits from a specific relief. The only exception to this is a specific relief which allows local authorities and certain other bodies in the public sector to reclaim VAT in respect of non-business purchases. This is simply to avoid an unnecessary financing burden.

5. Our previous approach had been to follow broadly this VAT approach. All lending would have been assumed to be taxable, unless the borrower could certify to the lender that the loan was for a business purpose or fell under some other specific relief. This would have meant considering legislating for relief for any categories of borrower which were neither businesses in the generally understood sense, nor individuals. As well as charities, bodies also falling to be considered would have been professional associations, political parties, trade unions, non-charitable associations, and local authorities. In view of the decision not to tax lending to charities, it seems to us that lending to all these other bodies should equally be outside the tax. Many of them have equal political clout and are equally able to claim that they are not really proper subjects of a tax on lending to consumers. Many of them have or could get charitable status, and this could give rise to hopelessly anomalous borderlines.

6. If we had to operate borderlines which involved differentiating between charities and non-charities, there would be serious problems of definition, both for us and lenders. It would not be sufficient to confine the relief to registered charities (the relevant legislation applies only to England and Wales, and does not cover analogous bodies such as churches). Any general VAT relief has always been refused on the grounds that it is extremely difficult to define charities, and impossible to distinguish between worthy

mainstream charities and more dubious fringe activities. In practice, we think that any relief for loans to charities will need to be drawn sufficiently wide to also cover churches, societies and organisations with philanthropic, educational or political aims, and clubs and organisations.

7. It therefore seems better to approach the matter the other way round. If the charge to tax related to loans to individuals, plus perhaps some categories very similar to individuals (discussed below). There would be the following advantages:

(a) A blanket decision would have been taken about the treatment of bodies which fall between businesses and individuals, rather than piecemeal decisions of great difficulty.

(b) The criteria for the tax would be sufficiently distanced from VAT to give a possible line of defence against charities which tried to exploit the precedent - in particular the argument that it would be administratively burdensome to give a VAT relief to charities would not be undermined.

(c) Compliance problems for lenders would be reduced, since they could accept that any lending to a corporate body would be outside the tax. Certification as a basis for exemption would be required only in respect of loans to individuals and similar categories brought within the tax.

8. The minutes of the overview meeting suggested that loans to groups of individuals or clubs could reasonably be taxed. We deal with groups of individuals below, and there might have to be anti-avoidance provisions against clubs formed for avoidance purposes. But we are doubtful about taxing bona fide clubs as such. Some are very like businesses, and are treated as businesses for VAT purposes. If they borrow on any scale they could form themselves into companies (they may do so in order to limit the liability of their officers or committee members). Some could become registered

charities; a civic amenity society for example can become a charity if its objectives are in part educational. There must be an enormous number of clubs which are neither companies nor charities; but apart from bank overdrafts, we doubt if they are borrowers on any significant scale. In view of the anomalies and scope for complaint that would result from taxing loans to those clubs which were unable or unwilling to constitute themselves so as legitimately to avoid the tax, we suggest that loans to clubs should normally be exempt.

9. Applied across the board, this approach would mean that all loans to individuals would be potentially taxable. But we see residual problems in three main areas:

(a) It would be necessary to ensure that individuals did not try to avoid the tax by, for example, establishing a trust for an individual or forming clubs or organisations solely for the purpose of avoiding the tax. Although in practice we do not think that this is likely to be done on any substantial scale given a relatively low rate of tax, the legislation would need to include powers to take anti-avoidance measures; for example, by deeming a type of organisation advocated for avoidance purposes to be essentially "individuals" or by defining "individual" further in secondary legislation.

(b) Any definition confining the tax charged to individuals would automatically exclude loans to partnerships. This would obviously be correct in the case of larger partnerships which in all other respects are on a par with a limited company. But smaller partnerships (eg between husband and wife) could give rise to similar opportunities as for the self-employed for "business" loans to be syphoned off to private use. We need to consider how far the provisions proposed below for certification of loans to individuals for business purposes should also extend to small partnerships.

(c) With the possible exception of partnerships, the self-employed individual would be singled out amongst businesses by having all their loans potentially taxable unless business use can be proved. We would need to require lenders to obtain certificates of intended business use from the self- employed before treating them as exempt. This would be relatively easy to do in the case of those loans which normally involve a written contract. But would be harder in the case of bank overdrafts or loans which involved many individual "over the counter" transactions (for example in the relatively few cases where traders have interest- bearing monthly accounts at a cash and carry). Self certification is unlikely to have much more than a deterrent effect, but we see no alternatives other than allowing the self-employed a free-for-all, or wholly excluding them from the general business relief.

B. <u>Lenders : The business/non-business borderline</u>

10. We envisage putting an obligation to register and account for tax on all persons making taxable loans. Such a comprehensive definition of "registrable lenders" would be considerably wider than the provisions under VAT (where taxable supplies must be made in the course or furtherance of "business") or the Consumer Credit Act. But it would avoid creating inequities between, for example, charities and commercial organisations providing loans for home repairs or the purchase of equipment for the disabled. (At the overview meeting, it was thought reasonable to tax lending by charities.) In practice, the position of charitable and other non-commercial lenders would be mitigated by the operation of the de minimis limit, and by the fact that many of their loans would be made at below commercial rates. Problems would also be avoided in relation to lending by local authorities, which would be brought within the tax without the need for any specific provision. We would therefore favour a comprehensive definition of registrable lenders. This could probably be

legislated for most easily by applying the tax to all loans to individuals except where specifically relieved. But to avoid an obvious anomaly, the specific reliefs would need to include an exemption for individuals lending to other individuals solely in a non-business capacity (eg to blood relatives).

11. The main exemption for lenders, however, would be a provision exempting all loans made by a lender whose total taxable interest receipts were below a prescribed limit. The limit would have the general aim of reducing the number of registrable traders as far as possible to the 10% or so of lenders who are probably responsible for well over 90% of total lending, in order to minimise the control effort required and thus keep down the staff numbers and administration costs which would stem from an attempt to control up to 70,000 lenders. More specifically, if set at a sufficiently high level it could automatically exclude loans by many non-business lenders such as charities, clubs and associations and employers not normally in the lending business lending to employees.

12. The de minimis provisions would be modelled on those for VAT in that they would provide for:

(a) Separate registration and de-registration limits (in order to avoid lenders with a seasonal pattern of business dropping in and out of the tax).

(b) These limits to be varied by Treasury Order.

(c) Disaggregation measures like those enacted for VAT in the Finance Act 1986, enabling legally separate businesses to be treated as one in order to combat avoidance.

13. We have done a considerable amount of work on the level at which the de minimis limit would need to be set in order to achieve the maximum revenue for the minimum control effort. But there is not sufficient published data on which to base any conclusion in advance of the public consultation. There is no obvious VAT analogy, since VAT is charged on a different basis; and in any case we are likely to

need to set any de minimis limit at a higher level than that for VAT in order to restrict the number of registrable traders sufficiently. Any figure is likely to be contentious; whilst much of the pressure will be for a high limit, the banks and larger institutions will favour a low threshold. We think that the published legislation should not include a figure, but that the announcement should make it clear that this will be a matter for consultation.

C. Credit cards

14. Throughout, this note has dealt with the position for the broad-based tax. Whatever decisions are reached for that, we continue to think that no de minimis limit or relief for business use should be applied to credit cards. Any such reliefs would endanger the chances of the card providers being able to operate the tax in 1987-88; and, by definition, they are likely to be in a substantial way of business. In practice, the opportunities for borrowers to abuse any exemption for business use are most acute for cardholders, and possibly least defensible.

D. Recommendations

15. (a) The basis of the tax should be loans to individuals, treating as exempt all loans to corporate bodies, including public authorities, professional bodies, charities and clubs.

(b) There should be a provision to safeguard against avoidance by individuals.

(c) Exemption of loans to individuals and possibly partnerships for business purposes should be backed by a system of certification by the borrower.

(d) All lenders should be potentially registrable except individuals lending to other individuals in a non-business capacity.

(e) There should be a de minimis limit related to the lender's potential taxable receipts. This should announced in principle and the level set after consultation.

(f) Interest-bearing loans on credit cards should be taxable whatever their purpose and without de minimis limit.

Ph L

P Jefferson Smith

MST MEETING 23/1

BUDGET SECRET

COPY 1 OF 40

NOTE OF A MEETING HELD AT 10.30AM ON FRIDAY, 23 JANUARY 1987

Present: Minister of State
Mr Cassell
Mr Scholar
Mr Peretz
Miss Sinclair
Mr Ilett
Mr Cropper
Mr Tyrie

Mr Knox - C&E
Mr Jefferson Smith - C&E
Mr Maclachlan - C&E

Mr B O'Connor - IR

CUSTOMS PROJECT FIVE

1. The meeting focussed on paragraph 15 of Mr Jefferson Smith's submission of 22 January, "Consumer Credit Tax: Scope and Coverage", which FP are circulating to those who have not seen it. Please note the **code title** above, which I suggest should be used on all future papers. - C Are you happy with this? Yes

(a) Basis of the tax

2. The meeting discussed the proposition in paragraph 15. (a) of Mr Jefferson Smith's submission. The Minister of State was concerned to identify cases which could cause problems at a later date.

3. Mr Jefferson Smith confirmed that borrowing by **charities** and **trusts** would be exempt. Miss Sinclair wondered whether this would encourage individuals to turn themselves into trusts: Mr O'Connor pointed out that if they did so they would not be eligible for MIR. Mr Jefferson Smith added that such trusts would have to find lenders that were prepared to lend in these dubious circumstances: Mr Ilett and Mr Tyrie did not think this would be a problem. Customs and the Revenue will liaise further about trusts, especially those set up for the benefit of individuals.

(b) Provisions to safeguard against avoidance by individuals

4. Mr Jefferson Smith pointed out that the "catch-all" provision he proposed would be attacked as giving Customs arbitrary and excessive powers, much as with VAT. But to do nothing would invite avoidance, with all the attendant political difficulties. The use of VAT Tribunals for appeals, rather than the Courts, would be a positive point. Customs would need to explore this further with their lawyers and Parliamentary Counsel. He confirmed Mr Scholar's suggestion that these powers would be used to counter lenders systematically inviting borrowers to describe themselves in such a way as to be exempt from the tax.

5. A possible route for avoidance would be Credit Unions - co-operative ventures set up by, eg, workplace colleagues. Their **borrowing** would be exempt, as would their lending - unless they were above the **de minimis** limit. The anti-avoidance provisions would also have to cover an individual setting up a company and hoping thereby to escape the tax.

(c) Exemptions to be backed by certification

6. Mr O'Connor, Mr Scholar and Mr Cropper stressed the difficulty of splitting loans to **sole traders** and **partnerships** between personal and business uses. It might not be possible to determine this split until well after the interest and tax was due. Mr Jefferson Smith emphasised that the **lender** will be accountable for the tax, and will need to know if the borrower is exempt when he charges the interest.

Discuss

7. Mr O'Connor said that it was quite common for small companies, partnerships and sole traders to intermingle personal and business finances. They did this not just to avoid tax, but because they could often get better interest rates.

→ but there is already a tax allowable/not allowable distinction.

8. Mr Scholar thought that there was a case for making the tax even simpler than presently planned. Apart from the exemptions in paragraph 15 (a) of Mr Jefferson Smith's submission, loans could be exempted if the borrower:

i. was registered for VAT; or

ii. paid self-employed NIC contributions; or (possibly)

iii. provided a certificate that the loan was for a business use.

This would cut down red tape and avoid most of the certification process. Mr Jefferson Smith offered to estimate the revenue cost.

9. Mr Ilett asked who would be responsible if an incorrect certificate was submitted to a lender. Mr Jefferson Smith said that, provided the lender acted carefully and in good faith then he would not be liable for the back tax. Mr Jefferson Smith said that Customs would not be able to recover tax from borrowers who had submitted false certificates. They had no contact with such people and policing would be very expensive.

10. Mr O'Connor said that lenders were only persuaded to operate MIRAS, and deduction at source of tax on interest, if they were allowed to accept self-certification at face value. Lenders would complain loudly if they had to do more than this with consumer credit tax.

11. Mr Ilett pointed out that most personal loans were handled almost entirely by computer, whereas loans to businesses would have more manual input from the lender. He hoped that this would mean that lenders would have more reliable information about loans to businesses. Mr Tyrie added that lenders did not want to lend to small businesses for non-business purposes, but Mr O'Connor said that many lenders were not bothered, especially if security was available.

12. Miss Sinclair pointed out that a simpler tax on these lines would be a perk for the self-employed. Mr Peretz said that it would not cost an enormous amount, especially compared with wider concessions already available to them.

13. The Minister of State said that a further option would be to have an intermediate tax rate on loans to partnerships and

for

the self-employed, with the option of sumbitting certificates if a business could prove that all or nearly all its loans were business purposes. But Mr Jefferson Smith thought that lenders would complain about having to operate three rates and two boundaries between them. I agree

why?

14. Mr Tyrie asked whether start-up loans for new businesses would be taxable. Mr Jefferson Smith thought it would be impossible to exempt them. The Minister of State pointed out that this would cause problems with Lord Young, as would the tax collection burden on small lenders. Mr Tyrie agreed. But of course this would be balanced if the self-employed were exempted.

15. Mr Jefferson Smith said that the Revenue had now supplied a full list of interest payments allowable against income tax. They proposed to exempt such loans to individuals from consumer credit tax; such loans to businesses would of course automatically be exempted. He said he would cover this issue - which was not expected to cause too many problems - in his next submission.

16. The Minister of State wondered whether, and if so when, it would be sensible to raise these issues with **Lord Young** and **Mr Channon**. Mr Scholar said that the Chancellor was seeing Lord Young shortly to discuss his proposed Enterprise measures; Mr Cassell thought it might be helpful to mention this Budget proposal at the end of that meeting, but that this would need to be discussed at the next Overview Meeting.

?

(d) Registration of Lenders

17. Mr Jefferson Smith said that the Consumer Credit Act only applied to businesses. Although we could assume that all loans between individuals would be below the **de minimis** limit (not yet decided), the taxing of large loans between members of a rich family would certainly be a political issue and could not be ignored. The Minister of State thought it would be best to exempt such lending, unless obvious abuses occurred.

(e) De minimis limit

18. Mr Jefferson Smith said that Customs had no data at all on which to prepare even a tentative proposal. He felt it was best to admit to ignorance and consult with an open mind. He agreed to supply what information Customs had to Mr Scholar.

(f) Credit cards

19. The policy on credit cards was reaffirmed.

SPJ

S P JUDGE
Private Secretary

Circulation: Those attending
PS/Customs & Excise (8 copies)
Those attending Overview Meeting
Mrs Lomax

MR 11/46

CONFIDENTIAL

FROM: CATHY RYDING
DATE: 27 January 1987

PS/MINISTER OF STATE

cc: PS/Chief Secretary
PS/Financial Secretary
Economic Secretary
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Jenkins
Parliamentary Counsel
Mr D J Howard - C&E
PS/C&E
PS/IR

VAT: SMALL BUSINESS REVIEW

The Chancellor has seen Mr Howard's minute to the Minister of State of 23 January.

2. The Chancellor has commented that he agrees with the final sentence of paragraph 16 - that there can now be a little prospect of proceeding with compulsory deregistration at least for this year.

CR

CATHY RYDING

10 DOWNING STREET

LONDON SW1A 2AA

22 January 1988

From the Private Secretary

The 'until 1992' is particularly unhelpful

I enclose a copy of a message to the Prime Minister from Mr Lubbers about the forthcoming European Council. While it gets off to a good start it finishes up in a thoroughly unhelpful way by asking us to accept limitations on our abatement. I think the Prime Minister will wish to make a rapid reply and I should be grateful for an early draft.

I am copying this letter and enclosure to Alex Allan (HM Treasury), Shirley Stagg (Ministry of Agriculture, Fisheries and Food) and Trevor Woolley (Cabinet Office).

Charles Powell

Lyn Parker, Esq.,
Foreign and Commonwealth Office.

CH/EXCHEQUER
REC. 22 JAN1988
ACTION Mr A J C EDWARDS,
COPIES TO CST, Sir P. MIDDLETON, Sir G. LITTLER, Mr LANKESTER, Mr MORTIMER, Mr MERCER.

21-1-1988

COPY

PM THATCHER WILL RECEIVE THE FOLLOWING LETTER FROM PM LUBBERS

QUOTE

DEAR PRIME MINISTER,

THE STATE SECRETARY FOR FOREIGN AFFAIRS, MR. VAN DER LINDEN, HAS REPORTED TO ME ON THE USEFUL DISCUSSIONS WHICH HE HAD IN LONDON ON THE 20 OF JANUARY WITH SIR GEOFFREY HOWE AND LINDA CHALKER. AS I UNDERSTAND IT, WE ARE STILL IN AGREEMENT ON THE BASIC PRINCIPLE THAT AGRICULTURAL SPENDING MUST FIRST OF ALL BE BROUGHT UNDER CONTROL AND THAT WE SHOULD COOPERATE IN THE FURTHER DEVELOPMENT OF THE COMMUNITY ONCE THAT GOAL HAS BEEN ACHIEVED.

DEVELOPMENTS SINCE THE COPENHAGEN MEETING HAVE DONE NOTHING TO SET MY MIND AT REST. MY IMPRESSION - AND THE COURSE OF EVENTS IN THE COUNCIL OF MINISTERS OF AGRICULTURE WOULD APPEAR TO CONFIRM THIS - IS THAT THE PROSPECTS OF REACHING AN AGREEMENT IN BRUSSELS ARE GRADUALLY RECEDING. WE MUST DO ALL WE CAN TO RESCUE THESE PROSPECTS. I BELIEVE THAT, WHILE IT IS IMPORTANT STRICTLY TO MAINTAIN OUR POSITION CONCERNING THE REQUIRED BUDGETDISCIPLINE IN THE AGRICULTURAL SECTOR, WILLINGNESS TO DISCUSS CONCESSIONS ON OTHER POINTS IS CALLED FOR. AND SUCH AT A SUFFICIENTLY EARLY STAGE.

THIS BRINGS ME TO THE MAIN POINT ON WHICH WE DISAGREE, NAMELY THE QUESTION OF THE REBATE FOR THE UK. WE ARE PREPARED TO MAKE A CONCESSION ON THIS MATTER BY ACCEPTING THE CONTINUATION OF A REBATE ARRANGEMENT UNTIL 1992 ON CONDITION THAT THE REBATE IS CALCULATED ON THE BASIS OF SPENDING UNDER THE AGRICULTURAL GUARANTEE-SECTION. IF YOU WOULD BE ABLE TO AGREE TO THIS, I BELIEVE THAT IT WILL BE POSSIBLE TO PERSUADE OTHER COUNTRIES TO MAKE AT LEAST SOME CONCESSIONS. I WOULD BE PLEASED TO DISCUSS THIS FURTHER WITH YOU, A PERSONAL MEETING SHORTLY BEFORE THE EUROPEAN COUNCIL IN BRUSSELS WOULD INDEED BE VERY USEFUL.

YOURS SINCERELY,

UNQUOTE

CONFIDENTIAL

2789/34

FROM: M PARKINSON
DATE: 27 JANUARY 1988

1. Sir Geoffrey Littler

2. Chancellor

CH/ Content?

One para reads oddly: I have redrafted slightly.

cc: Mr Edwards
Mr Peretz
Mr Matthews
Mr Mortimer
Ms O'Mara

EUROPEAN COUNCIL: BRUSSELS 11-12 FEBRUARY

The FCO have commissioned a brief on the international economic situation, as part of their overall briefing for the Prime Minister for the European Council.

2. I attach a brief, which has been cleared with Mr Matthews and Miss O'Mara. I should be grateful for your approval to send this to the FCO, who have asked for the brief by close on 29 January.

Mark Parkinson

M PARKINSON

I have redrafted the 'Speaking Notes'.
Otherwise, I agree.

28/1

CONFIDENTIAL

EHG(B)(88)1B COPY NO

EUROPEAN COUNCIL, BRUSSELS
11-12 FEBRUARY 1988

INTERNATIONAL ECONOMIC SITUATION

Objectives

To avoid substantive new declarations on international situation, or on future European monetary developments.

Speaking Note

On the world economic situation, prospects appear a little more promising than many expected two or three months ago. It is now clear that the pace of activity in most of the major economies was stronger in the second half of 1987 than had been predicted. (For the G7 together output in the third quarter was 3 1/4 per cent higher than a year earlier). The prospect is for somewhat slower but still substantial continuing growth through 1988, with inflation remaining low. Excessive further exchange rate changes are unnecessary and could undermine growth prospects. ~~and~~ But there is still need to demonstrate that the major current account balances are being corrected and that individual national policies will continue to help the process. The G7 statement of 23 December underlined these points and renewed the commitments and cooperation of members of the group. A further EC statement from this meeting would not be a helpful contribution.

On developments within Europe, the UK welcomed the measures agreed at the September informal meeting of EC Finance Ministers to strengthen the EMS, and has also welcomed and joined in the practical cooperative steps taken since then, especially in the management of interest rates and differentials. We are prepared to play our part in improving conditions in Europe for further internally-generated non-inflationary growth. The UK economy has been growing strongly, with good prospects for growth in 1988 too.

I am pleased also that progress is being made towards achieving full abolition of exchange controls. This is an important aspect of completing the internal market by 1992 and should be given high priority.

RESTRICTED

THIS DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

EHG(B)(88)2G COPY NO

EUROPEAN COUNCIL BRUSSELS
11-12 FEBRUARY 1988

INTERNATIONAL ECONOMIC SITUATION

References

A. Press briefing text on the international economic and monetary situation agreed at 16 November ECOFIN meeting.

B. Statement of the Group of Seven, 23 December 1987.

Background

1. The Chancellor gave a full account of the international economic situation in the Autumn Statement debate on 14 January. He noted that world activity had picked up markedly during 1987, with only the performance of continental Europe (particularly Germany) remaining disappointing, though modest growth was continuing. However, serious imbalances in the world economy remained, with the US budget deficit at their heart. Congress agreement to a $30 billion reduction for 1988 was welcome, but not sufficient by itself to reduce the deficit to a tolerable level. The US action and the ½ per cent reduction in European interest rates on 3 December led the way to the G7 communique on 23 December. The Chancellor explained again the clear advantages of a more managed approach to exchange rates, thereby achieving greater international cooperation in economic policy more generally. He noted that the recent renewed commitment by the US and others to official intervention was an important tactical weapon. Beyond this, important changes in imbalances were taking place with current accounts beginning to adjust in volume terms.

2. Although the Germans have allowed their federal budget deficit to overshoot by DM10 billion in 1988, Stoltenberg has indicated that the federal deficit in 1989 will be held to DM30 billion, DM10 billion below the currently estimated level for 1988.

3. ECOFIN discussed the international monetary and economic situation at its November meeting. A press briefing text was agreed, urging continuation of the international fiscal and monetary cooperation agreed at the Louvre; promising a contribution to that process by European countries; noting the urgency of decisions on the US budget deficit; and reaffirming the objectives on completing the internal market and strengthening the EMS. In the light of this and the G7 communique further comment at the Brussels European Council is unlikely to be useful.

4. On the EMS, the informal meeting of Finance Ministers at Nyborg on 12-13 September welcomed the agreement by the Committee of Central Bank Governors on 8 September on measures to strengthen the operating mechanisms of the EMS. The Governors also agreed to strengthen the procedures for joint monitoring of economic and monetary developments and policies. M. Balladur wrote in January to the Chancellor and other EC finance ministers suggesting how the system might be strengthened and advocating the creation of a European Central bank. Much of this thinking is very long term, as Herr Kohl has indicated. But it is helpful to see the French acknowledgement of the need for rapid capital liberalisation.

5. The UK position on the ERM is well known - our membership is kept under review and we will join when the balance of arguments is in favour. Capital liberalisation does not necessitate membership of the ERM. The UK liberalised capital markets earlier than other EC members, other than Germany.

6. On the role of ecu, there should be no barriers to the use of the private ecu, but otherwise further developments are best left to the markets.

7. The Commission introduced its proposals on capital market liberalisation at the November ECOFIN meeting. They are currently being discussed by the Monetary Committee and by the Committee of Central Bank Governors. There will be oral interim reports at the February ECOFIN meeting on 9 February. The UK supports progress on full liberalisation during the German Presidency, while seeing no need for retaining and strengthening the 1972 Directive on regulating international capital flows, which is proposed by the Commission but not supported by most other member states.

CONFIDENTIAL

✓ 3/2

10 DOWNING STREET

LONDON SW1A 2AA

I discussed X with the For'n Sec'y. He is now convinced that – regrettably – the max. rate constraint mentioned there is not attainable. Pse ask Mr Edwards for a note on how, if that be so, we can most effectively curb the growth of the [illegible] in the course of the standstill years pre [illegible] of the Future Financing Settlement. (ps I know he has already seen this [illegible])

From the Private Secretary

2 February 1988

Mr Bonney.

Dear Lyn,

PRIME MINISTER'S MEETING WITH CHANCELLOR KOHL

The Prime Minister had a talk this morning with Chancellor Kohl about the forthcoming European Council. Chancellor Kohl was accompanied by Herr Stavenhagen, State Secretary in the Federal Chancellery, and Herr Hartmann, also from the Federal Chancellery. The talk was generally good-natured and revealed a readiness on the part of the Germans to move towards us on a number of issues which will come up at the European Council. But it also revealed continuing substantial differences, particularly on stabilisers for cereals and oil seeds. The question of the United Kingdom's abatement was raised briefly and gingerly, without any attempt to link it to other issues. Following the meeting the Prime Minister and Chancellor Kohl gave a press conference, the transcript of which will be available to you.

European Council

Chancellor Kohl said that his meeting with the Prime Minister was very important and there were high expectations from it. The European Community had reached a watershed. There were major world problems which needed urgent attention. The Community must settle its housekeeping problems so that full attention could be given to these wider issues. The Community had to show some vision. Germany's net contribution was now some DM 8 billion. He had to be able to show that the Community was making progress on the wider issues if this was to continue. There was no point in a postponement of the Brussels Council. It would be even more difficult to reach agreement at Hanover in June. Four more months of argument about agriculture and future financing would preclude progress on the internal market. If the Community was to complete the internal market by 1992 - and he regarded that as its single most important task - the European Council must clear away subsidiary issues next week. He was prepared to do everything humanly possible to reach an agreement. But it would require a compromise in which everybody would have to move. Concessions would be painful for the German Governmnent but he was prepared to confront public opinion with the need for them. In his view, discussions in Brussels had gone on long enough. The moment had come to reach decisions both on agriculture and the budget. And it must be done in a

Community spirit. There was no question of putting the burden all on to one country. Everybody must share the difficulties. He would be meeting with his Ministerial colleagues later this evening to decide what proposals to put to the European Council.

The Prime Minister said she was ready to take decisions at Brussels. Indeed, she had been ready to do so at Copenhagen. Unfortunately others had not been similarly ready. The nub of the matter was the need to reduce agricultural surpluses. The Community had been discussing this for at least eight years but had always failed to grasp the nettle. It was not a question of compromise. It required tough decisions which would actually get the surpluses down and not add to them. It was a choice between sense and nonsense. The Community could not go on putting more and more money into agriculture. Farmers were more realistic than Ministers: they knew that the problems had to be dealt with and they wanted a firm basis on which they could plan for the future. She agreed with Chancellor Kohl that the Community was at a watershed. She was ready to take decisions. But they must be the right decisions, equal to the scale of the problem.

Chancellor Kohl thought that the Prime Minister underestimated the degree of progress which had already been made. For instance tough measures had already been taken to curb milk surpluses. German farmers had accepted price reductions of twenty-five per cent for their main crops in recent years. Farm incomes in the Federal Republic had fallen substantially. He was ready to see further drastic reductions in surpluses. But it must be done in a way which gave people time to adjust. It must be a step by step process which was politically tolerable. Germany could not simultaneously be the largest contributor to the Community and be expected to inflict disproportionate hardship on its farmers.

The Prime Minister said that she understood Chancellor Kohl's worry about the size of the German contribution. But the most effective way to reduce that contribution was to control agricultural spending. She wished to make another general point: Germany benefited greatly in Europe from the efficiency of its manufacturing sector and ought not to penalise the efficiency of other countries in agriculture.

Agricultural Stabilisers

Chancellor Kohl said he had looked at the various problems which had been on the table in Brussels. There were a number of areas where he thought some adjustment was possible in the interests of agreement on an overall package. For instance he could accept that stabilisers on other products (ie all except cereals and oil seeds) should be agreed on the basis of the Presidency proposals in Copenhagen. On cereals, Germany could accept a Maximum Guaranteed Quantity of 158m tonnes. He understood that the proposed 20-tonne exemption under the co-responsibility levy caused difficulties. He could agree to a modification whereby an exemption applied only to small farmers. There were other points on which the German Presidency's proposals seemed to be misunderstood. For instance, on cereals the changes proposed by the Commission to the intervention arrangements would in effect amount to a price reduction in the first year. On oil seeds, no ceiling was proposed on price cuts. The co-efficient for price reductions was something that could be looked at. But equally there were points on which Germany could not move. The proposed MGQs on oil seeds and proteins and the price reduction and co-responsibility levy proposals for cereals were as far as he could go. He could accept the need for an effective brake on farm spending but it should not be used to make an emergency stop.

The Prime Minister said that she too would like to go through some of the details. On cereals, we disliked the co-responsibility levy which was a tax and not a stabiliser. Moreover, the proposed 20-tonne exemption would be highly discriminatory. Germany would pay less than half as much as the United Kingdom even though it produced the same amount of cereals. She noted that Chancellor Kohl had suggested a compromise. She was not in a position to judge the full implications of this. What she could not accept was a situation which penalised efficient producers while protecting the inefficient. There was no justification for a higher MGQ for cereals than the 155m tonnes proposed by the Commission at Copenhagen. This was above the level of the 1986 and 1987 harvest and contained ample headroom for the Community's traditional exports. You would never get surpluses down if you started by putting them up. Moreover, the proposals which had been discussed in Copenhagen had provided for in-year price cuts with no ceilings. This was essential if the surpluses were to be cut back. For oil seeds, the mechanism proposed by the Presidency was sound but the numbers were too high. The effect of the Presidency's proposals would be expenditure some 600m ecu higher than envisaged under the proposals considered in Copenhagen. There had been a vast growth in the production of oil seeds and protein products over the last ten years and the Community could not go on financing such an expansion indefinitely. She could agree that all the other stabilisers should be settled on the basis proposed in Copenhagen, even this though this caused considerable difficulties for our farmers. But major differences remained over cereals and oil seeds. She would never be able to get an increase in Community resources through Parliament unless she could demonstrate that effective action had been taken to reduce the surpluses and control agricultural spending. The Prime Minister added that we had gone out of our way to try and take account of German views over set-aside even though we had doubts about its effectiveness. Chancellor Kohl could present this as a considerable victory. But set-aside could never be a substitute for price cuts. The Prime Minister added that there was no question of our accepting the French proposal to put a time-limit of three years on stabilisers.

Herr Stavenhagen commented that an MGQ of 158m tonnes for cereals seemed a very restrictive figure to Germany. It was well below the trend of Community production. Predictions for the 1988 harvest were that it would be at least 158m tonnes, in which case stabilisers would come into force immediately. On oil seeds, Germany was prepared to give up a ceiling on price reductions and acknowledge that such reductions would be cumulative. That would be a deterrent to switching from cereals to oil-seeds. The Prime Minister came back to the point that it made no sense to say you were dealing with surpluses and then go right ahead and decide to increase production. We were prepared to accept a mix of price reductions and co-responsibility levies. But she did not want to blur the remaining differences between British and German positions. We wanted to see more weight given to price reductions both for cereals and oil seeds: the proposed co-responsibility levy for cereals was discriminatory: we still had difficulties with some of the details of the set-aside scheme: we thought MGQs for both cereals and oil seeds were set too high: and many of the savings claimed by the Germans were calculated on the basis of projected expenditure which was quite unrealistic anyway. We had been closer to a solution with the Commission's original proposals than we were now.

Chancellor Kohl said that he did not disagree with the Prime Minister on the broad objectives. He had been saying for years that the Community must reduce production. The CAP was badly flawed. It had been encouraging farmers to go in the wrong direction for thirty years. The tide was now beginning to turn. But he could not force through a complete adjustment in just one or two years. He had to have time. He would think over the points which the Prime Minister had made to him. The discussion had revealed discrepancies between British and German figures. These should be reconciled before the European Council, so that we were working on a common data base. Experts should get together to do this.

Agriculture Guidelines

Chancellor Kohl said that in Copenhagen there appeared to a considerable measure of agreement on a guideline of 27bn ecu, exclusive of old stocks, with provision for it to increase at 60% of the rate of GNP growth. The Commission were now arguing that this was not sufficient and that the base line would need to be higher and the rate of growth 100% of the GNP rate. He wondered whether an acceptable compromise would not be an 80% growth rate. The Prime Minister said that the Commission had said explicitly in Copenhagen that 27bn ecu with 60% growth rate would be adequate to finance the CAP and they could not now shift their ground. She was not prepared to move from this.

Monetary Reserve

Chancellor Kohl said there appeared to be near agreement on this at the Foreign Ministers conclave in Brussels. The Prime Minister said that a reserve must be limited to compensating for exchange rate movements. French concerns about the trade practices of other countries would have to be dealt with by other means.

Fourth Resources

Chancellor Kohl said that the German Presidency would agree to whatever produced a consensus. Germany ended up paying anyway. The Prime Minister said that this was not a prime concern for us. She had agreed in Copenhagen that we would not seek any additional benefit as a result of a fourth resource.

Own Resources Ceiling

Chancellor Kohl raised the size of the own resource ceiling but the Prime Minister cut him off, saying that it was premature to discuss this and anyway she had no authority from her colleagues to discuss figures until she could demonstrate that action had been taken to reduce the surpluses and impose strict financial discipline through binding regulations.

Structural Funds

Chancellor Kohl said that Germany had no problem with the United Kingdom's proposal for a 50% increase, but there was no chance of southern Member States accepting it. A compromise would have to be found somewhere between a 50 and 75% increase. The Prime Minister said that a very important point of principle was at stake. Unless any increase was contained within 1½ times the maximum rate for non-obligatory expenditure we would face constant problems with the European Parliament over the budget. This would be to the disadvantage of the southern States themselves. Provided Britain, France and Germany stuck together she thought that we could get our position accepted. It would enable the four least prosperous States to double their receipts from the Regional Fund and would also double the overall receipts of Spain and Portugal.

X

United Kingdom Abatement

Chancellor Kohl said that he assumed the Prime Minister wished the Fontainebleau arrangement to remain unchanged. The Prime Minister said that it had been justified in 1984 and was even more justified now. Our net contribution even after abatement had doubled since then. The abatement would have to be linked to the duration of a new own resources decision, just as it had been at Fontainebleau. Chancellor Kohl said that there might be some inclination to argue that our abatement should be degressive. The Prime Minister said that it was set as a percentage of the VAT/expenditure gap. If the gap declined so would our abatement. But you could not decrease the remedy unless you first decreased the size of the problem.

French Position

The Prime Minister asked Chancellor Kohl whether he thought the French were actually in a position to reach an agreement at Brussels given the imminence of their elections.

Chancellor Kohl said that it would be very difficult. But he thought that they would prefer a reasonable agreement now to postponement.

Press Handling

The Prime Minister and Chancellor Kohl agreed that they would say to the press that their meeting had been an interesting and constructive one in which they had made considerable strides towards narrowing differences. Both wanted to reach agreement in Brussels and would be prepared to work for that. Nonetheless, substantial differences remained on a number of agriculture issues.

East/West relations and Defence

The Prime Minister and Chancellor Kohl had a very brief exchange on East/West relations and defence. The Chancellor stressed that he did want to see a third zero option or a denuclearised Europe.

I am copying this letter to Alex Allan (H.M. Treasury), Shirley Stagg (Ministry of Agriculture, Fisheries and Food) and to Trevor Woolley (Cabinet Office).

Yours sincerely,

Charles Powell

C.D. POWELL

Lyn Parker, Esq.,
Foreign and Commonwealth Office.

 Order of talk

ok

SUMMARY OF PRESIDENCY'S CIRCULATED PAPER

Structural funds. Increase of 66 to 70 per cent in real terms by 1992. Doubling of expenditure in backward regions. Two-thirds of total funds concentrated on these regions.

Budget discipline (agriculture). Guideline limit of 27.5 becu for 1988, rising by 70-80 per cent of GNP growth each year. Spain and Portugal to contribute at 1987 rates to costs of disposing of old stocks.

Exceptional circumstances. Monetary reserve of 1 becu with no mention of symmetry. Highly prejudicial declaration on other exceptional circumstances (trading partners less disciplined or international commitments not honoured).

Budget discipline (NCE). No content: discussions to be held with European Parliament.

Own resources ceiling. "1.25 to 1.3 per cent of GNP:" Not clear whether abatement-exclusive or inclusive. Pres. inclusive

Third and fourth resources. Two options: (a) 1.4 per cent VAT and "diff tax" with concession to Italy, or (b) 1.4 per cent VAT falling to 1 per cent VAT by 1992 and GNP-based tax. which more sovereign

Cereals. MGQ of "155 to 160" million tonnes. 3 per cent maximum co-responsibility levy. Price reductions of up to 3 per cent from 1989 if MGQ exceeded by this amount or more. Small producers' exemption from co-responsibility levy. Possibility of reduced monthly cereals prices supplements during 1988. Not now 1988

Oilseeds. Combined MGQs of 11.3 million tonnes (as against 10.3 at Copenhagen) and price reduction of "0.4 to 0.5 per cent" for each 1 per cent excess. 0.5 10.8

Set-aside. As expected. Premium of 100 to 600 ecu/ha. Exemption from coresponsibility levy on 20 tonnes for producers setting aside 30 per cent of land. Community contribution of 70 per cent for first 200 ecu, 25 per cent for next 200 to 400 ecu and 15 per cent for 400 to 600 ecu: half these amounts for "green fallow".

Budgetary imbalances. PM entry only.

1988 Budget. Community to make available any funds required in excess of existing ceiling in the form of non-repayable advances.

ANNEX B

INDIVIDUAL DOSSIERS:

OPENING POSITIONS AND BOTTOM LINES

1. AGRICULTURAL EXPENDITURE GUIDELINE

Opening position

(a) 27 becu basic limit in 1988, with possibility of extra 0.5 becu plus 2 weeks extra delay in Community payments (worth another 1.2 becu) in 1988 in recognition of the fact that stabilisers and set aside will not have much impact until 1989.

(b) 27 becu limit to grow by 60 per cent of rate of growth of Community GNP.

(c) disposals of old stocks to be financed outside guideline at a cost of 1.2 becu in 1988 and 1.4 becu a year in each of the four following years.

(d) monetary reserve of 1 becu which is symmetrical on both expenditure and revenue sides.

Bottom line

As above but possibly consider:

(i) basic limit of 27.5 becu, growing by 60 per cent of rate of growth of Community GNP, <u>or</u> preferred

(ii) basic limit of 27 becu growing by 80 per cent of rate of growth of Community GNP;

(iii) on disposals of old stocks, Spain and Portugal to contribute at their 1987 financing shares (at an estimated cost to the UK over the period of 10-15 mecu).

Approaches (i) and (ii) would produce approximately the same guideline limit figure in 1992. Approach (i) would be more likely to command agreement and has the attractive 60 per cent slope. Approach (ii) would cost 1.4 becu less over the period.

2. EXCEPTIONAL CIRCUMSTANCES AND MONETARY RESERVE

Opening position

(a) no exceptional circumstances except large movements in ecu/dollar rate and no moral commitment to adjust or reopen guideline limit for any reason at all.

(b) a fully symmetrical monetary reserve, under which less revenue would be called up from member states if the dollar appreciated by more than the threshold percentage in just the same way that more revenue would be called up if the dollar depreciated by more than the states percentage.

(c) adjustment to the guideline limit to be limited to 1 billion ecu in any year; no provision for supplementary budgets beyond this.

Bottom line

As above but:

(i) declaration about need for other countries too to play their part (but this must not imply that the guideline limit can be raised or exceeded);

(ii) agreement on "full symmmetry" without specific provision at this stage that it will apply to the revenue as well as the expenditure sides. Far better however to have this tied up now if possible. NWH

3. CEREALS

Opening position

- (a) MGQ of 155 million tonnes

  (b) price cut of <u>more than</u> 3 per cent (say 4½ per cent) in 1988/89 and same again, cumulatively, in each subsequent year if the MGQ is exceeded (and regardless of amount of the excess);

  (c) 3 per cent extra co-responsibility levy as proposed by the Presidency;

  (d) no general exemption from co-responsibility levy on first 20 tonnes of production; retain instead existing aid for small farmers.

Bottom line

- (a) MGQ of 158 million tonnes initially, falling to 156 million tonnes by 1990 as set aside scheme contributes to reduced production;

  (b) 3 per cent price reductions in 1988 followed by further 3 per cent price reductions in each of the following years if MGQ exceeded <u>or</u> cumulative price cuts of 3 per cent a year unless average excess over MGQ is less than this;

  (c) co-responsibility levy as above;

  (d) general exemption from co-responsibility levy limited to small producers;

  (e) 500 mecu over 3 years ceiling on set-aside payments.

- It may be necessary to envisage a system which would be likely in practice to have broadly the above effects, albeit with less certainty.

4. OILSEEDS

Opening position

(a) Copenhagen MGQs (rapeseed 4.0, sunflower seed 1.9, soya 1.1 and proteins 3.3 MT) and a 0.5 per cent price reduction for each 1 per cent excess over the MGQ.

Bottom line

(i) insist throughout on 0.5 per cent price reduction factor for 1 per cent excess over MGQ;

(ii) increase Copenhagen MGQ figures by 0.1 million tonnes each (possibly 0.2 million tonnes on rape and proteins);

(iii) in extremis, accept Commission's revised MGQ figures adopted by German Presidency.

5. OTHER STABILISERS

Opening position and bottom line

No change to Copenhagen package.

6. STRUCTURAL FUNDS AND NCE

Opening position

(a) 1.5 time maximum rate limit for NCE;

(b) 50 per cent real increase in structural funds by 1992;

(c) 80 per cent increase in regional fund receipts of backward regions.

Bottom line

(a) budget discipline package for NCE as set out in Treasury note circulated by Mr Lavelle on 5 February;

(b) 67-70 per cent increase in structural funds, but with no commitment to allocating two-thirds of the total structural funds to backward regions (pace the suggestion in the DTI note attached to Mr Lavelle's minute);

(c) doubling or near-doubling of receipts of backward regions by 1992.

7. OWN RESOURCES STRUCTURE

Opening position

(a) support Commission's diff tax proposal while noting that UK has agreed to forswear any benefit (or disbenefit) from this reform;

Bottom line

(a) go along with anything that others can agree provided that position on UK abatement is fully safeguarded.

8. OWN RESOURCES CEILING

Opening position

(a) suspend judgement

Bottom line

(a) 1.2 per cent GNP or, just possibly, 1.25 per cent GNP (abatement-inclusive); or (preferably but less plausibly) 1.1 per cent or 1.15 per cent GNP (abatement exclusive).

(b) solve special problems of 1988 by using surplus of over 500 mecu from 1987, cancelling or rescheduling the 1984 IGA repayments (500 mecu); continuing the postponement of own resources refund payments (400 mecu); a realistic rate of growth in the structural funds and adjustments in timing of FEOGA payments and disposals of existing stocks.

9. UK ABATEMENT

Opening position and bottom line

(a) stand rock solid on Copenhagen position: replicate Fontainebleau abatement/own resources position exactly.

(b) ensure that any languague used to describe (a) is symmetrical: ie we would receive <u>extra</u> compensation in the unlikely event that the new own resources structure turned out to our disadvantage in any particular year.

(c) abatement must in no circumstances be time-limited: it must be part of the own resources decision and last for as long as that decision lasts.

(d) expenditure share / VAT-plus-fourth-resource share gap would be acceptable (and mildly beneficial) to UK provided compensation rate remains at 66 per cent.

10. FINANCING 1988 BUDGET

Opening position and bottom line

(a) can agree to supplementary financing through an IGA in 1988 so as to expedite implementation of new agreement on own resources provided that the net effects on every member state are identical with what they would have been if the new system had been able to be implemented immediately.

(b) cannot agree to "voluntary advances" to tide Community over 1988: our Parliamentary procedures do not permit this kind of approach.

6.9

CONFIDENTIAL

FROM: A J C EDWARDS
DATE: 8 February 1988

CHANCELLOR

cc: Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir G Littler
Mr Anson
Mr Lankester
Mr Bonney
Mr Mercer
Mr Mortimer
Mr Evans
Mr Tyrie

EUROPEAN COUNCIL:

BRIEFING MEETING WITH PRIME MINISTER, 10 FEBRUARY AT 2.30 PM

The purpose of the Prime Minister's meeting, at which Sir Geoffrey Howe and Mr MacGregor will be present as well as yourself, will be to decide on the Prime Minister's strategy for the Brussels European Council on Thursday/Friday.

Prospects

2. Since my assessment of last Wednesday, there have been stronger indications from other member states of a will to settle, together with signs of greater flexibility in Bonn. Until 6.30 this evening, therefore, I was inclined to raise the chances of agreement at Brussels to better than evens, perhaps 70 per cent. We have now however received the German — behind Presidency paper, (summary at Annex A). This is so objectionable from our point of view that I would revise the chances down again to 50/50. The paper dodges the abatement and budget discipline on ~~NCE~~ BNO issues; goes much too far on the structural

funds, the agricultural expenditure guideline and the own resources ceiling; is inadequate on stabilisers and unacceptable on exceptional circumstances and the 1988 budget.

General strategy

3. There are, I think, two broad issues which it is useful to consider before addressing the individual dossiers:

(i) is it likely to be in the UK's interests to withold agreement at Brussels and push off decisions to Hanover?

(ii) what should our order of priorities be, bearing in mind that we could all too easily be isolated on virtually every important dossier in the negotiation?

Brussels vs Hanover

4. On the first issue, we might still be confronted by other member states at Brussels with a package which was so manifestly outrageous, particularly on the abatement, that the Prime Minister would have no realistic option but to break. On balance, however, this seems a little improbable.

5. A more likely scenario is that we shall be confronted by a package which is decidedly less good than we would wish, particularly on agriculture and the structural funds, without being outrageous. In that event, the critical question will be whether we would be likely to improve the final deal by refusing, probably in isolation, to give our agreement now and pushing off decisions to Hanover.

6. It is difficult to judge these things in advance. As of now, however, delay in such circumstances would seem unlikely to be to our advantage. The other member states, if they

had conceded our case on the abatement, would be so incensed that they would be united in their determination to make us suffer. A further consideration is that, by the time of the Hanover European Council in early June, the price fixing will inevitably be in full swing and will tend to become tied up with the future financing discussion. This seems likely on balance to be unhelpful. A better evolution will be for the Brussels European Council to take decisions and for the Commission to propose such further measures of restraint in the price fixing as they judge necessary to enable the guideline limit to be respected. A further hazard is that the notorious agrimonetary agreement is due for review in the spring as well. The Germans would be all too likely to try to offset any adverse effects from the stabilisers package by adjusting the agrimonetary co-efficient.

Order of priorities

7. From a Treasury standpoint, the UK's order of priorities should be broadly as follows:

(i) to stand rock solid on the abatement, with no hint of any possibility of change in our position;

(ii) to keep the increase in the own resources ceiling as low as possible, much preferably not exceeding 1.2 per cent of GDP, abatement inclusive, or (better) 1.1 per cent GNP, abatement exclusive, though it will be difficult to avoid conceding 1.25 or 1.15 per cent respectively;

abatement exclusive, [illegible] [illegible], [illegible] stronger [illegible]

(iii) to obtain a respectable deal on stabilisers, while recognising that the package which emerges is unlikely of itself to solve the problem of compressing expenditure within the guideline limit or stabilising production (see further the Prime Minister's position at Annex C);

(iv) to get the best deal we can on the agricultural guideline, much preferably with a starting figure
27.5 not exceeding 27 becu in 1988 (though with some once-only additions to cover the problems of 1988) and growing thereafter at a rate not exceeding
2/3 60 per cent of the rate of growth of Community GNP (see again the Prime Minister's position at Annex C);

(v) to eliminate "exceptional circumstances" and to insist that any "monetary reserve" provision is

(a) genuinely symmetrical on the revenue and expenditure side of the budget (ie we contribute less if the dollar appreciates), and

(b) limited to dollar/ecu movements, with

(c) no moral commitment to raise the guideline limit if trading partners do things we dislike or anything else goes wrong;

(vi) on non-~~compulsory~~ Obligatory expenditure ~~(NCE)~~ (DNO), to argue for a new budget discipline based on 1½ times the maximum rate of increase and a 50 per cent increase in the structural funds by 1992, but if this fails (as it almost certainly will, given the German Presidency's proposals):

(a) to limit any further growth of ~~NCE~~ DNO and the structural funds as far as possible;

(b) to ensure that it can be offset within a fixed own resources ceiling by a slower growth of the agricultural spending guideline;

(c) to salvage as much budget discipline as possible, along the lines discussed in the Treasury note circulated by Mr Lavelle, and

NB.

(d) to minimise any commitments on concentration of the funds on the least prosperous member states and in particular not to concede two-thirds concentration on the backward regions.

Items (iii), (iv) and (v) should be seen as hanging together rather than as indicating an internal order of priority within the agricultural dossier.

Individual dossiers

8. Suggested UK objectives and fall back positions for each of the main dossiers in the negotiations are at Annex B. The Prime Minister may not wish to go into all the technicalities at your meeting. As so often, however, the devil will be in the detail, and there are four or five points on the individual dossiers which you should make if possible:

(a) Exceptional circumstances/monetary reserve. Very important to get it agreed at Brussels, if we can, that the reserve will be symmetrical on the revenue as well as the expenditure side: that is, the own resources called up from member states will be reduced if the dollar appreciates just as they will be increased if it depreciates, within a limit of 1 becu. Also essential to avoid any moral commitment to exceed the guideline, as adjusted by this monetary reserve provision, in any circumstances. The German Presidency text offends in both respects.

(b) Structural funds. If we have to go beyond a 50 per cent real increase, as now seems inevitable, we should start with a 60 per cent increase in the structural funds while adding the two conditions that (i) larger totals must mean less concentration on backward regions, (we should not concede that two-thirds of the total structural funds should go the the backward regions) and (ii) there must be adequate new budget discipline arrangements (as set out in the Treasury note circulated by Mr Lavelle).

(c) Own resources ceiling. We would like to end up with an abatement-exclusive ceiling of 1.1 per cent of GNP. If, as is probable, others insist that the ceiling must include the abatement, the aim should be an abatement-inclusive ceiling of not more than 1.2 per cent of GNP. In practice however this would be extremely tight (see Table 1 at Annex D) if there are expensive deals on agriculture and on the structural funds. It will therefore be difficult to resist going to 1.25 per cent of GNP (abatement-inclusive).

(d) UK abatement. In addition to standing rock solid on our Copenhagen position and giving no hint of flexibility at any point, two other crucially important points are:

(i) any language about the abatement must make it clear that adjustments to our abatement to offset the effects on the UK of the new fourth resource will be symmetrical: that is, if (as is unlikely but not impossible) our share of the fourth resource in any year should be greater than our VAT share, the difference would be made good to us just as the benefits in the reverse case would be deducted;

(ii) that there must be no time-limiting of the abatement: it must form part of the new own resources decision and last as long as that decision lasts.

We may be pressed by the Commission and other to agree to a modified Fontainebleau system based on the gap between our expenditure and VAT-plus-fourth-resource shares. We should be prepared to accept this p@rovided that the abatement rate remaining at 66 per cent. It would be ~~positively~~ fractionally to our advantage.

(e) 1988 budget. Since it will not be practicable to ratify the new own resources decision in time to affect this year, we can go along with special supplementary financing for 1988 provided (but only provided) that (i) there has been agreement to raise the own resources ceiling (ii) the special financing would be properly set out in an IGA (we have no Parliamentary basis for paying ex gratia advances) and (iii) it would replicate exactly the overall effect on member states of immediate implementation of the new own resources decision.

Presentation

9. The kind of package on which the European Council is likely to converge will be rather unpalatable from the UK's point of view. The bad points will be:

- The substantial increase in the own resources ceiling, giving the Community extra revenues of perhaps 25-30 per cent compared with now;

- A prospective increase in the UK's net contribution after abatement of some £250 million a year at 1987 prices on top of the large figures already projected in the Public Expenditure White Paper (see further Mr Mortimer's calculations at Annex D);

Not true: better than status quo

- The enormous relaxation of budget discipline on agricultural expenditure, where the stabilisers are not likely to be adequate to keep expenditure within the guideline; and

- The still more enormous relaxation of budgetary discipline on non-compulsory expenditure.

10. On the other hand, there will be some good points as well, in particular:

- The continuation of the UK abatement;

- The introduction of stabilisers, albeit not likely to be sufficient in themselves to produce the results we need on production and expenditure;

- The limiting of the growth of the agricultural expenditure guideline (if we have our way) to 60 per cent of the rate of GNP growth;

- The replacement of the "exceptional circumstances" (if we have our way) loophole with something considerably better;

- The new provisions for more systematic depreciation of stocks; and

- The beating off of demands for a doubling of the structural funds.

11. On past experience, the most effective way to present a package on these lines would be, not to pretend that it is good, but rather to argue that (thanks to the Prime Minister's efforts) it is very much better than it might have been and far better than what the Commission and many other member states had in mind. The Government would need to acknowledge that it is not the kind of deal which the UK would have chosen if it had been for us alone to decide and that it will involve a significant increase (perhaps of the order of £250 million a year) in our net contribution. But on the positive side it would be possible to stress the "good" points in paragraph 10 above and to note how the central importance of the UK abatement has been underlined once again.

abatement unchanged; [illegible] (AP pp) [illegible]

Attendance at European Council

12. Mr Mortimer and I will be present in the wings once again to give what help we can.

AJCE

A J C EDWARDS

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ANNEX C

9/2

CH/EX	
REC.	09 FEB 1988
ACTION	Mr A J C EDWARDS
COPIES TO	CST, Sir P. MIDDLETON, Sir G. LITTLER, Mr LANKESTER, Mr MORTIMER, Mr MERCER, Mr BONNEY

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

8 February 1988

EUROPEAN COUNCIL

The Prime Minister had a talk this afternoon with Sir David Hannay, Mr. Lavelle and Mr. Hadley about some of the detailed issues which will arise at the European Council. There is to be a discussion among Ministers most closely concerned on 10 February.

Among the points which emerged this afternoon were:

- the size of the agricultural guideline was absolutely crucial to our efforts to control spending. It should not be treated as the residual of whatever could be agreed on the stabilisers. We should make clear from the beginning that a guideline of 27 bn ecu with a slope of 60% is a crucial point for us;

- the Prime Minister also identified a price cut for cereals in the current year as a point we must win;

- the size of the MGQ for cereals, while important, was not as vital as securing adequate price cuts both in the first year and subsequently. We should suggest a degressive MGQ, falling by one million tonnes a year over three years;

- we should press hard for complete removal of the twenty tonne exemption for the cereals co-responsibility levy, while maintaining the special aid for small producers;

- very large sums were involved in the oil seeds and proteins sector. A reduction in the MGQs, which had been greatly inflated by the German Presidency, must be a very high priority.

I am copying this letter to Shirley Stagg (MAFF), Alex Allan (HM Treasury) and Roger Lavelle (Cabinet Office).

(C.D. POWELL)

Lyn Parker, Esq.,
Foreign and Commonwealth Office.

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ANNEX D

TABLE 1

COMMUNITY EXPENDITURE 1987-92: A POSSIBLE OUTCOME

mecu: 1988 prices

	1987	1988	1989	1990	1991	1992	87-92
1. Agricultural guarantee	27639	28200	28811	29232	29659	30095	8.9
2. Monetary reserve	-	1000	1000	1000	1000	1000	
3. Own resources refunds	782	1603	1188	1187	1196	1196	
4. IGA repayments	-	515	257	-	-	-	
5. SpP refunds	1539	1325	971	616	126	-	
6. Structural funds	6161	6814	7318	7866	8449	9069	47.2
7. R&D	792	885	1060	1142	1204	1286	62.3
8. New policies	0	51	103	154	206	257	
9. Aid	1142	912	936	961	988	1015	-12.2
10. Other	2544	2827	2702	2674	2667	2644	3.9
11. Total (excluding abatement)	41599	44132	44348	44833	45494	46561	12.2
12. % GNP	(1.075)	(1.138)	(1.114)	(1.097)	(1.084)	(1.081)	
13. Expenditure effect of abatement (lagged)	2352	3615	3553	3690	3818	3905	
14. Total (including abatement)	42951	47747	47901	48523	49312	50466	15.0
15. % GNP	(1.138)	(1.231)	(1.203)	(1.187)	(1.175)	(1.171)	
16. Increase in net contribution (compared with Autumn Statement)	120	316	285	314	322	335	

NOTES TO TABLE 1

Line 1: agricultural guarantee expenditure assumed to be 28.2 becu in 1988 with the agricultural guideline growing at 60% of GNP growth rate thereafter. Expenditure on stock disposals is 1200 mecu in 1988 and 1400 mecu a year thereafter (at 1988 prices) and outside the guideline.

Line 2: 10% own resources refunds are retained. The 400 mecu of refunds postponed from 1987 are paid in 1988.

Line 3: the 250 mecu IGA repayment postponed from 1987 is paid in 1988 along with the 1988 repayment. The remaining repayment is made in 1989.

Line 5: expenditure on structural funds derived in 3 stages. First, figures for total DNO expenditure calculated assuming DNO grows 1½ times the maximum rate. Second, DNO expenditure on structural funds estimated by subtracting from total DNO non-structural fund spending (assumed to grow at maximum rate). Third, total structural fund expenditure found by adding on obligatory structural fund spending (assumed to grow at the same rate as non-obligatory structural fund expenditure).

Line 6: R&D expenditure consistent with the framework programme.

Line 7: expenditure on new policies as in the original scoresheet.

Line 8: aid expenditure in 1988 is the figure in the 1988 PDB. Spending thereafter assumed to grow in line with the maximum rate.

Line 12: abatement is assumed to be the Fontainebleau abatement less the benefit of the fourth resource (assuming 1.25% VAT and GNP contributions). In this line (but not in line 16), it is assumed the abatement is paid a year in arrears and that the expenditure effect of the abatement is 1.4 times the actual size of the abatement.

1987 figures, except for agricultural guarantee and Spanish and Portuguese refunds, taken from 1987 budget.

TABLE 2

POSSIBLE COMMUNITY SPENDING IN 1988

becu 1988 prices

	Agricultural base 27.0 becu	Agricultural base 27.5 becu
Guarantee expenditure (excluding monetary reserve)	27.0	27.5
Stock depreciation	1.2	1.2
Monetary reserve	1.0	1.0
Total budget (abatement exclusive)	44.1	44.6
% of GNP	1.138	1.151
Total budget (abatement inclusive)	47.7	48.2
% of GNP	1.231	1.244
Excess over 1.2% ceiling (abatement inclusive)	1.2	1.7
Increase in UK net contribution (£m, compared to Public Expenditure White Paper)	(224)	(238)

Note: this table shows what the size of the Community budget might be in 1988 on two different assumptions about the base for the agricultural guideline. It is assumed that total DNO in 1988 will grow at 1½ times the maximum rate whatever the agreed increase for the structural funds between now and 1992. The expenditure projection assumes 10% own resources refunds, two IGA repayments, and the repayment of the 400 mecus worth of own resources refunds postponed from last year. It is assumed the monetary reserve will be fully spent. Total spending in the first column is the same as in table 1 with the addition of a 1 becu monetary reserve.

Ways of constraining expenditure within a 1.2% GNP ceiling	mecu
1. Constrain growth of DNO to the maximum rate rather than 1½ times maximum rate.	342
2. Budgetise likely 1987 surplus.	500
3. Postpone or cancel 1984 IGA repayments.	500
4. Postpone payment of 400 mecu of own resources refunds carried forward from last year.	400
5. Additional two week delay in payment of agricultural advances (ie additional to the two weeks likely to be agreed in any case).	1200
6. Possible rephasing of costs of disposing of existing stocks.	250
7. Effects of possible decision to reduce own resources refunds to 5%. Effect of abolition would be to increase "saving" to 1200 mecu.	600

TABLE 3

POSSIBLE COMMUNITY SPENDING IN 1992

1988 prices

	Agricultural base 27 becu plus slope of			Agricultural base 27.5 becu plus slope of		
	60%	80%	100%	60%	80%	100%
Structural fund assumptions						
52% increase (1½ x MR)						
Total budget (becu, excluding abatement)	46.6	47.1	47.7	47.0	47.7	48.3
% of GNP (abatement exclusive)	1.081	1.094	1.107	1.093	1.106	1.120
% of GNP (abatement inclusive)	1.170	1.184	1.198	1.183	1.197	1.212
Increase in net contribution (£m)	247	263	281	263	280	297
60% increase						
Total budget (becu, excluding abatement)	47.0	47.6	48.2	47.6	48.2	48.7
% of GNP (abatement exclusive)	1.092	1.105	1.118	1.104	1.118	1.131
% of GNP (abatement inclusive)	1.181	1.195	1.209	1.194	1.209	1.223
Increase in net contribution (£m)	254	269	288	270	287	305
66% increase (Copenhagen compromise)						
Total budget (becu, excluding abatement)	47.4	48.0	48.6	47.9	48.5	49.1
% of GNP (abatement exclusive)	1.100	1.114	1.127	1.113	1.126	1.140
% of GNP (abatement inclusive)	1.189	1.204	1.218	1.203	1.217	1.232
Increase in net contribution (£m)	260	276	293	275	293	310
75% increase						
Total budget (becu, excluding abatement)	47.8	48.4	49.0	48.4	49.0	49.5
% of GNP (abatement exclusive)	1.110	1.124	1.137	1.123	1.136	1.150
% of GNP (abatement inclusive)	1.200	1.215	1.229	1.214	1.228	1.243
Increase in net contribution (£m)	266	283	300	282	299	317
100% increase						
Total budget (becu, excluding abatement)	49.2	49.8	50.3	49.7	50.3	50.9
% of GNP (abatement exclusive)	1.142	1.155	1.168	1.154	1.168	1.181
% of GNP (abatement inclusive)	1.232	1.246	1.260	1.245	1.260	1.274
Increase in net contribution (£m)	287	303	321	303	320	337

Notes:

The net contribution figures are after abatement and show the increases compared with the figures in the last Public Expenditure White Paper. They assume the 1 becu monetary reserve will be fully spent. The percentage figures for the structural funds are for commitment appropriations: the corresponding increases for payment appropriations are assumed to be 47%, 55%, 61%, 68% and 90%. It is assumed that our receipts share from the structural funds remains constant whatever the overall increase in the funds. Non-structural fund DNO is assumed to grow at the maximum rate. The abatement inclusive figure assume an own resources structure of 1.25% VAT plus GNP contributions.

Table 4

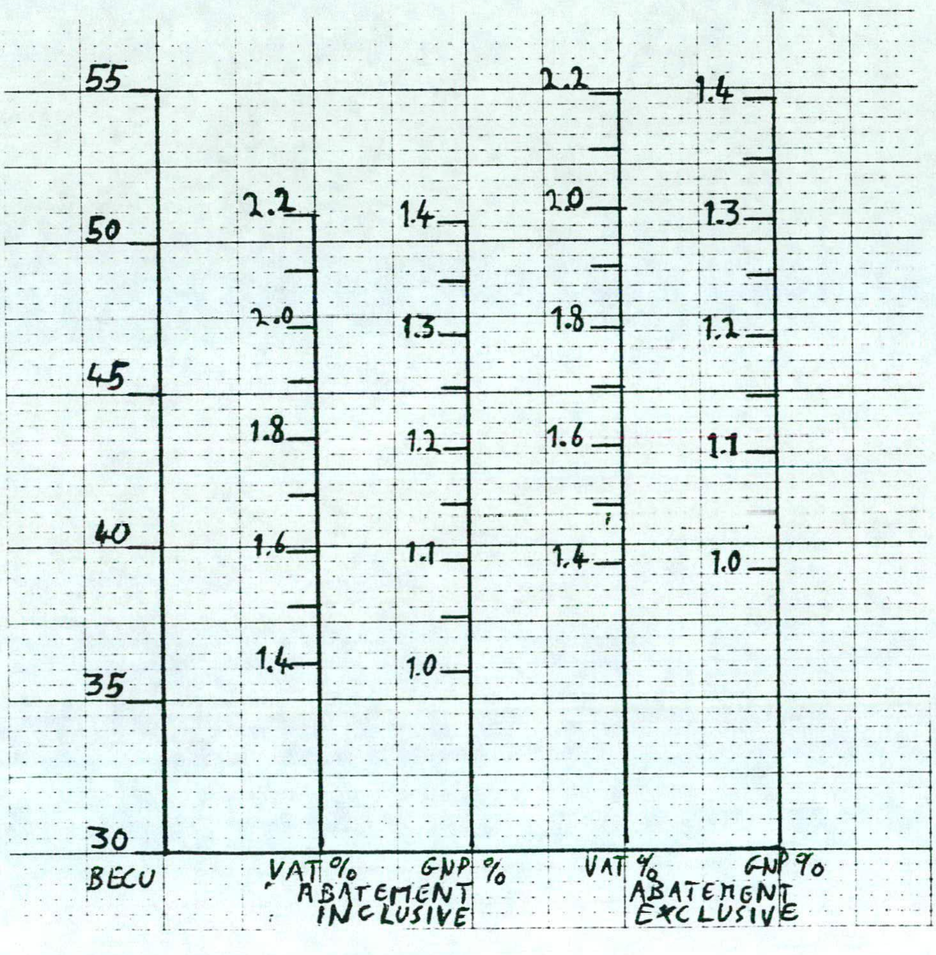
VAT/GNP CEILING CONVERSION TABLE (REVISED 9ii 88)

Abatement-inclusive				Abatement-exclusive			
VAT%	Available revenue (becu)	GNP%	Available revenue (becu)	VAT%	Available revenue (becu)	GNP%	Available revenue (becu)
1.4	36.2	1.0	35.9	1.4	39.4	1.0	39.1
1.5	38.0	1.05	37.7	1.5	41.3	1.05	41.0
1.6	39.8	1.10	39.5	1.6	43.3	1.1	43.0
1.7	41.7	1.15	41.4	1.7	45.2	1.15	44.9
1.8	43.5	1.20	43.2	1.8	47.2	1.2	46.8
1.9	45.4	1.25	45.1	1.9	49.1	1.25	48.8
2.0	47.2	1.30	46.9	2.0	51.0	1.3	50.7
2.1	49.0	1.35	48.7	2.1	53.0	1.35	52.7
2.2	50.9	1.4	50.6	2.2	54.9	1.4	54.6

Notes - abatement-inclusive figures assume "Fontainebleau" abatement (modified to take account of assumed own resources structure of 1.25% VAT and GNP) of 3.2 becu (expenditure equivalent) at 1% GNP and that the abatement uses up 100 mecu of resources for each additional 0.1% VAT, and 200 mecu for each 0.1% of GNP.

- figures are based on updated Commission estimates of EC12 GNP and UK estimates of VAT and traditional own resources in 1988.

- EC12 GNP, 3878 becu; 1% VAT, EC12, 19.41 becu; traditional OR, 11.9 becu; other revenue, 0.3 becu.



(09.02)
(OR.d)

German Presidency
9 Feb compromise

Letter from the President of the European Council to his colleagues

Salutation (for the record)

At the European Council in Copenhagen we were able to make substantial progress on fundamental questions regarding the course of major Community policies in the medium term, i.e. on the "Delors package".

In recent weeks Foreign Ministers and Agriculture Ministers, working closely with the Commission, have been able to achieve some clarification of the questions that were still unresolved and bring positions closer together.

Building on the preparatory work done by the Danish Presidency, we have now established all the pre-requisites for taking the necessary decisions at our meeting in Brussels this coming Thursday and Friday.

In achieving the reform aims of the Single European Act, the strengthening of economic and social cohesion within the Community is an essential basis for creating a viable internal market.

In the same way, European agriculture needs a clear policy and a reliable basis on which to plan for the future.

These aims can be achieved only if Community financing is placed on a sound, realistic basis.

It is therefore in everybody's interest to give the Community clear guidelines in these central areas now. All the Member States must contribute their fair share, in keeping with the principle of solidarity.

Accordingly, I should like discussion at the European Council to focus on the major questions in the Delors package which are still unresolved. Enclosed is a proposal for an overall compromise. It contains orders of magnitude and options on some points. In my view it should be possible to come to a decision within this framework.

I am assuming that if agreement is reached on this, the other parts of the negotiating package can be regarded as being adopted on the basis of the Danish Presidency's paper of 5 December 1987. The full text of the conclusions, including these parts of the negotiating package, will be distributed in Brussels.

In view of the importance of the questions before us, the European Council must really have all the time it needs to discuss the compromise proposal in depth. We should therefore confine ourselves mainly to the Delors package.

Assuming that the progress of discussion allows, I would not rule out the possibility that we might touch on topical international questions during dinner on Thursday. In this connection, the President of the Commission could, as he did in Copenhagen, give us his view of the developing economic situation.

However, we should not adopt any conclusions or statements on these topics. If need be I shall give a short account of them in my press conference at the end of the meeting.

I do not need to point out how urgently the Community needs a decision on the Delors package if it is to progress further. Thus the Community will at the same time be free to press ahead with the difficult issues involved in completion of the internal market. Only if we succeed in making some headway with these discussions in the coming months shall we be able to achieve our common aim of actually completing the internal market by the end of 1992. That is my goal for the European Council in Hanover in June.

I would appeal to you for your support and assistance in advancing the cause of European unity by adopting the Delors package. Having regard to the international political and economic situation, Europe cannot afford to put off pressing decisions. Europe will not be able to take the place in international politics which we all know it deserves unless the Community is united and able to act.

In the final analysis, this is also the aim of the Single European Act. Let us work together to make this reform a success for Europe.

Yours sincerely

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(09.02)
(OR. d)

PRESIDENCY PROPOSAL FOR AN OVERALL COMPROMISE

European unity has received fresh impetus from the entry into force of the Single European Act. The completion of the internal market will release growth potential necessary for European competitiveness and for the economic and social cohesion of the Member States. Accordingly, the Community's ability to act must be strengthened.

Document SN 461/88 contains a summary text of the conclusions. If the European Council reaches agreement on the overall compromise, these conclusions will be deemed to be adopted.

The Presidency is proposing the following solutions for the major questions in the Delors package which are still unresolved. It intends to focus discussions in the European Council on these problems.

6

A. Structural Funds

(Funding and geographical concentration)

The European Council confirms the decisions taken on 29 and 30 June 1987.

In addition to the resources earmarked for the financial year 1988, commitment appropriations for the Structural Funds in the period 1989 to 1992 will increase annually by 1,1 to 1,3 thousand million ECU (1988 prices).

ie 70 to 82% increase

~ 66 to 77

The Structural Funds' contributions to the regions covered by Objective No 1 will be doubled. By 1992, two-thirds of all Structural Fund resources will therefore be concentrated on those regions.

The Commission will ensure that the additional resources for the regions covered by Objective No 1 are concentrated on the least-favoured regions.

7

B. Budgetary discipline

1. Budget discipline in agriculture

(a) Agricultural guideline

The reference basis for 1988 will be set at 27 500 MECU.

The annual rate of increase in EAGGF Guarantee expenditure must not exceed 70% to 80% of GNP growth.

Depreciation of existing surplus stocks will be financed outside the agricultural guideline.

The period for payment of advances to the Member States by the Commission will be extended from two to two and a half months.

(b) Special provisions concerning the contributions of Spain and Portugal to the financing of stock depreciation:

For the purposes of their financial contribution to stock depreciation Spain and Portugal will be treated as if such depreciation had been fully financed by the Community in 1987.

(c) Exceptional circumstances

(i) Monetary reserve, as proposed by the Commission, to an amount of 1 000 MECU, with a franchise of 400 MECU.

(ii) The only other exceptional circumstance to be taken into consideration is that which may arise from the situation described in the statement in Annex I.

2. Budget discipline in the field of non-compulsory expenditure

(i) Budget discipline in the field of non-compulsory expenditure will be applied in conformity with the principles set out in the conclusions of the Brussels European Council (29/30.6.1987) as follows:

"Budgetary discipline must be applied to all the Community's expenditure, both to payment appropriations and to commitment appropriations. It must be binding on all the bodies which will be associated with its implementation."

(ii) The Council decisions to implement the decisions of the European Council in this field will be adopted in the light of the outcome of the discussions with the European Parliament and in conformity with the principles set out in (i) above and at the same time as the new Own Resources Decision.

[No safeguards here]

C. Own resources

1. Overall ceiling

The overall ceiling for own resources will be set at 1,25% to 1,30% of total Community GNP.

2. Third and fourth resources

First option:

- for all Member States, application of a rate of payment of 1,4% to the harmonized VAT assessment basis.

- Application of a single rate of payment to be determined under the budgetary procedure in the light of the total of all other revenue to the difference between

  - the sum of the gross national product at market prices and

  - the sum of the harmonized VAT bases of assessment of the Member States.

The assessment basis defined in this manner may not exceed 55% of the GNP at market prices of each Member State.

The rate of payment for the fourth resource may not exceed the rate of payment for the third resource.

Second option:

- For all Member States, application of a rate of payment of 1,4% in 1988, 1,3% in 1989, 1,2% in 1990, 1,1% in 1991 and 1,0% in 1992 to the harmonized VAT assessment basis. The assessment basis for VAT may not exceed 60% of the GNP at market prices of each Member State.

- Application of a uniform rate of payment, to be determined under the budgetary procedure in the light of the total of all other revenue, to the sum of the GNP at market prices.

.../...

11

It is assumed that the UK's compensatory payments will be dealt with in accordance with the present method (by means of VAT).

3. Collection costs

When transferring traditional own resources Member States will withhold 10% to cover collection costs.

D. Agricultural Stabilizers

I. Cereals

1. For the marketing years 1988/1989, 1989/1990 and 1990/1991, the guarantee threshold will be set at 155 to 160 million tonnes.

2. At the beginning of each marketing year an additional co-responsibility levy (CL) of 3% maximum will provisionally be charged in order to keep expenditure on market management within the budgetary limits.

3. If at the end of the marketing year the guarantee threshold proves not to have been overshot or to have been overshot by less then 3%, the provisional CL will be entirely or partially reimbursed.

4. If the guarantee threshold has been overshot, at the beginning of the next marketing year the intervention price will be reduced (1% overshoot = 1% price reduction) up to a ceiling of the long-term productivity increase (= 3% per year).

5. The basic CL (currently 3%) and the additional CL will be paid by the first buyer.

6. Small producers will be exempted from the general and from the additional co-responsibility levy, in accordance with implementing provisions to be adopted by the Council on a proposal from the Commission as part of the 1988/1989 farm price package.

2nd fallback

7. The European Council takes note that the Commission intends to propose appropriate adjustments to the amount of the monthly cereals supplements as part of its next farm price proposals.

8. The European Council requests the Commission to examine what measures could be introduced for the utilization of

.../...

cereals in compound feedingstuffs and to submit appropriate proposals in the context of the 1988/1989 price-fixing.

II. Oilseeds and protein products

1. The annual guarantee thresholds for the marketing years 1988/1989, 1989/1990 and 1990/1991 will be fixed as follows:

- colza	4,5 million tonnes	(Community of 10) (*)
- sunflower seed	2,0 million tonnes	(Community of 10) (*)
- soya	1,3 million tonnes	(Community of 12)
- protein products	3,5 million tonnes	(Community of 12)

Res. nos.

2. To keep expenditure on market management within the budgetary limits, where the maximum quantity is exceeded the institutional prices (**) for the current marketing year will be reduced by 0,4% or 0,5% for each 1% overshoot at the latest by:

- 31 August for colza
- 30 September for sunflower seed
- 31 October for soya
- 31 August for protein products.

Aid will be paid provisionally until it is established whether the maximum quantity has been exceeded.

(*) A corresponding adjustment in the guarantee thresholds for colza and sunflower seed is provided for in the case of Spain and Portugal.

(**) - For colza, rape and sunflower seed: guide price, intervention price
- [illegible] minimum price, target price

III. Withdrawal of land (set-aside)

The European Council agrees to accept a mechanism for limiting supply by withdrawing agricultural land from production. This will complement the other stabilizers; application will be compulsory for the Member States, but optional for producers. Regional exceptions to compulsory application will be possible.

In order to qualify, a producer must set aside at least 20% of his arable land for at least 5 years. A producer who sets aside at least 30% will, in addition to the premium, be exempted from the co-responsibility levy for 20 t of cereals marketed by him.

The minimum premium will be 100 ECU/ha and the maximum 600 ECU/ha; the Community contribution will be 70% for the first 200 ECU, 25% for the following 200 to 400 ECU and 15% for 400 to 600 ECU.

If the arable land is used for fallow grazing or converted to certain types of protein plant production, the premium will be approximately 50% of the amount granted for complete set-aside.

The Community contribution will be financed 50% from the EAGGF Guarantee Section and 50% from the EAGGF Guidance Section.

.../...

IV. Cessation of farming (early retirement) and aids to incomes

1. The European Council agrees to introduce optional Community arrangements for promoting the cessation of farming (early retirement). It calls on the Council to take the necessary decisions on the basis of the Commission proposals together with the decisions on stabilizers and the proposals on set-aside by 1 April 1988.

2. As regards aids to incomes, the European Council refers to its conclusions of June 1987 and calls on the Council to take a decision on the matter by 1 July 1988.

.../...

E. Adjustment of Budgetary Imbalances

The United Kingdom is to be allowed compensation for the duration of the new own resources decision.

p.m.: machinery

.../...

F. Statements:

The statements given in Annexes I - III are adopted.

ANNEX I

European Council statement on exceptional circumstances

The European Council would give a reminder of the conclusions adopted by the OECD and the Venice Summit on the need for a better adjustment of supply to demand through measures to enable the market to play a greater role.

It considers that the arrangements in force since 1984, and those it is adopting to control production and agricultural expenditure, meet these commitments and will achieve their full effect only if other world producers apply equivalent discipline.

It confirms in this respect the negotiating directives adopted by the Community under the Uruguay Round.

If this discipline were not observed all round, or if a third country failed to meet its international commitments and this caused serious repercussions on world markets, this situation would be regarded by the Council, on a proposal from the Commission, as justifying recourse to the provisions of the Treaty and in particular Articles 43, 113 and 203.

ANNEX II

20

European Council statements on agricultural policy

Utilization of agricultural commodities in the non-food sector

NB nec or relevt. P↓ is ✓.

The European Council requests the Commission to investigate all possibilities of increasing the utilization of agricultural commodities in the non-food sector and to submit proposals to that effect. The Commission will set priorities in this respect.

Trade policy aspects

Oppose Ost. tax

The European Council calls upon the Commission to ensure, in the context of the Uruguay Round and having regard to the general provisions of the GATT, that the Community's measures with respect to prices and quantities are given due consideration, and to press for an appropriate solution to the problems arising in connection with imports of cereal substitutes, oilseeds and protein plants into the Community.

NB accept [illegible] problems

Inter-professional co-operation

The European Council takes note of the Commission's intention to draw up a report on inter-professional co-operation and to submit conclusions to the Council by 1 July 1988.

ANNEX III

21

European Council statement on the 1988 budget

In order to cover the 1988 budget requirements and guarantee the Community's normal activities, the European Council agrees that until the new own resources decision enters into force, Member States will make available any funds that are required in excess of the existing ceiling on own resources, in the form of non-repayable advances on payments due after entry into force of the own resources decision.

17/G/JN/5/029

FROM: MRS R A THOMAS

DATE: 9 FEBRUARY 1988

1. MR MERCER

2. PAYMASTER GENERAL

cc P/S Chancellor
P/S Financial Secretary
P/S Economic Secretary
Mr Edwards
Mr Mortimer
Mr Evans
Mr Kaufmann
Mr Dyer
Miss Bogan
Miss Wright
Mr Cropper
Mr Tyrie

DEBATE ON THE 1986 COURT OF AUDITORS REPORT

The Scrutiny Committee has now recommended the 1986 Court of Auditors Report for debate.

2. The Report will be considered at ECOFIN on 7 March and we need to arrange for a Debate before then to satisfy the normal Scrutiny rules that Community documents should be debated before they are adopted by the Council. This points to a date no later than the week beginning 29 February. As in the past, the Debate would be on the floor of the House after 10.00pm and would last for 1½ hours.

3. The Court's Report is usually debated on an expanded take note Motion referring to the Government's efforts to support the work of the Court of Auditors. The Motion might be as follows:

> "That this House takes note of Official Journal C336, Annual Report of the European on Court of Auditors for the financial year 1986, together with the replies of the Institutions; and approves the Government's continued efforts to press for effective Budget discipline and proper financial control of Community expenditure".

4. I have discussed this with the L Committee Secretariat who feel that a memorandum is not necessary and that a letter to Mr Wakeham would suffice. A draft is attached for your approval.

R A Thomas

ROSEMARY THOMAS

17/G/JN/5/030

DRAFT LETTER TO MR WAKEHAM FROM THE PAYMASTER GENERAL

DEBATE ON THE EUROPEAN COURT OF AUDITORS REPORT ON THE 1986 FINANCIAL YEAR

The House of Commons Scrutiny Committee on European Legislation has recommended a debate on the 1986 Court of Auditors Report.

Timing

2. The Council's draft recommendation for discharge of the 1986 Community Budget is due to be considered at ECOFIN on 7 March. The normal Scrutiny rules require that Community documents be debated before they are adopted by the Council. This points to a debate no later than the beginning 29 February.

3. I recommend that, in line, with normal practice, the Court of Auditor's debate is taken on the floor of the House for 1½ hours after 10.00pm.

Form of the Debate

4. The Report is usually debated on an expanded take note Motion referring to the Government's efforts to support the work of the Court of Auditors. I suggest that the Motion this year might be as follows:

> "That this House takes note of Official Journal C336, Annual Report of the Court of Auditors on the financial year 1986, together with the replies of the Institutions and approves the Government's continued efforts to press for effective Budget discipline and proper financial control of the Community".

A copy of this letter goes to members of 'L' Committee.

What is the agenda for this?

CONFIDENTIAL

041025
MDHIAN 6507

Ch

I told UKREP before and after this COREPER discussion that you would have to fly back at 4.00 pm (for a MISC 128 discussion of broadcasting). Sir D Hannay will have to lead for us if this future financing discussion goes beyond 3.15 pm

5/2

It will scarcely have started by 3.15

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TO DESKBY 050900Z FCO
TELNO 379
OF 042150Z FEBRUARY 88
INFO PRIORITY THE HAGUE, BONN

FRAME ECONOMIC

COREPER (AMBASSADORS): 4 FEBRUARY:

ECOFIN COUNCIL DISCUSSION ON FUTURE FINANCING

SUMMARY

1. FUTURE FINANCING LIKELY TO BE DISCUSSED IMMEDIATELY AFTER LUNCH BUT INFORMALLY (I.E. NOT ON COUNCIL AGENDA). PRESIDENCY AND A NUMBER OF DELEGATIONS UNHAPPY AT THE PROSPECT.

DETAIL

2. PERMANENT REPRESENTATIVES MET ALONE ON 4 FEBRUARY TO CONSIDER THE DUTCH REQUEST FOR A FORMAL AGENDA ITEM AT THE 9 FEBRUARY ECOFIN ON ''THE BUDGETARY CONSEQUENCES OF THE DELORS PLAN''.

3. AFTER UNGERER (CHAIRMAN COREPER) HAD MADE ONE OR TWO UNAVAILING ATTEMPTS TO RULE THE POINT OUT OF ORDER ON THE GROUNDS THAT IT HAD NOT BEEN TABLED IN TIME (IT HAD, ERSBOELL SAID) THERE WAS A LENGTHY DISCUSSION OF THE DESIRABILITY OF FINANCE MINISTERS DEALING WITH FUTURE FINANCING SO CLOSE TO THE EUROPEAN COUNCIL.

4. THE BELGIAN AND PORTUGUESE PERMANENT REPRESENTATIVE WERE AGAINST ANY DISCUSSION AT ALL BY FINANCE MINISTERS BEFORE THE EUROPEAN COUNCIL. TROJAN (DEPUTRY SECRETARY GENERAL OF THE COMMISSION) WAS CLOSE TO BEING IN THE SAME CAMP. THE ITALIAN, FRENCH AND LUXEMBOURG PERMANENT REPRESENTATIVES FAVOURED SOME INFORMAL DISCUSSION OVER LUNCH BUT RESISTED A FORMAL AGENDA ITEM AND SPENT MORE TIME SAYING WHAT SHOULD NOT BE DISCUSSED (THE DETAIL OF AGRICULTURAL REFORM AND THE STRUCTURAL FUNDS) THAN WHAT SHOULD. I SAID WE FIRMLY SUPPORTED THE DUTCH REQUEST FOR A FULL DISCUSSION OF FUTURE FINANCING ON 9 FEBRUARY. WE WERE REASONABLY RELAXED ABOUT WHETHER OR NOT IT SHOULD BE A FORMAL AGENDA ITEM, BUT WE BELIEVED THERE WERE A NUMBER OF SERIOUS ISSUES IN THE FUTURE FINANCING NEGOTIATIONS WHICH NEEDED TO BE DISCUSSED ON THIS OCCASION.

5. NIEMAN (NETHERLANDS) SAID HE WOULD REPORT THAT THERE WAS A

WIDESPREAD DESIRE TO AVOID A FORMAL AGENDA ITEM. BUT A DISCUSSION THERE MUST BE. THE MINISTERS OF AGRICULTURE HAD TAKEN THE LAW INTO THEIR OWN HANDS AND HAD DISCUSSED FAR MORE THAN HAD BEEN REMITTED TO THEM BY THE MINISTERS OF FOREIGN AFFAIRS. THEY HAD THEN SERVED UP A PACKAGE WHICH WAS UNACCEPTABLE. THE MINISTERS OF FINANCE HAD EVERY RIGHT TO FOCUS ON THE BUDGETARY CONSEQUENCES OF THAT PACKAGE. DISCUSSIONS OVER LUNCH WERE NOT SATISFACTORY. A RESTRICTED SESSION WITH MINISTERS PLUS ONE AND NO FORMAL AGENDA ITEM MIGHT BE A POSSIBILITY.

6. AFTER MUCH FURTHER DISCUSSION, IN WHICH IT BECAME CLEAR THAT THE DELEGATIONS OPPOSING MORE THAN A CURSORY LUNCH TIME DISCUSSION WERE PRINCIPALLY WORRIED LEST THE MINISTERS OF FINANCE SHOULD ADDRESS THEMSELVES IN DETAIL TO THE PRESIDENCY COMPROMISE FOR THE EUROPEAN COUNCIL WHICH HAVE BEEN CIRCULATED A FEW HOURS BEFORE THE MINISTERS OF FINANCE MET, UNGERER SAID HE WOULD REPORT THE DISCUSSION TO STOLTENBERG AND SEEK HIS AGREEMENT TO HAVING A DISCUSSION OF FUTURE FINANCING AFTER LUNCH BUT IN AN INFORMAL SETTING.

7. UNGERER ADDED THAT THE LUNCH TIME DISCUSSION PROPER WOULD NEED TO COVER THE ECONOMIC SITUATION SINCE KOHL HAD RULED THAT THERE WOULD BE NO DISCUSSION OF THAT ISSUE AT THE EUROPEAN COUNCIL ITSELF.

HANNAY

YYYY

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FRAME ECONOMIC ECD (I)
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ADDITIONAL 1

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RESTRICTED Passed on to UKREP

054311
MDHIAN 7056

Sir Geoffrey Howe or P X

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INFO ROUTINE EC POSTS, STRASBOURG

FRAME ECONOMIC

ECOFIN COUNCIL 9 FEBRUARY 1988

SUMMARY TELEGRAM
(X DENOTES ITEMS NOT RECORDED ELSEWHERE)

1. THE CHANCELLOR AND I REPRESENTED THE UK.

A POINT (X)

2. COMMON POSITION ON NON-LIFE INSURANCE SERVICES DIRECTIVE (DOCS 4508/88 AND 4477/88) APPROVED WITH ENGLISH CORRIGENDUM TO MINUTE 7 (ON CUMUL) AND COMMISSION DECLARATION DRAWING COUNCIL'S ATTENTION TO THE EP RESOLUTION OF 9 APRIL 1987 AND NOTING THAT THE EP COULD THEREFORE ASK FOR RECONSULTATION. DELORS (COMMISSION) HOWEVER INDICATES THAT AS A RESULT OF LORD COCKFIELD'S APPROACH TO LORD PLUMB, THE EP WERE LIKELY TO ACCEPT THE COMMON POSITION AND NOT SEEK RECONSULTATION.

LIBERALISATION OF CAPTIAL MOVEMENTS

3. AFTER INTERIM REPORTS FROM THE CHAIRMEN OF THE MONETARY COMMITTEE AND COMMITTEE OF CENTRAL BANK GOVERNORS, FOLLOWED BY A TOUR DE TABLE, PRESIDENCY ASK FOR FINAL REPORTS BY APRIL ECOFIN AND FOR COUNCIL WORKING GROUP DISCUSSIONS TO BEGIN FORTHWITH WITH A VIEW TO COREPER REPORTING TO MINISTERS AT SAME ECOFIN.

FUTURE FINANCING OF THE COMMUNITY

4. RUDING OBJECTS TO NON-MONETARY EXCEPTIONAL CIRCUMSTANCES, REDUCTION IN 10 PERCENT TRADITIONAL OWN RESOURCE REFUNDS, INTERESTS COSTS TO NATIONAL EXCHEQUERS FROM DELAY IN FEOGA ADVANCES: CHANCELLOR ENDORSES FIRST POINT, EYSKENS THE SECOND.

LUNCHTIME DISCUSSION: FUTURE ECOFIN WORK ON EMS, INDIRECT TAX, IMF AND IBRD MEETINGS (X)

5. IT WAS AGREED:

(A) THAT THE MONETARY COMMITTEE AND COMMITTEE OF CENTRAL BANK GOVERNORS WOULD CONSIDER BALLADUR'S IDEAS ON THE DEVELOPMENT OF

THE EMS AND REPORT TO THE JUNE ECOFIN:

(B) THAT THE CHAIRMAN OF THE ECONOMIC POLICY COMMITTEE WOULD PRESENT THE COMMITTEE'S REPORT ON INDIRECT TAX APPROXIMATION TO THE APRIL ECOFIN WITH THE MAIN DISCUSSION TAKING PLACE AT THE MAY INFORMAL ECOFIN (AT TRAVEMUNDE):

(C) THAT PREPARATION FOR THE APRIL IBRD/IMF MEETINGS WOULD BE DISCUSSED AT THE MARCH ECOFIN.

6. STOLTENBERG ALSO REPORTED ON HIS DISCUSSION WITH US TREASURY SECRETARY BAKER, INCLUDING THE LATTER'S COMMENTS ABOUT NIC EXCHANGE RATE POLICY. DELORS ENDORSED HELPFULLY CHANCELLORS' DISTINCTION BETWEEN KOREA/TAIWAN (TRADE POLICY AND EXCHANGE RATE PROBLEM) AND HONG KONG/SINGAPORE (OPEN ECONOMIES, SO ONLY SECOND PROBLEM). FIRST GROUP HIGHEST PRIORITY: THEY HAD BENEFITTED MOST AND WERE MOST URGENT TARGETS TO CHANGE THEIR WAYS.

7. FOR DETAILS SEE MY TWO IFTS.

HANNAY

YYYY

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FRAME ECONOMIC ECD (I) [-]

ADDITIONAL 1

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10/5

FROM: M PARKINSON

DATE: 30 March 1988

Agreed in draft

1. MR EDWARDS

2. PS/CHANCELLOR

Ch, This provides a little more detail about the April ECOFIN agenda. I have already confirmed 'X'.

AW 30/3

Thanks

cc PS/Paymaster General
PS/Economic Secretary
Sir G Littler
Mr Byatt
Mr Lankester
Mr R I G Allen
Mr Mercer
Mr Mortimer
Ms O'Mara
Ms Sinclair

ECOFIN 18 APRIL

The next ECOFIN meeting is expected to be on 18 April at 2.00 pm preceded by lunch at 12.30 pm. It will be in Luxembourg.

2. The main items for the formal agenda are:

- liberalisation of capital movements (the final reports by the Monetary Committee and Committee of Central Bank Governors);

- follow up to the European Council on budget discipline (including preparations for the key phase of the Council's negotiation with the Parliament on an inter-institutional agreement); and

- indirect tax approximation (presentation of the EPC's report in preparation for a fuller discussion at the informal ECOFIN on 13-15 May).

3. We understand that the Chancellor hopes to attend. I should be grateful if you could confirm tht we should now plan firmly on that basis. X

M. Parkinson

MARK PARKINSON

Ch/
ZGL says that ~~[illegible]~~ approx^n, though formally on the agenda, will be "buried" + left over for a substantive discussion at the informal ECOFIN.
I have asked Mr Edwards to provide a sitrep on all three points before ECOFIN. — thanks.
JT 25/3

Ch/ (You were planning anyway to attend this ECOFIN.)
Now a "must" that you do, I think. Right.
JS 22/3

RESTRICTED

004343
MDHIAN 2916

PS – But should wait for discussion until the MAY Ecofin? X 26

RESTRICTED
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FRAME ECONOMIC/FRAME AGRICULTURE
M.I.P.T. (NOT TO ALL)
BUDGET DISCIPLINE AND OWN RESOURCES : PROCEDURE

SUMMARY

1. PRESIDENCY INTEND ECOFIN TO TAKE LEAD ON BUDGET DISCIPLINE. WORKING GROUP TO COMPLETE WORK ON BUDGET DISCIPLINE DECISION AND OWN RESOURCES DECISION IN TIME FOR COREPER DISCUSSION ON 14 APRIL.

DETAIL

2. AT THE END OF TODAY'S FINANCIAL QUESTIONS GROUP THE PRESIDENCY OUTLINED THE FOLLOWING PROCEDURAL ARRANGEMENTS.

3. DRAFT DECISION ON BUDGET DISCIPLINE FOR COMPULSORY EXPENDITURE: FQG AGAIN ON 28 MARCH, COREPER 14 APRIL, ECOFIN COUNCIL 18 APRIL. ECOFIN TO DISCUSS FOLLOW-UP TO THIS WEDNESDAY'S TRILOGUE WITH THE EUROPEAN PARLIAMENT ON A POSSIBLE INTER-INSTITUTIONAL AGREEMENT. PRESIDENCY MAY CIRCULATE IN ADVANCE A NOTE ON THE POSSIBLE CONTENTS OF AN IIA.

4. OWN RESOURCES DECISION. COREPER TO DISCUSS THE ITALIAN PROBLEM THIS THURSDAY (24 MARCH). FQG TO WORK THROUGH TEXT OF DRAFT ORD ON 25 MARCH AND 11 APRIL. TO COREPER ON 14 APRIL, THEN TO APRIL FOREIGN AFFAIRS COUNCIL.

5. SAME TIME TABLE FOR DRAFT REGULATION ON COMPENSATION TO SPAIN AND PORTUGAL FOR COSTS OF DEPRECIATING OLD AGRICULTURAL STOCKS.

6. WE ASKED :

(A) WHETHER THE PRESIDENCY WOULD ENSURE THAT ALL RELEVANT DRAFT LEGAL TEXTS (DRAFT DECISION ON BUDGET DECISION FOR COMPULSORY EXPENDITURE, AMENDMENT TO REGULATIONS 729/70, 1883/78 AND TO FINANCIAL REGULATIONS). WERE PUT BEFORE COREPER AT THE SAME TIME. PRESIDENCY RESPONSE: BEST ENDEAVOURS.

(B) HOW THE PRESIDENCY INTENDED TO HANDLE WORK WHICH FORMED PART BOTH OF THE NEW OWN RESOURCES DECISION AND OF THE NEW ARRANGEMENTS FOR BUDGET DISCIPLINE - NOTABLY ANNUAL

SUB-CEILINGS. PRESIDENCY RESPONSE : TOO EARLY TO SAY.

COMMENT

7. THE PRESIDENCY'S WORK PROGRAMME HAS TWO IMMEDIATELY DISCERNIBLE CONSEQUENCES:

(A) DIVIDING WORK BETWEEN THE FAC AND ECOFIN WILL ADD A FURTHER COMPLICATION TO THE NEGOTIATIONS OF THE NEXT FEW WEEKS.

(B) ECOFIN ON 18 APRIL WILL HAVE A HEAVY AGENDA: MAJOR DISCUSSIONS ON BUDGET DISCIPLINE AND THE LIBERALISATION OF CAPITAL MOVEMENTS AS WELL AS A REPORT FROM THE ECONOMIC POLICY COMMITTEE ON TAX APPROXIMATION.

HANNAY

YYYY

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FRAME ECONOMIC ECD(I)
FRAME AGRICULTURE

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TELNO 75
OF 221030Z APRIL 88
INFO ROUTINE UKREP BRUSSELS

MY TELNO 60 : ECOFIN COUNCIL : BELGIUM/LUXEMBOURG DUAL EXCHANGE MARKET

1. THIS SUBJECT CAME UP WHEN I CALLED YESTERDAY ON RAYMOND KIRSCH OF THE FINANCE MINISTRY WHO IS ONE OF LUXEMBOURG'S REPRESENTATIVES ON THE MONETARY COMMITTEE. HE SAID THAT THE REAL PROBLEM FOR LUXEMBOURG LAY IN DOUBTS ABOUT THE STRENGTH OF THE BELGIUM ECONOMY IN THE LONGER TERM. IF BELGIUM SHOULD EVER BE FORCED TO RE-IMPOSE EXCHANGE CONTROLS, THE EXISTENCE OF A FREE MARKET FOR CAPITAL TRANSACTIONS WOULD PREVENT USERS OF LUXEMBOURG'S FINANCIAL MARKETS BEING CAUGHT ''IN A MOUSETRAP''. THEY WOULD BE ABLE TO GET OUT ''AT A COST''. BUT LUXEMBOURG LIKE BELGIUM (''OR AT LEAST EYSKENS'') WAS SOMEWHAT EMBARRASSED BY MAINTAINING A MECHANISM THAT COULD BE REGARDED AS UN-EUROPEAN AND WHOSE REAL VALUE WAS IN ANY CASE LIKELY TO ERODE AS A RESULT OF OTHER DEVELOPMENTS. BILATERAL TALKS HAD THEREFORE JUST BEGUN TO CONSIDER WHAT ALTERNATIVE SAFEGUARDS MIGHT BE POSSIBLE.

2. I ASKED HOW WHAT HE WAS TELLING ME SQUARED WITH THE LINE THAT OTHER STATES SHOULD FULLY PARTICIPATE IN THE EXCHANGE RATE MECHANISM IF BELGIUM AND LUXEMBOURG WERE TO GIVE UP THEIR DUAL EXCHANGE MARKET. THAT WAS A POLITICAL POINT, HE SAID, TO BE DISTINGUISHED FROM THE UNDERLYING ISSUES.

CAMPBELL

Eyskens is quite clearly no longer insisting on this linkage, as HMA should be aware

YYYY

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FRAME ECONOMIC ECD (I)

ADDITIONAL 1

FRAME

NNNN

V33.36

FROM: J E MORTIMER
DATE: 2 June 1988

PAYMASTER GENERAL

cc Chancellor
Sir G Littler
Mr Lankester
Mr RIG Allen
Mr Mercer
Mr Bonney
Mr Evans
Mr Kaufmann

Ch. / Content with line in paras 5+6?
25 3/6

NBA @ PW

FOLLOW UP TO EUROPEAN COUNCIL: THE IIA

I attach at Flag A a copy of the draft inter-institutional agreement (IIA), agreed ad referendum by the Trilogue, and designed to give effect to the European Council conclusions on budget discipline, particularly in respect of DNO.

2. At Flag B is a useful telegram (Telno.1811) from UKREP identifying some of the major weaknesses in the draft IIA and asking whether, notwithstanding its shortcomings, we should be prepared to agree to it.

3. Some of the main weaknesses in the IIA are:

(i) the financial perspectives (the five-year forecasts covering 1988 to 1992) which would lie at the heart of the IIA have not yet been agreed;

(ii) it is not absolutely clear whether it is now agreed by all concerned that own resources subceilings will be included in the new ORD;

(iii) the conclusion of the European Council regarding the control of DNO other than multi-annual programmes (ie the provision that such DNO will be subject to the maximum rate) appears to have been ignored, despite your recent letter to Tietmeyer urging him to remain faithful to what the European Council agreed;

(iv) the European Council conclusions tightening up the arrangements for the carry-forward of unused commitments also appear to have been ignored (in fact, the draft IIA provides that, if expenditure on multi-annual programmes falls behind schedule, there will be a catching-up exercise in later years);

(v) paragraph 12 of the draft IIA appears to allow for adjustments by qualified majority to the financial perspectives. We would want it to be made clear that there can be no question of revising upwards the agricultural guideline, the monetary reserve or the agreed provision for the depreciation of existing agricultural stocks which are fixed in the budget discipline decision.

4. On the other hand, it is clear that we will come under pressure to accept the IIA at ECOFIN on 13 June. Others will argue that, while the IIA itself achieves relatively little, it is not positively damaging. Moreover, by agreeing it:

X|

(i) we would secure the agreement of the Parliament and other member states to annual subceilings, and this would represent a real, effective, legally-binding control on DNO spending;

(ii) it would be much easier to secure agreement to the budget discipline decision (far more important than the IIA, so far as we are concerned);

(iii) there would be no risk of the UK being isolated and hence incurring the odium of holding up agreement on the whole future financing package.

5. We do not need to form a final view at this stage on the acceptability of the IIA. It is possible, however, that the IIA will be discussed at COREPER on Monday. If so, and subject to any views you may have, we will instruct UKREP to adopt a

critical and questioning approach without ruling out altogether the possibility of some sort of agreement at ECOFIN. They would need to make clear that a precondition for accepting the IIA would be agreement by all parties on the financial perspectives and on the inclusion of subceilings in the ORD. They should ask why the Presidency had not remained faithful to what the European Council agreed on the control of DNO and carry-forwards. They would need to explore whether there was any possibility of making further changes to the text of the IIA or whether acceptance of it was on a take it or leave it basis.

6. UKREP suggest that our concern over the provisions in the IIA relating to other DNO (paragraph 3(iii) above) might be protected by repeating in the ECOFIN Council minutes the relevant part of the European Council conclusions. If it is clear that there will be no opportunity for amending the IIA text, we would see no objection to Sir David Hannay injecting this thought into the COREPER discussion at an appropriate point.

7. We would be grateful to know if you are content with this approach.

JEM

J E MORTIMER

I do not believe it would be possible to achieve any changes in the IIA. The questions, i.e., are (i) should we agree to it or not? We can only agree to it if we are sure that X is true (ii) what agreements by the Council of Min., presumably the form of a declaration or resolution, are needed to buttress it.

N

(1)

ED folder

Brussels, 30 May 1988

INTERINSTITUTIONAL AGREEMENT ON BUDGETARY DISCIPLINE AND IMPROVEMENT OF THE BUDGETARY PROCEDURE

(Text established ad referendum at the Trialogue meeting on 27 May 1988)

I. BASIC PRINCIPLES OF THE AGREEMENT

1. The main purpose of the Interinstitutional Agreement is to achieve the objectives of the Single European Act, to give effect to the conclusions of the Brussels European Council on budgetary discipline and accordingly to improve the functioning of the annual budgetary procedure.

2. Budgetary discipline under the Interinstitutional Agreement covers all expenditure and is binding on all the institutions involved for as long as the Agreement is in force.

3. This Agreement does not alter the respective budgetary powers of the various institutions as laid down in the Treaty.

4. The contents of the Interinstitutional Agreement may not be changed without the consent of all the institutions which are party to it.

II. BUDGET FORECASTS: FINANCIAL PERSPECTIVE 1988-92

A. Contents

5. The financial perspective 1988-92 constitutes the reference framework for interinstitutional budgetary discipline. Its contents are consistent with the conclusions of the Brussels European Council; it forms an integral part of the Agreement.

6. The financial perspective 1988-92 indicates, in commitment appropriations, the volume and breakdown of foreseeable Community expenditure, including that for the development of new policies.

The overall annual totals of compulsory expenditure and non compulsory expenditure are also shown in both commitment appropriations and payment appropriations.

(The consolidated text after technical 'cleaning-up')

Murfax destry to S. Wall, ERD(I)
J. Mortimer, HMT
C. Budd, CAB

UKRep FF distribution
Pa. 100/77

(obtained in confidence).

31/5/88

cc Mr Allen
Mr Kaufmann
a Mr Evans

Dsc'd with Mortimer + Kaufmann 2/6/88 ...
Kaufmann passed comments to UKREP

(2)

B. Nature

7. Parliament, the Council and the Commission recognize that each of the financial objectives laid down in the perspective 1988-92 represents an annual expenditure ceiling for the Community. They undertake to observe the different ceilings during the corresponding budgetary procedure.

8. Parliament, the Council and the Commission will join in the effort undertaken by the Community to achieve gradually a better balance between the various categories of expenditure.

They give an undertaking that any revision of the compulsory expenditure figure given in the financial perspective will not cause the amount of non-compulsory expenditure shown in the perspective to be reduced.

C. Annual adjustment

- Technical adjustments

9. Each year, the Commission will update the perspective ahead of the budgetary procedure for year n + 1, making technical adjustments to the figures in line with movements in GNP and prices.

- Adjustments connected with the conditions for implementation

10. When notifying the two arms of the budgetary authority of the technical adjustments to the financial perspective, the Commission will present any proposals for adjustments it considers necessary to take account of the conditions for implementation on the basis of the schedules of utilization of commitment appropriations and payment appropriations.

Parliament and the Council will take decisions on these proposals, before 1 May of year t, in accordance with the majority rules specified in Article 203(9) of the Treaty.

11. If the allocations provided in the financial perspective for multiannual programmes cannot be used in full during a given year, the institutions party to the Agreement undertake to authorize the transfer of the remaining allocations.

D. Revision

12. In addition to the regular technical adjustments and adjustments in line with the conditions for implementation, the financial perspective may be revised by a joint decision of the two arms of the budgetary authority, acting on a proposal from the Commission.

The joint decision will be taken in accordance with the majority rules specified in Article 203(9) of the Treaty.

The revision of the financial perspective may not raise the overall expenditure ceiling, as set by this perspective after the annual technical adjustment, above a margin for unforeseen expenditure of 0.03% of GNP.

It must also respect the provisions of paragraph 8 of this Interinstitutional Agreement.

E. Consequences of the absence of a joint decision by the institutions on the adjustment or revision of the financial perspective

13. In the absence of a joint decision by the institutions on any adjustment or revision of the financial perspective proposed by the Commission, the financial objectives already determined will, after the annual technical adjustment, remain applicable as the expenditure ceilings for the financial year in question.

III. BUDGETARY DISCIPLINE FOR COMPULSORY EXPENDITURE

14. (a) Parliament, the Council and the Commission are in agreement on the conclusions of the European Council concerning budgetary discipline for compulsory expenditure in the EAGGF Guarantee Section.

The three institutions are prepared to undertake, within this Agreement, to respect these conclusions.

(b) Parliament, the Council and the Commission confirm the principles and the mechanisms for the agricultural guideline and the monetary reserve.

(c) As regards the other compulsory expenditure, the three institutions undertake to honour the Community's legal obligations in a manner consistent with the financial perspective.

IV. BUDGETARY DISCIPLINE FOR NON-COMPULSORY EXPENDITURE AND IMPROVEMENT OF THE BUDGETARY PROCEDURE

15. The two arms of the budgetary authority agree to accept, for the financial years 1988-92, the maximum rates of increase for non-compulsory expenditure deriving from the budgets established within the ceilings set by the financial perspective.

16. The Commission will present each year, within the limits of the financial perspective, a preliminary draft budget based on the Community's actual financing requirements.

(4)

It will take into account:

- the capacity for utilizing differentiated appropriations, endeavouring to maintain a strict relationship between commitment appropriations and payment appropriations;

- the possibilities for starting up new policies or continuing multiannual operations which are coming to an end, after assessing whether it will be possible to secure a proper legal base.

17. Within the maximum rates of increase for non-compulsory expenditure specified in paragraph 15 of this Agreement, Parliament and the Council undertake to respect the allocations of commitment appropriations provided in the financial perspective for the structural Funds, PEDIP, the IMPs and the RTD framework programme.

They also undertake to bear in mind the assessment of the possibilities for executing the budget made by the Commission in its preliminary drafts.

V. EQUIVALENCE BETWEEN ANNUAL EXPENDITURE CEILINGS AND ANNUAL CEILINGS FOR CALLING IN COMMUNITY OWN RESOURCES*

18. The three institutions party to the Agreement agree that the overall expenditure ceiling for each year also represents the annual own resources call-in ceiling for the corresponding budget year. This will be expressed as a percentage of Community GNP.

19. This equivalence between annual expenditure ceilings and annual revenue ceilings is embodied in the own resources Decision of 1988, allowance being made for a safety margin for unforeseen expenditure of 0.03% of GNP.

This Decision defines the annual ceilings for calling in Community revenue on the basis of the annual expenditure ceilings set in the financial perspective 1988-92, which is an integral part of this Agreement.

These ceilings are such that each year sufficient Community resources are allocated to the various financial objectives set in this perspective.

VI. FINAL PROVISIONS

20. This Interinstitutional Agreement will enter into force on

Before the end of 1991 the Commission will present a report on the application of this Agreement and on the amendments which need to be made to it in the light of experience.

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* If the Council decides that the Decision on own resources should retain annual revenue call-in ceilings expressed as a percentage of Community GNP, Parliament would like Chapter V of the Interinstitutional Agreement to be dropped.

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MY TELNOS 1729 AND 1744

FOLLOW UP TO EUROPEAN COUNCIL: INTER INSTITUTIONAL AGREEMENT

SUMMARY

1. UK NEEDS TO DECIDE ON RESPONSE TO DRAFT IIA. TEXT WILL NOT MUCH SIMPLIFY BUDGET PROCEDURE AND HAS SOME UNWELCOME ELEMENTS: BUT SHOULD FACILITATE INCLUSION OF OR SUB-CEILINGS IN NEW ORD AND PROVISION OF EP OPINIONS ON DRAFT BUDGET DISCIPLINE DECISION AND OTHER TEXTS. COUNCIL RULES ON DNO BUDGET DISCIPLINE PERHAPS BEST DEALT WITH IN COUNCIL MINUTES STATEMENT.

DETAIL

2. WE HAVE NOW SEEN A COPY OF THE TEXT OF THE INTER INSTITUTIONAL AGREEMENT (IIA): IN CONFIDENCE, FOR THE PRESIDENCY SAY THAT THE AGREEMENT WILL BE DISTRIBUTED PERSONALLY BY STOLTENBERG TO HIS ECOFIN COLLEAGUES, NOT IN THE USUAL WAY IN BRUSSELS. THE TEXT (MUFAXED TO WALL, MORTIMER AND BUDD) DIFFERS IN ONLY ONE SIGNIFICANT RESPECT FROM THAT SUMMARISED IN FIRST TUR: IT PROVIDES THAT THERE WILL BE ANNUAL OWN RESOURCES (OR) SUB-CEILINGS, EXPRESSED AS A PERCENTAGE OF GNP, AND ACKNOWLEDGES THAT THE COUNCIL MAY INSIST ON THEIR INCLUSION IN THE NEW OWN RESOURCES DECISION (ORD) (IN THE LATTER CASE THE SECTIONS IN THE IIA DEALING WITH OR SUB-CEILINGS WOULD BE DELETED).

3. WE NOW NEED TO DECIDE ON OUR RESPONSE TO THE IIA IN READINESS FOR ECOFIN ON 13 JUNE AND ANY PREPARATORY DISCUSSIONS IN COREPER (THOUGH NONE IS YET SCHEDULED).

4. AN IIA IN THE TERMS AGREED IN THE TRILOGUE WILL NOT MUCH SIMPLIFY OR CLARIFY THE ANNUAL BUDGET PROCEDURE. PARAGEAPH 15 STATES THAT THE COUNCIL AND EP ''AGREE TO ACCEPT, FOR THE FINANCIAL YEARS 1988-92, THE MAXIMUM RATES OF INCREASE FOR NON-COMPULSORY EXPENDITURE DERIVING FROM THE BUDGETS ESTABLISHED WITHIN THE CEILINGS SET BY THE FINANCIAL PERSPECTIVE.'': AN AMBIGUOUS FORMULA,

WHICH THE EP WILL INTERPRET AS AN ENTITLEMENT TO GO UP TO THE EXPENDITURE CEILINGS SET OUT IN THE FIVE YEAR FORECAST WHICH WILL FORM PART OF THE IIA, AND WHICH NORTHERN MEMBER STATES WILL SAY REPRESENTS ONLY AN UPPER BOUND.

5. THE DRAFT IIA CAN ALSO BE CRITICISED ON A NUMBER OF GROUNDS:

A) IT CONTAINS NO TRACE OF THE RULE IN PARAGRAPH A14 OF THE EUROPEAN COUNCIL CONCLUSIONS THAT DNO OTHER THAN IN THE STRUCTURAL FUNDS, THE PEDIP, IMPS AND THE R AND D FRAMEWORK PROGRAMME, SHOULD INCREASE AT THE 'STATISTICAL' MAXIMUM RATE, AND THAT THE PROVISIONS OF ARTICLE 9 OF THE 1984 BUDGET DISCIPLINE CONCLUSIONS SHOULD APPLY TO SUCH EXPENDITURE (IE THE COUNCIL STICKS TO HALF THE MAXIMUM RATE AT ITS FIRST READING, AND THE MAXIMUM RATE AT ITS SECOND READING, WHILE NOTING THAT ARTICLE 203.9 PROVIDES FOR THE POSSIBILITY OF AGREEMENT BY THE COUNCIL AND EP TO SET A NEW RATE OF INCREASE).

B) PARAGRAPHS 10 AND 11 OF THE TEXT PROVIDE THAT, IF EXPENDITURE ON MULTIANNUAL PROGRAMMES FALLS BEHIND SCHEDULE, COUNCIL AND EP WILL AGREE TO A CATCHING-UP EXERCISE IN SUBSEQUENT YEARS. THIS PROVISION APPEARS TO SIT AWKWARDLY WITH THE EUROPEAN COUNCIL'S INSISTENCE THAT THE ANNUALITY OF THE BUDGET PROCEDURE BE STRENGTHENED, THOUGH IT REFLECTS AN UNDERSTANDABLE ANXIETY ON THE PART OF THE EP THAT, ON THE STRUCTURAL FUNDS, THE COMMUNITY SHOULD LIVE UP IN PAYMENTS TO WHAT THE EUROPEAN COUNCIL PROMISED IN COMMITMENTS.

C) PARAGRAPHS 12 AND 13 OF THE TEXT SAY THAT THE BALANCE OF EXPENDITURE AMONG CATEGORIES OF EXPENDITURE CAN ONLY BE ALTERED WITH THE AGREEMENT OF BOTH BRANCHES OF THE BUDGET AUTHORITY. THIS IS A THINLY VEILED EP ATTEMPT TO PREVENT THE EXPANSION OF DO AT THE EXPENSE OF DNO. BUT IT IS THE FRENCH AND OTHER SUPPORTERS OF AGRICULTURAL SPENDING WHO ARE MOST LIKELY TO FIND IT OBJECTIONABLE.

D) THE DRAFTING OF THE IIA IS IN SEVERAL PLACES NOT WHAT WE WOULD HAVE CHOSEN: NOR WILL THE FIVE YEAR FORECAST PRESENT MATTERS IN THE WAY WE WOULD HAVE PREFERRED.

6. SO THE IIA IS NOTHING TO CHEER ABOUT. THE PRESIDENCY HOWEVER SAY THAT STOLTENBERG WILL PUT HIS WEIGHT BEHIND GETTING THE AGREEMENT ENDORSED AT ECOFIN ON 13 JUNE: AND THEY ARE UNLIKELY TO LOOK KINDLY ON COUNCIL ATTEMPTS TO REDRAFT THE TEXT PUT TOGETHER IN

THE TRILOGUE OR TO HAVE IT ACCOMPANIED BY FURTHER TEXTS WHICH THE EP WILL SEE AS WRECKING AMENDMENTS.

7. ARE THERE ANY ADVANTAGES FOR US IN AGREEING TO THE IIA AS IT STANDS? TWO POINTS ARE WORTHY OF CONSIDERATION.

A) THE EP TEAM HAS SWALLOWED THE PILL OF OWN RESOURCES SUB-CEILINGS: ALL BEING WELL, WE SHOULD NOW BE SPARED THE TRAVAIL OF A DIFFICULT CONCILIATION PROCEDURE ABOUT SUB-CEILINGS IN THE ORD: A CONCILIATIONS PROCEDURE IN WHICH THE EP WOULD HAVE HAD ALLIES WITHIN THE COUNCIL.

B) THE PACKAGE DEAL WHICH IS NOW BEGINNING TO FALL INTO PLACE FOR THE WEEK OF 13 JUNE INVOLVES COUNCIL ACCEPTANCE OF THE IIA AND POLITICAL AGREEMENT ON THE OTHER OUTSTANDING ISSUES IN THE FUTURE FINANCING PACKAGE, FOLLOWED BY THE PROVISION OF EP OPINIONS ON A RAFT OF COMMISSION PROPOSALS WHICH CAN THEN BE FORMALLY ADOPTED BY THE COUNCIL BEFORE 30 JUNE. AMONG THESE PROPOSALS IS THE IMPORTANT DRAFT DECISION ON BUDGET DISCIPLINE, ON WHICH AN EP OPINION IS HIGHLY DESIRABLE IN ORDER TO GIVE THE DECISION LEGAL WEIGHT COMPARABLE TO THE LEGISLATION ON AGRICULTURAL MARKETS. UKREP HAS LOBBIED THE PRESIDENCY AND EP CONTACTS HEAVILY OVER THE LAST FEW DAYS TO ENSURE AN OPINION IN THE JUNE EP SESSION: BUT THAT OPINION WOULD PROBABLY BE AN EARLY CASUALTY OF COUNCIL REJECTION OF THE IIA.

8. AGREEMENT ON THE IIA WOULD THUS BE NOT WITHOUT ITS BENEFITS. THERE REMAINS THE EUROPEAN COUNCIL'S AGREEMENT ON THE APPLICATION OF BUDGET DISCIPLINE TO DNO. (ON THIS, THE DRAFT BUDGET DISCIPLINE DECISION AGREED AT ECOFIN ON 18 APRIL INCLUDES ONLY A ''PM'': THE COMMISSION DRAFT OF THE DECISION REFERS THE READER TO THE IIA). A NUMBER OF OTHER MEMBER STATES WILL SHARE OUR RESISTANCE TO MERELY LETTING THIS AGREEMENT VANISH WITHOUT TRACE. ON THE OTHER HAND, TO SEEK TO GIVE IT A HIGH PROFILE (EG BY WRITING DETAILED PROCEDURES INTO THE DRAFT BUDGET DISCIPLINE DECISION) COULD SERIOUSLY PREJUDICE AGREEMENT ON THE IIA: FOR BETTER OR WORSE, THE GERMAN PRESIDENCY HAS GONE ALONG WITH AN IIA WHICH TAKES LITTLE ACCOUNT OF PARAGRAPH A14(B) OF THE EUROPEAN COUNCIL CONCLUSIONS. IN MY VIEW THE BEST WAY FORWARD WILL BE TO REPEAT IN THE COUNCIL MINUTES THE TEXT OF PARAGRAPH A14 OF THE EUROPEAN COUNCIL CONCLUSIONS, WORD FOR WORD. THAT TEXT STATES CLEARLY THAT WHAT IS PROPOSED BINDS ONLY THE COUNCIL AND MEMBER STATES: IT NONETHELESS SETS OUT, BY REFERENCE TO THE 1984 CONCLUSIONS, CLEAR RULES FOR THE COUNCIL'S APPROACH TO THE BUDGET NEGOTIATIONS.

ec2.ss/mcm/ecofin

CHANCELLOR

FROM: M C MERCER
DATE: 9 JUNE 1988

cc: Paymaster General
Sir G Littler
Mr Lankester
Mr R Allen
Mr Mortimer
Mr Bonney
Mr Kaufmann
Mr Evans

Ch/ My minute of 3/6 (flagged) recorded your earlier comments on this.
Agree with Mr Mercer's "tentative conclusions" (para 18)?

It is v. finely balanced. [illegible]. In the circs, I would tend to [illegible] to give him OK. N.

PS. Presumably [illegible] we shall need to [illegible] the OK'd.

EC FINANCE: THE INTER-INSTITUTIONAL AGREEMENT

Stoltenberg has written to ECOFIN colleagues enclosing the text of the draft IIA agreed ad referendum by the Trilogue on 30 May, together with figures for the financial perspective 1988-1992 (attached at flag A). The Presidency will be pressing hard for agreement on the document and the figures at ECOFIN on Monday. This submission considers the UK's position.

BACKGROUND

2. In a nutshell the IIA involves agreement by the parties to

i) respect the expenditure ceilings set out in the financial forecasts;

ii) a mechanism to adapt the forecasts within a limit of 0.03% of GNP for unforeseen expenditure;

iii) respect the forecasts for the structural funds and multi-annual programmes.

3. The IIA would not, however, simplify or rationalise the budget procedure. The vagueness of its wording leaves ample scope for continued haggling between the Parliament and the Council over each year's Budget.

4. The Presidency do not regard the present text as negotiable. The indications are that most if not all of the other member states will be prepared to agree to it as it stands. That of course should not prevent us from seeking amendments. But, in practice, the key questions for us are:

i) Is the present text positively damaging?

ii) How best could the agreement be clarified or reinforced, eg by Council Declarations.

5. The main criterion for judging (i) above is the agreement's consistency or otherwise with the conclusions of the Brussels European Council. As regards (ii) above, any Council Declaration would be worthless unless it was unanimous. Even then, it would represent no more than a moral commitment (but so, in reality, would the IIA itself).

PROBLEMS

6. There are five main problems with the Stoltenberg document:

i) the financial forecasts are not strictly consistent with the Brussels conclusions;

ii) the text omits any reference to paragraph A14 of the Brussels conclusions, which provides that non-obligatory expenditure other than the structural funds and multi-annual programmes (so-called "non-privileged" DNO) should increase at the statistical maximum rate;

iii) paragraph 11 appears to provide for the automatic transfer to other areas of any appropriations for multi-annual programmes which cannot be used in full. If this were so, it would run counter to the Brussels conclusions tightening up the arrangements for the carry forward of unused commitments (annuality);

iv) paragraph 12 may be construed as permitting an increase by QM in the agricultural guideline, the monetary reserve, or the agreed provision for the depreciation of existing agricultural stocks, all of which are fixed in the Budget Discipline Decision;

v) it is not absolutely clear whether all concerned now agree that the annual own resources sub-ceilings will be included in the new ORD.

7. Progress was made in all of these areas at COREPER yesterday (the reporting telegram is at flag B). The following paragraphs summarise and assess the current state of play.

<u>**The forecasts**</u>

8. Our main concerns on the figures for 1992 circulated by Stoltenberg are:

- provision of 450 mecu for <u>set-aside and income aids</u> is in addition to, rather than subsumed within, the agreed figure of 13 becu for the structural funds. We have however become isolated in opposing this and have reconciled ourselves to the possibility of making a concession;
- the figure of 2.4 becu for <u>multi-annual programmes</u> is little more than notional. But an extremely helpful footnote to the table makes clear that there is no legal base for expenditure in 1992 of more than 1.16 becu;
- the 2.8 becu entered for <u>"other policies"</u> is around 300 mecu higher than we would have calculated. But the Presidency claim that when administration is taken into account, the growth of so-called "non-privileged" DNO (including other policies) is in line with the statistical maximum rate. We think that this is broadly correct.

9. There is no realistic prospect of further improving the figures. They are unsatisfactory, but bearable. And it is worth noting that, on present forecasts, commitments in 1992 would represent 1.23% of GNP, some way short of the 1.3% agreed by the Brussels Council.

<u>**Non-obligatory expenditure**</u>

10. At COREPER the Presidency suggested that in the absence of any reference in the IIA to the Council's agreed rules for DNO, the Council could make a Declaration referring to the relevant section of the Brussels conclusions. This suggestion was prompted by the UK and it now seems likely that a Declaration on the following lines will be on the table at ECOFIN:

"The Council for its part will interpret section IV of the IIA in accordance with the European Council conclusions of 11-12 February 1988, and in particular paragraph A14."

It is vital that we should secure such a Declaration. The rule in paragraph A14 is the only explicit decision which the European Council took on budget discipline for DNO and it must not be swept under the carpet.

Annuality

11. The Commission maintain that paragraph 11 of the IIA is quite consistent with the new regime on annuality agreed at the Brussels Council, and with the strict budgetary management of credits. They agreed at COREPER to make a formal statement of the minutes to this effect. We do not yet have a text, but are doubtful whether a statement by the Commission will be sufficient. A Council Declaration would help, but we are not confident that even that would be a watertight safeguard. In theory, since the new regime on annuality is to be enshrined in the Financial Regulation it will have legal force and should therefore override the IIA. But in practice, the automatic upward adjustment of the financial perspectives which could take place under paragraph 11 of the IIA is quite likely to blunt the effectiveness of the new regime.

Obligatory expenditure

12. Paragraph 12 of the IIA is damaging. We must insist on a solution which scotches any suggestion that, eg, the agricultural guideline could be revised upwards by qualified majority. At COREPER the UK proposed a Council Declaration on the following lines:

"The Council, for its part, would act only by unanimity in any area where explicit financial provision had been made by the European Council."

13. Sir D Hannay has also recommended (telegram at flag C) that one of the conditions which the UK might attach to acceptance of

the IIA is that the Budget Discipline Decision must be endorsed by the European Parliament and adopted substantially in the form it was agreed at ECOFIN in April. In our view, this condition, plus a Council Declaration, should be sticking points: together they should go most, if not all of the way towards ensuring that paragraph 12 becomes redundant.

<u>Own resources sub-ceilings</u>

14. The position here is relatively straightforward. Stoltenberg says in his letter that he has made quite clear to the Parliament that sub-ceilings must be laid down in the ORD in accordance with the Brussels conclusions. There should be no question of our accepting the IIA on any other basis: moreover, the ORD must specify the sub-ceilings as percentages which cannot be revised.

CONCLUSIONS

15. Sir D Hannay takes the view that, subject to the conditions in his telegram at flag C, we should accept the IIA, warts and all. The FCO agree. The following additional factors are also relevant:

i) through the IIA we would, in effect, secure the agreement of the Parliament to sub-ceilings which would represent a legally-binding control on total EC expenditure;

ii) a possible package deal is now beginning to fall into place for next week involving Council acceptance of the IIA, political agreement on the other outstanding issue relating to future financing, and the provision of Opinions by the Parliament on a raft of Commission proposals. Among these proposals is the draft Budget Discipline Decision, on which an Opinion is important. An Opinion would almost certainly not be forthcoming next week if the Council were to reject the IIA;

iii) the UK would incur political odium if we were isolated in opposing the IIA.

16. The issue is very finely balanced. The Presidency have not been entirely faithful to the Brussels Conclusions (despite the Paymaster's recent letter to Tietmeyer) and we think that as it stands the text is damaging and that the minimum requirement for an acceptance of it should be a unanimous Council Declaration covering:

- DNO (the growth of non-privileged expenditure);
- agricultural guarantee spending (the Budget Discipline Decision); and
- annuality.

17. Even if these requirements were met, we would remain uneasy about the IIA, not least because of our doubts as to whether a Declaration on annuality would have much practical effect.

18. On the other hand, the factors summarised at paragraph 15 above suggest that rejection of the IIA could make it more difficult to apply the Brussels package.

19. Taking all of these factors into account, our tentative conclusions are that:

i) we should refuse to accept the IIA unless the Council unanimously agrees on a satisfactory Declaration;
ii) even if a satisfactory Declaration is agreed, we should not accept the IIA if any other member state was holding out on grounds which we considered to be reasonable;
iii) if having secured a satisfactory declaration we were isolated in holding out, the balance of advantage might lie, just, in our accepting the IIA.

20. We would be most grateful to have your views on this tomorrow morning in order that we can reflect them in the briefing for ECOFIN.

M. C. Mercer

M C MERCER

CHANCELLOR

Ch/

Content to minute as proposed?

25

10/6

Thanks. OK.

FROM: M C MERCER

DATE: 10 JUNE 1988

cc: Paymaster General
Sir G Littler
Mr Lankester
Mr R Allen
Mr Mortimer
Mr Bonney
Mr Kaufmann
Mr Evans

EC FINANCE: THE INTER-INSTITUTIONAL AGREEMENT

We understand that you wish to consult the Prime Minister about the UK's position on the draft IIA. I attach a draft minute.

M.C. Mercer

M C MERCER

ec2.ss/mcm/d8

DRAFT MINUTE TO THE PRIME MINISTER

EC FINANCES: INTER-INSTITUTIONAL AGREEMENT

At ECOFIN on Monday the Presidency will press hard for adoption of the draft Inter-Institutional agreement (IIA) which Stoltenberg has negotiated with the European Parliament, together with "financial perspectives" (expenditure ceilings) for 1988-92. This minute summarises the issues and the line which I would propose to take.

2. The purpose of the IIA is to establish a procedural framework for implementing the expenditure decisions of the Brussels European Council. In essence, it would involve political agreement by the Council, the Parliament and the Commission to:

- respect the ceilings set out in the financial perspectives,
- a mechanism permitting revision of the perspectives within the small safety margin for unforeseen expenditure agreed at the Brussels Council;
- respect the forecasts for the structural funds, R&D and IMPs.

3. The draft IIA and accompanying ~~forecasts~~ perspectives are not entirely satisfactory. But the German Presidency ~~have tabled~~ will be urging

their acceptance
~~them on a take-it or leave-it basis~~ and the indications are that other member states will be prepared to sign up. I believe that the key questions for the UK are whether the draft as it stands is positively damaging; and if so, whether Council Declarations for the minutes would help.

4. The main problem areas for us are:

i) in the ~~the~~ financial perspectives the figure for 1992 is higher than we would have wished, largely because a notional amount has been entered for R&D. Even so, commitments in 1992 would, on present forecasts, represent only 1.23% of Community GNP, well short of the 1.3% ceiling agreed at the Brussels Council;

ii) the text does not refer to the Council's undertaking to ensure, for its part, that non-obligatory expenditure other than the structural funds and multi-annual programmes increases at the maximum rate. This is an important omission. But it should, I hope, be possible to secure a satisfactory Council Declaration referring back to the Brussels Conclusions;

iii) the draft could be construed as enabling ~~the~~ agricultural guarantee spending to be increased by qualified majority. The legal position here is not at issue: the guideline is enshrined in the legally-binding decision on Budget Discipline (which we hope will be adopted at the FAC on Monday). But for the avoidance of all doubt I would propose to press for a further Council Declaration making clear that decisions on the agricultural guideline and related expenditure must be unanimous; and to say that the UK could not accept the IIA unless the Parliament endorses the Budget Discipline decision in the form in which it was agreed at ECOFIN in April;

iv) the text appears to cut across the new rules agreed at the Brussels Council to reinforce the principle of annuality in budget management. The Commission deny this and have offered to make a formal statement for the minutes. It may be necessary to press for a Council Declaration as well, ~~but~~ though even this might not be sufficient in practice to prevent some weakening of the new regime.

5. There is also the closely related issue of the annual own resources sub-ceilings. Stoltenberg has made clear to the Parliament that these must be laid down in the new ORD in accordance with the Brussels Conclusions. We could not accept the IIA on any other basis.

6. More generally, the Presidency are aiming for political agreement next week on all of the outstanding future financing issues. The necessary formal instruments could then be adopted by the end of June.

But this depends on the Parliament delivering its opinion on the relevant Commission proposals, including the draft Budget Discipline decision. Opinions would almost certainly not be delivered next week if the Council failed to endorse the IIA. And If the UK were seen to be responsible for the failure we would incur considerable political odium for holding up the entire future financing package.

7. The issues here are very finely balanced. The Presidency have not been totally faithful to the Brussels Conclusions, despite Peter Brooke's recent letter to Tietmeyer. Sir David Hannay nevertheless takes the view that, subject to certain conditions, the UK should accept the text as it stands. I believe that the minimum conditions should be:

- satisfactory Declarations on non-obligatory expenditure (paragraph 4(ii) above), agricultural guarantee spending (4(iii)), and annuality (4(iv));
- the Parliament's endorsement of the Budget Discipline Decision; and
- the inclusion of own resources sub-ceilings, set as a percentage of Community GNP, in the ORD.

8. Subject to your views, I would propose to accept the IIA and the financial perspectives if these conditions were met, and if the UK were otherwise at risk of becoming isolated. I would, however, join any other

member state which was holding out on grounds which I considered to be reasonable.

9. Copies of this go to Geoffrey Howe and to Sir Robin Butler.

[NL]

iae.st/Wy/094 CONFIDENTIAL

FROM: P WYNN OWEN
DATE: 24 June 1988

1. MR ~~BURR~~ TBurr 24/6.

2. CHANCELLOR

cc PS/Paymaster General
Sir P Middleton
Mr Lankester
Mr Monck
Mr Burgner
Mr R I G Allen
Mrs Lomax
Miss Barber
Mr Bent
Mr Ilett
Miss Noble
Mr Kroll
Mr Parkinson

Ch/ The relevant part of the briefing is in para. 12 of the attached. I doubt that it is worth troubling the PM at this stage; if it is, this will need to be done orally. 24/6

Why cannot the draft below – wh. is OK – be faxed to the PM?

HANOVER SUMMIT: EC MERGER CONTROL

This note updates you on EC Mergers policy in the context of preparation for the Hanover Summit. It offers you a note you might consider sending the Prime Minister before Hanover.

2. At the 16 June Internal Market Council, Mr Maude basically stuck to his brief, maintaining the UK's general reserve and outlining a number of areas of uncertainty about the draft proposal. The Commission and the German Presidency nonetheless continued to run this one hard, apparently encouraged by a more positive position adopted by the French.

3. A German draft of the possible conclusions for Hanover has now been circulated, which the UK delegation will doubtless want to change it in several key respects. On EC mergers, there is a reference to this being one of a list of Commission proposals that should be "speedily agreed".

4. We sought an explicit statement in the Prime Minister's briefing saying that any such reference should be stuck out. But the final brief as produced by the FCO ends with the formulation that "we need to avoid any reference in the conclusions which would commit us to a regulation". We think a reference to mergers in the Hanover conclusions which did <u>not</u> effectively commit us to a regulation would be very difficult to draft. Our request for the brief to include the points you made at OD(E) last week, on non-competition barriers in other EC countries, was also rejected.

5. Mr Lavelle has advised that the content of the Prime Minister's briefing is unlikely to matter much in practice. He thinks it fairly unlikely that EC mergers would survive in a shortlist of action points, partly because no other country (besides Germany) is likely to push it and partly because the Prime Minister will argue against it. He thinks that, even if it does survive in the conclusions, the Prime Minister would probably be prepared to disown it in public in some way. On the other hand, Mr Lavelle also noted that Commissioner Sutherland is currently very unpopular with the Prime Minister, given his stance on BAe/Rover. So this might be the right time to rubbish Sutherland's EC merger's proposal to her. The Prime Minister may also not be aware of the forceful arguments on non-competition barriers to hostile bids in other member states which you recently put to OD(E).

6. All this suggests <u>either</u> there is little need to press the point with the Prime Minister before Hanover, <u>or</u> that it is a favourable moment to win her over to ensuring nothing features in the conclusions. If you were minded to warn her of your strong views on this issue, this could be done orally over the weekend or in a short minute, a draft of which is attached.

Philip Wynn Owen

P WYNN OWEN

CONFIDENTIAL

Pse type final

DRAFT MINUTE FROM CHANCELLOR TO PRIME MINISTER:

HANOVER SUMMIT - EC MERGER CONTROL

At Hanover you may well find the Commission and the German Presidency pressing for a reference in the conclusions to the need for speedy agreement on the Community Merger Control directive. My own convinction is that it would be a serious error to allow any reference to this issue to appear in the final conclusions.

The draft mergers directive being pressed by Commissioner Sutherland is unsatisfactory to us in a wide range of ways. But the essential point, as recently highlighted by the Rowntree case, is that most member states have a far more extensive range of non-legislative barriers to contested takeovers than we do (eg commercial bank holdings and proxy voting in Germany; tight family controls in Italy). If national merger controls are subordinated to Community controls, our companies will be left still more open to overseas predators whereas others will maintain their covert means of control. It was agreed at OD(E) last week that the Cabinet Office should coordinate a comprehensive study on the barriers to takeover activity in other member states and how these might be overcome. We should make the abolition of these barriers a condition of agreement to any regulation. But, in the meantime, I think it essential that we in no way cede our reserve of principle on EC Mergers Control by allowing any reference to it in the Hanover conclusions.

I am copying this note to Geoffrey Howe, David Young and other members of OD(E).

[N L]

ec.jn/mparkinson/min3 BF 1/7.

⇒ Jonathan - I will let MOODPS know. Julie

On present plans, I doubt whether it is worthwhile for the Chancellor to attend, but I agree with X below.

RIGA.

FROM: M PARKINSON
DATE: 24 JUNE 1988

1. MR R I G ALLEN
2. PS/CHANCELLOR

cc: PS/Paymaster General
PS/Economic Secretary
Sir G Littler
Mr Byatt
Mr Lankester
Mr H Evans
Mr Gilhooly
Mr Mortimer
Mr Gieve
Mr R Allen (C&E)

Ch/ Put PMG (~~~~EST?~~) on alert and confirm after COREPER next Thursday? 24/6

Yes pse

JT 24/6

ECOFIN 11 JULY

The provisional agenda (attached) for the ECOFIN meeting on 11 July was distributed at COREPER on 24 June.

2. The agenda at present is light. The only two definite items at this stage are discussion of the Commission's second quarterly economic review and follow-up to the Toronto Economic Summit. It is possible that there will also be a follow-up discussion on the Hanover European Council. One other possibility which UKREP are aware of is that the Commission may wish to seek endorsement of a list of questions for further consideration on indirect tax approximation, discussed by a High Level Group following the May informal ECOFIN, but it is uncertain whether this will be on the July ECOFIN agenda.

3. I should be grateful if you could confirm whether the Chancellor would like us to plan on the basis that he will attend or what alternative arrangements he would prefer. X The Chancellor may wish to finalise the position after the COREPER meeting next Thursday when we will know the outcome of the Hanover Council and have firmer information on the agenda.

Mark Parkinson

M PARKINSON

162560
MDHIAN 4433

RESTRICTED
FM UKREP BRUSSELS
TO IMMEDIATE FCO
TELNO 2092
OF 221352Z JUNE 88
INFO ROUTINE EUROPEAN COMMUNITY POSTS

FRAME ECONOMIC

COREPER (AMBASSADORS) : 22 JUNE 1988 : PREPARATION FOR 11 JULY ECOFIN

1. PROVISIONAL AGENDA FOR THE ABOVE COUNCIL WAS DISTRIBUTED BY UNGERER (PRESIDENCY) TODAY, PRESUMABLY WITH THE AGREEMENT OF THE INCOMING GREEK PRESIDENCY. SO FAR THERE ARE TWO DEFINITE ITEMS - (I) THE SECOND QUARTERLY ECONOMIC REVIEW AND (II) FOLLOW-UP TO THE TORONTO ECONOMIC SUMMIT, BUT UNGERER THOUGHT IT POSSIBLE THAT THERE WOULD ALSO BE A FOLLOW-UP DISCUSSION TO THE HANOVER EUROPEAN COUNCIL.

2. SUBSEQUENTELY WE ASKED PINI (COUNCIL SECRETARIAT) ABOUT ARRANGEMENTS FOR THE MEETING OF THE COORDINATING GROUP TO PREPARE FOR ITEM (I). HE CONFIRMED THAT AS USUAL THIS WOULD TAKE PLACE ON THE MONDAY BEFORE ECOFIN (IE 4 JULY), AND THAT THE DISCUSSION WOULD BE BASED ON A PAPER TO BE DISTRIBUTED (DIRECT TO CAPITALS) SOMETIME NEXT WEEK.

HANNAY

YYYY

<u>DISTRIBUTION</u> 206

<u>MAIN</u> 205

.FRAME ECONOMIC ECD (I)

<u>ADDITIONAL</u> 1

FRAME

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Fwd. 2. Re X, what is officially meant by "monetary union"? ...

10 DOWNING STREET

LONDON SW1A 2AA

Ch/ This looks OK: Mr Lankester & Mr Allan are content.

29/6

From the Private Secretary

28 June 1988

EUROPEAN COUNCIL: STATEMENT

I enclose a draft of the Prime Minister's Statement to the House on Thursday on the outcome of the European Council in Hanover. I should be grateful for comments and amendments by 1100 on 29 June. The draft builds on contributions, for which I am most grateful, from Roger Lavelle, Sir John Fretwell and John Kerr.

I am copying this letter and enclosure to Alex Allan (HM Treasury), Neil Thornton (Department of Trade and Industry), Philip Mawer (Home Office) and Trevor Woolley (Cabinet Office).

CH/EXCHEQUER	
REC.	29 JUN1988
ACTION	PMG
COPIES TO	

29/6

C. D. POWELL

A. C. Galsworthy, Esq., C.M.G.
Foreign and Commonwealth Office

SP2AAY

PRIME MINISTER'S STATEMENT

ON THE

EUROPEAN COUNCIL

IN HANOVER

ON

27/28 JUNE

With permission, Mr Speaker, I shall make a statement about the European Council in Hanover on 27-28 June, which I attended with my rt hon and learned Friend the Foreign and Commonwealth Secretary.

The Council's detailed conclusions have been placed in the Library.

The Council dealt with two main issues:

- progress towards completion of the Single Market by 1992; and
- arrangements for progressively closer economic and monetary co-operation in Europe.

First, the Single Market.

The Council was able to note that over one third of the measures in the European

Commission's White Paper on the Single Market have now been agreed.

Agreements reached in recent weeks cover a number of subjects of particular interest to the United Kingdom: the full liberalisation of capital movements, the mutual recognition of professional qualifications and the opening up of the road haulage market by progressive abolition of lorry quotas.

The Council also agreed that priority should be given over the next twelve months to decisions on:

- opening up of public purchasing;
- further liberalisation of banking and other financial services;
- mutual recognition throughout the Community of national standards for

products rather than an attempt to harmonise such standards;

- and intellectual property, that is to say patents and trade marks.

The list does <u>not</u> include the harmonisation of indirect taxes, where the Council simply noted the further studies set in hand by Economic and Finance Ministers. The Government's view is that such harmonisation is <u>not</u> necessary for completion of the Single Market.

In considering the social aspects of the Single Market, the Council noted that removing the obstacles to growth offers the best prospects for creating jobs and spreading prosperity.

It also encouraged better protection for health and safety at the work place.

The United Kingdom's record in this respect is of course good.

The Council reaffirmed the objective of removing obstacles to the free movement of persons in Europe but also stressed the need for effective measures to combat terrorism, drug abuse and organised crime. This again is a matter to which the United Kingdom attaches particular importance.

It is very satisfactory that the need for adequate safeguards at frontiers was explicitly recognised.

Second, <u>economic and monetary co-operation</u>.

The Council agreed to establish a committee of Governors of Central Banks appointed in their personal capacity. The committee is to be chaired by the President of the Commission and will contain a second Commission representative and three additional members.

The committee's task will be to study and propose concrete steps towards the <u>progressive</u> realisation of an economic and monetary union.

X That goal was, of course, set in the preamble to the Single European Act which was passed by this House.

There is no reference in the committee's mandate to a European Central Bank.

The committee will report through the Committee of Economic and Finance Ministers to the meeting of the European Council in Madrid next June.

The Council approved the reappointment of M. Jacques Delors as President of the

Commission for a further two year term from 1 January 1989.

Foreign Ministers discussed a number of political co-operation subjects, concentrating particularly on East/West relations, Afghanistan, the Middle East, South Africa and Latin America. The Council conclusions on all these subjects are recorded in the final communiqué.

Finally, we were able to note with satisfaction that the important decisions taken at the meeting of the European Council in February on budget discipline and agriculture have now been translated into binding legal instruments.

Legislation to give effect to the new arrangements for financing the Community budget will shortly be laid before the House.

Following the Council, I had a meeting with the Taoiseach to discuss a number of current issues in Anglo-Irish relations. We reaffirmed our commitment to the Anglo-Irish Agreement and agreed to maintain, indeed strengthen, whole-hearted co-operation against terrorism.

Mr Speaker, the outcome of this Council was very satisfactory for the United Kingdom. We have confirmed that the way forward in Europe lies through the creation of wealth and jobs as obstacles to trade, and burdens on business are steadily removed. Thanks to this Government's policies, British firms will be particularly well placed to take advantage of the opportunities which the Single Market in Europe offers.

BF 475 4/7

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Ch/ 'X' + 'Y' slightly tip the balance towards you going. And I suppose courtesy to Roumeliotis, whose first meeting this is, also points that way. Do you think you should go? Or leave to EST and/or JGL?

UKREP

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FM UKREP BRUSSELS
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OF 301315Z JUNE 88
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ADVANCE COPY

FRAME ECONOMIC

COREPER 30 JUNE: PREPARATION OF ECOFIN COUNCIL 11 JULY

SUMMARY

1. AGENDA: SECOND QUARTERLY EXAMINATION OF ECONOMIC SITUATION, FOLLOW UP TO TORONTO, FOLLOW UP TO HANNOVER, INDIRECT TAX APPROXIMATION (COMMISSION STATEMENT, NO DISCUSSION). MAJOR SHAREHOLDINGS NOT YET ON AGENDA BUT STILL POSSIBLE. 1230 START.

DETAIL

2. THE DRAFT AGENDA CIRCULATED AT COREPER CONTAINED THREE SUBSTANTIVE ITEMS:

A) SECOND QUARTERLY ECONOMIC SITUATION IN THE COMMUNITY:

B) FOLLOW UP TO TORONTO ECONOMIC SUMMIT:

X C) FOLLOW UP TO HANNOVER EUROPEAN COUNCIL.

LYBEROPOULOS (GREECE) ADDED:

D) THAT THE COUNCIL WOULD START, WITH LUNCH, AT 1230:

X E) THAT ROUMELIOTIS (CHAIRMAN OF ECOFIN) WOULD EXPLAIN HIS PLANS FOR THE COUNCIL OVER THE NEXT SIX MONTHS, AND WOULD BE GLAD TO HEAR OTHER MINISTERS' VIEWS:

Y F) THAT THE COMMISSION HAD ASKED THAT THE AGENDA SHOULD ALSO INCLUDE THE ABOLITION OF FISCAL FRONTIERS. LORD COCKFIELD WANTED TO ADDRESS THE COUNCIL IN PREPARATION FOR THE SEPTEMBER INFORMAL MEETING OF FINANCE MINISTERS. THE GREEK PRESIDENCY DID NOT ENVISAGE ANY DISCUSSION AT THE JULY COUNCIL.

3. SCHEER (FRANCE), NIEMAN (NETHERLANDS), DE SCHOUTHEETE (BELGIUM) AND I CRITICISED THE COMMISSION'S WISH TO ADD INDIRECT TAX APPROXIMATION TO THE AGENDA. FINANCE MINISTERS HAD AGREED AT TRAVEMUNDE THAT THE HIGH LEVEL GROUP SHOULD MEET AGAIN: IT WOULD DO SO ON 7 JULY: THERE SHOULD BE NO FURTHER DISCUSSION UNTIL ITS WORK HAD BEEN CONSIDERED IN CAPITALS. IT WOULD BE BETTER FOR LORD COCKFIELD TO WRITE TO MINISTERS THAN TO ADDRESS THE JULY ECOFIN. TROJAN (COMMISSION) SAID THAT IT WAS NOT THE COMMISSION'S INTENTION TO PROVOKE A DISCUSSION. BUT LORD COCKFIELD WISHED TO IDENTIFY SPECIFIC ISSUES WHICH MINISTERS NEEDED TO ADDRESS. UNGERER

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(PRESIDENCY) RULED THAT THE DRAFT AGENDA WOULD INDICATE THAT ON FISCAL APPROXIMATION THERE WOULD BE ONLY A COMMISSION STATEMENT, WITHOUT DISCUSSION.

4. THERE WAS SOME DISCUSSION OF WHETHER FOLLOW UP TO HANNOVER WOULD BEST BE DELETED FROM THE FORMAL AGENDA AND DEALT WITH AT LUNCH. I INSISTED THAT, AT WHATEVER STAGE THE DISCUSSION TOOK PLACE, THE SUBJECT MUST REMAIN ON THE FORMAL AGENDA: FINANCE MINISTERS HAD A FORMAL RESPONSIBILITY FOR THE SUBJECT ON WHICH DELORS'S COMMITTEE OF CENTRAL BANK GOVERNORS AND OTHERS HAD BEEN ASKED TO REPORT. LYBEROPOULOS SAID THAT FURTHER DISCUSSION MIGHT BE APPROPRIATE AT NEXT WEEK'S COREPER.

5. THE DANISH REPRESENTATIVE ASKED WHEN THE COMMISSION'S PROPOSAL ON TRAVELLERS ALLOWANCES WOULD BE PUT BEFORE ECOFIN: TROJAN UNDERTOOK TO FIND OUT.

6. NO MENTION OF DISCLOSURE OF LARGE SHAREHOLDINGS. THE COUNCIL SECRETARIAT SAY THAT THE INCOMING PRESIDENCY HAVE NOT YET DECIDED WHETHER THEY WANT THE SUBJECT ON THE AGENDA AND THAT NO OTHER DELEGATION HAS ASKED FOR ITS INCLUSION: BUT THINK THAT INCLUSION ON THE AGENDA IS MORE LIKELY THAN NOT. THE GERMAN PR SAY THAT UNGERER WAS BRIEFED TO RAISE THE SUBJECT FROM THE CHAIR BUT NEGLECTED TO DO SO: AND THAT TIETMEYER IS IN NO HURRY TO BE VOTED DOWN ON THE DRAFT DIRECTIVE.

7. LORD COCKFIELD'S CABINET SAY THAT HE IS LIKELY TO BE VERY CRITICAL OF SOME OF THE QUESTIONS FOR MINISTERS WHICH THE HIGH LEVEL GROUP HAS ESTABLISHED, AND TO ARGUE THAT THE ONLY MAJOR POLITICAL DECISIONS WHICH ECOFIN SHOULD ADDRESS ARE THE NUMBER OF VAT RATES, THE WIDTH OF VAT RATE BANDS, THE ALLOCATION OF GOODS AND SERVICES BETWEEN RATE BANDS, AND WHETHER THERE SHOULD BE A CLEARING HOUSE.

HANNAY

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ADVANCE 31

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MR KERR
HD/ECD(I)(3)
HD/NEWS
HD/ERD
~~MR WALL FCO~~
MR DUFFIELD FCO ECD(1)
MR R LAVELLE CAB OFF
MR J H HOLROYD CAB OFF
MR PARKER CAB OFF
MR C R BUDD CAB OFF
MR CRASKE C/E
MR KNOW C/E
MR STOW DTI
MR NEWMAN DTI
MR POTTLE DTI
MR VARLEY DTI
SIR GEOFFREY LITTLER TRSY
MR J E MORTIMER TRSY
MR M. MERCER, TRSY
MR PARKINSON TSY
PS/CHANCELLOR TSY
PS/PMG TSY
MR LANKESTER TSY
MRT ODLING-SMEE TSY
MR PRICE BANK
MR ARROWSMITH BANK
PERMANENT SEC/MAFF
MR P KENT HM CUSTOMS

NNNN

mgl.bw/docs/(5)8.7

FROM: MISS M O'MARA
DATE: 8 July 1988

ECONOMIC SECRETARY

Ch/
Sensible suggestions.
8/7

cc Principal Private Secretary
Sir G Littler
Mr Lankester
Mr Mortimer
Mr Parkinson
Mr N Williams
Mr Bostock - UKREP

ECOFIN 11 JULY: MONETARY UNION

Sir G Littler held a meeting with the Bank, Foreign Office and Cabinet Office today on the approach the UK should take on the remit given to the Delors Committee at Hanover.

2. In the light of that discussion, we have concluded that it would be unreasonable to expect the Committee to produce its report by the end of March and we therefore advise you to press instead that it should be available by mid-May. This would permit discussion by ECOFIN in early June, following examination by the Monetary Committee, before the European Council meets in Madrid at the end of the month.

3. It was also suggested this afternoon that Delors might be asked to make an oral report to ECOFIN on progress around the turn of the year. (UKREP believe he would be quite happy to do so.) We think this would be sensible. It would also provide the Chancellor with an opportunity to give a helpful steer to the Committee's work programme, if necessary.

4. I attach a revised copy of this section of your brief incorporating these suggestions.

I am still awaiting the answer to my question: "What does monetary union mean?"

N

MISS M O'MARA

ECOFIN 11 JULY

SUBJECT: Follow-up to Hanover European Council
European Monetary Union

Relevant document: Presidency conclusions of European Council in Hanover

UK objectives

(i) To ensure ECOFIN does not prejudge subjects to be studied by Delors Committee by reformulating Committee's terms of reference in more detail. In particular, to avoid any explicit mention of European central bank or common European currency.

(ii) To make sure Committee reports its conclusions to ECOFIN in sufficient time to enable Finance Ministers to consider them thoroughly before discussion at European Council in Madrid.

(iii) To check that satisfactory arrangements are being made for the provision of a Secretariat for the Committee.

(iv) To leave scope for Monetary Committee to undertake parallel studies of some of the issues to be covered by the Delors Committee.

Line to Take

Committee has valuable contribution to make in study of this important topic. So vital ECOFIN should have sufficient time to study its conclusions. Suggest sensible for Monetary Committee to take first look at Delors Committee's study and report to ECOFIN. This implies Delors Committee will need to have completed its work by, say, mid May, if ECOFIN is to be able to examine results thoroughly before European Council in Madrid at end of month. Important Delors Committee should make every effort to keep to this timetable, even if this means identifying issues for further study after Madrid.

Suggest it would be helpful if M Delors could make an oral report to ECOFIN on progress around turn of year.

Defensive briefing

Terms of reference: European Council stated simply that Delors Committee should study and propose concrete stages leading towards economic and monetary union. For Committee to decide how best to fulfil this remit. See no need to specify terms of reference in more detail.

Secretariat:

If Delors proposes Padoa-Schioppa and you are pressed for UK view: Agree sensible that Secretariat should be provided by central banks themselves, given composition of Committee. Is there some useful role the BIS could play?

If Germans propose BIS Secretariat and you are pressed for UK view: Can see advantages of using BIS Secretariat, since Committee will presumably be meeting in Basle. But suggest this is matter for Committee itself to resolve.

If Delors, contrary to expectation, proposes **Commission** Secretariat: Surely more sensible to seek Secretary from among central banks themselves, who are providing most of Committee's membership. Why not look to BIS, since Committee will be meeting in Basle?

Work programme of the Monetary Committee: Proposing in any case that Monetary Committee should examine Delors Committee's report before it is discussed by ECOFIN. So seems sensible for Monetary Committee to study some of the more practical issues in parallel.

Background

We expect the discussion of this subject at ECOFIN to be almost wholly procedural, in the light of the decision at Hanover to set up a Committee under the chairmanship of M Delors to study and propose "concrete stages" leading towards European economic and monetary union.

Terms of Reference

The Council did not specify in any detail the subjects the Committee should cover. In particular, it did not refer to the proposals put forward within the Community for the creation of a European central bank or common currency area. While the Committee is bound to discuss these topics, we would not want ECOFIN to make any specific reference to them either.

Committee's work programme

Delors does not appear to be very clear about this as yet but his speech of 28 April to the European Parliament's Economic and Monetary Affairs Committee probably provides the best clue. There, he suggested four questions should be studied:

(i) Should there be a common currency? If so, should it be a parallel currency or replace national currencies?

(ii) Who would manage the new currency? A federal European central bank or a "more unitary" body.

(iii) How would we get to a central bank; directly or by changing the EMCF into a European monetary fund?

(iv) How is the ecu to be sustained and revived?

We gather Delors wants to start work quickly.

Composition

The Committee is to be composed of EC central bank governors (invited in their personal capacity), a further Commission member (Andriessen) and Mr Thygesen, a Danish Professor of Economics, Mr Lamfalussy, Director-General of the Bank for International Settlements in Basle and Mr Boyer, President of the Banco Exterior de Espana and a former Spanish Finance Minister.

We have considered whether we might try to alter the composition of the Committee eg by suggesting that the Chairman of the Monetary Committee, currently Sir G Littler, should be co-opted, but we have concluded that we should rest with the membership laid down by the European Council.

Secretariat

The European Council made no provision for the Committee's Secretariat and at first we feared Delors would insist it should be provided by the Commission. We therefore had it in mind to suggest that, since the Committee would presumably be meeting in Basle, where central bank governors already meet monthly under the auspices of the BIS, the BIS might be invited to provide the Secretariat, particularly since Mr Lamfalussy of the BIS is himself a Committee member.

However, we now understand Delors plans to invite Tommaso Padoa-Schioppa, Deputy Director General of the Italian Central Bank, to take a leading role in the Committee's Secretariat, although the precise arrangements remain vague and the BIS could still have a role to play. While Padoa-Schioppa's enthusiasm for monetary union prevents him from being a wholly neutral choice, we think it difficult to raise any objection. He is a central banker, intelligent and certainly much to be preferred to a Commission Secretary. Despite this, we gather the Bundesbank may still press for a wholly BIS Secretariat. Central bank governors are to hold an informal meeting on procedural arrangements associated with the establishment of the new Committee when they gather in Basle next Monday and the Bank of England will let Sir G Littler know what transpires in advance of your own discussion at ECOFIN. Subject to any central bank developments, we see no need for you to intervene on this subject at ECOFIN, unless you are specifically asked to give a view, provided there is no suggestion that the Commission should supply the Committee's Secretariat.

Overlap with work of Monetary Committee

The Monetary Committee had been expecting to examine some of the more practical issues which are now likely to figure on the Delors Committee's agenda. We ourselves see no reason why this work should not be taken forward in parallel.

Timing

The European Council charged the Committee with completing its proceedings "in good time" to enable ECOFIN to examine its results before the European Council in Madrid in June 1989. We believe that the best way of ensuring that ECOFIN is given sufficient opportunity to discuss the report in detail is to suggest that the conclusions be discussed by the Monetary Committee first. This would imply that the report should be available by mid-May, even if it needs to identify issues for further study after the Madrid Council.

We think it would be useful if M Delors were asked to make an oral report to ECOFIN on his Committee's progress around the turn of the year and see no reason why he should object. We shall, of course, be able to monitor developments through the Governor's membership of the Committee but a report by M Delors would provide the Chancellor with the opportunity to give a helpful steer to the Committee's work programme, if necessary. (We do <u>not</u> suggest the Committee be asked to produce an interim <u>written</u> report which might only serve to distract them from their main task.)

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The argument for the regulation is that, even though this is a matter for the Governors of Central Banks in other EC countries it is the responsibility of Finance Ministers.

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FM UKREP BRUSSELS
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OF 071150Z JULY 88
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FRAME ECONOMIC
COREPER (AMBASSADORS): 7 JULY 1988
PREPARATION FOR 11 JULY ECOFIN

SUMMARY

1. AGENDA CONFIRMED - SECOND QUARTERLY ECONOMIC REVIEW, FOLLOW-UP TO TORONTO, FOLLOW-UP TO HANOVER (BOTH ONLY IF NOT FINISHED AT LUNCH), INDIRECT TAX APPROXIMATION (COMMISSION STATEMENT) AND CHANGES IN MAJOR SHAREHOLDINGS. 12.30 LUNCH START.

DETAIL

2. A REVISED AGENDA FOR THE FORMAL SESSION (STARTING 14.30 - 1500 AND PRECEDED BY LUNCH AT 12.30) WAS CONFIRMED AS FOLLOWS:-
A) SECOND QUARTERLY REVIEW OF ECONOMIC SITUATION IN THE COMMUNITY.
B) FOLLOW-UP TO TORONTO.
C) FOLLOW-UP TO HANOVER EUROPEAN COUNCIL.
D) INDIRECT TAX APPROXIMATION (STATEMENT BY LORD COCKFIELD).
E) CHANGES IN MAJOR SHAREHOLDINGS.

3. LYMBEROPOLOUS (PRESIDENCY) HOWEVER INDICATED THAT ROUMELIOTIS, PRESIDENT OF THE COUNCIL, INTENDED TO TAKE THE FOLLOW-UP TO TORONTO AND HANOVER AT LUNCH, WHERE DELORS WILL BE PRESENT: IF DISCUSSION ON EITHER HAD NOT BEEN COMPLETED, THEY COULD BE CONTINUED IN THE FORMAL SESSION AND HE WOULD CONSIDER MOVING THEM TO FIRST PLACE AS REQUESTED BY DE SCHOUTHEETE (BELGIUM). OVER LUNCH ROUMELIOTIS WOULD ALSO INDICATE THE ECOFIN PROGRAMME HE PLANNED FOR THE GREEK PRESIDENCY.

4. AS TO THE TAX APPROXIMATION ITEM, THIS WOULD ONLY BE A COMMISSION STATEMENT BY LORD COCKFIELD AT HIS REQUEST: NO DISCUSSION WAS ENVISAGED UNTIL THE INFORMAL ECOFIN IN SEPTEMBER.

5. CALAMIA (ITALY) VOICED CONCERN AT THIS PROCEDURE, AS THE ITALIAN MINISTER RESPONSIBLE FOR TAX MATTERS DID NOT ATTEND INFORMAL ECOFINS. DE SCHOUTHEETE HAD SIMILAR PROBLEMS ALTHOUGH HE AND SCHEER (FRANCE) SIMPLY THOUGHT IT PREMATURE TO BE CONSIDERING THIS ITEM AT MONDAY'S ECOFIN. LYBEROPOLOUS POINTED OUT THAT LORD COCKFIELD HAD

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ASKED FOR THE FLOOR AND THE PRESIDENCY HAD TO COMPLY. IN ANY CASE, THE GREEK PRESIDENCY ATTACHED CONSIDERABLE IMPORTANCE TO THIS SUBJECT BUT CONSIDERED THE INFORMAL ECOFIN IN SEPTEMBER AN APPROPRIATE SETTING FOR MINISTERS TO GIVE THEIR FIRST REACTIONS: HE WOULD TAKE ACCOUNT OF ITALIAN CONCERNS, HOWEVER.

X 6. ON THE HANOVER FOLLOW-UP, SCHEER QUESTIONED THE USE OF ANY DISCUSSION ON EUROPEAN MONETARY UNION SO SOON. LYBEROPOLOUS SAID IT WAS A EUROPEAN COUNCIL DECISION WHICH INVOLVED ECOFIN: MINISTERS WOULD PROBABLY DO LITTLE MORE THAN NOTE THE DECISION THIS TIME. A FULLER DISCUSSION COULD TAKE PLACE AT THE INFORMAL ECOFIN, ALONG WITH PREPARATION FOR THE IMF/IBRD ANNUAL MEETINGS.

7. THE DANISH REPRESENTATIVE MEANWHILE CONFIRMED THAT HIS MINISTER WOULD BE RAISING OVER LUNCH THE QUESTION OF A POSSIBLE EXTENSION TO THE EXISTING DEROGATION ON DANISH TRAVELLERS ALLOWANCES.

8. THERE WAS NO COMMENT ON THE MAJOR SHAREHOLDINGS ITEM: BUT IT IS NOW ASTERISKED, INDICATING THAT A VOTE MAY BE CALLED.

HANNAY

YYYY

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<u>MAIN</u> 206

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<u>ADDITIONAL</u> 1

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p.p. ECOFIN.

MINISTRY OF NATIONAL ECONOMY
THE MINISTER'S OFFICE

Athens, 27th October 1988

Ch/ You are in the first few. You might like to pass some of the others on to the Governor & Sir G. Littler.
Shall I draft a thank you note for you to send to Roumeliotis?
Julie 14/11.

STT
Gov

no need

H.E. Mr. Nigel Lawson
Chancellor of the Exchequer
Parliament Street
LONDON SWIP 3AG

Following the request of Mr. P. Roumeliotis, Minister of National Economy, I have the pleasure of sending you some photographs in remembrance of the last informal ECOFIN meeting which took place on the island of Crete, in September 1988.

Meanwhile, I avail myself of this opportunity to kindly ask you to forward some of the photographs to the members of your delegation.

Thanking you in advance for your kind cooperation, with best wishes,

Yours faithfully,

P. Voulgaris (Mrs.)
Public Relations Dept.

Enclosure

AGENDA

ec2.ss/symes/ecofin

FROM: MS S SYMES
DATE: 28 OCTOBER 1988

PS/CHANCELLOR

cc: PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir G Littler
Mr Byatt
Mr Lankester
Mr R I G Allen
Mrs Lomax
Mr Mortimer
Mr Kroll

Ch. Do you wish to reconsider? Or confirm that EST will attend on your behalf?

28/10

ECOFIN 7 NOVEMBER

The agenda for the next ECOFIN on 7 November is unchanged after discussion at COREPER yesterday, but still not finalised. As it is planned to discuss banking reciprocity over lunch (now also joined by financial engineering), the Chancellor may just wish to reconsider whether to attend after all.

2. The formal Council will begin at 1430. Provisional ECOFIN agenda is:

(a) NIC IV, earthquake assistance for Kalamata (Greece);

(b) Financing of major infrastructure projects (financial engineering);

(c) Own funds of credit institutions;

(d) Second banking directive;

(e) Public offer prospectuses;

(f) Economic situation in the Community;

(g) Successor regulation to 2892/77 on the collection of VAT own resources.

Susie Symes

MS S SYMES

FROM: J C DODDS

DATE: 7 NOVEMBER 1988

PS/CHANCELLOR

PS/CST

PS/FST

PS/EST

PS/PAYMASTER GENERAL.

PRESS RELEASE ON REGIONAL GDP.

Mr Gieve has asked that Ministers' offices be made aware of the attached as soon as possible.

Thanks. Not conspicuously helpful. How are regional GDP figs known?
N.

John C Dodds

J. C. DODDS
(EI DIVISION)
x 5620

They are based on the Income measure only, apparently, for which regional stats can be assembled

MPW.

Thanks.

FROM: J C DODDS
DATE: 4 NOVEMBER 1988

MR GIEVE

cc Mr Odling-Smee
Mr Spackman
Mr Hibberd
Mr Meyrick
Miss Simpson

PRESS RELEASE ON REGIONAL GDP

BACKGROUND

The CSO will issue a press notice on Monday 7 November containing figures of regional GDP. They will follow it up with an article in the November issue of Economic Trends (to be published in early December). The press notice will give revised regional estimates of GDP from 1977 to 1986 and will present, for the first time, estimates for 1987. The figures for the UK as a whole will be consistent with those published in the 1988 Blue Book.

2. It is a new practice to release the results in advance of November's Economic Trends. This break with tradition is in order to supercede as quickly as possible the previous estimates of regional GDP which had a number of defects, notably the understatement of Northern Ireland GDP by some 11 per cent in 1986. This Northern Ireland error was made public and received considerable press coverage in October.

3. In the past the publication of this regional data has stimulated a number of press articles focusing on the North-South divide and doubtless this year's data will also receive some attention from journalists.

ANALYSIS

4. The data which will be released is attached at annexe 1. Graphs at annexe 2 illustrate the trends in regional GDP per head expressed as a percentage of the UK average (excluding the continental shelf). Four major points stand out:

- Nominal GDP has been growing strongly in the United Kingdom in recent years. Annual growth of 9.5% between 1984 and 1985, 6.1% between 1985 and 1986, and 9.5% between 1986 and 1987 was well ahead of inflation.

- The new data confirms the expectation that between 1986 and 1987 the gap between the faster growing regions of southern England and the rest of the country widened. Regional GDP per head as a percentage of the national average increased over this period in the South East, Greater London, East Anglia and the South West but declined in all other regions except for the North where there was a slight rise and the West Midlands where it remained unchanged. But, nominal GDP grew strongly in all regions; between 1984 and 1987 the lowest growth was in the Northern region at an annual average of over 8.5 per cent.

- There has been a particularly sharp decline in the relative GDP per head of Wales since 1985. However the estimate for 1985 was itself considerably higher than the 1984 figure.

- As a result of lower oil prices, GDP from the continental shelf (shown in table but not graph) fell by over 50 per cent between 1985 and 1986. Between 1986 and 1987 it recovered slightly and in 1987 was at 52% of its 1985 value.

COMPARISON WITH LAST YEAR'S DATA

5. The graphs in annexe 3 illustrate the extent to which the data released last year has been revised. With the exception of Northern Ireland, the data has generally been changed by no more than about +/- 2.5% (slightly larger for Wales). This is not an unusual degree of revision for statistics of this kind and reflects both improved information, which becomes gradually available over a long period, and methodological refinements.

6. LINE TO TAKE

- New data shows strong recent nominal growth in all regions. Confirms the expectation (given by regional unemployment rates) that growth has been quickest in the southern part of the country. But all regions have grown strongly.

- Widening gap between GDP per head in north and south not necessarily indicating widening living standards. Prices differ in different regions, especially house prices which tend to be much higher in the regions with high nominal income per head. More companies are now considering relocating out of the South East which may even things up in the future.

- Sharp decline in relative GDP for Wales? Pattern distorted by exceptionally high estimate for 1985 which may have been a statistical oddity. Between 1984 and 1987, nominal GDP in Wales grew by an annual average of 9.7 per cent.

- Northern Ireland revision? Refer enquiries to CSO press office for technical details. Treasury line: These statistics play an important role in informing public debate so important they are right. Not aware of any specific instance when the erroneously low Northern Ireland GDP influenced policy.

7. For further information, contact John Dodds (x5260) or Tony Meyrick (x4629).

John C Dodds

JOHN DODDS

Annexe 1

Gross domestic product
Factor cost: current prices

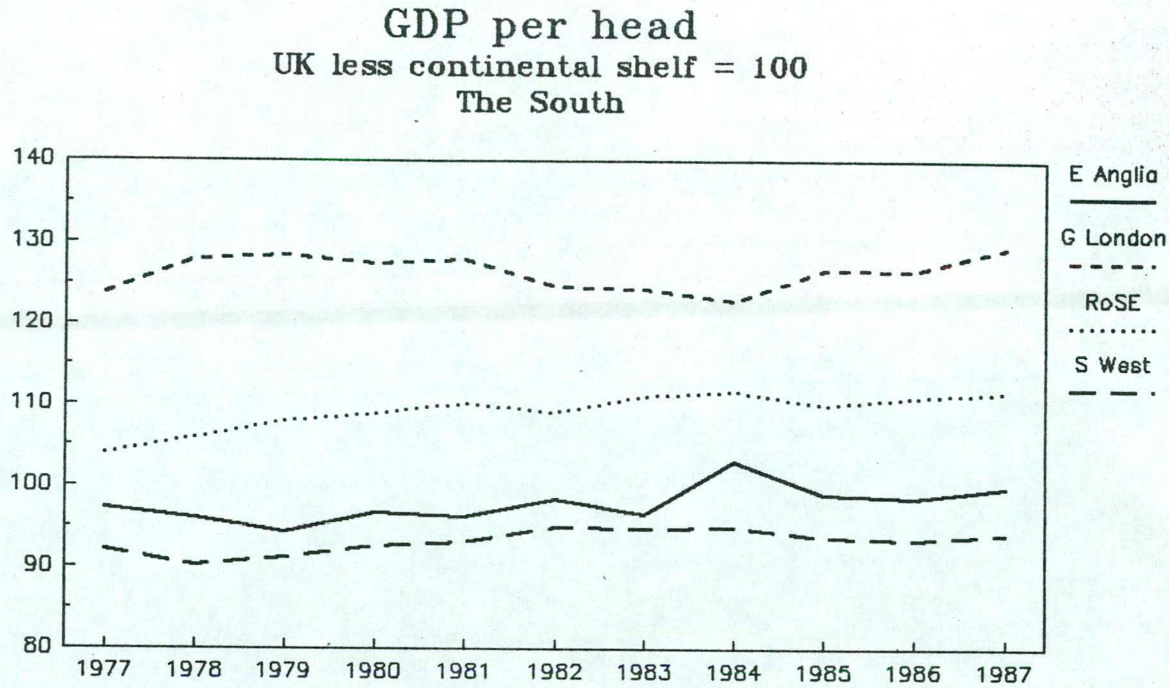
TABLE 1

	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987[1]
£ million											
United Kingdom	128,750	147,916	171,696	199,377	217,716	238,025	260,925	278,742	305,262	323,829	354,519
North	6,740	7,449	8,380	9,764	10,671	11,458	12,379	12,924	14,153	15,134	16,580
Yorkshire & Humberside	10,558	11,982	13,465	15,559	16,470	18,185	19,684	20,531	22,949	25,512	27,507
East Midlands	8,304	9,377	10,882	12,635	13,664	14,968	16,168	17,473	19,053	21,148	22,714
East Anglia	4,010	4,579	5,198	6,163	6,665	7,507	8,080	9,185	9,853	10,913	12,178
South East	42,895	50,370	58,210	66,963	72,948	78,160	86,492	91,636	101,774	112,327	124,385
Greater London	19,580	22,988	26,128	29,568	31,844	33,631	36,502	38,149	43,386	47,631	53,080
Rest of South East	23,315	27,382	32,082	37,394	41,104	44,529	49,990	53,487	58,388	64,696	71,305
South West	8,938	10,072	11,687	13,672	14,920	16,649	18,211	19,492	21,362	23,590	26,147
West Midlands	11,373	13,075	14,723	16,328	17,145	18,674	20,317	21,635	24,214	26,356	28,846
North West	14,249	16,393	18,468	21,097	22,293	24,301	26,160	27,645	30,316	33,344	35,832
England	107,066	123,297	141,013	162,181	174,778	189,901	207,491	220,521	243,674	268,324	294,190
Wales	5,490	6,153	7,054	7,992	8,571	9,558	10,451	10,718	12,299	13,149	14,151
Scotland	11,451	12,729	14,540	16,582	18,223	20,094	21,775	22,735	24,833	27,112	29,266
Northern Ireland	2,745	3,074	3,528	4,034	4,396	4,855	5,292	5,645	6,168	6,843	7,387
United Kingdom *less* Continental Shelf	126,752	145,253	166,134	190,789	205,968	224,408	245,009	259,619	286,974	315,427	344,994
Continental Shelf [2]	1,998	2,663	5,562	8,588	11,748	13,617	15,916	19,123	18,288	8,402	9,525
United Kingdom *less* Continental Shelf = 100											
United Kingdom	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North	5.3	5.1	5.0	5.1	5.2	5.1	5.1	5.0	4.9	4.8	4.8
Yorkshire & Humberside	8.3	8.2	8.1	8.2	8.0	8.1	8.0	7.9	8.0	8.1	8.0
East Midlands	6.6	6.5	6.6	6.6	6.6	6.7	6.6	6.7	6.6	6.7	6.6
East Anglia	3.2	3.2	3.1	3.2	3.2	3.3	3.3	3.5	3.4	3.5	3.5
South East	33.8	34.7	35.0	35.1	35.4	34.8	35.3	35.3	35.5	35.6	36.1
Greater London	15.4	15.8	15.7	15.5	15.5	15.0	14.9	14.7	15.1	15.1	15.4
Rest of South East	18.4	18.9	19.3	19.6	20.0	19.8	20.4	20.6	20.3	20.5	20.7
South West	7.1	6.9	7.0	7.2	7.2	7.4	7.4	7.5	7.4	7.5	7.6
West Midlands	9.0	9.0	8.9	8.6	8.3	8.3	8.3	8.3	8.4	8.4	8.4
North West	11.2	11.3	11.1	11.1	10.8	10.8	10.7	10.6	10.6	10.6	10.4
England	84.5	84.9	84.9	85.0	84.9	84.6	84.7	84.9	84.9	85.1	85.3
Wales	4.3	4.2	4.2	4.2	4.2	4.3	4.3	4.1	4.3	4.2	4.1
Scotland	9.0	8.8	8.8	8.7	8.8	9.0	8.9	8.8	8.7	8.6	8.5
Northern Ireland	2.2	2.1	2.1	2.1	2.1	2.2	2.2	2.2	2.1	2.2	2.1
Per head, £ [3]											
United Kingdom *less* Continental Shelf	2,256	2,586	2,954	3,387	3,655	3,986	4,343	4,593	5,062	5,556	6,059
North	2,140	2,377	2,677	3,121	3,423	3,687	3,993	4,178	4,587	4,913	5,389
Yorkshire & Humberside	2,145	2,435	2,736	3,161	3,349	3,704	4,010	4,186	4,681	5,207	5,613
East Midlands	2,193	2,469	2,850	3,292	3,547	3,886	4,189	4,510	4,889	5,395	5,762
East Anglia	2,197	2,486	2,789	3,275	3,518	3,928	4,197	4,736	5,015	5,480	6,048
South East	2,531	2,974	3,434	3,941	4,288	4,596	5,055	5,334	5,898	6,506	7,183
Greater London	2,792	3,309	3,793	4,316	4,679	4,970	5,404	5,647	6,411	7,030	7,840
Rest of South East	2,347	2,740	3,188	3,687	4,028	4,349	4,827	5,131	5,566	6,168	6,761
South West	2,079	2,335	2,696	3,135	3,405	3,786	4,116	4,369	4,746	5,192	5,699
West Midlands	2,198	2,527	2,843	3,149	3,306	3,605	3,925	4,180	4,672	5,087	5,550
North West	2,179	2,515	2,842	3,257	3,451	3,779	4,081	4,323	4,740	5,221	5,621
England	2,296	2,644	3,020	3,466	3,733	4,058	4,423	4,690	5,164	5,677	6,205
Wales	1,960	2,194	2,510	2,838	3,046	3,406	3,722	3,818	4,374	4,661	4,989
Scotland	2,191	2,442	2,794	3,193	3,518	3,889	4,228	4,418	4,835	5,294	5,725
Northern Ireland	1,802	2,018	2,309	2,632	2,859	3,157	3,429	3,641	3,959	4,367	4,690
Per head, United Kingdom *less* Continental Shelf = 100											
United Kingdom	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North	94.9	91.9	90.6	92.2	93.6	92.5	91.9	91.0	90.6	88.4	88.9
Yorkshire	95.1	94.2	92.6	93.3	91.6	92.9	92.3	91.1	92.5	93.7	92.6
East Midlands	97.2	95.5	96.5	97.2	97.0	97.5	96.5	98.2	96.6	97.1	95.1
East Anglia	97.4	96.1	94.4	96.7	96.3	98.5	96.6	103.1	99.1	98.6	99.8
South East	112.2	115.0	116.2	116.3	117.3	115.3	116.4	116.1	116.5	117.1	118.5
Greater London	123.8	128.0	128.4	127.4	128.0	124.7	124.4	122.9	126.6	126.5	129.4
Rest of South East	104.1	106.0	107.9	108.9	110.2	109.1	111.1	111.7	110.0	111.0	111.6
South West	92.1	90.3	91.3	92.6	93.2	95.0	94.8	95.1	93.8	93.5	94.0
West Midlands	97.4	97.7	96.2	93.0	90.5	90.5	90.4	91.0	92.3	91.6	91.6
North West	96.6	97.3	96.2	96.2	94.4	94.8	94.0	94.1	93.6	94.0	92.8
England	101.8	102.2	102.2	102.3	102.1	101.8	101.8	102.1	102.0	102.2	102.4
Wales	86.9	84.9	85.0	83.8	83.3	85.5	85.7	83.1	86.4	83.9	82.3
Scotland	97.1	94.5	94.6	94.3	96.2	97.6	97.4	96.2	95.5	95.3	94.5
Northern Ireland	79.9	78.0	78.1	77.7	78.2	79.2	79.0	79.3	78.2	78.6	77.4

1 Provisional.
2 Gross domestic product for the Continental Shelf region does not include income from employment, which is allocated to the region of residence of the employee.
3 Estimates of gross domestic product per head cannot be calculated for the Continental shelf region as there is no resident population in this region.

outlier.

Annexe 2


GDP per head
UK less continental shelf = 100
The South
140
130
120
110
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90
80
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E Anglia
G London
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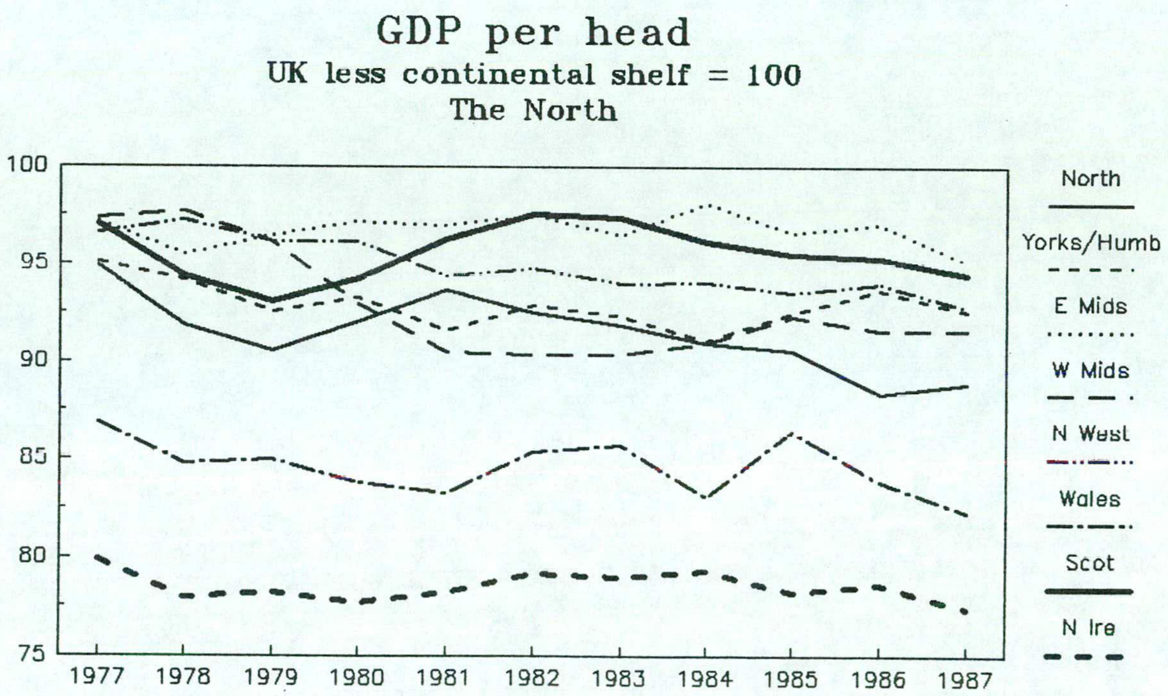
S West


GDP per head
UK less continental shelf = 100
The North
100
95
90
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75
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1986
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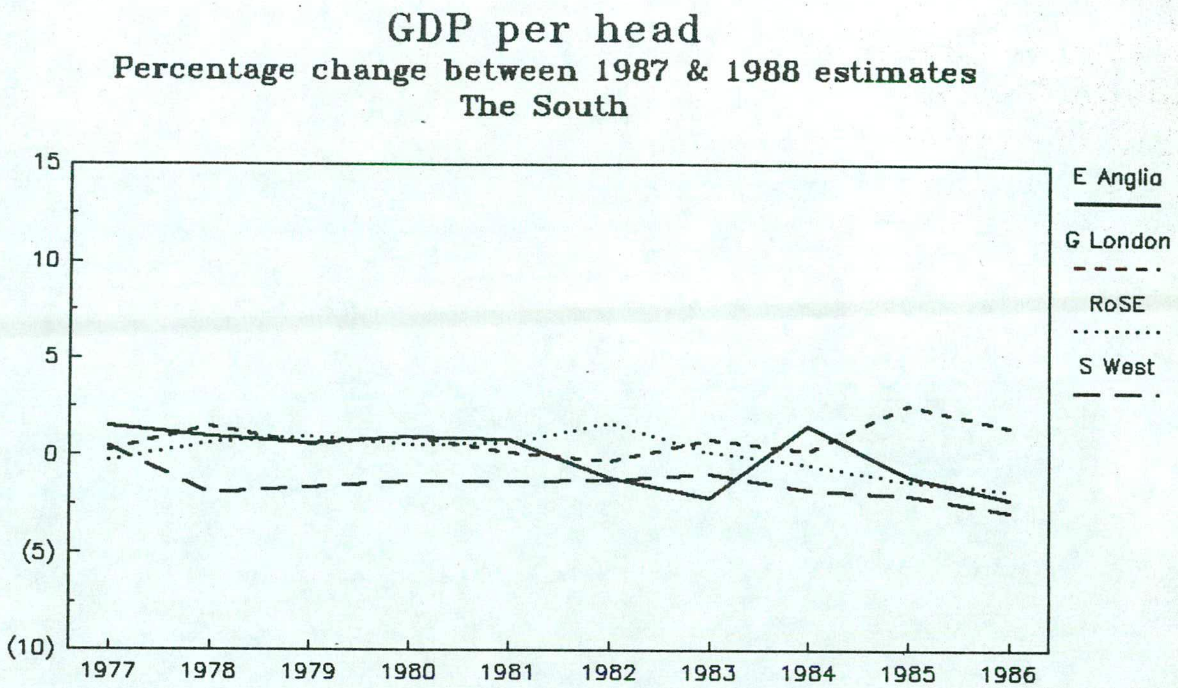
North
Yorks/Humb
E Mids
W Mids
N West
Wales
Scot
N Ire


GDP per head
Percentage change between 1987 & 1988 estimates
The South
15
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(5)
(10)
1977
1978
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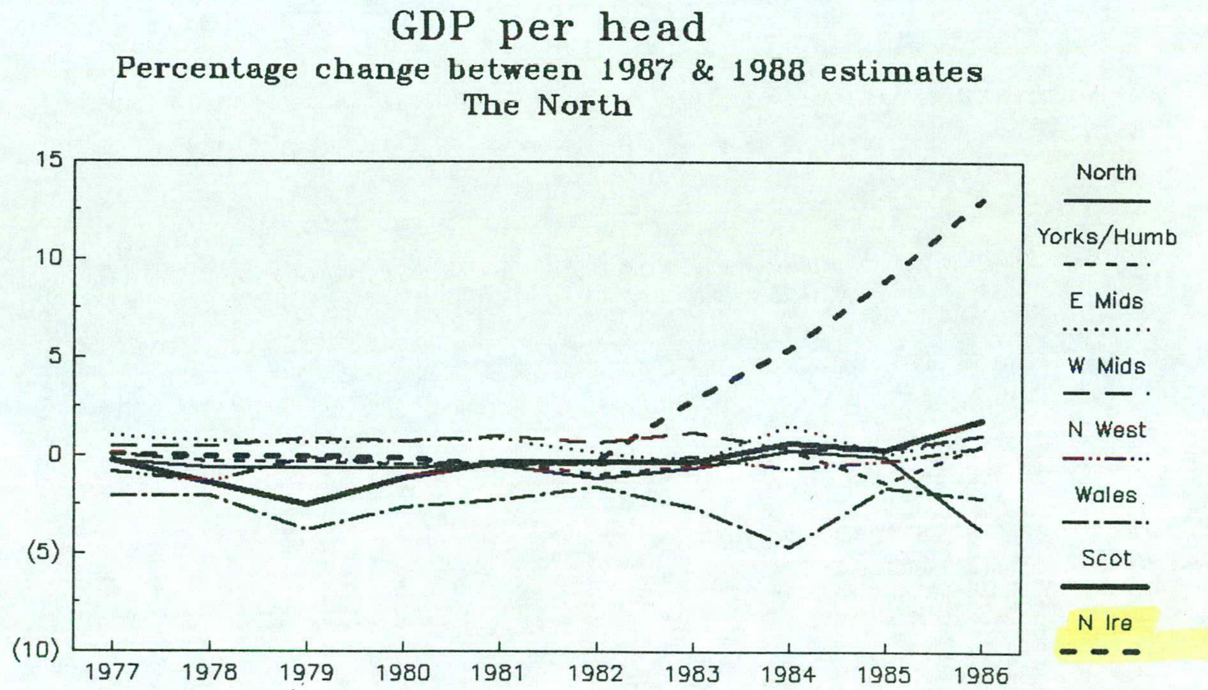
E Anglia
G London
RoSE
S West


GDP per head
Percentage change between 1987 & 1988 estimates
The North
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Wales
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FROM: N P WILLIAMS

DATE: 15 November 1988

1. MISS ~~O'MARA~~ MOM 15/11
2. CHANCELLOR

1. ~~Alex~~ You will want to see.
2 Ch.

cc Sir G Littler
Mr Lankester
Mr R I G Allen
Mr Mortimer
Ms Symes
Mr Nelson

EUROPEAN COUNCIL, RHODES 2/3 DECEMBER

Given the sensitivity of the subject, we thought you would want an opportunity to comment on the attached brief on monetary cooperation prepared for the Prime Minister, which Sir G Littler has seen, before it is sent to the Foreign Office. Although this item does not figure on the formal agenda for Rhodes, FCO have nevertheless asked us to produce a brief.

NPW

N P WILLIAMS

Ch

Seems OK.

AA

OK as amended

Jonathan

Please pass to

N Williams asap

Alex

For The Steering Brief

Monetary cooperation is not on the agenda for the Rhodes European Council. The subject is under active consideration by the Delors Group who are to report back to ECOFIN initially and then to the Madrid Council in June 1989. The Monetary Committee is, in parallel, discussing ways of strengthening and improving the EMS which do not require institutional change. If monetary cooperation is raised in discussion, you should note that the Madrid Council is the appropriate forum for further consideration on the basis of the Delors Report and, if pressed, focus on practical steps on which early progress can be made.

EHG(R)(88)(1E)

EUROPEAN COUNCIL, RHODES, 2/3 DECEMBER

Monetary Cooperation

This subject is not on the agenda.

UK Objectives

To avoid substantive discussion since monetary cooperation is under active consideration by the Delors Group, who are to report back to ECOFIN initially and then to the Madrid Council in June 1989. (The proceedings of the Delors Group are meant to be confidential. ~~and your knowledge of them should not be revealed.~~) The Monetary Committee is discussing in parallel some measures which do not involve institutional change.

?silly

If the subject is raised:

- to note that the European Council meeting in Madrid in June 1989 is the appropriate forum for further consideration of monetary cooperation on the basis of the Delors Report;

- [IF PRESSED: to urge that discussion should focus on practical steps on which early progress can be made.]

Opening speaking note (if required)

Must remember important steps have already been taken:

- Member States adopted a Directive in June to secure the free movement of capital throughout the Community. This is an essential precondition for the completion of the single market by 1992. The UK, of course, abolished all exchange controls nine years ago.

- Changes in the working of the EMS agreed by Central Bank Governors and Finance Ministers meeting in Basle and Nyborg in September 1987 have contributed to a smoother working of the system.

But, of course, scope remains for further practical steps to be taken. For instance, the UK has already advocated a number of developments which it would regard as helpful in the important field of exchange rate management

- greater use of Community currencies in intervention;

- greater cross holdings of Community currencies in official reserves;

- development of the private ecu market, leading to greater use of the ecu in intervention and official reserve holdings. (The UK's Ecu Treasury Bill programme, launched this autumn, points the way.)

We also favour greater informal cooperation over setting relative interest rates.

But we must ~~beware of~~ avoid committing ourselves to institutional changes with far-reaching ramifications which we have scarcely begun to explore. ~~That simply discredits the whole concept of economic and monetary union at the outset.~~

[IF RAISED: While completion of the internal market in 1992 will emphasise the need and provide greater opportunities for closer cooperation in and greater convergence of economic policy, it does not require or imply full economic and monetary union. Indeed, neither Lord Cockfield's White Paper nor the Cecchini Report suggested it would.]

We have enough to do in securing the successful completion of the single market by the end of 1992. That must be our priority.

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Others' Objectives

Member States vary over the extent to which their approach to economic and monetary union is dominated by a long-term objective or by the steps which could be agreed in the near future. Moreover, Central Banks (represented on the Delors Group) may not always take the same view as their national governments; and national governments may not have adopted a final position at this stage in any case.

Germany: The views of the Bundesbank are likely to predominate but it is not entirely clear what their underlying attitude is. Poehl has correctly argued in the Delors Group that monetary union presupposes a loss of national sovereignty over economic and monetary policy that would only be likely in the context of close and irrevocable political integration. He may regard such a ~~clear~~ blunt statement as tantamount to a wrecking move, but this is not clear. For his part, the Finance Minister, Stoltenberg has been very concerned that Delors would try to push through radical proposals at a late stage and in such circumstances he has been envisaging that Poehl and like-minded members might produce a minority report. The German~~s~~ Finance Minister certainly see a European Central Bank as a long-term objective only. If it were adopted, they have insisted it should be entirely autonomous and follow the Bundesbank model in most other respects. On other issues, ~~Germany~~ the Bundesbank remains opposed to reserve diversification, although there is evidently some internal debate on the subject. The ~~Germans are~~ Bundesbank is also uneasy about developing the private ecu because they fear that, given the heavy weight of the deutschemark in the ecu basket and some discussion of a link between the official and private ecu circuits, this could give rise to the creation of deutschemarks on a large scale which they would be unable to control. (Our ideas for development of the ecu are much more modest and ought not to arouse German hostility.)

France: President Mitterrand favours more ambitious proposals for European monetary construction. M Rocard, out of an apparent concern to gain German support, has declared himself willing to contemplate an autonomous European Central Bank. The Tresor, by contrast, have been focusing on pragmatic measures (eg strengthening the EMS, including UK participation in the ERM, and

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The Governor

greater use of Community currencies in intervention) as a way of promoting symmetry. De Larosiere, of the Bangue de France, appears to ~~favours~~ favour monetary union as a locomotive for securing economic union. France will hold the EC Presidency after the Madrid Council meeting - this will give them an influential role in the follow-up to the Delors Report.

Italy favours a practical step-by-step approach towards greater monetary co-operation. Like the French, the Italians would like to see greater symmetry in the EMS (including UK membership of the ERM) to counteract the dominant role of the deutschemark. Italy favours increased use of the ecu and greater collaboration between Central Banks.

The Netherlands instinctively ~~naturally~~ follow the German (Bundesbank/Finance Ministry) view. They favour step-by-step moves towards greater co-ordination of economic and monetary policies and strengthening of the EMS. They are opposed to premature efforts to introduce a common currency or a European Central Bank. ~~They have expressed some unease about developing the private ecu which they regard as a distraction in the process leading eventually to a common currency.~~

Presently

Belgium and Luxembourg favour greater use of the ecu and strengthening the EMS. Like the French, they are generally receptive to the more visionary ideals and see monetary union as promoting economic union. They consider it early days to examine a European Central Bank in detail.

Spain favours a pragmatic approach to further developments of the EMS. They will want to avoid a clash at the Madrid European Council meeting in June 1989 which will take the Delors Report.

Denmark takes a pragmatic approach and strongly supports UK participation in the ERM.

Ireland favours a gradualist approach and also strongly supports UK participation in the ERM.

Portugal and Greece have played little part in discussions about monetary cooperation. They are particularly concerned about regional problems within EC.

Our Response

[If others question our commitment to Economic and Monetary Union:]

- Rather than pursuing such ~~far-sighted~~ ambitious objectives with ramifications which we have scarcely begun to explore, we should concentrate on practical measures on which early progress can be made.

- We have advocated a number of technical developments in the field of exchange rate management: greater use of Community currencies in intervention; greater cross-holdings of Community currencies in official reserves; and development of the private ecu market. (The UK's Ecu Treasury Bill programme shows what can be done.) We also favour greater informal cooperation over setting relative interest rates.

[If others argue that economic union and monetary union are linked with 1992:]

- While completion of the internal market in 1992 will emphasise the need and provide greater opportunities for closer cooperation in and greater convergence of economic policy, it does not require or imply full economic and monetary union. Indeed, neither Lord Cockfield's White Paper nor the Cecchini Report suggested it would.

EHG(H) 88 (2E)

EUROPEAN COUNCIL : RHODES, 2/3 DECEMBER

MONETARY COOPERATION

<u>References</u>

A: Extract from Conclusions of the Presidency of European Council meeting in Hanover 27/28 June, setting up Delors Group

B: Report by Chairman of the Monetary Committee (Sir G Littler)

C: Extract from interview by Delors in "Le Monde", 20 July.

BACKGROUND

1. Delors has made it clear to the Foreign Secretary that there will be no need to discuss monetary issues at the Rhodes European Council. The Report of his Group will be ready in time for discussion by ECOFIN, before the Madrid European Council.

2. The Monetary Committee has been pursuing parallel studies on ways of strengthening and improving the EMS which do not involve institutional change on the basis of the report by the Chairman of the Monetary Committee (Sir G Littler) to the Informal ECOFIN on 14 May. A number of issues have been identified for further discussion.

<u>HM Treasury</u>
<u>14 November 1988</u>

ANNEX A

CONCLUSIONS OF THE PRESIDENCY OF EUROPEAN COUNCIL MEETING, HANOVER 27/28 JUNE

MONETARY UNION

The European Council recalls that, in adopting the Single Act, the Member States confirmed the objective of progressive realisation of Economic and Monetary Union.

They therefore decided to examine at the European Council meeting in Madrid in June 1989 the means of achieving this Union.

To that end they decided to entrust to a Committee the task of studying and proposing concrete stages leading towards this Union.

The Committee will be chaired by Mr Jacques DELORS, President of the European Commission.

The Heads of State and Government agreed to invite the President or Governor of their Central Banks to take part in a personal capacity in the proceedings of the Committee, which will also include one other member of the Commission and three personalities designated by common agreement by the Heads of State or Government. They have agreed to invite:

- Mr Niels THYGESEN, Professor of Economics, Copenhagen

- Mr LAMFALUSSY, Director-General of the Bank for International Settlements in Basle, Professor of Monetary Economics at the Catholic Univerty of Louvain-la-Neuve

- Mr Miguel BOYER, President of "Banco Exterior de Espana".

- The Committee should have completed its proceedings in good time to enable the Ministers for Economic Affairs and for Finance to examine its results before the European Council meeting in Madrid.

MONETARY COMMITTEE

OF THE EUROPEAN COMMUNITIES

Lübeck, 14 May 1988

II/176/88

INFORMAL MEETING OF FINANCE MINISTERS, LÜBECK 14 MAY 1988
ORAL REPORT BY THE CHAIRMAN OF THE MONETARY COMMITTEE

The Committee has had only one discussion of this subject, but it was long and thorough. We had the benefit of a paper by our French colleagues supplementing M. Balladur's letter and paper of February; we also took note of memoranda circulated since then by Sr. Amato, yourself* and M. Poos, as well as our knowledge of other recent documents on the subject.

As a preliminary observation the Committee emphasises the need to remember and hold on to what has already been achieved and to continue to build on this solid ground. The management of the EMS Exchange Rate Mechanism has been highly successful in recent times and particularly during the troublesome months since your Nyborg meeting. Proposals for new refinements of the system need not and should not be rushed; time should be allowed for the full benefits of the changes agreed last September to become clear.

The Committee has discussed positively a wide range of ideas, with a view to identifying ones which may deserve to be pursued. We found it convenient to consider them in three groups:

- ideas which could in principle be implemented at a relatively early stage within present institutional arrangements and the Treaty as it stands;
- ideas which relate to a much fuller form of monetary (and economic) integration and would of course require Treaty changes and significant institutional developments;
- possible intermediate moves which might pave the way to fuller integration.

*Herr Stoltenberg

I emphasise that these are not proposals. They are ideas which command as much doubt as support. But the Committee feels that it (and the Central Bank Governors' Committee) might, subject to your views, usefully explore some of them over the coming months. I shall list them briefly and, if you wish, can elaborate them more in writing in my report for the June ECOFIN.

Early steps

Under the heading of possible early steps, we identified the following questions:

- While the Committee believes that adjustment processes in the EMS should be oriented to best performance rather than to the average, there remain questions whether a greater symmetry could be achieved in intervention - particularly when pressures seem to arise from causes outside the Community?
- A partly related question is whether intervention to maintain equilibrium within the Community, including some intra-marginal intervention, could be more effective in Community currencies, rather than in dollars?
- Again partly related is the question whether it would be right to encourage greater cross-holdings of Community currencies by members?
- Is there a case for further encouragement of the private ecu, in particular by deliberately fostering its use by monetary authorities in the Community, for intervention and as a reserve asset?
- When can the present Exchange Rate Mechanism be completed by full participation of all members of the Community on the same terms?
- Would it be useful and timely to explore possibilities of closer cooperation on objectives of economic policy? For example, while continuing our efforts to converge on price stability, we might cooperate more closely in order to improve fiscal performance, and to cultivate more vigorous and even growth potential.

Long-term

Before turning to possible intermediate steps I touch briefly on long-term objectives.

The Committee noted that recent ideas for a common currency and a single central bank raise issues which were propounded nearly two decades ago in the Werner Report and in the Resolution of the Council and of the Representatives of the Governments of the Member States of 22 March 1971.

I draw four elements from the Committee's discussion.

First, there are deep problems of parallelism between progress on the monetary and other fronts. A common currency and central bank could for example be uncomfortable, to say the least, without centralised control of national budgets.

Secondly, on the institutional level there are important issues for debate over the objectives of a central bank (how the balance between price stability and other objectives should be struck), its degree of independence (from national and Community institutions), and its structure (federal or other).

Thirdly, the dominant economic issue for the Community over the next few years is the achievement of the 1992 single market. In the Committee's view that certainly requires the full capital liberalisation to which we have been giving due priority. It may well also create both pressures and opportunities for closer monetary integration. But the Committee's discussion reached a clear view that the single market can be established on the basis of present monetary arrangements: there is no operational reason to associate with it - as a prior, parallel or even subsequent condition - a completely unified monetary system.

Fourthly, if there is a political momentum for further early exploration of the implications of full monetary integration, the Committee would respectfully suggest that it would be better undertaken by those responsible in Finance Ministries and Central Banks (which means ECOFIN, Monetary Committee and Committee of Central Bank Governors) than by any outside group of "wise men".

Intermediate steps

Finally, our discussion gave rise to several suggestions for possible future development, falling well short of complete monetary integration, but more ambitious than those described as possible early steps. We view them at present as "asking some of the right questions", rather than "giving the right answers".

These include:

- much broader development of the ecu, for example as an instrument for Community government borrowing;
- development of the European Monetary Cooperation Fund, not in the direction of issuer of currencies or ecu, but perhaps as clearing-house and as agent for some interventions vis-à-vis third currencies.

As I have indicated, some of these ideas can be developed further in my report for the June ECOFIN.

Conclusion

To conclude, if the full freedom of capital movements seems to call for monetary changes, these should be built on our present present arrangements. There is no justification for delaying any aspect of the planned completion of the internal market, while waiting for further progress with monetary integration. And should a political momentum develop for fuller monetary integration, the necessary basic work should involve the two competent committees.

ANNEX C

"LE MONDE" INTERVIEW WITH DELORS: 20 JULY

Questioned on monetary union, M Delors told "Le Monde" that he saw the questions raised as:

- Does economic and monetary union imply a common currency? If so, does that mean one alongside national currencies, or replacing them?

- Who would manage such a currency? A European Monetary Fund or a central bank? If the latter, what form would it take - a federal structure?

- If the common currency were the ecu, how should it be defined: a basket of currencies, or a currency whose value would be fixed by the market without reference to a weighted average of the national currencies? What should be done to increase the economic, commercial and financial attractiveness of the ecu?

- What should be the stages en route to the final destination?

- What should the relationship be between monetary and economic union? What are the macro-economic conditions needed to make them a success?

- How should we "translate in institutional terms" a common currency and a European central bank?

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Ch
A letter of welcome to Mr Reynolds ?
25/11

MY TELNO 566: IRISH GOVERNMENT RESHUFFLE

SUMMARY

OK.
What do we know abt him? –

1. MINOR CHANGES IN THE IRISH CABINET.

DETAIL

2. THE TAOISEACH ANNOUNCED IN THE DAIL ON 24 NOVEMBER THAT MR RAY MACSHARRY, MINISTER FOR FINANCE, HAD RESIGNED TODAY ON APPOINTMENT TO BE AC COMMISSIONER. HE WAS MAKING THE FOLLOWING CONSEQUENTIAL CHANGES TO HIS GOVERNMENT:

(A) MR ALBERT REYNOLDS (MINISTER FOR INDUSTRY AND COMMERCE) TO BECOME MINISTER FOR FINANCE:

(B) MR RAY BURKE (MINISTER FOR ENERGY AND COMMUNICATIONS) TO BECOME MINISTER FOR INDUSTRY AND COMMERCE, BUT TO RETAIN RESPONSIBILITY FOR COMMUNICATIONS:

(C) MR MICHAEL SMITH (MINISTER OF STATE FOR ENERGY) TO BECOME MINISTER FOR ENERGY:

(D) MR LIAM AYLWARD, TD FROM CARLOW/KILKENNY, IS PROMOTED FROM THE BACK BENCHES TO SUCCEED MR SMITH AS MINISTER OF STATE.

3. MR PADRAIG FLYNN, MINISTER FOR THE ENVIRONMENT, WHO HAD BEEN A CONTENDER FOR THE DEPARTMENT OF FINANCE HAS BEEN AWARDED AS CONSOLATION PRIZE A COORDINATING ROLE OVER THE ECONOMIC AND SOCIAL INFRASTRUCTURE IN THE CONTEXT OF THE SINGLE EUROPEAN MARKET. THIS COULD BE A KEY APPOINTMENT. IT COULD ALSO BE COSMETIC.

4. IN HIS ANNOUNCEMENT (TEXT FAXED TO RID, FCO AND NIO(L)) THE TAOISEACH PROMISED ''CONTINUING AND UNRELENTING DISCIPLINE ON GOVERNMENT SPENDING AND BORROWING....(WHICH) MUST BE MAINTAINED WITHOUT RELAXATION OR DEVIATION''. HE APPEARED MUCH RECOVERED FROM HIS ILLNESS ALTHOUGH HE REPEATEDLY HAD TO CLEAR HIS THROAT AND HIS

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VOICE WEAKENED TOWARDS THE END OF HIS EIGHT-PAGE STATEMENT.

COMMENT

5. THE BALANCE OF THE CABINET IS LITTLE ALTERED BY THESE CHANGES. THE NEWCOMER, MR MICHAEL SMITH, A FARMER FROM TIPPERARY, IS NOT A WELL KNOWN FIGURE. MR REYNOLDS IS A PRAGMATIC AND SUCCESSFUL BUSINESSMAN WHO IS UNLIKELY TO MAKE MAJOR DEPARTURES FROM THE GOVERNMENT'S AUSTERE ECONOMIC STRATEGY.

6. I RECOMMEND THAT THE CHANCELLOR OF THE EXCHEQUER AND THE SECRETARIES OF STATE FOR TRADE AND INDUSTRY AND FOR ENERGY SEND SHORT CONGRATULATORY MESSAGES TO THEIR NEW COLLEAGUES. MR LAWSON MAY ALSO WISH TO SEND HIS CONGRATULATIVE AND BEST WISHES TO MR MACSHARRY.

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FRAME GENERAL
RHODES EUROPEAN COUNCIL : DELORS PRESS CONFERENCE

SUMMARY
1. DELORS SAYS NO BUST-UP AT RHODES. SHOULD AVOID DOCTRINAL DEBATES. NO NEED FOR GREAT REVIEW OF SOCIAL DIMENSION. COMMUNITY SHOULD REFUTE ''FORTRESS EUROPE' NOTION. STEP BY STEP ON MONETARY COOPERATION. G7 FINANCE MINISTERS SHOULD MEET IN DUE COURSE TO DISCUSS US DEFICIT AND DOLLAR.

2. STUDIOUS EFFORT TO CHARACTERIZE RHODES AS NORMAL STOCKTAKING COUNCIL WITH NO INTENTION ON HIS PART TO STOKE UP CONTENTIOUS ISSUES.

DETAIL
3. DELORS SAID AT THIS REGULAR PRE-EUROPEAN COUNCIL PRESS CONFERENCE TODAY THAT THE COMMUNITY HOUSE WAS IN ORDER. HEADS OF GOVERNMENT WOULD WANT TO TAKE STOCK AT RHODES OF WHAT HAD BEEN ACHIEVED AND CONSIDER CURRENT PRIORITIES, FIXING GUIDELINES AS NECESSARY. HE SAID LIGHHEARTEDLY THAT IF HEADS OF GOVERNMENT FOLLOWED HIS ADVICE AND STAYED OFF SUBJECTS THAT WERE NOT READY FOR DISCUSSION ALL WOULD GO SMOOTHLY.

4. INTERNAL MARKET : DISCUSSION OF THE COMMISSION'S MID-TERM REPORT WOULD ALLOW THOSE WHO WANTED A BALANCE BETWEEN THE INTERNAL MARKET AND THE OTHER OBJECTIVES OF THE SINGLE ACT TO REFER TO THE STRUCTURAL FUNDS, R AND D ETC. THERE WOULD NO DOUBT BE SOME DISCUSSION OF THE SOCIAL DIMENSION. BUT HANOVER HAD FIXED THE PRIORITIES AND PROGRESS WAS BEING MADE ON THESE. THERE WAS NO NEED FOR A RELAUNCH OF THE SOCIAL DIMENSION OR FOR IT TO FIGURE IN THE CONCLUSIONS. DELORS REMINDED THE PRESS, HOWEVER, THAT HE BELIEVED THERE WERE FOUR MAIN COMPONENTS ON THE SOCIAL SIDE:
A) WORKING CONDITIONS
B) EUROPEAN COMPANY STATUTE
C) A WORKERS CHARTER TO INCLUDE PARTICIPATION
D) SOCIAL DIALOGUE. DELORS ANNOUNCED THAT HE WOULD CALL A 'SUMMIT' OF EMPLYERS/TRADE UNIONS ON 12 JUNE 1989.

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5. MONETARY COOPERATION : THE DISCRETION WHICH HE HAD ASKED MEMBERS OF HIS COMMITTEE TO FOLLOW WOULD APPLY AT RHODES. HE REMAINED OPTIMISTIC ABOUT PROGRESS TOWARDS MONETARY UNION AS LONG AS THE COMMUNITY WAS FAITHFUL TO THE STEP BY STEP APPROACH AND DID NOT GET BOGGED DOWN IN DOCTRINAL DEBATE. IT WAS POSSIBLE TO BE PRAGMATIC AND TO MAKE PROGRESS AT THE SAME TIME. ON TAX APPROXIMATION, THE INFORMAL ECOFIN ON CRETE HAD SHOWN WIDE DISPARITIES BETWEEN TWO MEMBER STATES AND THE OTHER TEN. COCKFIELD WAS DUE TO REPORT ON HIS BILATERALS BY THE END OF THE YEAR AND THE COMMISSION WOULD THEN CONSIDER THE NEXT STEPS.

6. THE COMMUNITY IN THE WORLD : HEADS OF GOVERNMENT WOULD WANT TO RESPOND FIRMLY TO THE UNFOUNDED ALLEGATIONS ABOUT FORTRESS EUROPE.

7. WORLD ECONOMIC SITUATION : DELORS HAD NO FEARS ABOUT THE EMS. ASKED ABOUT BEREGEVOY AND STOLTENBERG'S VIEW THAT THERE SHOULD BE AS EARLY G7 MEETING ONCE THE US ADMINISTRATION WAS IN PLACE, DELORS THOUGHT THIS WOULD BE USEFUL: SHOULD DISCUSS THE US DEFICIT AND THE DOLLAR: AND BE IN SECRET. !!

8. ASKED WHETHER HE WAS NOT STAGE-MANAGING THE DEBATE ABOUT EUROPEAN UNION, DELORS SAID THE TASK WAS TO GET THE COMMUNITY MOVING. HE WOULD NOT ENGAGE IN A POST-BRUGES DEBATE, EVEN THOUGH HE MIGHT HAVE ENJOYED IT. HE WOULD LEAVE IT TO OTHERS TO DECIDE IF HE WAS BEING A GOOD CIVIL SERVANT OR A COWARD.

9. HE HAD NOT YET SEEN THE LETTER FROM PAPANDREOU - HE HOPED THERE WOULD BE A CHANCE TO DISCUSS AUDIO-VISUAL AND PROBLEMS RELATING TO IMMIGRATION AND POLITICAL ASYLUM.

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