

*part B*

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*Begins: 14/7/81  
Ends: 22/7/81.*

  
**PO -CH /GH/0050**  
  
**PART B**

**PO -CH /GH/0050**  
**PART B**

*Chancellor's (Howe) Papers:*

**OTTAWA WORLD ECONOMIC  
SUMMIT JULY 1981**

*Disposal Directions: 25 years*

*Phillips  
25/7/95.*

*m*

When can I have  
the briefings of Lords  
with KEC on all this?

CHANCELLOR OF THE EXCHEQUER

(with budget  
affairs)

✓  
As usual

For Information:

Chief Secretary  
Financial Secretary  
Sir Douglas Wass  
Mr Hancock  
Mrs Hedley-Miller  
Mr Lavelle  
Mr Mountfield  
Mr Bottrill

## OTTAWA COMMUNIQUE

I attach a draft letter to the Prime Minister as requested in Mr Jenkins' minute of 13 July. It can now refer to Sir Robert Armstrong's report dated 13 July, of which a copy has been sent to you (I suggest you could safely disregard most of the Annexes - with the possible exception at some stage of the Canadian paper on Aid).

2. I have put the last paragraph of the draft letter in brackets. The proposal to which we are objecting emerged from the Personal Representatives and is, I suppose, very much a matter for Heads of Government. You may prefer to make the point orally to the Prime Minister at the briefing meeting or elsewhere.

3. You will recall that the FCO were preparing a paper suggesting the possibility of increased aid expenditure or other concessions to the LDC's so as to ease Ministers' path through the Summits of Cancun and Melbourne. They hoped that this could be put forward as an agreed paper from a group of Permanent Secretaries under Sir Robert Armstrong which has met twice to consider preparations for the Mexico Summit. I had to urge (with support from Sir Brian Hayes) that if it were to be put forward, it should be by a Foreign Office Minister. The FCO found this unattractive. In the end Sir Robert Armstrong said he would be putting a paper on his own authority to the Prime Minister. We shall not get it until tomorrow: I think he will do his best to make it a balanced one. However there is some awkwardness if options for expenditure reach Ministers in this particular way. I hope it will not be discussed on Thursday and that we can consider whether and how to react later.

KEC

K E COUZENS  
14 July 1981

enc

CONFIDENTIAL

pl type 2

*Minute*  
DRAFT LETTER TO THE PRIME MINISTER FROM THE CHANCELLOR

cc. Foreign & Commonwealth Secretary  
Secretary of State for Trade  
Secretary of State for Energy  
Sir Robert Armstrong, Cabinet Office

## OTTAWA COMMUNIQUE

It may be helpful for your briefing meeting on the Ottawa Summit if I record some comments on the draft communique which our representatives brought back from the recent Preparatory Group meeting.

2. As Sir Robert Armstrong has said in his report to you on the preparatory work, Heads of Government are entirely free to modify the draft communique if they wish. Having studied the section on the Economy however I feel that we would have good reason to be satisfied with it if it survived in its present form. While it would be attractive from some points of view to have a much shorter declaration, I fear that we could easily lose from a substantial shortening of the section on the Economy. For example, the French would no doubt like to remove the idea that the economic policy reaction to the second energy price increase has been better managed than the first. The references to inflation and unemployment are a carefully constructed balance which could easily be upset to our disadvantage. We have no interest in deleting phrases which German representatives saw as helpful to Chancellor Schmidt's domestic budgetary arguments. And we also want to preserve the words about interest rates, exchange rates and budgetary deficits which are

aimed at the Americans, which they have so far accepted and which largely meet what the Community (and we) would like to say. Finally, I would not like to see the section on the Economy made shorter than the section on relations with developing countries.

3. My other main comment is on that section (Part III). Heads of Government will be faced with a choice of formulae on the Global Negotiations. The first and more forward formula corresponds with the one included in the Presidency Conclusions of the Luxembourg European Council and we cannot take the lead in modifying it, particularly given our Presidency role. If however it becomes clear that the first formula does not command general agreement, I trust that we shall move to a position as close as possible to the American formula which on the merits I believe to be more nearly right. The whole concept of Global Negotiations institutionalises the division between North and South which I find so unattractive: and it is long odds that if these Negotiations start they will produce either bitter recrimination or objectionable concessions. I do not suggest that we campaign single-handed against them, or make ourselves a special target as opponents of them but I certainly do not think that we should fight strongly against the Americans in favour of an early start to these Negotiations.

4. I also have some doubts about further institutionalisation of the Summits on the lines envisaged at the very end of the draft communique - especially as the next one will be under French chairmanship. But perhaps we can discuss this at your briefing meeting.

5. I am copying this to the Foreign and Commonwealth Secretary, ~~and~~ the Secretaries of State for Trade and Energy and to Sir Robert Armstrong.

G HOWE

## EUROPEAN NEWS

## Bonn-Paris aim to avoid clash with U.S. at summit

BY JONATHAN CARR IN BONN

WEST GERMANY and France are determined to avoid confrontation with the U.S. at next week's world economic summit conference in Ottawa, despite their concern about high U.S. interest rates. This has emerged at the end of top-level talks here, which brought wide foreign policy agreement but failed to remove Bonn's worry about the socialist economic course

being followed by the new French Government.

Both Chancellor Helmut Schmidt and President Francois Mitterrand agreed that U.S. monetary policy, and its depressive impact on European economies, must come under scrutiny at the Ottawa conference. But there is to be no effort to isolate the issue and put the U.S. "on the spot," an effort which it is felt would be doomed to failure.

The main aim for Ottawa is now described as an in-depth discussion aimed at avoiding development of "nationalistic-egotistical" policies in trade, monetary and other fields. The draft communique is understood to be already complete—apart from a general political section to be inserted later—and to contain "no surprises" on interest rates or anything else.

This round of the regular Franco-German consultations—the first since M Mitterrand became President—has been marked by repeated public assurances that bilateral ties are good and will remain so.

M Mitterrand has delighted his West German hosts in particular by his firm support for the Nato decision of December 1979 which aimed to correcting the East-West imbalance in intermediate-

range nuclear missiles. This is useful help for Herr Schmidt, who is under strong pressure on the issue from his own Social Democratic Party.

But West German fears remain strong that the Paris Government's economic policies, which imply a bigger public sector credit intake, will mean a further increase in the already high French inflation rate.

M Pierre Mauroy, the

French Prime Minister, and M Jacques Delors, the Finance Minister, explained that France had much leeway to make up in social policy and that greater state expenditure was inevitable. Publicly, the West Germans express understanding for this, but privately say the results could be catastrophic, not least for the future of the European monetary system.

## Schmidt and Mitterrand find plenty to agree about

BY OUR BONN CORRESPONDENT

AT FIRST sight it looked just like old times. There was Chancellor Helmut Schmidt praising the exceptionally close relations between West Germany and France and expressing confidence that these will be maintained in coming years. There was the French President speaking of the "privileged friendship" between Bonn and Paris and saying he was "exceptionally satisfied" with his two-day visit to Bonn.

The odd thing is that this was not the liberal French President Valery Giscard d'Estaing with whom Herr Schmidt has had such friendly ties for years. It was M Francois Mitterrand, who defeated M Giscard in the May elections, and whose socialist views were once said to be too radical for a middle-of-the-road Social Democrat like Herr Schmidt to stomach.

It had long been expected in Bonn that M Mitterrand would be much closer to his old acquaintance, Herr Willy Brandt, chairman of the West German Social Democratic Party, than to Herr Schmidt. Yet in his talks in Bonn on Sunday and yesterday M Mitterrand made at least one thing very clear. He is, if anything, an even stricter supporter of the Nato decision to correct the East-West nuclear missiles imbalance than is the Bonn Government.

M Mitterrand clearly thinks little of the apparent concessions made by the Soviet side during Herr Brandt's recent talks in Moscow. The President's main concern seems to be that the West should negotiate with Moscow from a position of reasonable strength—which means in the first place further armament efforts.

On yet another key issue M Mitterrand and Herr Schmidt found themselves in accord—that the U.S. high interest rate policy is seriously depressing the European economies, and that the consequences of this must be underlined to President Ronald Reagan at the Western economic summit conference in Ottawa next week.

## Given up hope

For Herr Schmidt, close ties with France remain a foreign political necessity and a matter of personal conviction. The Chancellor is reliably understood to have given up hope that Britain will play what he feels to be a far-sighted role within the European Community. He has, in short, become a "Gaullist" as far as Britain is concerned.

France thus remains at the top of Herr Schmidt's European policy list, despite the change of power in Paris and its attendant problems.

Despite appearances, this does not imply that Franco-German relations remain the same as ever. The French side stresses that M Mitterrand wants to see excellent ties with Bonn maintained, but also to see some bridges rebuilt with Britain which he feels were destroyed under his predecessor.

A senior Bonn Government official also underlined yesterday the problems which he felt could well emerge for West Germany and the rest of Europe from the socialist economic course announced by M Mitterrand's administration. He declared bluntly that the consequences in terms of increased French inflation could be "simply disastrous" and expressed hope that the new Government in Paris would trim its policy sails before it was too late.

The same official acknowledged that broad foreign political accord with France was highly desirable, but also stressed that Bonn and London had a considerable common interest in EEC budgetary reform as the two biggest net contributors to Brussels. It was not clear that Bonn and Paris were so close to one another on this issue.

● M Mitterrand and Herr Schmidt (right) meet in Bonn



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CONFIDENTIAL

cc CST  
FST  
Sir D Wass  
Sir K Couzens  
Mr Hancock  
Mrs Hadley Miller  
Mr Lavelle  
Mr Mountfield  
Mr Bottrill

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15/7/81.

Treasury Chambers, Parliament Street, SW1P 3AG  
01-233 3000

PRIME MINISTER

OTTAWA COMMUNIQUE

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4. I also have some doubts about further institutionalisation of the Summits on the lines envisaged at the very end of the draft communique - especially as the next one will be under French chairmanship. But perhaps we can discuss this at your briefing meeting.

5. I am copying this to the Foreign and Commonwealth Secretary, the Secretaries of State for Trade and Energy and to Sir Robert Armstrong.

A handwritten signature in dark ink, appearing to be 'G.H.'.

(G.H.)

15 July 1981



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15/7/81.

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cc Chief Secretary  
 Financial Secretary  
 Sir Douglas Wass  
 Mr Burns  
 Mr Hancock  
 Mrs Hedley Miller  
 Mr Lavelle  
 Mr Mountfield  
 Mr St Clair  
 Mr Bottrill  
 Mr Slater  
 Mr Bonney

CHANCELLOR

WORLD BANK ENERGY AFFILIATE

I attach a useful note by Mr St Clair about this.

2. You may also like to see a telegram just received recording a discussion in the World Bank Board on 7 July. I think Mr Smith of the ODA made a very respectable presentation of the UK position at that meeting which ought to have given no offence to anybody. The US position continued to be negative not only on the Affiliate but even on the idea of a larger energy programme within the World Bank. The German spokesman was distinctly cooler about an Affiliate than, for example, Herr Schulmann has been until recently. I also see a reflection in what the German representative said at a recent German view, possibly deriving from Chancellor Schmidt's visit to Saudi Arabia, that the Saudis were not really prepared to put up large sums for an Affiliate.

3. I think we should avoid becoming identified with the American view on this, although we should be careful to emphasise the realities created by the American position. Those include giving priority to getting IDA VI through Congress; and recognising that no new lending programme or Affiliate will have worthwhile credit in the markets if the Americans do not support it. We could say that we are not opposed to an Energy Affiliate if it is demonstrated that that is the best way of securing "additionality" in energy investment in LDCs; and the best way of mobilising additional OPEC and market funds. But we are interested in the results, not the machinery.

4. This is a good practical British line which is in the tradition of the British attitude to the IMF and the World Bank. It is close enough to the attitude of eg the Germans. It contains elements of the US position, without identifying us with them.

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5. We have however to remember all the time that the ODA would have to find any new capital subscription within the aid programme, if in fact a separate Energy Affiliate emerged. More multilateral aid is contrary to the direction in which Ministers wished to move. This has made the ODA at least as cautious as the Treasury about the Energy Affiliate idea. We have to be careful not to appear to get out in front of them.

6. However, these were the questions I think you wished to discuss.

JKR

PP K E COUZENS  
15 July 1981

- 9/173. 10
1. SIR KENNETH COUZENS
  2. CHANCELLOR

Copies attached for:

Chief Secretary  
Financial Secretary  
Sir Douglas Wass  
Mr Burn

cc Mr Hancock  
Mrs Hedley-Miller  
Mr Lavelle  
Mr Mountfield  
Mr Bottrill  
Mr Slater  
Mr Bonney

OTTAWA COMMUNIQUE - ENERGY AFFILIATE

The Private Secretary minute of 13 July says that you would like to discuss the energy affiliate question. A note may be useful before hand.

2. The proposal for an energy affiliate derives from the World Bank itself. It is supported, in principle, by the main OPEC countries, by France, Canada, the Netherlands, the Nordics, and virtually all LDCs. Details have never been worked out, but the World Bank envisages a capital of between £10b and £15b with a paid in proportion of 10%. The affiliate would be permitted to borrow up to, say, 2½ times the capital. The shareholding would be divided among OECD, OPEC, and the LDCs so as to give OPEC a far bigger role (though less than 50%) than in the World Bank itself.

3. Those who favour the energy affiliate put forward the following reasons:

(a) There is a great need to develop energy resources in the Third World, and a new institution could attract support, if directed at energy, which would not be available to the World Bank itself.

(b) In particular OPEC would be prepared both to put in capital and to lend very substantial sums.

(c) Giving OPEC a bigger share in the ownership and management would be a worthwhile step forward.

(d) Indeed the OECD countries ought to support the initiative for, if it were to be successful, the only

losers would be OPEC itself since their present grip on energy supply and prices would be loosened.

4. On the other side the following points are made:

(a) Some people doubt whether, in reality, there are large numbers of profitable energy investment opportunities in Third World countries which would remain unexploited if World Bank finance were not available. They fear that an energy affiliate programme might simply displace private sector investment. (On the other hand it is known that there are some countries which will not deal with oil companies without World Bank involvement and also countries which the oil companies will not touch without World Bank involvement for fear of political risks.)

(b) There is little that can be achieved by the energy affiliate which could not be equally well achieved by expanding the energy component of the World Bank programme as a whole. The only unique feature is a higher gearing (capital to borrowing) ratio than the World Bank, and if this is not available, the attraction of the concept falls away. Given the attitude of the United States (see below) a high gearing ratio does not look feasible.

(c) Do we really want to give OPEC a larger share of control? Especially if the energy affiliate takes over some of the existing portfolio of the World Bank? In particular why should they claim credit for lending to the energy affiliate? They would not be doing the world a favour, but rather OPEC would be provided with first class investment media for their financial surpluses.

5. At the moment the energy affiliate proposal is stalled. Most countries, including ourselves, have said that they would be prepared to continue discussions. The Americans say they cannot support an energy affiliate at this time. Given their difficulties with Congress

over IDA 6 and the general capital increase, as well as their wish to reduce expenditure, it is hard to see them finding the money to subscribe to an energy affiliate for several years at least. An energy affiliate without whole hearted American participation would almost certainly not be able to borrow the large sums required at the fine terms required on world capital markets. Certainly it would be unlikely to achieve the gearing up. Furthermore establishing an energy affiliate is equivalent to establishing a full scale new international institution, requiring action by legislatures in all participating countries. It would take years to establish.

6. The Canadians wanted the Ottawa outcome to include a decision in principle in favour of the energy affiliate. It would be a concrete initiative to be able to point to.

7. Mr Hamad, the Kuwaiti Finance Minister, outlined more ambitious ideas for the energy affiliate when he saw you on 30 June, than have been envisaged hitherto. He seemed to see it covering not just oil, coal, and other hydro-carbon energies, but dams and electricity which could be linked with irrigation projects and food production. There certainly ought to be close links between energy development in Third World countries and the uses to which the new energy is to be put, but that is an argument in favour of our own line of the need for close integration with the main World Bank activities. It is not clear what Mr Hamad has in mind with "a more aggressive approach". This is an area which certainly needs imagination and expertise, especially if it is to be confined to marginal projects and avoid displacing potential private sector projects. At the moment the World Bank and the regional banks contain the main international sources of this kind of expertise, although obviously experts could be hired from oil companies and elsewhere.

8. There seems no need at present to change the British line, which is that we are willing to continue discussions on ways of increasing the World Bank's energy programmes. The idea of an energy affiliate can be discussed, but it is not the only way forward. If the Americans are unwilling or unable to participate, then some of the main attractions fall away. Certainly it would be wrong for the UK to take the initiative in proposing a decision at Ottawa on the energy affiliate.

*W.L. M.C.*

W L ST CLAIR  
14 July 1981

13  
RESTRICTED

SAVING TELEGRAM

BY BAG

FM UKDEL IMF/IBRD WASHINGTON

RESTRICTED

TO ROUTINE FCO SAVING TELEGRAM NO. 333 OF 7 JULY 1981

IBRD/IDA Board Meeting, 4 June 1981

Expanded Energy Lending: ENERGY AFFILIATE (R81-78)

The discussion of this paper is summarised in our tel no 154 of 5 June. All Directors (or their Alternates) spoke.

American position

2. Once again, the US line overshadowed the meeting. Dawson (US) spoke first from a prepared statement (copies by bag). He said that the US were themselves studying the energy potential and requirements of the developing countries in the light of the Bank's proposed expansion of its energy lending programme. The study was expected to be completed "in the coming weeks" and its conclusions would be shared with the Board.

3. In the meantime, the US considered that it would be premature for the Board to endorse a larger energy programme or to proceed with negotiations on an energy affiliate. They were not prepared to support the creation of, or participate in, an energy affiliate "at this time". A particular US concern was the respective roles of private and official capita: they favoured avoiding Bank assistance with public sector energy involvement where this would pre-empt private initiative. (McNamara intervened that the Bank was a lender of last resort and that its funds would only be used if private investment could not be mobilised).

4. Dawson indicated that the US would support the formation of a working group to consider how the Bank could assure its lending contributed to an increased flow of private capital in LDC energy development and avoided competition with private capital; the need for further expanded energy lending by the Bank; and the project and country composition the Bank foresaw for the proposed expanded energy programme. The conclusions of the working group could form the basis for a future decision on the proposed energy lending expansion.

5. No other chairs cast doubt on the need for some form of expanded energy lending programme under Bank auspices although there were differences of approach on the institutional or other framework for channelling these additional funds and on how discussions should be taken forward.

/ Support

## Support for energy affiliate

6. Adbulai (Nigeria etc), Blanco (Bolivia etc), Garcia-Parra (Colombia, etc), Kivanc (Turkey etc), Drake (Canada etc), Al-Hegelan (Saudi Arabia etc), Khelil (Tunisia etc), Looijen (Netherlands etc), Lundstrom (Sweden etc), McLeod (Australia etc), Mentre (France), Guimares (Portugal etc), Ray (India etc), Razafindrabe (Madagascar etc), Wang (China) and Aung Pe (Burma etc) all came down in favour of the establishment of an energy affiliate as the quickest and most effective way of mobilising additional resources for energy development. Of these, Adbulai, Garcia Parra, Kivanc, Drake, Looijen, Lundstrom and McLeod specifically stated they were ready for the door to be left open for considering any alternative ways of channeling funds for energy, provided that the overall aim of an expanded programme could be met.

## UK Position

7. Morioka (Japan), Muns (Spain etc) and Smith (UK) indicated a readiness to consider all the possible alternatives including the affiliate. Smith said that the UK recognised the energy needs of ldc's and, bearing in mind the conclusions of the Venice Summit, was prepared to consider an expansion of the Bank's energy programme. Our basic approach was to see how additional funds could be mobilised without displacing private flows. The proposal for an energy affiliate was one of several possible solutions and should not be looked at in isolation from other alternatives. Further work should include a comparative assessment of the market borrowing prospects of an expanded IBRD with energy investments forming a large element in its portfolio, and a new and unfamiliar institution - albeit having close links with the IBRD - concerned exclusively with energy investments. Consideration should be given to the time it would take for an affiliate to become operational, as compared with other alternatives such as increasing the IBRD's callable capital without a paid-in element. The rate of increase in total energy investments should be looked at in the light of the capacity of the developing countries to absorb them; this involved questions such as the manpower resources to ensure that standards of project preparation, execution, and subsequent operation were maintained. Smith said that he did not propose, at that stage, to go into details of what structure an affiliate might adopt.

## German position

8. Kurth said that the German government was opposed in principle to the setting up of new international institutions, with all the problems of coordination and additional administration that this could involve. They would prefer instead a further general capital increase of the IBRD involving callable capital only. He realised that with the existing GCI exercise still under

negotiation, this might not seem a particularly appropriate proposal; but he doubted whether the existing climate augured more favourably for a new energy affiliate than for an increase in the Bank's callable capital which would of course have no immediate budgetary implications .

9. Kurth said he could see merit in an affiliate if it was likely to attract recycled OPEC funds; but so far there had been no clear sign on this from the OPEC countries. However, if it was decided that an affiliate should be established, Kurth said that he thought his government would be prepared to go along with this. But they would consider it to be of great importance that all major shareholders of the Bank participate in the affiliate (Morioka, Guimares and Al-Hegelan also took this line); and that it was integrated as closely as possible with the Bank. IFC's relationship with the Bank was the loosest form of link that the Germans would be prepared to contemplate.

Affiliate's links with Bank

10. A number of other Directors, notably Abdulai, Blanco, Garcia-Parra, Al-Hegelan, Razafindrabe, Khelil, McLeod, Kivanc and Wang, also stressed the importance of any new affiliate having very close links with the Bank, referring variously to the greater confidence this would engender on the markets, to the Bank's existing expertise in the energy sector and to the role the Bank should have in advising ldc's on the place that energy development should assume in the context of their other economic activities. McLeod made the point that priorities for development could change. He thought it might therefore be prudent for a body dealing with one particular sector only, to be affiliated as closely as possible to the Bank which, with its overall economic view, could advise more objectively if and when the energy affiliate had fulfilled its useful role.

French position

11. Mentre, on the other hand, considered that the options on the proposed affiliate's links with the Bank should be kept open. He saw four possible alternatives; (i) an IDA-type link; (ii) an IFC-type link ; (iii) an autonomous affiliate loosely within the Bank Group; (iv) and a completely independent affiliate maintaining external links with the Bank. He thought that there was a strong case for a continuing role for the Bank in energy development but that this was not incompatible with some form of autonomy for the proposed new institution.

He did not make clear whether his preference was for (iii) or (iv)  
Mentre added that the proposal for basing voting rights on factors other than simply the size of shareholdings was a positive move. He also suggested that if certain countries had difficulty in making their contributions at an early stage, the Bank should take direct shares in the affiliate itself and sell them off to member countries as they became willing or able to purchase them.

/ Arab



### Arab position

12. The contributions by Al-Hegelan (Saudi Arabia etc) and Khelil (Tunisia etc), representing the two main Arab constituencies, did not reveal any details of the likely OPEC contributions to the proposed affiliate. However, both strongly supported the establishment of an affiliate as the best means of meeting the pressing energy needs of the ldc's. Khelil pointed out that, if the affiliate was set up quickly this would release funds earmarked for energy in the Bank's budget for use on the China programme and structural adjustment lending. Both Khelil and Al-Hegelan urged the speedy convening of a Deputies meeting to consider both the affiliate and the expansion of energy lending. Al-Hegelan said that his constituency would certainly participate in the negotiations and hoped all other members would also do so.

### Form of negotiations

13. Kurth, Drake and Smith all made the point that it was premature to talk of formal negotiations by Deputies, when there were still issues of principle to be resolved. They all favoured the continuation of informal consultations. Morioka said that the Japanese would go along with a Deputies meeting if the majority favoured it, but indicated that if it was to be effective all major shareholders would need to be involved. All the other chairs (except for the Americans) supported the early convening of a Deputies meeting although several, notably Kivanc, Garcia-Parra, McLeod and Ray again urged the involvement of all shareholders. Only Lundstrom said that the negotiations should go ahead whether or not all major shareholders (ie the Americans) chose to participate.

### Role of Private Sector in Energy Development

14. Many Directors returned to the point first raised by Dawson, concerning the role of the private sector in energy development. Abdulai, Drake, Mentre, Kurth, Al-Hegelan, Garcia-Parra and Razafindrabe all specifically recognised the important and probably major role that private investment had to play in this sector, underlining McNamara's point that the Bank should only be a lender of last resort, and should not pre-empt the use of private funds where these could be more available. But none saw this latter point as a real danger. Energy was not just oil and there were other areas of energy development - for example, fuel wood, electricity and conservation - where the private sector was just not able or willing to participate by itself. Kurth, Drake, Abdulai, Al-Hegelan and Garcia-Parra drew attention to the complementary and catalytic role of the Bank in these areas. Through the "good-housekeeping seal" of its involvement, it was able to encourage the participation of private investors; and the Bank was able to provide not just additional finance but also technical advice and administrative and institutional support which made the overall package more attractive to sources of private finance.

/ Miscellaneous

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RESTRICTED

5  
CONFIDENTIAL

MR TOLKIEN

cc Sir K Couzens  
Mr Hancock  
Mr Mountfield  
Mr Bottrill  
Mr Peretz

BRIEFING FOR THE OTTAWA SUMMIT: EXPORT CREDITS

In response to your note of 13 July to Miss Ratter, I attach a brief on export credits to supplement the references to this subject in paragraphs 5, 15 and 16 of the brief on Trade (PMVL(81)4).



M V HAWTIN  
15 July 1981

EXPORT CREDITS

POINTS TO MAKE

1. Vital to maintain Consensus to avoid export credit war, from which only recipient countries would gain.
2. Three key issues to concentrate on:-
  - i. early increase in Consensus minimum rates, to bring them more in line with world market levels
  - ii. the position of the low interest rate countries, notably Japan
  - iii. the need for greater transparency in the use of mixed credits
3. EC resolved to establish constructive position on these points before resumed OECD negotiations in the Autumn.
4. Compromise necessary on all sides if agreement to be reached. In particular, significant increase in interest rates will depend on satisfactory arrangements to deal with the position of Japan. Accept that Japan cannot be expected to change its export financing system. But reasonable to ask Japan:-
  - i. to pay some price (in terms of a premium over market interest rates) for being allowed to offer its exporters official financing support through ExIm Bank at sub-Consensus rates
  - ii. for assurances on access to yen finance for matching purposes.

## BACKGROUND

1. There is a real prospect of breakdown in the Consensus unless some compromise agreement can be reached between the three main participants (the EC, US and Japan) at resumed negotiations this Autumn. The new US Administration is under strong political pressure for early progress in reducing export credit subsidies. The Americans are already applying pressure on various fronts (eg. derogations on credit length, action in GATT). They have made it clear that they will step up this action if the negotiations become deadlocked. There are Bills in the Congress which would provide funds to enable the US to embark on large scale programme of export credit subsidies, if they so chose; and they have had talks with Canada and Japan about a possible understanding on credit terms, not involving subsidised interest rates, to which other non-EC countries might be invited to subscribe.

2. The prospects for agreement have improved with some signs of movement in the previously inflexible French position. At the meeting of ECOFIN on 6 July, EC Ministers agreed on the need for a significant increase in minimum interest rates, a strong common position regarding the Japanese problem and transparency in mixed credits. The Commission are now undertaking informal exploratory discussions with the Americans and Japanese in Paris, with a view to drawing up firm proposals for consideration by the Council on 17 September. The Americans appear to accept that the immediate negotiations should concentrate on the three key issues identified by the Commission. In particular, while not abandoning their objective of an automatic system of interest rate adjustment, differentiated by currency, they recognise that this is not likely to be negotiable in the short term.

3. The key to progress is some compromise to deal with the so-called Japanese problem. This arises because Japanese market interest rates would be below the Consensus if an increase in minimum rates is agreed. In the past Japan, through its official ExIm Bank, has adhered to the Consensus interest rates by ensuring that the overall rate on credits supported by its official ExIm Bank respects the Consensus minimum. But the Japanese have made it clear that if Consensus rates are increased, they would want to be able to offer ExIm Bank finance at lower rates.

4. Given the present state of trade relations between Europe and Japan, there are clearly strong objections to any arrangements which might appear to give the Japanese a privileged position under the Consensus. The general position of most EC countries (including ourselves) is therefore that while it is not reasonable to expect the Japanese to change their export financing system, they should be asked to pay some premium (in terms of the interest rate charged) in return for the advantages to their exporters of official financing through ExIm Bank at sub-Consensus rates. They should also be pressed to give satisfactory assurances on foreign access to yen finance, in order to match low rate Japanese offers. In the case of most European countries (like ourselves), this access is required for exporters and banks, rather than for official institutions like US ExIm Bank, for which it may present fewer problems. In practice, the scope for access will be difficult to establish until it is actually put to the test. This strengthens the case for requiring some premium over Japanese market rates on officially provided export financing, so as to limit their competitive advantage on the new Consensus rates.

5. Pending decisions in September on the EC position, it clearly would not be appropriate to engage in detailed discussions on the size of the increase in Consensus rates, and the various possible approaches to resolving the Japanese problem. But it would be useful to get across the general point that the EC is now urgently reviewing its position and genuinely seeking a basis for agreement: we hope the Japanese will respond by showing flexibility in their own position. It is also important to impress on the Americans that the prospect for Community agreement to an increase in minimum interest rates of a size likely to be sufficient to satisfy them (which may be a minimum of 2% for the relatively poor recipient countries) depends crucially on acceptable arrangements for dealing with the Japanese issue. It would obviously be helpful if they could put some pressure on the Japanese on this. (The US might also be advised to play down threats of action in the event of a breakdown in the negotiations, which could have a counter productive effect on the attitude of the French.)

6

For Ottawa PPS 19

GR 275  
UNCLASSIFIED  
DESKBY 160900Z  
FM WASHINGTON 152225Z JUL 81  
TO IMMEDIATE F C O  
TELEGRAM NUMBER 2157 OF 15 JULY

PRESIDENT REAGAN'S MID-SESSION REVIEW OF 1982 BUDGET

1. FOR THE FIRST TIME SINCE THE PUBLICATION OF ITS ECONOMIC SCENARIO IN FEBRUARY, THE ADMINISTRATION TODAY PUBLISHED REVISED ECONOMIC PROJECTIONS FOR THE PERIOD AHEAD.

2. THE MAIN FIGURES ARE AS FOLLOWS.

THESE ARE FORECASTS TO 1982. THEREAFTER THEY ARE PROJECTIONS OF THE TREND OF ECONOMIC PERFORMANCE EXPECTED UNDER THE ADMINISTRATION'S ECONOMIC POLICY.

A. PERCENTAGE CHANGES  
YEAR ON YEAR

	1981	1982	1983	1986
GNP NOMINAL	12.4	11.7	12.3	9.3
GNP REAL TERMS	2.6	3.4	5.0	4.2
CONSUMER PRICE INDEX	9.9	7.0	5.7	4.2

B. PERCENT LEVEL

	1981	1982	1983	1986
UNEMPLOYMENT	7.5	7.3	6.6	5.5
INTEREST RATE 91-DAY TREASURY BILL	13.6	10.5	7.5	5.5

C. DOLLARS BILLION

	FY81	FY82	FY83	FY86
BUDGET RECEIPTS	605.6	662.4	705.8	923.3
BUDGET OUTLAYS	661.2	704.8	728.7	895.1
BUDGET BALANCE	-55.6	-42.5	-22.9	28.2

3. THE MAIN REASON FOR THE INCREASE IN FORECAST BUDGET OUTLAYS IN FY81 AND 82 IS HIGHER DEBT INTEREST. THIS IS BROADLY OFFSET BY INCREASED RECEIPTS ARISING FROM THE SUBSTITUTION OF THE QUOTE BIPARTISAN TAX PACKAGE UNQUOTE FOR THE ADMINISTRATION'S ORIGINAL TAX PROPOSALS. THE FIRST YEAR FOR WHICH A BUDGET SURPLUS IS PROJECTED REMAINS 1984 (PLUS 0.5BN).

4. F C O PLEASE ADVANCE TO BOTTRILL (TREASURY) AND HAYWARD (BANK OF ENGLAND).  
[ADVANCED AS REQUESTED]  
HENDERSON [COPIES ALSO SENT TO OUTSIDE RECIPIENTS OF FINANCIAL DISTRIBUTION]  
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NAD

Comparative figures about violence

	1980 homicides per 100,000 pop.	Total 1970-81	Average per year	1980
N. Ireland	5	2113	184	75
New York	26			1814
Chicago	29			863
Los Angeles	30			908

Urban disturbances

	Deaths	Injuries	Property damage
<u>All</u> UK disturbances 3-15 July	—	800 police (fewer civilians)	\$ 90 m
Miami 17-18.5.80	<del>34</del> 16	400	\$ 100 m
Watts 1965	34	1032	\$ 200 m
Paris 1968		2000	

(injuries much less than UK in recent riots in Switzerland, W Germany, Neth., & France)

8

15/7/81. 21



Miss Lutter

The Chancellor has seen the attached telegram (2125) about US press treatment of UK economic policy and performance and asked that a suitable speaking note be prepared for him to use at Ottawa.

It may be that the PMVL briefing provides a good basis for this. In any event the point can be raised at the meeting tomorrow at 9.0 am to talk about briefing for Ottawa.

R.T. 15/7



CONFIDENTIAL

GRS 550

CONFIDENTIAL  
FM WASHINGTON 132322Z JUL 81  
TO PRIORITY F C O  
TEL NO 2125 OF 13 JULY 1981

*Not only for my  
CBS broadcast,  
I should be a guest  
available to speak to*

U S VIEWS ON THE BRITISH ECONOMY.

1. BEFORE THE OTTAWA SUMMIT YOU MAY LIKE A BRIEF SUMMARY OF U S VIEWS ON BRITISH ECONOMIC DEVELOPMENTS AND POLICIES.

*an opportunity*

2. THERE IS A GROWING AMOUNT OF GLOOM HERE ABOUT THE STATE OF THE UK ECONOMY AND ABOUT THE PROSPECTS FOR ANY EARLY RECOVERY. THE ADMINISTRATION REMAINS BASICALLY SYMPATHETIC TO THE GENERAL OBJECTIVES OF OUR DOMESTIC ECONOMIC POLICY. ESPECIALLY OUR DETERMINATION TO GET OUR RATE OF INFLATION DOWN, TO REDUCE THE DISINCENTIVE EFFECTS OF HIGH TAXATION, AND TO REDUCE THE ROLE OF GOVERNMENT AND THE PUBLIC SECTOR. WHERE SOME OF THEM (SUCH AS SPRINKEL AND ROBERTS AT THE TREASURY) HAVE DOUBTS IS MORE ABOUT PERFORMANCE, PARTICULARLY WHETHER ENOUGH HAS BEEN DONE TO CUT SPENDING AND TAXES, AND TO KEEP THE MONEY SUPPLY UNDER CONTROL.

*points  
in Ottawa  
- discuss  
in U.S.  
media*

3. PRESIDENT REAGAN HIMSELF IS LIKELY TO TAKE THE VIEW THAT IT IS UP TO EACH INDUSTRIALISED COUNTRY TO GET ITS OWN ECONOMY RIGHT, FIRST AND FOREMOST BY REDUCING INFLATION.

4. GIVEN THE BASIC SIMILARITIES BETWEEN U S AND UK ECONOMIC OBJECTIVES, COMMENTATORS HERE FREQUENTLY SEEK TO READ ACROSS FROM UK EXPERIENCE TO THE PROSPECTS FOR SUCCESS OF REAGAN'S PROGRAMME (DESPITE THE STRUCTURAL DIFFERENCES BETWEEN THE TWO COUNTRIES). FOR THIS REASON, THE UK ECONOMY CONTINUES TO GET A GOOD DEAL OF PRESS COVERAGE. SOME, SUCH AS LEONARD SILK OF THE NEW YORK TIMES, REGARD THE QUOTE BRITISH EXPERIMENT UNQUOTE AS HAVING FAILED THROUGH DEFICIENCIES OF IMPLEMENTATION, AND POINT TO THE ADVERSE EFFECT ON OUTPUT AND EMPLOYMENT. OTHERS, PROBABLY THE MAJORITY, ARE WILLING TO GIVE US CREDIT FOR REDUCING INFLATION AND WAGE SETTLEMENTS FROM THEIR PEAK LEVEL, FOR SEEKING TO GET BETTER CONTROL OVER THE MONEY SUPPLY, AND FOR IMPROVEMENTS IN PRODUCTIVITY. EVEN THIS GROUP, HOWEVER, POINT TO THE COST OF WHAT HAS BEEN ACHIEVED. HOBART ROWEN OF THE WASHINGTON POST HAS DRAWN ATTENTION TO A RECENT STAFF STUDY FOR THE JOINT ECONOMIC COMMITTEE OF CONGRESS, WHICH RAISES THE QUESTION WHETHER THE BENEFITS OF REDUCED INFLATION AND WAGE SETTLEMENT OUTWEIGH THE COST IN TERMS OF LOST OUTPUT AND UNEMPLOYMENT. BUT OVERALL THE RECENT U S PRESS TREATMENT OF THE UK ECONOMY APPEARS NO MORE CRITICAL THAN THE UK PRESS, WHERE MUCH OF THE MATERIAL PUBLISHED HERE ORIGINATES.

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5. THE AMERICAN VIEW OF THE UK ECONOMY HAS RECENTLY BEEN OVERSHADOWED BY FULL MEDIA COVERAGE (REPORTED IN TELEGRAM NO 2071 OF 9 JULY) OF THE DISTURBANCES IN MAJOR CITIES AROUND THE UK. THESE DEVELOPMENTS HAVE BEEN LINKED WITH THE HIGH LEVEL OF UNEMPLOYMENT IN THE UK AND THE GOVERNMENT'S ECONOMIC POLICIES, ALTHOUGH OTHER FACTORS SUCH AS RACIAL TENSION AND INNER CITY DECAY HAVE ALSO BEEN CITED. WHILE PRESIDENT REAGAN IS UNLIKELY TO REGARD THIS AS A REASON FOR QUESTIONING OUR BASIC ECONOMIC POLICIES, HE MAY ENQUIRE HOW THEY MIGHT BE AFFECTED BY THESE DEVELOPMENTS.

HENDERSON

Fco | WH  
NAD

THIS TELEGRAM  
WAS NOT  
ADVANCED

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CONFIDENTIAL

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24

CONFIDENTIAL

SIR K COUZENS.

TREASURY.

GRS 640

CONFIDENTIAL

FM PARIS 160926Z JUL 81

TO IMMEDIATE FCO

TELEGRAM NUMBER 622 OF 16 JULY 1981

INFO PRIORITY WASHINGTON, BONN, OTTAWA.

INFO SAVING TO TOKYO, ROME, UKREP BRUSSELS.

OTTAWA SUMMIT

1. THE COMMUNIQUE ISSUED AT THE END OF THE FRENCH COUNCIL OF MINISTERS MEETING YESTERDAY STATED THAT DISCUSSION ON FOREIGN AFFAIRS HAD MAINLY CENTRED ON PREPARATION FOR THE OTTAWA SUMMIT. ACCORDING TO THE COMMUNIQUE, "THE FRENCH GOVERNMENT IS DETERMINED TO OBTAIN A FREE AND DIRECT DISCUSSION ON THE MAJOR PROBLEMS OF THE HOUR, NAMELY THE ECONOMIC AND SOCIAL SITUATION IN THE INDUSTRIALISED COUNTRIES AND RELATIONS BETWEEN THESE COUNTRIES AND LDCS, UNDERLINING THE UNACCEPTABLE NATURE OF UNEMPLOYMENT IN THE INDUSTRIALISED COUNTRIES AND OF THE MISERY AND GROWING IMPOSSIBILITY OF ACHIEVING DEVELOPMENT IN THE THIRD WORLD. THE FRENCH GOVERNMENT ON THIS OCCASION WILL UNDERLINE THE INAPPROPRIATENESS OF CERTAIN RESPONSES NOW BEING PROPOSED TO THE CRISIS SUCH AS THE GAME OF HIGH INTEREST RATES, THE SOARING RISE OF CERTAIN CURRENCIES AND THE SUDDEN FLUCTUATIONS IN THE PRICES OF RAW MATERIALS."

*but growth in  
LDC's higher  
than in  
developed —*

2. WHEN FINANCIAL COUNSELLOR SAW MOREL (ECONOMIC ADVISER AT THE ELYSEE DEALING WITH THE SUMMIT) YESTERDAY EVENING THE LATTER GAVE AN ACCOUNT OF FRENCH AIMS WHICH BROADLY FOLLOWED THE ASSESSMENT IN PARIS TELEGRAM NO 595 BUT HINTED AT A CHANGE OF TONE. MOREL SAID THAT FOLLOWING HIS DISCUSSIONS AT THE EUROPEAN COUNCIL, HIS BREAKFAST WITH MRS THATCHER AND THE FRANCO/GERMAN SUMMIT PRESIDENT MITTERRAND NOW HAD A CLEAR IDEA OF THE APPROACH TO ADOPT. HE WOULD GO TO OTTAWA NEITHER TO PREACH NOR TO BE PREACHED AT. HIS INTENTION WOULD BE TO EXPLAIN TO OTHER HEADS OF GOVERNMENT THE FUNDAMENTAL OBJECTIVES OF HIS ECONOMIC POLICIES WITHOUT EXPECTING THAT OTHERS WOULD NECESSARILY FIND THIS STRATEGY APPROPRIATE IN THEIR OWN COUNTRY. THE AIM OF THE SUMMIT SHOULD NOT BE TO TAKE DECISIONS BUT TO ENABLE THE WORLD LEADERS TO GET TO KNOW EACH OTHER AND TO DISCUSS FUNDAMENTAL LONG - TERM ECONOMIC PROBLEMS AGAINST A LARGER PERSPECTIVE THAN THE IMMEDIATE TECHNICAL ISSUES NORMALLY DISCUSSED. HENCE FRANCE HAD PLACED A RESERVE ON HAVING ANY COMMUNIQUE, SINCE PRESIDENT MITTERRAND WAS CONCERNED THAT DISCUSSION SHOULD NOT BE CONSTRAINED BY A PREFABRICATED DOCUMENT, THOUGH MOREL ADDED THAT A COMMUNIQUE WOULD OF COURSE BE NEEDED: THE SHORTER THE BETTER.

*4/6*

*13.*

CONFIDENTIAL

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Mr Wilkinson, Planning Staff

OTTAWA SUMMIT DRAFT COMMUNIQUE

1. I should be grateful for comments from all recipients of this minute on the attached Canadian draft of the communiqué which we received this morning. These should reach me by lunchtime today if possible so that we have a line to take ready for the Prime Minister's briefing meeting this afternoon.

D E Lyscom  
Economic Relations Department

16 July 1981 233 4916

- cc: PS/PUS
  - Lord Bridges
  - Mr Bayne
  - Sir K Couzens , H M T
  - Mr Bottrill, H M T
  - Miss Sinclair, H M T
  - Mr Abramson, DOT
  - Mr Manning, ODA
  - Mr Kinchen, ECD(E)
  - Ms Boyes, D of En
  - Mr Johnson, EESD
- Planning Staff

C O N F I D E N T I A L

FM EXTOTT SPS0380 15JUL81

TO WSHDC TOKYO FLASH

LDN ROME BONN PARIS BRLEC DELIVER BY 160900

INFO POECD GENEV BRATO PRMNY

REF OURTEL SPS0360 05JUL

---ECONOMIC SUMMIT:DRAFT COMMUNIQUE

PLEASE PASS FOLLOWING MSG TO PERS REPS IMMEDLY.QUOTE.

CONFIDENTIAL

OTTAWA, JULY 15, 1981

DEAR.....

I SHOWED TO MR TRUDEAU THE TEXT OF THE COMMUNIQUE ON WHICH WE LABOURED LAST WEEK AT MONTEBELLO.HE WAS GENUINELY PLEASED WITH THE RESULTS BUT ASKED IF IT COULD BE SUBSTANTIALLY SHORTENED.HE VERY MUCH HAS IN MIND THE DESIRE EXPRESSED BY ALL SUMMIT PARTICIPANTS THAT WE SHOULD AIM FOR A BRIEF,CLEAR EXPRESSION OF CONSENSUS.

I HAVE TRIED MY HAND AT A REVISED TEXT AND THIS IS ATTACHED.IT ATTEMPTS TO ELIMINATE UNNECESSARY VERBIAGE,REPETITIOUS LANGUAGE, RETROSPECTIVE ANALYSIS AND ILLUSTRATIONS OF POINTS.I HAVE HOWEVER TRIED TO KEEP ALL THE SUBSTANTIVE POINTS OF OUR MONTEBELLO TEXT AND TO CAST THEM IN THE FORM OF A DECLARATION.

THE NEW TEXT OBVIOUSLY REMOVES MANY OF THE NUANCES WHICH WE SO DELICATELY NEGOTIATED AND I AM SURE EACH OF US WILL MISS CERTAIN EXPRESSIONS WE THOUGHT IMPORTANT.YOU WILL ALSO NOTICE I HAVE DONE AWAY WITH SQUARE BRACKETS.THIS WAS NOT/NOT THE RESULT OF AN

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PAGE TWO SPS4788 CONF

ASSUMPTION ON MY PART THAT OUR DIFFERENCES HAVE DISAPPEARED BUT RATHER AN EFFORT TO GIVE YOU AN OPPORTUNITY TO SEE A CLEAR TEXT WITH COMPROMISE LANGUAGE.

I PUT FORWARD THIS TEXT AT THIS LATE STAGE WITH SOME TREPIDATION, APPRECIATING THE SENSITIVITIES INVOLVED, BUT HOPE IT WILL BE USEFUL WHEN WE MEET AT THE SUMMIT NEXT WEEK.

YOURS SINCERELY,

ALLAN E. GOTLIEB

DRAFT

JULY 15, 1981

DECLARATION OF THE OTTAWA SUMMIT (SHORT VERSION)

WE, THE LEADERS OF THE MAJOR INDUSTRIAL DEMOCRACIES, MEETING AT A TIME OF RAPID CHANGE AND INTENSE CHALLENGE TO WORLD ECONOMIC PROGRESS AND PEACE, BUT IMPRESSED BY THE STRENGTH OF OUR BONDS ON WHICH WE INTEND TO BUILD, MAKE THE FOLLOWING DECLARATION.

(1) WE REAFFIRM OUR COMMON OBJECTIVES AND JOINT DETERMINATION TO TACKLE OUR PROBLEMS IN A SPIRIT OF SHARED RESPONSIBILITY, BOTH AMONG OURSELVES AND WITH OUR PARTNERS THROUGHOUT THE WORLD, TAKING INTO ACCOUNT THE EFFECTS ON OTHERS OF POLICIES WE PURSUE.

THE ECONOMY

(2) THE PRIMARY CHALLENGE IS THE REVITALIZATION OF THE ECONOMIES OF THE INDUSTRIAL DEMOCRACIES.

(3) THERE IS A PROSPECT IN THE COMING YEAR FOR MODERATE GROWTH BUT

PAGE THREE SPS038D CONF

LITTLE EARLY RELIEF FROM UNEMPLOYMENT AND ONLY A MODEST EASING OF INFLATION.

(4)THE FIGHT TO BRING DOWN INFLATION AND REDUCE UNEMPLOYMENT MUST BE OUR HIGHEST PRIORITY AND THESE LINKED PROBLEMS MUST BE TACKLED AT THE SAME TIME.

(5)TO MEET THIS PRIORITY WE REQUIRE THE BALANCED USE OF A RANGE OF POLICY INSTRUMENTS WHICH WILL PROMOTE CHANGES IN OUR ECONOMIES AND EXPECTATIONS,AND ENCOURAGE SUPPORT FOR CHANGE BY OUR SOCIAL PARTNERS.

(6)WE NEED TO ACCEPT AND STRENGTHEN THE APPLICATION OF MARKET DISCIPLINES THROUGHOUT THE ECONOMY.

(7)WE SEE LOW AND STABLE MONETARY GROWTH AS ESSENTIAL TO REDUCING INFLATION.

(8)TO REDUCE PRESSURES ON INTEREST RATES AS MUCH RELIANCE AS POSSIBLE SHOULD BE PLACED ON RESTRAINT IN GOVERNMENT EXPENDITURE AND CONTAINMENT OF BUDGETARY DEFICITS;IT IS ALSO DESIRABLE TO MINIMIZE VOLATILITY OF INTEREST RATES AND EXCHANGE RATES.

(9)IN VIEW OF THE LARGE AND PERSISTING PAYMENTS IMBALANCES,IT IS IN THE INTERESTS OF ALL THAT THE FINANCIAL SOUNDNESS OF THE INTERNATIONAL BANKING SYSTEM SHOULD BE FULLY MAINTAINED;WE WELCOME THE EXPANDED ROLE OF THE IMF IN FINANCING DEFICITS AND ENCOURAGING NEEDED ADJUSTMENT.

RELATIONS WITH DEVELOPING COUNTRIES

(10)WE SUPPORT THE STABLILITY,GROWTH,INDEPENDENCE AND GERUINE

PAGE FOUR SPS0380 CONF

NON-ALIGNMENT OF DEVELOPING COUNTRIES AND REAFFIRM OUR COMMITMENT TO COOPERATE WITH THEM IN A SPIRIT OF MUTUAL INTEREST, RESPECT AND BENEFIT.

(11) WE LOOK TO DEVELOPING COUNTRIES TO PLAY A FULL PART IN THE INTERNATIONAL SYSTEM COMMENSURATE WITH THEIR CAPABILITIES AND RESPONSIBILITIES AND TO BECOME MORE FULLY INTEGRATED IN IT.

(12) WE LOOK FORWARD TO CONSTRUCTIVE AND SUBSTANTIVE DISCUSSIONS WITH THEM, AND BELIEVE THE CANGUN SUMMIT OFFERS AN EARLY OPPORTUNITY TO ADDRESS OUR COMMON PROBLEMS IN A NEW LIGHT.

(13) WE ARE WILLING TO PARTICIPATE IN EFFORTS TO REACH AN AGREED BASIS FOR THE LAUNCHING OF GLOBAL NEGOTIATIONS.

(14) WE REMAIN READY TO SUPPORT THE DEVELOPING COUNTRIES IN THE EFFORTS THEY MAKE TO PROMOTE THEIR OWN ECONOMIC AND SOCIAL DEVELOPMENT.

(15) WE ARE COMMITTED TO MAINTAINING SUBSTANTIAL AND, IN MANY CASES, GROWING LEVELS OF ODA, AND WILL SEEK TO INCREASE PUBLIC UNDERSTANDING OF THIS POLICY.

(16) WE WILL ALLOCATE THE MAJOR PORTION OF OUR AID TO POORER COUNTRIES.

(17) WE POINT OUT THAT THE STRENGTHENING OF OUR OWN ECONOMIES, INCREASING ACCESS TO OUR MARKETS, AND REMOVING IMPEDIMENTS TO CAPITAL FLOWS CONTRIBUTE LARGER AMOUNTS OF NEEDED RESOURCES AND TECHNOLOGY AND THEREBY COMPLEMENT OFFICIAL AID.

(18) THE SOVIET UNION AND ITS PARTNERS WHOSE CONTRIBUTIONS



PAGE FIVE SPS0380 CONF

ARE MEAGRE, SHOULD MAKE MORE DEVELOPMENT ASSISTANCE AVAILABLE, AND TAKE A GREATER SHARE OF EXPORTS OF DEVELOPING COUNTRIES, WHILE RESPECTING THEIR INDEPENDENCE AND NON-ALIGNMENT.

(19) WE WILL MAINTAIN A STRONG COMMITMENT TO THE INTERNATIONAL FINANCIAL INSTITUTIONS AND WORK TO ENSURE THAT THEY HAVE, AND USE EFFECTIVELY, THE FINANCIAL RESOURCES FOR THEIR IMPORTANT RESPONSIBILITIES.

(20) WE CALL ON THE SURPLUS OIL-EXPORTING COUNTRIES TO BROADEN THEIR VALUABLE EFFORTS TO FINANCE DEVELOPMENT IN NON-OIL DEVELOPING COUNTRIES, ESPECIALLY IN THE FIELD OF ENERGY; WE STAND READY TO COOPERATE WITH THEM FOR THIS PURPOSE AND TO EXPLORE WITH THEM, IN A SPIRIT OF PARTNERSHIP, POSSIBLE MECHANISMS, SUCH AS THOSE BEING EXAMINED IN THE WORLD BANK, WHICH WOULD TAKE DUE ACCOUNT OF THE IMPORTANCE OF THEIR FINANCIAL CONTRIBUTIONS.

(21) WE RECOGNIZE THE IMPORTANCE OF ACCELERATED FOOD PRODUCTION IN THE DEVELOPING WORLD AND OF GREATER WORLD FOOD SECURITY, AND THE NEED FOR DEVELOPING COUNTRIES TO PURSUE SOUND AGRICULTURAL AND FOOD POLICIES; WE WILL EXAMINE WAYS TO MAKE INCREASED RESOURCES AVAILABLE FOR THESE PURPOSES.

(22) WE RECOGNIZE THE NEED FOR MANY DEVELOPING COUNTRIES TO DEAL WITH PROBLEMS OF EXCESSIVE POPULATION GROWTH AND TO DEVELOP HUMAN RESOURCES; WE WILL PLACE GREATER EMPHASIS ON INTERNATIONAL EFFORTS IN THESE AREAS.

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TRADE

(23) WE REAFFIRM OUR STRONG COMMITMENT TO MAINTAINING LIBERAL TRADE POLICIES AND TO THE EFFECTIVE OPERATION OF AN OPEN MULTILATERAL TRADING SYSTEM AS EMBODIED IN THE GATT.

(24) WE WILL WORK TOGETHER TO STRENGTHEN THIS SYSTEM IN THE INTEREST OF ALL TRADING COUNTRIES AND TO SEEK POSITIVE STRUCTURAL ADJUSTMENT TO THE CHANGING WORLD ECONOMIC ENVIRONMENT.

(25) WE WILL IMPLEMENT THE AGREEMENTS REACHED IN THE MULTILATERAL TRADE NEGOTIATIONS AND INVITE OTHER COUNTRIES, PARTICULARLY DEVELOPING COUNTRIES, TO JOIN IN THESE MUTUALLY BENEFICIAL TRADING ARRANGEMENTS.

(26) WE WILL CONTINUE TO RESIST PROTECTIONIST PRESSURES, SINCE WE RECOGNIZE ANY PROTECTIONIST MEASURE NOT ONLY UNDERMINES THE VIABILITY AND DYNAMISM OF OUR ECONOMIES BUT ALSO AGGRAVATES INFLATION AND, OVER TIME, UNEMPLOYMENT.

(27) WE WELCOME THE PROPOSAL BY THE CONSULTATIVE GROUP OF EIGHTEEN THAT THE GATT CONTRACTING PARTIES SHOULD CONVENE A MEETING AT MINISTERIAL LEVEL DURING 1982.

(28) WE WILL WORK TOGETHER WITH THE OTHER OECD COUNTRIES IN THEIR PROGRAMME OF STUDY TO EXAMINE TRADE ISSUES.

(29) WE WILL KEEP UNDER REVIEW THE ROLE PLAYED BY OUR COUNTRIES IN THE SMOOTH FUNCTIONING OF THE MULTILATERAL TRADING

...?

PAGE SEVEN SPS0380 CONF

SYSTEM AND IN ENSURING MAXIMUM OPENNESS OF MARKETS.

(30) WE ENDORSE EFFORTS TO CONCLUDE BY THE END OF THIS YEAR AN AGREEMENT TO REDUCE THE SUBSIDY EFFECTS OF OFFICIAL EXPORT CREDIT SCHEMES.

ENERGY

(31) WE ARE CONFIDENT THAT, WITH PERSEVERANCE, THE ENERGY GOALS WE SET AT VENICE FOR THE DECADE CAN BE ACHIEVED, ENABLING US TO BREAK THE LINK BETWEEN ECONOMIC GROWTH AND OIL CONSUMPTION THROUGH STRUCTURAL CHANGE IN OUR ENERGY ECONOMIES.

(32) RECOGNIZING OUR COUNTRIES ARE STILL VULNERABLE AND ENERGY SUPPLY REMAINS A POTENTIAL CONSTRAINT TO ECONOMIC GROWTH, WE WILL ACCELERATE THE DEVELOPMENT AND USE OF ALL OUR ENERGY SOURCES, BOTH CONVENTIONAL AND NEW, AND CONTINUE TO PROMOTE ENERGY EFFICIENCY AND THE REPLACEMENT OF OIL BY OTHER FUELS.

(33) TO THESE ENDS WE WILL CONTINUE TO RELY HEAVILY ON MARKET MECHANISMS, SUPPLEMENTED AS NECESSARY, BY GOVERNMENT ACTION.

(34) WE APPRECIATE OUR CAPACITY TO DEAL WITH SHORT-TERM OIL MARKET PROBLEMS SHOULD BE IMPROVED, PARTICULARLY THROUGH THE HOLDING OF ADEQUATE LEVELS OF STOCKS.

(35) WE INTEND TO ENCOURAGE GREATER PUBLIC ACCEPTANCE OF NUCLEAR ENERGY, BEING CONVINCED THAT PUBLIC CONCERNS CAN AND WILL BE MET.

(36) WE WILL TAKE STEPS TO REALIZE THE POTENTIAL FOR THE ECONOMIC PRODUCTION, TRADE AND USE OF COAL AND WILL DO EVERYTHING IN OUR

PAGE EIGHT SPS0380 CONED

POWER TO ENSURE THAT ITS INCREASED USE DOES NOT/DAMAGE THE ENVIRONMENT.

EAST-WEST ECONOMIC RELATIONS

(37)WE RECOGNIZE THAT THERE IS A COMPLEX BALANCE OF POLITICAL AND ECONOMIC INTERESTS IN OUR EAST-WEST RELATIONS AND CONCLUDE THAT CONTINUING CONSULTATIONS AND, WHERE APPROPRIATE, COORDINATION ARE NECESSARY TO ENSURE THAT OUR ECONOMIC POLICIES CONTINUE TO BE COMPATIBLE WITH OUR POLITICAL AND SECURITY OBJECTIVES.

CONCLUSIONS

(38)OUR CONVICTION HAS BEEN HEIGHTENED THAT THE RESOURCES OF OUR DEMOCRATIC, FREE SOCIETIES ARE EQUAL TO THE IMPORTANT TASKS WE FACE AND THAT OUR COMMON PROBLEMS CAN BE RESOLVED ONLY THROUGH CLOSE CONSULTATION AND COOPERATION.

(39)IN ORDER TO ENSURE THE GREATEST POSSIBLE DEGREE OF CONCERTATION OF OUR APPROACHES, WE INTEND BETWEEN NOW AND OUR NEXT MEETING TO MAINTAIN CONTINUING CONTACT WITH EACH OTHER WITH A VIEW TO AGREEING HOW OUR CONSULTATION AND COOPERATION CAN BE EVEN CLOSER.

UNQUOTE.

CCC/071 152118Z SPS0380

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11  
O. POLAND

16/7/81.

Points to make

1. The Polish economic situation still looks very uncertain. Even if the Party Congress endorses the Recovery Plan, its chances of success look rather poor. Polish production and exports down sharply. Imports not yet cut back to match.
2. Western Governments have done their best. We all joined in a rescheduling agreement. Germany has provided a good deal of export credit. UK, a much smaller trading partner, has also done its share.
3. The banks have been less co-operative. German and British banks have tried hard to get a sensible rescheduling deal. But US opposition has meant postponing this till 1 January 1982.
4. Must acknowledge there is now a real danger of a default, triggered eg by a maverick US bank pressing for payment, or of a deliberate Polish moratorium. UK has tried to assess extent of possible damage. We don't think it is very great. UK banks should be all right. We assume Bundesbank can look after any German bank which gets into trouble.
5. Polish request for \$500 million short-term assistance remains on table. (Addressed to France, UK, FRG, Italy and Switzerland only). We think this will just be used to pay off short-term liabilities. No chance of getting it back. Haven't yet decided UK response. Any indication of German attitude?
6. M Delors proposed at OECD Ministerial in June to turn this into a BIS Syndicated loan, spread over 15 countries. Understand USA has already rejected this. Believe Central Bank Governors discussed it at Basle 13 July. General reluctance to do it without adequate security. Since no Polish gold, Central Banks would look to Governments for guarantees. Not very attractive to me, but no final decision. Obviously political factors. What do you think?

Background

7. There is no real sign yet of a default or moratorium, but a few rumours and intelligence reports.
8. Most assessments of Polish economy point to continued rundown. But US Treasury officials told us this week that they think it will bottom out, at a low level, later this year, provided harvest is good

and political climate remains calm. They believe rescheduling plus rollover of bank debt will be enough to avoid a default.

9. There is no general indication of Western willingness to help further. The US have said flatly "no more help". The Swiss, and perhaps Italians, Dutch and Norwegians, seem prepared to help at least if others do. We have had conflicting reports out of Bonn. We believe a Cabinet Committee met there last week to decide their line. The French tried to pass the buck to Central Bankers, who passed it smartly back.

10. The UK position still undecided. The Foreign Secretary's tactics are to play it long, at least until Party Conference is over. Your stated terms for a further loan are that Foreign Secretary should guarantee Bank of England, and accept the charge to his PES programme if guarantee is called. So far, this has been a conversation-stopper; the Foreign Secretary has neither accepted nor rejected.

11. But we can't stall indefinitely. A clear indication from Matthöfer of FRG attitude would help get a decision here too.

AEF Group

16.7.81

## EC STAFF PAY

A note is below on matters awaiting decision. The Chancellor may like to say to Herr Matthofer that he thinks that it would be a good thing for ECOFIN to take over the subject from the beginning of next year, and that UKREP are taking this up with their German colleagues in Brussels.

Matters expected to arise during the UK Presidencya. The Commission's detailed proposal on a new Pay Method

A decision on this will be required in time for the next annual pay review (see b. below). The Council's Declaration of 23 June 1981 has set a frame-work, under which smaller basic salary adjustments will be granted over the next 5 years. These will lead to a 10% reduction for the most senior staff. European Parliamentary opinion will be required on the necessary amendment to the staff regulations.

b. Annual Pay Review

The next annual pay review, with an effective date of 1 July 1981, is due to take place before the end of the year.

c) Council Forum for Decision Making

The Chancellor of the Exchequer wrote to the Lord Privy Seal on 18 May supporting the German suggestion that the Economic and Financial Council should take over staff pay and conditions from the Foreign Affairs Council. In preparation for a possible Council decision, UK officials will be suggesting that it should take effect from 1 January 1982, namely after decisions are due on a. and b. above.

d. Interim Salary Adjustments

The Council has deferred until September a decision on whether to take special steps for EC staff serving in countries with very high inflation rates (eg. Israel).



16/7/91

## DRAFT NON-LIFE INSURANCE SERVICES DIRECTIVE

Points to make

1. Freedom of services is a fundamental Treaty right. Services should be as freely traded as goods. After 25 years, that is still not so. That ought to worry the Community as a whole.
2. For 5 years member states including Germany have said that they want the insurance services directive but have placed every conceivable bureaucratic obstacle in its path. Ministers in the Council say they want progress, but officials seem instructed to the contrary and are reviving previously discussed and rejected proposals; this can only waste time.
3. The UK insurance market has been open to foreign competition for years. We have had no significant problems of control.
4. There is no need or justification for extra supervision for services. Under the Establishment Directives, authorisation and supervision by one member state should count for all. If there are problems, there is a well-established EC supervisors' network to sort them out.
5. Industrial, commercial and professional policyholders do not need the close control of insurers given to private consumers. UNICE say they do not want it.



Defensive point

1. Thresholds. The notion of thresholds does not sit easily with removal of barriers to free trade in services. Thresholds were dropped after years of discussion because they proved impossible to agree on. They were replaced by the distinction between mass and business risks. We believe the June Council approved that in principle, though others are now denying it.

Background

The non-life insurance services directive was proposed in 1975 and has made slow progress because Germany and others are unwilling to open their markets to competition. The Germans say they wish to protect the consumer, but their own employers' federation (BDI) support liberalisation.

The Finance Council discussed the Directive in March and June. Council appeared to accept that the proposed split between industrial, commercial and professional risks and mass risks provided the way forward, though others are now denying it. Italy and Denmark agreed with you on the need for Council decisions in September, but again there is no reflection of that at official level. The Germans only accepted that discussion should continue. UK insurers estimate that they will earn an extra £55m in the first year of liberalisation, rising thereafter. After 5 years of discussion and 25 years after the Treaty making freedom of services a right, it is time to reach decisions liberalising insurance services business. This is a major objective of our Presidency.

13

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16/7/81

TAWA SUMMIT: SUPPLEMENTARY BRIEFING  
OPENING UP THE JAPANESE MARKET

The Chancellor will recall that during his talks with Mr Komoto in June he referred to the fact that the Japanese market was very hard to penetrate and urged a positive approach in Japan to the encouragement of imports.

2. The brief on trade for the Ottawa Summit (PMVL(81)4) notes that during his visit to Europe in June the Japanese Trade Minister said his Government would make a statement in Japan on increasing imports from the EC and would seek the co-operation of the private sector in bringing this about. No such statement has yet been made.

3. The following is some additional background on the issue.

Japan's imports of manufactures

4. Recent figures produced by the European Commission indicating that in 1980 Japan's per capita imports of manufactures were only 41 per cent as large as those of the EC and 44 per cent of the US figure. Manufactured imports as a proportion of total imports were less than half as big in Japan as in the EC or the US. The detailed figures are:

	Imports of Manufactured goods in 1980 (\$ billion)	Imports of manufactures per capita (\$)	Imports of manufactures as a % of total imports
Japan	30	260	21.6
EC	164	627	43.8
US	130	588	51.8

5. The Japanese often assert that they cannot afford to step up their imports of manufactures because of their dependence on external sources of oil, raw materials and foodstuffs. This argument has some validity. But in 1980 per capita imports of these commodities by Japan were only marginally higher than by the EC (\$925 as against \$892).

5. The essential problem is that Japanese exports, though troublesome because of their geographical and product concentration, are relatively low as a percentage of GNP (around 10 per cent). So large-scale imports of both raw materials and manufactures would tend to lead to a structural trade deficit.

7. The long-term solution lies in a general increase in the openness of Japan's economy. Greater Japanese exports of investment and technology (eg through collaborative projects) would improve the efficiency of other economies and increase their ability to absorb Japanese exports. Japan would then be better able to step up its imports of manufacturers.

#### Specific trade barriers

8. Japanese tariffs are relatively low in general (3 per cent after implementation of the Tokyo round cuts, as compared with 4 per cent in the US and 5 per cent in the EC). But they remain high in some areas where the UK has a competitive advantage (eg scotch whisky). And imports are also deterred by restrictive testing procedures on chemicals, pharmaceuticals and cosmetics.

#### Non-tariff barriers

9. Exports to Japan encounter not only strong domestic competition but also an at times impenetrable combination of administrative regulations and impediments.

#### Japan should be urged to

- a) encourage the private sector to buy abroad
- b) place more public sector contracts overseas
- c) remove specific barriers to imports
- d) take a close look at ways in which its administrative practices cause difficulties which do not exist, or are minimal, elsewhere.

OTTAWA SUMMIT: SUPPLEMENTARY BRIEFING

INFLATION

1. Since the Venice Summit in 1980 the average inflation rate in the 7 main countries has fallen by around 2 1/4 percentage points to 9.7 per cent. As table 1 shows, there have been above average falls in the UK, the US and Japan (the gap between UK inflation and the average rate has narrowed from over 5 per cent to 2 per cent). In Germany, the inflation rate is now the same as last summer, though a bit lower than at the beginning of 1981; in France and Italy the fall has been modest; while in Canada the rate has accelerated.

Table 1: Year-on-year inflation rates (consumer prices)

	July 1980	May 1981
US	13.0	9.8
Japan	7.5	5.4
Germany	5.5	5.5
France	13.6	12.7
Italy	21.6	20.4
Canada	10.1	12.3
UK	17.0	11.7
Average of 7	11.9	9.7

INTEREST RATES

2. Table 2 shows the movement of 3 month interest rates in the major 7 since July 1980.

3. Short term rates in the US have eased only a little (and perhaps temporarily) in recent weeks despite indications of decelerating monetary growth and inflation. The Fed is acting cautiously, probably chastened by the experience of Spring 1980 when interest rates dropped precipitously. It has said that it will respond more quickly to upward surges in the monetary aggregates than to sluggish growth.

4. In Germany and France, short rates have declined a little from their respective peaks of March and June. But in Italy,

they continue to edge up. And in Japan the steady fall between the autumn of 1980 and April this year has subsequently been halted.

Table 2: 3-month money market interest rates

	July 1980	Sept 1980	Dec 1980	March 1981	July 1981
US	8.61	11.30	18.60	14.50	16.75
Japan	11.24	11.27	9.92	7.90	7.30
Germany	9.64	8.92	10.06	13.79	12.95
France	12.16	11.78	11.58	12.73	17.38
Italy	17.75	17.56	17.75	18.63	21.00
Canada	10.90	10.91	16.27	16.93	19.25
AVERAGE					
OF 6	10.45	11.41	14.65	13.50	14.80
UK	15.91	16.14	14.71	12.65	13.34

#### MONETARY DEVELOPMENTS

5. The US was the only major country (apart from the UK) where money supply growth exceeded its target range in 1980. In Germany, the lower end of the target range was undershot.

6. This year, monetary targets, or objectives, have been tightened in all the Summit countries, typically by  $\frac{1}{2}$ -1 per cent. Details are in table 3. There are reports that the Fed has now decided to aim for the lower end of the target range for MIB (which is the most widely watched aggregate). The Bundesbank is aiming, as last year, for the mid point of the CBM target range.

Table 3: Monetary aggregates, recent trends and targets

Country	Aggregate	1980 target	1980 Outturn	1981 target	Annualised growth over target base
US	MIA	3 $\frac{1}{2}$ -6	5.1	3-5 $\frac{1}{2}$	-10.1 to June
	MIB	4-6 $\frac{1}{2}$	7.1	3 $\frac{1}{2}$ -6	6.1 to June
	M2	6-9	9.7	6-9	9.4 to May
	M3	6 $\frac{1}{2}$ -9 $\frac{1}{2}$	9.7	6 $\frac{1}{2}$ -9 $\frac{1}{2}$	10.1 to May
Japan	M2 + CD's	10	7.5	7	8.2 to April
Germany	CBM	5-8	4.9	4-7	5.1 to May

Country	Aggregate	1980 target	1980 Outturn	1981 target	Annualised growth over target base*
France	M2	11	9.7	10	10.8 to March
Italy	M2	16½	12.1	11-12	11 to March
Canada	M1	5-9	5	4-8	6.6 to May

Notes:

- a) Not all countries set their targets for a calendar year. In particular, the US and German targets are on a Q4 to Q4 basis.
- b) In Japan and Italy there are no monetary targets as such. For Japan, the official projection of M2 + CD's has been quoted as a proxy. For Italy the "target" is the growth of M2 consistent with the ceiling for total domestic credit expansion.

EXCHANGE RATES

7. Table 4 shows the movement of Summit countries' currencies against the dollar and in effective terms since July 1980.

Table 4: Exchange rate changes, July 1980 to mid-July 1981

	Change in rate against the dollar	Change in effective rate
US	-	+21.6
Yen	+3.3	+11.9
DMark	-39.7	-11.6
F Franc	-43.8	-14.6
Lira	-46.3	-15.2
Can dollar	+ 4.5	+ 4.1
Sterling	-20.2	- 2.7

8. The future course of international exchange rates is notoriously hard to assess. The following summarises the broad messages from the Treasury's recent World Economic Prospects exercise.

- a) The dollar. Firm US monetary policies are likely to keep the dollar higher in the short term than underlying conditions (continuing inflation and a likely move into current account deficit) would suggest. However there may be a gradual fall in the dollar, especially against the DMark and the yen.
  
- b) The yen has weakened only a little recently against the dollar, despite a very wide adverse interest rate differential. The Japanese current balance is moving rapidly towards surplus and inflation continues to moderate. The authorities have said that a rate of about Y200 against the dollar would be appropriate and acceptable. The rate is currently ¥231 and may appreciate steadily in the course of next year.
  
- c) The DMark. Germany's improved competitive position and the recent strengthening of its current account point to a stronger D Mark. These factors could be partly offset by domestic political difficulties (eg over the budget) and the Polish situation. But on balance some appreciation against the dollar, and in effective terms seems likely.
  
- d) The franc. The new Government has so far managed to defend the central rate of the franc within the EMS, though its policies have called the longer term viability of that rate into question. M Delors has himself indicated that France may not be able to hold its central rate within the system for the rest of the year. We would agree.
  
- e) The lira. Italy will no doubt continue to exploit the full potential of the wider band for the lira within the EMS. But inflation is accelerating, the current account shows little sign of improving and a devaluation over the next year or so appears more likely than not.

FISCAL POLICY

9. In 1980 there was an increase in the average budget deficit (general government) as a proportion of GNP in the Summit countries. However this increase - around 1/2 per cent of GNP - was largely

accounted for the US (+1.7 per cent) and Germany (+0.6 per cent). Budget deficits fell in Japan and France (mainly because of higher taxes or social security contributions) and Italy (mainly because of fiscal drag).

10. In 1981 both the OECD and the IMF expect a move to greater fiscal stringency in the Summit countries as a whole. This is on the basis that "discretionary" tightening is forecast, on average, slightly to offset the impact of the built in stabilizers.

11. But the picture is likely to vary a lot from country to country. As table 5 indicates, the move to fiscal stringency will probably be most pronounced in the UK, Japan and Canada: in the last two countries discretionary tightening is taking the form largely of higher tax receipts; but in the UK, lower public expenditure is more important.

12. In the US, the forecast fall in the Budget deficit as a proportion of GNP in 1981 is slightly below the average for the Major 7. But in Germany, France and Italy, budget deficits are expected to rise.

Table 5 : Changes in general government financial balances as a percentage of GNP (OECD forecasts)

		Change in actual balance	Change due to automatic stabilizers	Change due to discretionary measures
US	1980	-1.7	-1.5	-0.2
	1981	+0.4	-0.5	+0.9
Japan	1980	+0.8	-0.4	+1.2
	1981	+0.9	-0.5	+1.4
Germany	1980	-0.6	-0.3	-0.3
	1981	-0.1	-1.9	+0.9
France	1980	+1.0	-0.8	+1.8
	1981	-1.2	-2.0	+0.8
Italy	1980	+1.6	0	+1.6
	1981	-0.6	-1.0	+0.4
Canada	1980	-0.5	-0.9	+0.4
	1981	+0.9	-0.8	+1.7
UK	1980	-0.3	-1.5	+1.2
	1981	+1.2	-1.6	+2.8
Average of 7	1980	-0.5	-1.0	+0.5
	1981	+0.1	-1.0	+1.1



NOTES:

a) A positive sign indicates a move towards restriction (ie a lower deficit); a negative sign indicates expansion.

b) "Discretionary" changes include the effects of fiscal drag. The built-in stabilizers are therefore estimated as the impact on the budget of variations in real economic activity and not of variations in the rate of inflation.

OUTPUT

13. Table 6 shows the OECD's latest forecasts

Table 6: growth of real GNP

	1980	1981	1982
US	-0.2	2½	1
Canada	0.1	2½	2½
Japan	4.2	3½	4
Germany	1.8	-1½	2
France	1.3	-½	1¾
Italy	4.0	-¾	1¾
UK	-1.8	-1½	½
Average of 7	1.2	1¼	1¾

19  
PRINCIPAL PRIVATE SECRETARY - 2nd

17/7/82  
47  
cc PS/Chief Secretary  
PS/Financial Secretary  
Sir Douglas Wass  
Sir Kenneth Couzens  
Mr Burns  
Mr Hancock  
Mr H P Evans  
Mr Kemp  
Mr Bottrill  
Mr Buckley  
Mr Peretz  
Mr Turnbull  
Miss Peirson  
Mr R G Ward

OTTAWA SUMMIT: NOTE ON UK ECONOMIC POLICIES AND PERFORMANCE

The Chancellor has asked for some speaking notes on UK economic policies and performance for use at Ottawa. I attach at A a note which is designed to pick up the points made in the recent Washington telegram No 2125 (a copy of which is also attached at B). The note covers the general economic situation and prospects (domestic and external) as well as the various criticisms of UK policies that have been raised by US commentators. The Chancellor will note, however, the statement in the telegram that: "... overall the recent US press treatment of the UK economy appears no more critical than the UK press, where much of the material published here originates".

2. I also attach (at C) four recent articles in the New York Times, Washington Post and International Herald Tribune which given a fair indication of the current line on UK policies in the US media. Leonard Silk's piece - "Thatcherism: a specter haunts Reagan's Washington" - is particularly critical of UK economic policies. The IHT piece argues (about the riots) that in Britain "there is no general perception that the Government sympathises with the problems of the poor and the unemployed". The NYT asks whether Mr Thatcher has become "a velvet fist inside an iron glove".

3. The Chancellor will recall that he has written two articles for the US press this year - in the New York Times of 25 January,

and in the July edition of the American Banker. He might wish to refer to these in the course of discussion, or in his CBS broadcast, and I attach copies at D and E respectively. The articles provide a useful summary of the economic situation inherited by the Government, and the rationale for present policies.

12A

R I G ALLEN  
EB  
17 July 1981

OTTAWA: NOTE ON THE UK ECONOMY

(1) General situation of the domestic economy

Output declined by 3% in 1980. But impact of recession uneven: manufacturing output down by 9%. Final demand held up well in 1980 but for stocks, down by nearly £2 billion at 1975 prices. Since turn of year industrial/manufacturing output appears to have stabilised. GDP (output) fell by 1/2% in 1981 Q1 compared with average quarterly fall of 1 1/2% in 1980. Business surveys show marked improvement in trend of business confidence and other indicators since 1980 H2. Evidence of higher productivity, both anecdotal and in aggregate data - eg Bank's estimate of 2 1/2% increase in manufacturing output per man hour in year to 1981 Q1.

2. Demand for labour has fallen sharply. Mid-1979 to 1981 Q1 employment down 1.4 million. Activity rates down. Unemployment (excluding school leavers, seasonally adjusted) has risen from 1.2 million (5.3%) in mid-1979 to some 2 1/2 million (10.6%) in June. However, rate of increase slackened considerably in 1981 (1981 Q2 only half that during 1980 Q4); average hours worked by manufacturing operatives stabilising. [New unemployment figures to be published 21 July.]

3. Inflation as measured by 12-monthly change in RPI virtually halved from almost 22% in 1980 to 11.3% in June 1981. Reflects competitive pressures of the recession and sterling's appreciation on industry. After remaining virtually flat over much of the latter half of 1980, wholesale input prices have risen rapidly in recent months reflecting upward pressure on sterling crude oil prices as dollar appreciated.

4. Average earnings rose by 13.2% in year to May 1981, compared with corresponding increases in excess of 20% last autumn. And 12-monthly increase in this index continues to reflect influence of high settlements in the last pay round (only 2/3 of employees covered by the index had settled by May in the current round). CBI

pay data bank shows settlements in manufacturing continuing to average 8-9%, with about  $\frac{2}{3}$  of settlements in single figures.

5. Government forecasts published with March Budget show slight upturn in activity in 1981-82 and 1982-83, but recovery is unlikely to be rapid. Principal factors underlying the forecast upturn are a falling rate of personal savings (reflecting falling real incomes, and moderating inflationary expectations) which facilitates increased consumption in 1982 H1, and a sharp slowdown in destocking during 1981 with a return to positive stockbuilding next year (reflecting both an upswing in the normal stock "cycle" and the further easing of financial pressures on industry). Against this, exports are expected to fall in the face of a sluggish recovery in the world economy [latest OECD economic outlook suggests further delay in world recovery as compared with expectations at turn of year] and past losses in competitiveness, and imports recover from the sharp reductions of 1980.

[IF PRESSED on deterioration in inflation outlook: FSBR forecast is for 12-monthly increase in RPI of 10% by 1981 Q4, falling to 8% by 1982 Q2. Fall in exchange rate, and higher import prices, have made this more difficult, but not impossible, to achieve. Forecasters severely underestimated deceleration of inflation last year: Budget forecast was 16 $\frac{1}{2}$ % for 1980 Q4, outturn was 15 $\frac{1}{4}$ %.]

(ii) External factors: exchange rate, competitiveness and balance of payments

6. Government's policy is to leave exchange rate to be determined primarily by market forces. Between May 1979 and January 1981, sterling appreciated by 17% against the dollar and by 23% against the deutschmark, continuing the steady appreciation of sterling since 1976. Sterling's strength reflects variety of international factors including the UK's position as oil producer in a period of uncertainty in world oil markets; confidence in the Government's determination to combat inflation; and the UK's current account surpluses.

7. Since January the world oil market has slackened and relative interest rates have tended to dominate currency movements. Most currencies have fallen against the dollar with sterling moving less than others at first and making a rapid adjustment in June. In April-May period sterling fell 6% against the dollar and rose 3% against the deutschemark and continental currencies. In early June, with the easing of pressures in EMS, market attention turned to sterling and there was a reassessment of the pound's position against both the dollar and deutschemark. [More recently, market sentiment appears to have been affected by the riots, though this may be a transitional phenomenon; the increase in short term interest rates last week was widely interpreted as a change in exchange rate policy, but the effect on markets now appears to have blown over.]

8. UK exporters have suffered sharp loss of cost competitiveness since 1978 (about 60% on IMF measure). With UK rate inflation down to around the average of our competitors and the fall in the effective exchange rate, cost competitiveness has probably improved slightly in recent months. Arithmetically, more than half of the loss of competitiveness since 1978 is result of UK labour costs rising faster than those of other countries.

9. No trade figures have been available since February as result of civil service strike. Large visible surpluses totalling £1.1 billion were recorded in January and February and, with estimated £1 billion surplus on invisibles during 1981 Q1, it is clear that current account surplus was well over £2 billion in 1981 Q1. Capital account figures show record outflow of £2½ billion in 1981 Q1 which is necessary counterpart to the UK's current account surplus. This large capital outflow appears to have resulted mainly from a continued high level of portfolio investment overseas and from sterling lending overseas by UK banks.

(iii) Monetary /fiscal policy

10. The Government's objectives for the medium-term are to bring down the rate of inflation and to create conditions for a sustainable

growth of output and employment. It is committed to a progressive reduction in the growth of the money stock and to pursuing fiscal policies necessary to achieve this without undue reliance on interest rates. These objectives are embodied in the Government's MTFS, first announced in March 1980.

11. 1980-81 proved to be a very exceptional year for the performance of the monetary aggregates and for a number of reasons the growth of £M3 was very much greater than envisaged in the Government's target range. However, the narrower measures of the money stock actually fell in real terms over the year as a whole, and other indicators also suggested that financial conditions in 1980-81 were tight: for example, the high exchange rate; high interest rates; pressures on corporate liquidity; and the absence of any marked upward movement in prices of houses or other real assets. PSBR in 1980-81 some £5 billion more than forecast at time of 1980 Budget, but effects of recession on expenditure and revenues responsible for about half of the overrun.

(iv) Money supply/PSBR remains out of control?

12. Assessment of the current monetary and fiscal position is complicated by the effects of the CS dispute. Borrowing by central Government in April-June totalled £7½ billion. It is estimated that some £3¼-3¾ billion of receipts of tax and NI contributions were delayed by the dispute. Allowing for this, borrowing appears to be in line with the 1981-82 FSBR forecast. [Recent outside forecasts of the PSBR for 1981-82 mostly fall within a fairly narrow band of £9½-11½ billion, compared with the FSBR forecast of £10½ billion.]

13. Monetary aggregates have also been distorted by the effects of the CS dispute. After allowing for distortions caused by the dispute, the increase in £M3 over the last 3 and 6 months is still probably within the target range of 6-10% a year.

(v) Government has failed in its aim to reduce expenditure and cut taxes?

14. Public expenditure is higher than we would have wished with inevitable consequences for taxation. This is partly an effect of the recession. Even so, public expenditure in 1981-82 will be nearly 5% below volume planned by previous Government. Two thirds of reduction in spending planned in 1980 White Paper has been preserved in spite of strong upward pressure exerted by the recession. Normal public spending review now in progress. Recent press reports (eg David Blake, Times, 11 July) that higher than expected inflation/continued slump causing disarray in this review are entirely misconceived.

15. Government's objective is to reduce taxes. But this has not been possible within overall financial constraints. Nevertheless, high marginal rates of income tax have been reduced, and a variety of measures (not all fiscal) introduced to assist new and small businesses, as part of Government's aim to improve supply side of the economy. Last Budget specifically designed to shield, and ease net tax burden on, hard pressed industry.

(vi) Adverse effects of present policies on output and employment?

16. Depth of current recession largely reflects cumulative effects of low industrial productivity and loss of competitiveness over many years. Latter largely reflects excessive wage increases. Though pay settlements moderated substantially in 1980-81, still no lower than average of competitor countries, and further progress essential if loss of competitiveness to be reversed. [IF PRESSED: If pay settlements do not fall in line with monetary targets so as to reflect "national cash limit", this will result in further losses in output and higher unemployment.]



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(vii) Recent riots reflect high unemployment/severe economic policies?

17. Certainly unemployment has been a contributing factor, but probably not the only or even the main factor. Some of the worst riots occurred where unemployment was far from being as high as in other areas. Our basic economic strategy will not be affected by these developments. But of course we will continue to do all we can to assist those groups most affected by the recession, including young people. Already spending over £1 billion this year on YOP and other special employment measures. Considering what further measures shall be taken [Despite media leaks, Chancellor will presumably not want to divulge details of new decisions in advance of formal announcement.]

B-55

CONFIDENTIAL

Not only for my  
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TEL NO 2125 OF 13 JULY 1981

U S VIEWS ON THE BRITISH ECONOMY.

1. BEFORE THE OTTAWA SUMMIT YOU MAY LIKE A BRIEF SUMMARY OF U S VIEWS ON BRITISH ECONOMIC DEVELOPMENTS AND POLICIES.

*as opportunity*

2. THERE IS A GROWING AMOUNT OF GLOOM HERE ABOUT THE STATE OF THE UK ECONOMY AND ABOUT THE PROSPECTS FOR ANY EARLY RECOVERY. THE ADMINISTRATION REMAINS BASICALLY SYMPATHETIC TO THE GENERAL OBJECTIVES OF OUR DOMESTIC ECONOMIC POLICY. ESPECIALLY OUR DETERMINATION TO GET OUR RATE OF INFLATION DOWN, TO REDUCE THE DISINCENTIVE EFFECTS OF HIGH TAXATION, AND TO REDUCE THE ROLE OF GOVERNMENT AND THE PUBLIC SECTOR. WHERE SOME OF THEM (SUCH AS SPRINKEL AND ROBERTS AT THE TREASURY) HAVE DOUBTS IS MORE ABOUT PERFORMANCE, PARTICULARLY WHETHER ENOUGH HAS BEEN DONE TO CUT SPENDING AND TAXES, AND TO KEEP THE MONEY SUPPLY UNDER CONTROL.

*points  
in Ottawa  
- aimed  
at U.S.  
media*

3. PRESIDENT REAGAN HIMSELF IS LIKELY TO TAKE THE VIEW THAT IT IS UP TO EACH INDUSTRIALISED COUNTRY TO GET ITS OWN ECONOMY RIGHT, FIRST AND FOREMOST BY REDUCING INFLATION.

4. GIVEN THE BASIC SIMILARITIES BETWEEN U S AND UK ECONOMIC OBJECTIVES, COMMENTATORS HERE FREQUENTLY SEEK TO READ ACROSS FROM UK EXPERIENCE TO THE PROSPECTS FOR SUCCESS OF REAGAN'S PROGRAMME (DESPITE THE STRUCTURAL DIFFERENCES BETWEEN THE TWO COUNTRIES). FOR THIS REASON, THE UK ECONOMY CONTINUES TO GET A GOOD DEAL OF PRESS COVERAGE. SOME, SUCH AS LEONARD SILK OF THE NEW YORK TIMES, REGARD THE QUOTE BRITISH EXPERIMENT UNQUOTE AS HAVING FAILED THROUGH DEFICIENCIES OF IMPLEMENTATION, AND POINT TO THE ADVERSE EFFECT ON OUTPUT AND EMPLOYMENT. OTHERS, PROBABLY THE MAJORITY, ARE WILLING TO GIVE US CREDIT FOR REDUCING INFLATION AND WAGE SETTLEMENTS FROM THEIR PEAK LEVEL, FOR SEEKING TO GET BETTER CONTROL OVER THE MONEY SUPPLY, AND FOR IMPROVEMENTS IN PRODUCTIVITY. EVEN THIS GROUP, HOWEVER, POINT TO THE COST OF WHAT HAS BEEN ACHIEVED. HOBART ROWEN OF THE WASHINGTON POST HAS DRAWN ATTENTION TO A RECENT STAFF STUDY FOR THE JOINT ECONOMIC COMMITTEE OF CONGRESS, WHICH RAISES THE QUESTION WHETHER THE BENEFITS OF REDUCED INFLATION AND WAGE SETTLEMENT OUTWEIGH THE COST IN TERMS OF LOST OUTPUT AND UNEMPLOYMENT. BUT OVERALL THE RECENT U S PRESS TREATMENT OF THE UK ECONOMY APPEARS NO MORE CRITICAL THAN THE UK PRESS, WHERE MUCH OF THE MATERIAL PUBLISHED HERE ORIGINATES.

CONFIDENTIAL

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**CONFIDENTIAL**

5. THE AMERICAN VIEW OF THE UK ECONOMY HAS RECENTLY BEEN  
OVERSHADOWED BY FULL MEDIA COVERAGE (REPORTED IN TELEGRAM  
NO 2071 OF 9 JULY) OF THE DISTURBANCES IN MAJOR CITIES AROUND  
THE UK. THESE DEVELOPMENTS HAVE BEEN LINKED WITH THE HIGH LEVEL OF  
UNEMPLOYMENT IN THE UK AND THE GOVERNMENT'S ECONOMIC POLICIES,  
ALTHOUGH OTHER FACTORS SUCH AS RACIAL TENSION AND INNER CITY DECAY  
HAVE ALSO BEEN CITED. WHILE PRESIDENT REAGAN IS UNLIKELY TO REGARD  
THIS AS A REASON FOR QUESTIONING OUR BASIC ECONOMIC POLICIES,  
HE MAY ENQUIRE HOW THEY MIGHT BE AFFECTED BY THESE DEVELOPMENTS.

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**THIS TELEGRAM  
WAS NOT  
ADVANCED**

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**CONFIDENTIAL**

## The Riot Experts

What a lot of experts in riot control have suddenly flowered on both sides of the Atlantic! The newest is New York's Governor Carey, who predicts social upheaval in the United States by October because of the Reagan administration's budget cuts. "Telescoped Thatcherism," he calls it, referring to the two years of austerity practiced by Prime Minister Margaret Thatcher of Britain. The governor's words are not merely provocative; they are arrogant. How does he know what causes riots?

No one really knows. For all the conscientious studies and commissions about urban violence, there is plenty of theory but little knowledge from which to generalize. Wise politicians in the United States and in Britain should be slow to pontificate and quick to seek facts. But what is being offered instead? Ideology.

To choose a theory of urban riots is to choose a policy. The rioting in Britain has now spread to 17 cities, even to Dundee, Scotland, where there are virtually no immigrant non-whites. Why? Liberals, almost reflexively, say: loss of jobs, loss of social welfare. Conservatives, just as reflexively, say: loss of parental authority, loss of respect for law. How can any of them be so sure?

Scholars are surely right that the British and American situations share an underlying problem of deprivation. But if stinginess on social spending is the cause of Britain's wrenching unrest in 1981, then what is the explanation for America's urban riots of 1967 and 1968? Remember that they coincided with the unparalleled outpouring of social spending called the Great Society. A com-

mon liberal explanation was rising expectations: The hopes of the poor do not ignite at darkest night but with the promise of dawn. Then why, in the supposed midnight of Thatcherism, does Britain ignite now?

There is much for conservative riot-control ideologists, too, to be modest about. In the 1960s, conservative Americans thought that urban riots arose because the liberal Kennedy and Johnson administrations had created an atmosphere of social giveaway and runaway permissiveness. Unleash the police, they said; shoot looters, pass tough new laws, send in the Army.

Conservatives in Britain say much the same thing. They even urge such absurdities as making parents pay for the damage. We are eager to learn how the proponents would punish poor parents unable to control either their children or their poverty. In any case, whose permissiveness is it they are protesting? Mrs. Thatcher's?

What is known about urban riots is that they are complex; it is sensible to address the concerns of both sides. The overwhelming imperative is to halt disorder with sensitivity and with force. Yes, communicate an awareness of grievances of poor communities; yes, use enough well-trained force to master the situation before contagion sets in.

The impression on the American side of the ocean is that Mrs. Thatcher has so far done the reverse. She has been talking tough but appears to be acting indecisively. Once they shake off their dismay over Hugh Carey, Americans may wonder: Has Mrs. Thatcher become a velvet fist inside an iron glove?

THE NEW YORK TIMES.

## British Cause and Effect

The House of Commons begins formal debate today on the worst civil disorder in Britain since the end of World War II. If its members are unable to meet the need for a far-reaching and imaginative solution based on analysis, compassion and a willingness to renounce partisan gain, the result could be a national disaster.

Prime Minister Margaret Thatcher can set the right tone by directing her attention away from the hardware of modern riot control — CS gas, water cannon and rubber bullets. In response, the frustrated opposition can abstain from shouting her down with pithy epithets like “stupid woman” and “silly cow.”

If both parties are true to form, though, the debate, itself, will probably go along the following lines: The prime minister will assert that discipline has broken down in the home and the community and that until order is restored, nothing can be accomplished. The Labor opposition will assert that unemployment is to blame and that until Mrs. Thatcher changes her economic policies the situation can only get worse.

It doesn't take much sense to recognize that both sides are partly right. There has been a breakdown of order and the Tory government's economic policies have brought the pot to the boil. There is also, however, a fundamental error in Mrs. Thatcher's position. She is describing an effect rather than a cause. The same complex web of circumstances that have brought about the riots are responsible for the collapse of discipline in the family and the community.

In the broadest sense, there seems to be a feeling in Britain that the old order has failed. Millions of young people, white, brown and black, see little hope of escaping from deprivation. The most alienated of the whites blame Asians and blacks for their troubles. The Asians and blacks blame the whites, symbolized by the police. All reject their parents to the extent that parents accept the status quo. All reject the community, because it represents the establishment.

Mrs. Thatcher recognizes the economic root of the problem. She understands that for any long-lasting solution to work, British productivity must be substantially increased; that spending cannot continue to outrun income; that inefficient operations, both in the private and the public sectors, must be turned around or phased out.

But she seems to have little understanding of the social magnitude of the British disease. Her single-minded focus on law and order to the exclusion of other dimensions of the upheaval can be expected to confuse and exacerbate matters, to further alienate the nonwhite and the jobless. Mrs. Thatcher is acting as if she thinks banging her fist on the table will make everything fall into place. Well, it hasn't in Ulster. And there is no reason why it should in Brixton, Bristol, Southall or Green Wood, either.

Mrs. Thatcher is right to insist on restoring law and order. She is also right to give the police the means to do their job efficiently, even if it means using rubber bullets. But she is wrong in not considering additional funds to improve living conditions in deprived areas until there is a full return to quiet. She is wrong to hold up spending aimed at creating new jobs for the young. She must display some awareness that the rioters are not all the same — that an East End skinhead off on a “Paki-bash” with swastikas on his arm, chains in his hands and steel toes on his boots, is very different from the Southall Asian he is out to maim. But most of all, Mrs. Thatcher must demonstrate that she understands that the British disease is now acute.

In the United States in the late 1960s, the cities were burning — Watts, Washington, Newark, Detroit. But the government was also in the process of putting into place the Great Society, which rightly or wrongly made it appear sensitive to the needs of the poor. There was a widespread perception that government cared. It is impossible to say just how much that feeling contributed to the quenching of the fires, but few would argue that it did not contribute at all.

In Britain, there is no general perception that the government sympathizes with the problems of the poor and the unemployed. The opposite may be true. One young West Indian told a New York Times reporter that Mrs. Thatcher “has no regard for human life. She has no moral standards.” If that view becomes widespread — and it may already be in the riot-torn areas — no amount of gas or rubber bullets will stop the riots. Unless Mrs. Thatcher can show more compassion than she has been able to project in the past, Britain may be just beginning the first in a series of long, hot summers.

INTERNATIONAL HERALD TRIBUNE

# Thatcherism: A Specter Haunts Reagan's Washington

By Leonard Silk

**N**EW YORK — A specter is haunting the Reagan administration: Thatcherism. The riots in Liverpool this week, stemming partly from the worst unemployment Britain has experienced since the Depression of the 1930s, are grim evidence of the failure of what was once regarded as a brilliant innovation in economic policy.

When Mrs. Thatcher became prime minister in May, 1979, she was the darling of con-



servatives on both sides of the Atlantic. Today she faces a revolt in her own party and has been disowned by the Reaganites in Washington, who say she departed from and made a mess of what initially was a correct

solution to the twin problems of inflation and industrial stagnation.

But was her fault one of execution or were there inherent inconsistencies and contradictions in the Thatcher program that the Reagan administration is on the way to repeating?

The Thatcher plan certainly began with close parallels to the Reagan program:

- A commitment to "monetarism," the doctrine that holds that the way to stop inflation is to reduce the growth of the money supply to a rate equal to the potential growth of the economy. Mrs. Thatcher elected to do this gradually: The Bank of England would cut the growth of the chosen monetary aggregate called "sterling M-3" — currency in circulation plus sterling-denominated demand and time deposits in commercial banks — to an annual rate of 9 percent in 1980-81 and to 6 percent in 1983-84.

- The real value of government spending — total outlays corrected for inflation — was to be cut. The money the government needed to borrow from the public to cover its debts and those of local authorities and public corporations would be scaled down to £7 billion in 1980-81 for openers.

- Marginal income tax rates would be cut sharply to spur savings and productivity growth, with the biggest cuts both absolutely and proportionately going to those in the higher income brackets.

How faithfully did Mrs. Thatcher carry

out her plan? On monetary policy she has striven to tighten up the money supply. It is true that sterling M-3 overshot its target, but this resulted largely from removing the so-called corset from the commercial banks, the special deposit regulations that had limited the extent to which the banks could increase their interest-bearing deposits. But the money supply narrowly defined, M-1, was held to 3-percent growth in the 12 months after Mrs. Thatcher took office and 8 percent thereafter.

The clearest indication of tight money was the sharp rise in interest rates. The outflow of funds from London to New York, attracted by still higher interest rates, helped lighten money further, despite government plans to make more funds available by bringing down public-sector borrowing.

In this Mrs. Thatcher failed. She quickly put through cuts in marginal income tax rates, bringing down the top rate on compensation income to 60 percent from 83 and the bottom rate to 30 percent from 33. She cut the top rate on investment income to 75 percent from 98. To promote the shift from consumption to savings, she nearly doubled value added tax from 8 percent to 15.

Sharply rising interest rates pushed the economy into a deep slump, and the budget fell deeper into deficit. To curb the growing public borrowing requirement, the government raised excise taxes on tobacco, alcohol, gasoline, diesel fuel and road vehicles.

Government spending kept climbing, despite Mrs. Thatcher's efforts at belt-tightening. She imposed her steepest cuts on public-sector investment items, thereby aggravating the problem of inflation. But instead of realizing her initial plan to bring down public borrowing to £7 billion in 1980-81, the Thatcher government ran its borrowing requirement up to £13.5 billion, or 6 percent of the gross national product, one of the highest levels in the world.

Thus Mrs. Thatcher's fundamental mistake has been to try to cure stagflation by combining tight monetary policy with loose fiscal policy. She has incurred big deficits that forced the government to be a heavy competitor for scarce private savings, forcing up real interest rates.

This has produced an extraordinary slump in production and employment. The jobless rate has doubled to more than 11 percent, from 5.4 percent when Mrs. Thatcher took office.

With the slump, inflation has fallen to low double-digit numbers, but the high interest rates on both government and private bonds reflect the pessimism of the financial markets about the prospects for solving the problem of British inflation.

The recent behavior of interest rates and the securities markets in New York reflects similar apprehension that the Reagan monetary and fiscal policies have more in common with those of the Thatcher government than Washington is willing to acknowledge.

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# When You Separate Economics From Social Policy

WASHINGTON — When I left London ten days ago, the wave of riots that has swept across the cities of Britain was just beginning. But a junior member of Margaret Thatcher's Conservative majority in Parliament made the observation, "This is what happens when you separate economic theory from social policy and pursue the one at the expense of the other."

An American journalist returning to his own country at the beginning of the long, hot summer, cannot help but wonder what warnings there may be for the United States in the calamities visiting Britain.

The Reagan administration says

there are none. Treasury Secretary Donald T. Regan has told questioners on television not to "push the parallel," adding, "You can have civil disturbances in any kind of economy."

He is right. The last round of serious urban riots in the United States occurred just as the Great Society, that last full flowering of welfare-state liberalism, was coming into bloom. Obviously there is no direct relationship between the growth rate in the federal budget and the tranquility or hostility of the city streets.

But it would be naive to think that in times of social and econom-

By David S. Broder

ic stress, such as ours, perceptions about the attitudes of the rulers do not influence the behavior of the most miserable of the ruled.

For all their professions of compassion, Thatcher and her associates in the Tory government are seen by many in Britain — including some not-so-secret critics in their own party — as economic ideologues who will govern by their monetarist doctrines, no matter what the consequences in Brixton or Manchester or Liverpool.

Ronald Reagan is a more affable personality than Thatcher; his economic theories are not as one-dimensional; the American economy is far healthier than Britain's, and its unemployment is one-third lower.

Yet the public opinion polls measure a growing belief that Reagan's economic policies are harmful to the elderly, harmful to the poor, harmful to minorities. And that suspicion is sharpest among those who live on the margins of the economy, out of work or working for subsistence wages.

Look back at the report of the Kerner Commission, which conducted a broad study of the causes of the 1963-67 urban unrest in the United States. In the chapter on "the basic causes," the commission described the factors of migration, discrimination and segregation

that led to the existence of the black ghettos — conditions that have not changed markedly in the 13 years since the report appeared.

And then it said that "recently, three powerful ingredients have begun to catalyze the mixture." These were "frustrated hopes, the legitimation of violence and a sense of political powerlessness."

Can we honestly say that those factors have diminished today?

In the intervening years, blacks have come to power in many major cities, from Atlanta to Los Angeles. Millions of black youths have achieved the dream of higher education and are making their way into the middle class. The "violence" of which the Kerner Commission spoke — white police attacks on black civil-rights demonstrators — has been ended.

## Evenhanded?

But the violence of crime is an ever-present factor in the ghetto. Hopelessness still dogs the 20 to 30 percent of big-city minority youths who cannot find their first jobs. And throughout the black community, at all levels, there is a sense of exclusion from the decision-making of this government greater than I have known in 20 years — a real sense of being the impotent outsiders.

A reader in Minnesota recently

sent me an editorial from the Princeton, Minn., *Union-Eagle*, a weekly newspaper published by Elmer L. Andersen, the former Republican governor of that state.

"Can we say there is an evenhanded application of a new fiscal policy to reduce government spending?" It asked, in appraising the Reagan record so far. "No, there is not. What is clear is an enormous shift in government spending from social services to military spending, and no indication that the result will be a balanced budget for many years to come ... Furthermore, there is a harshness about actions and attitudes in the social services area that is not evident toward excesses in military spending. We are going after school lunch programs, food stamp distribution, aid to families with dependent children, grants-in-aid for the arts and humanities, with crusading vigor."

If that is the way it looks to Elmer Andersen, a good Republican, in Princeton, Minn., how can it possibly look to Joe Jones on the South Side of Chicago?

Britain is offering a grim reminder that people are not laboratory animals, available for economic experimentation. When they reach the breaking point of frustration, they rebel. I pray the United States does not have to relearn the lesson.

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New York Times 25 Jan 1981

In recent weeks I have been struck by a number of articles in the United States press advising President Reagan on the main problems that would face him on taking office and the main steps the authors felt he should take.

What was particularly interesting to me was the close parallel between the problems identified, and the prescriptions made, in some of those articles, and my own view of the British economy. Indeed, there are close parallels with many of the industrialized countries around the world. We are all suffering from the effects of the severe rise in oil prices since 1979, which has sent the world economy into recession and added to inflationary fires.

But the parallels went further than the joint experience of recession. The articles highlighted the problems of inflation and how to tackle it, government spending and borrowing, and government over-regulation of the private sector. On all these, the authors raised issues that are important to the British economy as well.

Like the United States, after a long postwar period of growth, with relatively low inflation, we have seen serious inflation establish itself in our economy over the last decade or so. In Britain we have seen the inflationary paraphernalia of automatic indexation, wage claims at least in line with price movements, discussion of cost increases "in real terms" as if the general rise in the price level were unimportant, and so on.

Successive governments have played a part in our inflationary process, through excessive spending and borrowing, and the pretence that they can solve problems that can only be mastered by changes in economic behavior. In some cases, they have taken over tasks better performed privately.

In others, the problem has been the establishment of a level of entitlement, or standard of provision, that assumes substantial economic growth, which it is then difficult to scale down if the growth does not materialize. Thus, public spending has acquired a momentum divorced from the realities of the productive economy, which has had to bear an increasing burden. The productive sector has been further hampered by levels of personal taxation frustrating to enterprise and ef-

# Reagan Should Talk to Mrs. Thatcher

By GEOFFREY HOWE

fort, and by an excessive number of government regulations. I find echoes of all these phenomena in descriptions of American experience as well.

These are problems which have developed over many years, and they will not be solved overnight. But I now find near universal agreement among my fellow finance ministers that inflation must be cut to restore stable conditions for growth and new employment.

There is agreement, too, that monetary control is a necessary condition for the reduction of inflation, and that this control needs to be sustained. Indeed, a responsible attitude to the money supply needs to become a permanent feature if the deeply ingrained inflationary mentality is to be eradicated. The right method of monetary control will vary from country to country according to the nature of the financial institutions in each.

But no method of control, in our highly sophisticated modern economies, can work instant miracles. So far as Britain is concerned, I do not believe there can be any doubt that monetary conditions have been tight, despite the fact that the broader monetary aggregates have been growing rather faster than the Government's target would indicate. The narrower aggregates have been growing much slower than the rate of inflation.

We have succeeded in reducing our year-on-year inflation rate from a peak of 22 percent last May to just over 15 percent, while the annualized six-month rate is much lower — well below the rates in the United States and France, for example. Meanwhile,

reduced by 3 percent since last summer. And there is increasing evidence in the labor market of the sort of realism we need to insure adequate control over domestic costs. Many wage settlements have now come down to single-figure increases. And strikes have been at an all-time low.

The task of defeating inflation is immeasurably easier if fiscal policy is consistent with the monetary stance. If the government's demand for credit is excessive, the result is high interest rates crowding out private investors, and proper monetary control itself becomes much more difficult. But again, reducing the government's borrowing requirement takes time.

I HAVE already mentioned the built-in momentum of many spending programs. It takes time to reverse this. Further, at a time of recession there is upward pressure on the fiscal deficit from higher benefit payments and lower revenues. These are often regarded as automatic stabilizers, mitigating the effects of a recession, and we have judged that we should not try to counteract their effect altogether.

Nevertheless, we are reversing inexorable growth of public expenditure, and our plans now provide for a reduction in real terms of about 1 percent a year in 1981-82 and subsequent years as compared with the previous Government's plans for a 2 percent increase.

This has enabled us also to make a start on cutting the high personal taxes that were a uniquely foolish disincentive in the British economy. This objective of cutting personal taxes is potentially to short-circuit, as a matter

of simple arithmetic, with the objective of reducing Government borrowing. The long-term answer is planned cuts in spending, and extra revenue will be derived as the economy grows.

In the meantime, we have chosen to strike a prudent balance between the two goals, and have increased revenue from indirect taxation to offset reductions in income tax. But the fact remains that in my last budget I cut income taxes across the board and reduced the top rate of tax on earnings to 60 percent from 83 percent, thus substantially increasing the rewards successful managers are able to earn.

Reducing the burden of unnecessary regulation on industry and commerce is the other supply side policy. The first stages have been quickly achieved. I have removed a battery of controls in Britain; on prices, pay, dividends and movements of capital across foreign exchanges. But not all deregulation is as simple as we should wish. We all have to take account of legitimate anxieties about such matters as health and safety, and protection of the consumer and environment. We need to allow for our separate institutional constraints.

In Britain, we are sometimes constrained by our membership in the European Community; in the United States your administrations are sometimes constrained by the division of powers within the Congress. The difficulties of tackling these problems, particularly when the world outlook is so clouded, should not be underestimated. Yet, they are problems that must be tackled vigorously if we are to restore the health of our economies.

NHT  
25 Jan

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Sir Geoffrey Howe is Britain's Chan-



# More Stable Economic Environment Expected in Britain

## Reduced Public Sector Spending, Tight Monetary Policy Should Help Reduce Inflation

By SIR GEOFFREY HOWE  
Chancellor of the Exchequer

In this article I want to discuss "the prospect" rather than "the prospects" for the British economy, for two reasons. First, this is not the place to discuss the details of statistical economic forecasts. Valuable as they can be, forecasts tend to be based on how people, companies, even bankers have behaved in the past. For a radical Government which sees the need to change old attitudes and patterns of behavior, an assumption that past patterns and relationships will necessarily continue may not be realistic.

And, secondly, I do not believe that the coming revival in Britain's economic fortunes will be wholly, or even mainly, the Government's doing. The Government can only try to set the necessary financial and fiscal framework for revival, and, at the same time, remove many of the state controls and restrictions, penal taxation and excessive growth of our public sector which have too long held private enterprise back. The prospect now is one of a more liberal and more stable economic environment. The prospects depend on how quickly and successfully British businessmen and all who work with them take advantage of it. They, not the Government, will determine the outcome.

So let me explain our policy and the framework we have set for the economy.

Since 1945 successive British Governments have broadly followed policies of "demand management" in an attempt to achieve a high rate of economic growth and full, or nearly full, employment. Such policies may have had some success up to the mid- or late 1960s, although everyone complained of the "stop-go" approach to direction of the economy, and inflation remained reasonably low and stable. But since 1970 the average inflation rate has been 13% (three to four times the average rate in the previous 25 years), the economy has grown more slowly, and unemployment has quadrupled from 600,000 to 2½ million.

### Priority for Defeating Inflation

It was all the more because I took an active part in the counter-inflation and demand management policies of the Heath Government that I am now convinced that defeating inflation must come before anything else, and is a precondition of the sustained growth of output we in Britain all want to see.

Inflation is more than just a social evil, operating as an arbitrary and unpredictable wealth tax. It is very destructive of industrial growth through the uncertainty it creates. In recent years high and variable inflation has resulted in excessive fluctuations in relative prices as prices of particular

goods and services have moved at different speeds and times. So business planning has been made more difficult and investment decisions more risky. Yet getting such decisions right is fundamental to business success and industrial expansion. Defeating inflation is not the only pre-condition of higher output and higher employment — I will mention other parts of our policy later — but it is an essential one.

My past experience of pay and price controls convinces me that they can never be anything more than a short-term palliative. They do not attack inflation at its roots. They distort the labour and goods markets in harmful ways when it is on the improved functioning of those markets that we depend for the renewal of our economy.

### Providing the Framework

What is needed is a framework which allows relative prices (and pay) to adjust against a background of stability in the general price level. The British Government, like those in most other industrial countries, seeks to provide that framework by following a consistent policy of tight and stable monetary conditions. There is, in fact, nothing very new about monetary control, much as your people and ours like to argue about it. The old international gold standard and the Bretton Woods sys-

tem of fixed exchange rates, in effect imposed monetary discipline from without. Since a floating regime was adopted in 1971, an explicit internal system of monetary control has become necessary.

Perhaps the most important aspect of any policy for control of monetary growth is that it must be continuous and sustained over a period of years, and be seen to be so sustained. We have, therefore, set out our Medium Term Financial Strategy, at the heart of which is a progressive reduction in the rate of monetary growth over the period to 1983-84. In order to meet the monetary objectives without putting upward pressure on interest rates, we intend to progressively reduce the public sector borrowing requirement (PSBR) as a proportion of the gross domestic product.

### Unexpected Pressures

Over the last two years, the effective control of money and the interpretation of the aggregates has not been easy, and the growth of the broad monetary aggregate on which our policy has focused (M3) has been above the target range. We started at a time of world economic upheaval. The further doubling of the OPEC oil price added to inflationary pressures and con-

and at the same time, it has the effect of putting upward pressure on the sterling exchange rate because of our position of self-sufficiency in oil. At home, it took a long time before the adverse trading and financial conditions of industry, and the improved inflationary outlook, were reflected in wage settlements.

For a country that exports one third of all it produces — a higher proportion than Germany or Japan — this rise in labour costs, combined with the unexpected pressures from the world recession and the high pound, inevitably helped to produce a far more serious loss of jobs and output in manufacturing industry than had been predicted. That, in turn, made for a higher PSBR, with spending on unemployment and other benefits rising and less revenue from company and personal taxes. The unbalanced nature of the recession, with companies severely squeezed, while individual people fared relatively well, also added to the problems of monetary control.

From the outset we said that no single statistical measure of the money supply could tell us all we needed to know about monetary conditions. So we have looked at a range of indicators, as well as at the position of the exchange rate and the level of real interest rates, in taking decisions on the Bank of England's minimum lending rates (which can be thought of as a cross between the discount rate and the Federal funds rate). I have now been able to lower MLR by five percentage points since last summer. And the slower growth of £M3, I forecasted last November has indeed come about.

### Three Propositions

Techniques of monetary control can always, of course, be improved. I lay stress on three propositions in my approach to possible change. First I want to avoid arbitrary quantitative limits on

but they never removed them. Second, I rely on the fundamentals: taxation, expenditure control, interest rates and debt sales. And thirdly, I prefer an evolutionary approach to any sudden change of monetary control technique.

We are, for instance, studying the possibility of concentrating much more closely on movements in high-powered money in deciding on official intervention in the financial markets. Although the techniques of monetary control may be somewhat arcane, and reflect the particular circumstances of the country concerned, the essential need for such control to be maintained by whatever means are appropriate is a common feature of all the Western economies.

Moreover, they all face the reality that, although appropriately defined monetary objectives act as a medium-term constraint on the total growth of nominal spending, it is how individual people react that decides how that growth is divided between price inflation and the growth of real output. If too much is taken out in pay rises, as has happened for many years, the result can only be lower profits, lower investment and higher unemployment. Given the monetary limit, those involved in pay bargaining cannot escape responsibility for the level of unemployment.

### Public Expenditure Cut

In the same sort of way, all the Western economies need public spending and taxation levels consistent with the chosen form of monetary control. If the public sector spends and borrows too much, this can only be reconciled with the monetary target at the cost of markedly higher interest rates which frustrate the enterprise of the private sector.

In my recent budget I had to give priority to the need to reduce borrowing even at the cost of some increases in taxes. We have reduced public expenditure well below the level planned

would have liked. We shall continue the downward pressure on spending: by cutting spending programmes and reducing the size of the civil service; through our efforts to make the nationalised industries more efficient and more profitable, and through our pressure on local authorities to economise on both staff numbers and total spending.

Restraining expenditure is essential, but it needs to be complemented by measures to encourage enterprise. Here we have taken a series of major initiatives. The top rate of income tax is down from 83% to 60%. Pay, price and dividend controls have all been swept away. The controls on outflows of foreign exchange which existed since World War II have been abolished. British capital can now seek profitable investment wherever it is to be found, and there are signs that that is happening, not least because of our earnings from North Sea oil and its beneficial effects on our balance of payments.

### Help for Small Businesses

I have introduced a whole range of measures to ease the tax on small businesses to encourage new firms to start and existing ones to expand. This year, for instance, I am bringing in a new business start-up scheme allowing individuals to claim tax relief at their marginal rate for investment up to a certain level in new businesses — an incentive not matched in any other major country. There is also to be a loan guarantee scheme to help small businesses to raise the capital they need for expansion. It is to new firms, and expanding small businesses, that we are looking to create a large proportion of the jobs and opportunities of the future.

We are also trying a radical new experiment in the form of the creation of Enterprise Zones where — in ac-

of two... public regulation will be reduced to a minimum. Where years of planning and regulation have failed to revive derelict areas of urban wasteland, we are trying the opposite. Big or small firms will soon be able to set up in a dozen areas where planning rules will be substantially relaxed, local taxes will not apply and other encouragements to really free enterprise will be given.

### Augurs Well for Future

We have, of course, suffered badly from recession. Unemployment has risen from 1½ to 2½ million in the last 12 months. But there are now growing signs that output may have stopped falling, and frequent reports of new businesses being set up, new projects under way and, in some companies, quite large improvements in productivity. All this augurs well for the future.

Inflation has also come down more rapidly than expected — the 12-monthly increase in our retail prices index is down from nearly 22% last summer to about 12% in April. It is now lower than in some competitor countries. Our short-term interest rates are lower than most of them.

Pay settlements in manufacturing are running at less than 10% — about half the rate we saw a year ago. The Government is taking a tough stand to ensure that the public service pay bill is contained within the tight limits that have been laid down for the present financial year. Our balance of payments current account has held up extremely well — far better than was forecast. The number of strikes in 1980 was the lowest since the war.

I have always said that our policy was one for a decade. At present, the pains of transition are more apparent than the rewards. But that they will come, and long before a decade is out, I have no doubt at all.

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TO IMMEDIATE FCO

TELEGRAM NUMBER 632 OF 18 JULY 1981

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INFO SAVING TO UKDEL OECD BRUSSELS OTTAWA COPENHAGEN HELSINKI

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UKDEL NATO

ECONOMIC ASSISTANCE TO POLAND

1. FOLLOWING IS THE EMBASSY'S TRANSLATION OF THE TEXT OF A MESSAGE FROM M DELORS, MINISTER OF THE ECONOMY AND FINANCE, TO THE CHANCELLOR OF THE EXCHEQUER. THE MESSAGE IS DATED 17 JULY AND WAS RECEIVED THIS MORNING. ORIGINAL LETTER FOLLOWS IN MONDAY'S BAG TO PS/CHANCELLOR.

2. BEGINS. DEAR CHANCELLOR AND COLLEAGUE. IN MY LETTER OF 19 JUNE 1981, I PROPOSED THAT THROUGH THE BIS EXCEPTIONAL CREDITS SHOULD BE ESTABLISHED BY OUR CENTRAL BANKS TO DEAL WITH THE FINANCIAL PROBLEMS OF POLAND.

THE GOVERNORS OF THE CENTRAL BANKS MET IN BASLE ON 13 JULY. ALTHOUGH THEY CONSIDERED SUCH AN INTERVENTION TO BE TECHNICALLY FEASIBLE, THEY COULD ONLY AGREE TO SUCH ASSISTANCE AT THE REQUEST AND WITH THE SUPPORT OF THEIR RESPECTIVE GOVERNMENTS.

IN THESE CIRCUMSTANCES, AND IN ORDER TO IMPLEMENT THIS OPERATION AS RAPIDLY AS POSSIBLE, I AM WRITING TO YOU AGAIN TO ASK YOU KINDLY TO GIVE AS SOON AS POSSIBLE WHATEVER ASSURANCES YOU CONSIDER NECESSARY TO YOUR CENTRAL BANK.

ppp 674

I AM MAKING THIS SUGGESTION TO THE RELEVANT MINISTERS IN THE COUNTRIES WHO ARE SIGNATORIES OF THE MULTILATERAL AGREEMENT ON POLISH DEBT AND TO OUR SPANISH COLLEAGUE. HOWEVER, I AM NOT WRITING TO THE SECRETARY OF THE UNITED STATES TREASURY WHO HAS TOLD ME THAT FOR DOMESTIC LEGAL REASONS IT IS IMPOSSIBLE FOR HIM TO ASSOCIATE HIMSELF WITH THIS OPERATION.

SINCE YOUR COUNTRY IS ONE OF THOSE TO WHOM POLAND HAS MADE A REQUEST FOR SHORT-TERM HELP, I AM TAKING THE LIBERTY OF URGING YOU IN PARTICULAR AND OUR COLLEAGUES IN THE FEDERAL REPUBLIC OF GERMANY, IN ITALY AND IN SWITZERLAND TO PLAY A POSITIVE ROLE IN THE RAPID AND EFFECTIVE MOUNTING OF THIS OPERATION, AS I SHALL ENDEAVOUR TO DO AS FAR AS FRANCE IS CONCERNED.

THANK YOU FOR ALL THE PERSONAL ATTENTION WHICH YOU ARE GIVING TO THIS MATTER AT A PARTICULARLY DELICATE MOMENT FOR POLAND.  
(USUAL COURTESIES).

SIGNED JACQUES DELORS. ENDS.

ADVANCE COPIES: BROOMFIELD, MONTGOMERY EESD, FCO  
MOUNTFIELD TREASURY

FCO PLEASE PASS SAVINGS TO ALL EXCEPT UKDEL OECD

ARBUTHNOTT

COMMS NOTE:

OTTAWA HAVE TAKEN NO ACTION ON THIS TEL WITH S OF S PARTY.

NNNN

te

back P. 27

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c. Mr Kew

pwp 65  
(copy given to PM)

19/7/81

22/7  
S/23/7

CONFIDENTIAL

DEFENCE CASH LIMITS REVIEW

Aide Memoire for the Prime Minister

1. November 1980 Cabinet decision that the 1981-82 Defence cash limit should be reviewed, taking account of:-

- (i) the reduction required to offset the 1980-81 overspend (75 million pounds);
- (ii) the cost of any pay increase beyond the 6 per cent already provided (this is put at 80-90 million pounds); and
- (iii) any change justified by the movement of defence prices in relation to the 11 per cent already provided for.

2. It was agreed in restricted meetings earlier this year that the last tranche of cuts required by the November 1980 decision on the volume of defence expenditure should also be settled in the context of this review.

3. Urgently necessary to complete the review - before the Recess.

4. Ministry of Defence cash limit managers are expecting increases on account of (i) and (ii) in para 1 and also an increase of 295 million pounds on account of higher defence prices (which they attribute to a continuing fall in sterling and to high pay settlement in the defence industries). They also want exemption (cash cost 42 million pounds) from the last tranche of volume cuts.  
Total addition 427 million pounds.

5. Treasury calculate that defence prices will increase by only 9½ per cent, which would imply a reduction of 92 million pounds. Allowing for higher service (but not civilian) pay, and offsetting last year's cash limit overspend, this implies a total reduction of 99 million pounds.

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CONFIDENTIAL

- 2 -

6. Essential to stick to last year's volume decision, and to normal cash limit discipline that overspends must be offset. Defence cash limit must not be infinitely adjustable. Other cash limited programmes had to find ways of containing cash so as to keep within the limits. Defence should not exaggerate difficulties; last year's overspend only 75 million pounds as compared with 300 million pounds threatened earlier.

7. If Defence are to take timely action, decisions needed now. May be necessary to resist pleas by Defence Secretary to wait for more evidence on prices. Officials preparing joint report on facts, and issues for Ministerial decision.

19 July 1981

17

~~All these~~

19/7/91.

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So our discussions have linked the two  
 aspects of the preservation of the free world & the  
 free market economy which underpins it: ~~the problems~~  
 of defence & the ~~preservation~~ <sup>maintenance</sup> of peace; and the health of  
~~the~~ ~~all~~ ~~our~~ ~~economy~~ & ~~function~~ of the world economy.

~~Economic health~~

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Reference.....

PS / Chancellor

A suite has been  
Placed at the Chancellor's  
disposal in the Chateau  
Laurier. It is 476/478

Shirley Wagoner  
21 July



1. FLAVOUR OF MEETING

Tribute to Mr. Trudeau's chairmanship.

Excellent arrangements made by the Canadians in Montebello. Very good idea to have all the delegations and all the meetings in one building away from it all. This promoted a sense of coherence that was reflected in the discussions.

This is my third Economic Summit. Over that period we have increasingly given time in our discussions to the major political issues of the day, such as Afghanistan and the Middle East, as well as to the economic problems facing us. This development reflects reality. Political issues and economic matters cannot be isolated from each other and treated separately. They interact at every level, national and international. This reality was recognised more at this Summit than at any other.

Result was a workmanlike, balanced discussion comprehending all the major problems, economic and political, that face the Western world.

2. WORLD ECONOMY

At the ~~last~~ two Summits in Tokyo and Venice our work was ~~overshadowed~~ <sup>dominated</sup> by the impact of the second oil shock on the world economy. We considered the impact it would have and how we should react to it. This time we have met in the trough of the recession which that shock produced, but have had to look at the whole range of economic questions - the twin evils of inflation and unemployment, the need to adapt our economies and attitudes in order to beat unemployment and monetary disorders producing high interest rates and volatile exchange rates.

We were agreed on the need to fight inflation as the precondition for defeating unemployment, and on the need for low monetary growth, for reduction of public borrowing and for tight control of government expenditure. We are all giving effect to these principles in our own policies, according to our different circumstances.

3. DEVELOPING COUNTRIES

I take away three salient thoughts from our discussions on relations with developing countries. The first is that we share many of the problems of the world economy with them: the need to develop energy resources, to encourage investment, to maintain creditworthiness, to fight inflation and unemployment, to expand trade. The second is that we welcome discussion

discussion with developing countries in whatever forms are useful. The third is the particular needs of the poorer countries. We agreed to direct the major portion of our aid to the poorer countries and the UK has a good record on that.

*probably*

4. MIDDLE EAST

We have been meeting in the shadow of a further outbreak of fierce fighting in the Middle East; once again the unfortunate people of the Lebanon are bearing the brunt of a conflict that is not of their seeking.

*Whatever way we may think best*

~~Even if our analysis of the causes may differ, we all agree on the need for an urgent cease-fire in the Lebanon, for an end to the loss of innocent civilian life there and, above all, for a solution to the conflict between Arab and Israeli from which this violence flows. For the UK and for the European Community I pledge a continuing effort to use all our influence for this purpose.~~

*We shall*

*Calm is what we all want*

5. EAST/WEST

We also discussed the East West scene, the concern that all of us feel about the extent of the Soviet military threat to our interests. I have been ~~immeasurably~~ *much* heartened by the strength of common purpose that I sensed in our discussions. We all agreed - and agreed with real determination - on the need to maintain a strong defence capability and to insist on the reality of military balance.

/ Of course

Of course that goes hand in hand with our readiness to negotiate arms control agreements that will ensure genuine security for us all at a lower level of weaponry and resources.

But we have reasserted with total firmness our resolve to defend ourselves and to do what we can to help others who so desire to defend themselves too and to preserve their own independence and security.

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1. MR. WIGGINS  
CHANCELLOR OF THE EXCHEQUER

cc: Mr. Ingham

73  
20/7/81.

AMERICAN TV INTERVIEWS

The two requests for the Chancellor to appear on American TV to talk about the Summit discussions have now grown to three. They are outlined below.

The American TV companies are operating from a temporary studio in the Notre Dame Church which is, they say, a mere three minutes' stroll from the front gates of Montebello. This very conveniently means that the Chancellor will not need to make an early morning journey into Ottawa as we originally feared.

The interviews requested are as follows:

- (i) ABC Morning News (bid made yesterday and not yet put to the Chancellor):  
ABC would like five minutes, either live or pre-recorded, first thing on Tuesday morning.  
They are featuring the American delegation's news this morning and hope to interview one or two other Finance Ministers to give the European view tomorrow. They want to ask the Chancellor for his feelings about the economic issues and the discussion at the Summit. I would expect the level of American interest rates to feature fairly strongly.

I have told ABC that the Chancellor is already committed to appearing live on the rival CBS Morning News programme. They are hoping to tape the interview in advance tomorrow morning and have suggested the ridiculously early time of 6.15 to 6.30 am. If the Chancellor consents to giving the interview, I would of course

/ negotiate

negotiate a later time, but I fear that it would still be before 7.00 am when the programme starts live. In favour of the interview is the fact that the programme claims an audience of some 6 million, somewhat higher than that of CBS.

(ii) CBS Morning News:

The Chancellor has already consented to give this interview. His presence would be required in the Notre Dame Church between 7.20 and 7.45 am for a live 5-10 minute interview with Diane Sawyer, one of their senior reporters. If the weather is fine they would like to do the interview out of doors. CBS are looking for an overall view of the economic aspects of the Summit so far - what does the Chancellor think is the most important issue to arise and what are his views on US interest rates. (Estimated audience of 3½ million).

(iii) ABC Nightline:

The Chancellor has agreed to tape an interview with Ted Koppel on inflation, unemployment and interest rates. We now need to find a suitable slot in his timetable. The programme would like it as late as possible in order to cover the maximum proportion of the Summit proceedings (they cannot record between 6.00 and 7.30 pm). Is there a possibility that the Chancellor could tape his interview after 5.00 pm when the Heads of Delegation make their joint statement? We will have to find an Ottawa location. (Estimated audience of 8½ million).

The Chancellor may like to know that this morning's news is saying that it is clear that the key issues to emerge at the Summit "will be differences between America and the Europeans on East/West trade and on the level of American interest rates". Treasury Secretary Regan was interviewed on NBC at 7.45 am this morning and was asked about last night's dinner for Finance Ministers. He said

/ that

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that criticism of US interest rates "lasted right through from  
up to dessert" and admitted that he had felt somewhat beleaguered.

As I am some 60 miles away from Montebello, could you please  
reply with your thoughts on:

1. ABC Morning News bid;
2. Agreement to CBS News at 7.20 am on Tuesday 21 July;
3. Suggested time slot for ABC Nightline.

Could you please contact me either by telephone - Chateau  
Laurier (232 6411 x 176/178) or via Bernard Ingham, who will be  
travelling into Ottawa twice today?

Miss E. Drummond  
Press Officer

20 July 1981

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20/7/81.

pwp

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(Revised July 20, 1981)

DECLARATION OF THE OTTAWA SUMMIT

(Not final)

1. We have met at a time of rapid change and great challenge to world economic progress and peace.
  
2. We are confident in the strength of our bonds on which we intend to build, and we are conscious that economic issues reflect and affect the broader political purposes we share.
  
3. In a world of interdependence, we reaffirm our common objectives and joint determination to tackle our problems in a spirit of shared responsibility, both among ourselves and with our partners throughout the world, taking into account the effects on others of policies we pursue.

THE ECONOMY

4. The primary challenge we addressed at this meeting was the revitalization of the economies of the industrial democracies.
  
5. Since the Venice Summit the average rate of inflation has fallen although in four of our seven countries inflation remains in double figures. In many



countries unemployment has risen sharply and is still rising. There is a prospect for moderate growth in the coming year but at present it promises little early relief from unemployment. The large balance of payments deficits originating in the 1979 oil price increase have so far been financed without imposing intolerable adjustment burdens but are likely to persist for some time. Interest rates have reached record levels in many countries and, if long sustained at these levels, would threaten productive investment.

6. The fight to bring down inflation and reduce unemployment must be our highest priority and these linked problems must be tackled at the same time. We must continue to reduce inflation if we are to secure the higher investment and sustainable growth on which the durable recovery of employment depends. The balanced use of a range of policy instruments is required. We must involve our peoples in a greater appreciation of the need for change: change in expectations about pay and conditions, change in management and labour relations and practices, change in the pattern of industry, change in the direction and scale of investment, and change in energy use and supply.

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7. We need urgently to reduce public borrowing; where our circumstances permit or we are able to make changes within the limits of our budgets, we will increase support for productive investment and innovation. We have also to accept and strengthen the application of market disciplines in our economies, and we must not let transitional measures that may be needed to ease change become permanent forms of protection or subsidy.

8. We see low and stable monetary growth as essential to reducing inflation. Interest rates have to play their part in achieving this and are likely to remain high where fears of inflation remain strong. But we are fully aware that levels and movements of interest rates in one country can make stabilization policies more difficult in other countries by influencing their exchange rates and their economies. For these reasons we should also rely on containment of budgetary deficits by means of restraint in government expenditures as necessary. It is also highly desirable to minimize volatility of interest rates and exchange rates.

9. In a world of strong capital flows and large deficits it is in the interests of all that the financial soundness of the international banking system and the

international financial institutions be fully maintained. We welcome the recently expanded role of the IMF in financing balance of payments deficits on terms which encourage needed adjustment.

10. In shaping our long term economic policies care should be taken to preserve the environment, the ecology and the resource base of our planet.

RELATIONS WITH DEVELOPING COUNTRIES

11. We support the stability, growth, independence and genuine non-alignment of developing countries and reaffirm our commitment to cooperate with them in a spirit of mutual interest, respect and benefit, recognizing the reality of our interdependence.

12. We look to developing countries to play a full part in the international system commensurate with their capabilities and responsibilities and to become more fully integrated in it.

13. We look forward to constructive and substantive discussions with them, and believe the Cancun Summit offers an early opportunity to address our common problems in a new light.



14. We are willing to participate in efforts to reach an agreed basis for the launching of Global Negotiations.

15. We reaffirm our willingness to explore all avenues (U.S. of consultation and international cooperation with text) developing countries in whatever forums may be necessary, including a process of global negotiations in circumstances offering the prospect of meaningful progress.

16. We are deeply conscious of the serious economic problems in many developing countries, and the grim poverty faced especially by the poorer among them. We remain ready to support the developing countries in the efforts they make to promote their own economic and social development.

17. We are committed to maintaining substantial and, in many cases, growing levels of ODA, and will seek to increase public understanding of this policy. We will direct the major portion of our aid to poorer countries.

18. We point out that the strengthening of our own economies, increasing access to our markets, and removing impediments to capital flows contribute larger amounts of needed resources and technology and thereby complement official aid.

19. The Soviet Union and its partners, whose contributions are meagre, should make more development assistance available, and take a greater share of exports of developing countries, while respecting their independence and non-alignment.

20. We will maintain a strong commitment to the international financial institutions and work to ensure that they have, and use effectively, the financial resources for their important responsibilities.

21. We attach high priority to the resolution of the problems created for the non-oil developing countries by the damaging effects on them of high cost of energy imports following the two oil price shocks. We call on the surplus oil-exporting countries to broaden their valuable efforts to finance development in non-oil developing countries, especially in the field of energy. We stand ready to cooperate with them for this purpose and to explore with them, in a spirit of partnership, possible mechanisms, such as those being examined in the World Bank, which would take due account of the importance of their financial contributions.

22. We recognize the importance of accelerated food production in the developing world and of greater world food security, and the need for developing countries to pursue sound agricultural and food policies; we will examine ways to make increased resources available for these purposes.

23. [We recognize the need for many developing countries to deal with problems of excessive population growth, in any ways sensitive to human values and dignity; and to develop human resources, including technical and managerial capabilities. We will place greater emphasis on international efforts in these areas.]

TRADE

24. We reaffirm our strong commitment to maintaining liberal trade policies and to the effective operation of an open multilateral trading system as embodied in the GATT.

25. We will work together to strengthen this system in the interest of all trading countries with the structural adjustments to the world economic environment which this would involve.

26. We will implement the agreements reached in the Multilateral Trade Negotiations and invite other countries, particularly developing countries, to join in these mutually beneficial trading arrangements.

27. We will continue to resist protectionist pressures, since we recognize any protectionist measure, whether in the form of overt or hidden trade restrictions or in the form of subsidies to prop up declining industries, not only undermines the viability and dynamism of our economies but also aggravates inflation and, over time, unemployment.

28. We welcome the new initiative represented by the proposal of the Consultative Group of Eighteen that the GATT Contracting Parties convene a meeting at Ministerial level during 1982, as well as that of the OECD countries in their programme of study to examine trade issues.

29. \*We will keep under review the role played by our countries in the smooth functioning of the multilateral trading system and in ensuring maximum openness of markets.

\*This paragraph to be reviewed. Original of text attached as Annex.

30. We endorse efforts to reach agreement by the end of this year on reducing distortions and subsidy elements in official export credit schemes.

ENERGY

31. We are confident that, with perseverance, the energy goals we set at Venice for the decade can be achieved, enabling us to break the link between economic growth and oil consumption through structural change in our energy economies.

32. Recognizing that our countries are still vulnerable and energy supply remains a potential constraint to a revival of economic growth, we will accelerate the development and use of all our energy sources, both conventional and new, and continue to promote energy efficiency and the replacement of oil by other fuels.

33. To these ends we will continue to rely heavily on market mechanisms, supplemented as necessary, by government action.

34. Our capacity to deal with short-term oil market problems should be improved, particularly through the holding of adequate levels of stocks.



35. In most of our countries progress in constructing new nuclear facilities is disappointingly slow. We intend in each of our countries to encourage greater public acceptance of nuclear energy, being convinced that public concerns about safety, health, nuclear waste management and non-proliferation can and will be met; we will further our efforts in the development of advanced technologies and in spent fuel management.

36. We will take steps to realize the potential for the economic production, trade and use of coal; do everything in our power to ensure that its increased use does not damage the environment.

EAST-WEST ECONOMIC RELATIONS

37. We recognize that there is a complex balance of political and economic interests in our East-West relations and conclude that continuing consultations and, where appropriate, coordination are necessary to ensure that our economic policies continue to be compatible with our political and security objectives.

CONCLUSIONS

38. Our conviction has been heightened that the resources of our democratic, free societies are equal to the important tasks we face and that our common problems can be resolved only through close consultation and cooperation.

39. We will move forward together and with all countries ready to work with us in a spirit of cooperation and harmony. In order to ensure the greatest possible degree of concertation of our approaches, we intend between now and our next meeting to maintain continuing contact with each other with a view to agreeing how our consultation and cooperation can be even closer.

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A N N E X

ORIGINAL PARAGRAPH 27

We will keep under review the role played by our countries in the smooth functioning of the multilateral trading system with particular emphasis on the need to maximize the openness of markets [, while allowing for the safeguard measures provided for in the GATT] [At the same time, disruption by the concentration of exports on specific markets and in narrow sectors should be avoided through appropriate international cooperation. Within the framework of this cooperation and according to internationally established rules, a timely industrial adjustment should be sought].

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~~SECRET~~ Confidential 20/7/81

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EXCHANGE RATE: LONDON MARKET

Close 4 p.m.

Dollar rate: 1.8468 (after 1.8430)

DM cross rate:  $4.55\frac{3}{8}$

Effective rate: 91.7

Dollar:DM rate: 2.4660

Day's Intervention: \$46 m. gross  
\$36 m. net

20

~~SECRET~~ Confidential 20/7/81

88

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\$36 m. net



10 DOWNING STREET

MR. WIGGINS  
pwp 38

From the Private Secretary

20 July 1981

Dear Brian,

THE ITALIAN PRIME MINISTER

The Prime Minister had a discussion with the Prime Minister of Italy, Signor Spadolini, earlier today. Signor Spadolini was accompanied by Signor Berlinguer.

At the outset of the discussion, the Prime Minister invited Signor Spadolini to visit the UK at a convenient time. Signor Spadolini expressed his thanks but did not suggest a date or, indeed, indicate any intention of proposing a visit in the near future.

After a brief reference to the discussions yesterday evening and this morning, which both Heads of Government agreed had been positive, the Prime Minister asked Signor Spadolini for his assessment of the effects of President Mitterrand's electoral victory and of his decision to take Communists into the French Government. Signor Spadolini said that the fact that there were Socialist Governments in France and Germany undoubtedly made Italy easier to govern. It lent strength to the Italian Socialists. Signor Craxi's policies were on the same lines as those of Chancellor Schmidt. Signor Spadolini had the full support of the Socialists on such issues as the stationing of cruise missiles in Italy.

As regards the entry of Communists into the French Government, Signor Spadolini said that in one sense it was a negative development in that it created a precedent. Much had been done in recent years to exclude the Communists from Italian Governments and to strengthen the position of the Socialists. However, Signor Spadolini had found the justification given to him in Luxembourg by President Mitterrand for his action persuasive. He accepted that the long term consequences would be a further weakening of the position of the Communist Party in France. President Mitterrand had made it clear that he was prepared to part company with the Communists if they did not adhere to his policies. Moreover, President Mitterrand's firm commitment to the Atlantic Alliance, to the need for a strong Western European defence capability and, in particular, to the need for

/ a strengthening

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a strengthening of the military posture of the United States, created real difficulties for the Italian Communists. So long as the French Communists remain in President Mitterrand's Government, they were committed to the policies which he advocated. The Prime Minister agreed with this analysis and noted how useful it was to her to be able to contrast the policies of the Socialists in France with those of the Socialists in the United Kingdom.

Signor Spadolini said that he thought President Mitterrand's only mistake had been to give the transport portfolio to the Communists. The Prime Minister agreed. The Minister of Transport was in an influential and sensitive position. More generally, she thought it would be difficult for President Mitterrand to control the flow of information to his Communist Ministers. Signor Spadolini commented that given the Presidential structure of the French Government, it might be easier for him than it would be in, for instance, Italy or the United Kingdom.

In a brief reference to this morning's discussion, Signor Spadolini said that in his view President Mitterrand's restraint in commenting on the consequences for Europe of the high interest rates in the United States showed his gratitude for the restraint which the US had earlier shown in commenting on his decision to have Communists in his Government.

The remainder of the discussion between the two Heads of Government was about the domestic problems of the Italian Government and in particular about the economic situation in Italy. Signor Spadolini said that his Government were struggling against inflation which was currently running at 21% per annum. The basic political problem was how to cope with the Communist controlled trade unions who set an unacceptable political price - the entry of the Communists into the Government - on their co-operation. No social pact was possible in Italy. Many of the trade unions were content to see inflation continued since it weakened the present structure of Italian society. Signor Spadolini invited the Prime Minister to reflect on the difficulties of running a country which, in addition to the inefficiencies of a large nationalised sector and of universal indexation, had a work force the majority of whose members took as their model the Soviet Union.

The Prime Minister asked Signor Spadolini whether he thought he could implement the cuts in Government expenditure which he was seeking in order to reduce demand. Signor Spadolini said "I hope so". But in order to do so he would have to make concessions to the trade unions on price controls. There would have to be controls on some of the staple items such as bread and pasta. There were signs that some of the trade unions would be prepared to join in the fight against inflation provided the real value of their members' wages was kept intact. In return for price controls and some reduction in taxation, some trade unions had agreed to a review of the indexation system, and in particular the escalator clause in wage contracts.

/ The Prime Minister

The Prime Minister asked where the cuts in Government expenditure were likely to fall. Signor Spadolini referred to health, education, social security, local government expenditure and "movement of personnel". He was hoping to secure a 4% fall in the inflation rate, i.e. from 21% to 17%. This would enable him to cut interest rates which were presently at 26%. It was vitally important that he should succeed in doing so because at present small businesses in Italy were choking to death. This, if it continued, would have a most damaging effect on the nation's economy.

I am sending a copy of this letter to John Wiggins (HM Treasury).

*Yours ever*

*Richard Alexander*

Brian Fall, Esq.,  
Foreign and Commonwealth Office.



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21/7/81. 91

MACRO-ECONOMIC POINTS TO MAKE

1. Understand each others problems better. Personal recognition of these problems and their causes. See more clearly the realities each of us face.
2. Agreement once again that inflation has to be fought in order to get down unemployment. Renewed recognition that the fight against inflation cannot be abandoned.
3. Specific recognition of the need to achieve low growth of money supply to beat inflation; to control public deficits and to control strictly public expenditure. Several countries (Germany, Italy, Ireland) now embarking on programmes which reflect this.
4. Recognition also of need to be ready to change. To adapt, to adjust expectations, especially on pay, to be more competitive. Recognition of importance of market disciplines.
5. Unemployment position serious and tragic. Full recognised. But has to be tackled through and at the same time as fight against inflation and achievement of improvements in the flexibility and competitiveness of our economies.
6. Still all struggling with aftermath of major oil price increases. Still need to adapt industries and our expectations to cope with this.

/ 7. Have made

7. Have made progress in UK. Inflation down. Pay increases down. Productivity up inspite of recession. Interest rates lower than in some other European countries.

8. However US interest rates affecting us like others through exchange rate and pressure on our interest rates. Fully support US objectives but hope their policies will enable interest rates to fall.

21 July 1981

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PRIME MINISTER

21/7/81

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PRESS CONFERENCE

Mechanics

Your usual end of Summit press conference is to be held in the UK room at the Chateau Laurier (Salon Palladian) at 5.55 pm. We are trying to restrict it to the British, Canadian and a few US correspondents, though it is not possible to be absolutely certain of confining it to those nationalities.

It now appears that there is no shortage of time and that you will therefore be able to give separate radio and TV interviews to BBC, ITN, IRN and COI (five in all). Nonetheless, given the tendency for people to change their minds in Canada, I have agreed to their filming and recording the press conference.

At the end of the press conference (which I suggest you end after 25 minutes), we shall proceed to our press room on the first floor - one floor above the press conference room - for the short radio and TV news interviews.

I cannot I fear recommend you to give Canadian TV interviews; five is enough for anyone after a press conference.

/ Substance

Substance

As I see it you have four presentational problems:

1. To persuade the British public that the Summit rose to the occasion of the highly dangerous events in the Middle East (see Nick Fenn's brief Annex A);
2. To justify your cautious optimism expressed during the macro-economic discussion against the background of today's unemployment figures and economic forecasts;
3. To clarify your role on US interest rates and Japanese trade, given that others in Europe appear to have been less moderate than you on both accounts; and
4. To explain what some feel, perhaps because of the isolation in Montebello, has been your relatively low-key operation at this Summit; (one of the elements contributing to this feeling is the limited number of bilaterals you have held).

Background

By way of background on the last three points above:

Cautious optimism: I qualified that optimism in my briefing yesterday by the need for continuing oil price stability and the pursuit of sound

/ economic

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economic policies; there may be some who will argue that you have implicitly admitted the West is at the mercy of the Arabs.

Your role re interest rates and Japanese trade: as I mentioned this morning there is some evidence that your colleagues have been briefing more toughly than they spoke.

Your low profile: I do not take this too seriously, but some may be trying to suggest that you have kept your head down because you have been shaken by the riots.

#### Other points

Other points which could come up are:

- Northern Ireland: did you raise it with President Reagan and what did he say/is he going to do?
- North/South: did you really make any progress here? (I said at yesterday's final briefing that you felt that North/South, taken together with the macro-economic discussion, had constituted a very useful and workmanlike day.) They may be particularly interested in your idea of a code of practice for private investment.

/ - Namibia

- Namibia: (See Annex A).
  
- East-West Relations: the extent to which you are at one on the need to negotiate from strength (see Annex A).
  
- COCOM: Mr. Haig's views on high/low technology; it is clear to me that the USA is much freer in its briefing on such East-West trade issues than us.
  
- Patriation: Any significance that you did not reinstate your bilateral with Trudeau?
  
- Your frustrated interviews with Canadian TV:  
 Here I have said you always like to give an interview (s) to the local media and that in normal circumstances you would only do this at the end of the Summit. But the time constraints were such that you could only offer yesterday and these had to be cancelled when it was agreed that no Head of State or Government should give interviews until the end.
  
- What do you think of the Summit (and Reagan/Trudeau contributions)?



21 July 1981

PRIME MINISTER'S PRESS CONFERENCE

POLITICAL QUESTIONS

Middle East

1. A keynote of the Summit was our shared concern and anxiety at the deepening crisis in the Middle East. Deplore violence from whatever quarter. Particularly dismayed at the extent of Israeli bombing in Lebanon and the heavy loss of life there.

2. Conclusions drawn by the Summit:

- (a) support efforts to achieve ceasefire (Habib);
- (b) call for restraint (in tune with thrust of statement as a whole: "restraint and responsibility");
- (c) intensify search for just and peaceful settlement to Arab-Israel dispute. Welcome sense of urgency on American side (forthcoming visits to Washington of Sadat and Begin). The Ten will play their part. Determined to carry forward under British Presidency the work begun at Venice.

3. Comments on FI 6s? Respect/endorse the US view that shipment in present circumstances would be "inappropriate". Final decision for the Americans. Not for us to make a judgement.

East/West Relations

4. Full consensus on need for strong defence capability, political restraint and willingness for dialogue when Soviet conduct makes this possible. Negotiate from strength, e.g. TNF this autumn. Particularly encouraged by common mind among the seven on firm posture towards Soviet Union.

/Afghanistan

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Afghanistan

5. Welcome support of Summit for constructive proposals of European Council. Proposal for two-stage conference remains on the table. Soviet coolness unsurprising: but neither the problem nor the proposals will go away. Gathering international support.


Terrorism

6. Welcome declaration. British delegation active to ensure not only utter condemnation of terrorism in all its forms but also effective implementation of Bonn Declaration on Highjacking.

Namibia

7. Not discussed at the Summit. Separate meeting of the Five Foreign Ministers (Canada, France, Germany, Britain, US). The Americans have made useful progress in their discussions with South Africa, but not yet enough. Determined to press on to achieve peaceful independence for Namibia which would command international approval in accordance with Security Council Resolution 435. Statement will be issued tomorrow.



 PRIME MINISTER

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2/7/81

YOUR VIEW OF SUMMIT

Because Fleet Street is five hours ahead the Press are obviously extremely hard pressed today to round up the Summit.

They would greatly appreciate a quote from you which they could incorporate in their stories, embargoed until 5 p.m. Canadian time (10 p.m. London)? Content with the following:

"This has been a very valuable Summit though it has unhappily been overshadowed by the deepening crisis in the Middle East.

I strongly reiterate our call for the utmost restraint in that area.

Our overall discussions and particularly on East-West relations, the world economy and North/South issues were conducted in an excellent and constructive atmosphere. All of us, I am sure, know each others minds much better on a very wide range of issues.

And I am impressed and encouraged by our general resolve to negotiate on armaments from a position of strength."



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22/7/81 (W)

OTTAWA SUMMIT: OBJECTIVES FOR THE WORLD ECONOMY DISCUSSION

The Prime Minister may wish to make some of the following points in order to secure the right balance in the discussion and to get them reflected in the Communique and associated media reports:-

1. to sustain the line that there cannot be sustained progress on unemployment if inflation is allowed to rise; and to avoid a situation in which what is said publicly after the Summit on the fight against inflation is relegated below the fight against unemployment;
  
2. to make the point that unemployment requires structural remedies and moderate pay settlements, not reflation;
  
3. to say that in a world of recession it is particularly important that trading partners avoid export drives concentrated on narrow sectors, which create strong political pressures for protection;
  
4. to make the point about the impact of US interest rates on Europe in a moderate way, supporting the US objective but urging policies which take the strain off high and volatile interest rates; but to avoid a hostile outcome;

5. to say that we all want the non-oil LDC's to come through this period with least damage but that in their own interests they need to retain the confidence of markets in their policies or obtain IMF support with an appropriate programme;

6. to say that it is helpful if the Summits convey a sense of continuity in the leadership they give, and give some clear guidance on broad economic matters. On that ground the paragraphs for the Communique already agreed seem preferable;

7. to correct any impression that UK economic policy is a "failed experiment in monetarism" by emphasizing the success in reducing inflation; moderation in pay settlements and acceptance of improved productivity; and the history of inflationary conditions and structural problems.

OTTAWA SUMMIT

Some Paragraphs for the Prime Minister's intervention in  
the Economic Discussion

1. At the first Economic Summit which I attended in Tokyo 2 years ago we were faced with the second major round of oil price increases. We are now meeting at a time when the effect of those increases on inflation and on output has reached or just passed its peak but when unemployment is still rising.

2. Europe in particular has suffered and is suffering very badly from unemployment in this second oil price recession. Over many years in my country the level of unemployment has risen from one recession to the next, and I believe this has happened in many developed countries. The effect of structural factors has mounted in our economies and caused increasing damage to employment. Many of these factors have also added to inflation. A development of this kind over a long period takes time to reverse. Many of our economies have become less flexible and adaptable in the face of change. These are stubborn obstacles to reducing unemployment, but we must tackle them if we are to achieve lasting success.

3. Meanwhile we face tragic problems of youth unemployment and some of our social problems are made worse by recession. Some of us know the special problems of getting people to live harmoniously together where there are differences of race, colour or religion. Those problems have often been just as acute in times of prosperity as in times of recession. Occasionally, affluence seems even to produce more of them. And sometimes we face violence which is nothing to do with race, colour ~~or~~ religion. <sup>OR</sup> Unemployment may contribute to some of these problems but what is certain is that these situations of violence and hostility are themselves an obstacle to employment. They are part of our structural problems.

4. These Summits began in the shadow of the first oil price increase. I think it is worth considering for a moment how well the world and its economic leaders have coped with the second oil price increase

compared with the first. The IMF said recently that we had managed things better this time. Total output in the developed countries fell in 1975, but not in 1980 or indeed probably in 1981. Bad as it has been, experience on output and on inflation have both been better this time round. The fight against inflation has been pursued with more determination. It is unemployment, not output, that has been worse and that goes back to the cumulative structural problems I have mentioned.

5. Within this better story we have had different experiences. My own country has passed through higher inflation, lost more output, and suffered a bigger rise in unemployment than most because when the oil price increase came we had a worse history than most of pay inflation, more productivity problems and greater structural rigidities. But we have brought down inflation dramatically. We have achieved important productivity improvements, and brought down sharply the rate of pay settlements. I believe we can hold and reinforce these gains.

6. We support the efforts of the United States which are also directed at reducing a stubborn inflation and improving productivity. I believe they are right to give priority to control <sup>of</sup> monetary growth and reduction of public expenditure. We hope that in the interests of their partners they will do all they can to reduce the extent to which they have to rely on interest rates to achieve their objectives. We believe they understand why that is important to Europe in particular and we think it is in their own interests also. In the UK we have managed by a strict budgetary policy to give our industry for some months interest rates lower than in the United States and other countries.

7. There is another important area in which those of us in the eye of the recession in Europe seek the clear understanding of our friends and trading partners. At a time of such acute recession export efforts to our countries beamed on rather narrow sectors can be disruptive and expose us to great political pressures for protection. We need to avoid these risks through amicable international co-operation. I agree too that we need to avoid

wasteful and damaging competition in export credit.

8. What is striking is that our Western market system and the international financial markets have again survived the shock and served us well. Funds have been successfully recycled to the LDC's and the developed countries in deficit. The most striking financial problem has been in Eastern Europe. Perhaps the international market system is more flexible and responsive even than some parts of our domestic economies. There is no ground here for complacency, but some ground for satisfaction.

9. My conclusion is that there are important grounds for hope in the world economy alongside much reason for concern and perplexity. We are past the worst of the recession. The world is rather less dependent on imported oil than it was. Unemployment will begin to fall if we are spared further shocks to the international system and allowed to work steadily for the further reduction of inflation and improvement of the structure of our economies.

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22/7/81.

FINAL 105

DECLARATION OF THE OTTAWA SUMMIT

1. We have met at a time of rapid change and great challenge to world economic progress and peace. Our meeting has served to reinforce the strength of our common bonds. We are conscious that economic issues reflect and affect the broader political purposes we share. In a world of interdependence, we reaffirm our common objectives and our recognition of the need to take into account the effects on others of policies we pursue. We are confident in our joint determination and ability to tackle our problems in a spirit of shared responsibility, both among ourselves and with our partners throughout the world.

THE ECONOMY

2. The primary challenge we addressed at this meeting was the need to revitalize the economies of the industrial democracies, to meet the needs of our own people and strengthen world prosperity.

3. Since the Venice Summit the average rate of inflation in our countries has fallen, although in four of them inflation remains in double figures.

In many countries unemployment has risen sharply and is still rising. There is a prospect of moderate economic growth in the coming year but at present it promises little early relief from unemployment. The large payments deficits originating in the 1979-80 oil price increase have so far been financed without imposing intolerable adjustment burdens but are likely to persist for some time. Interest rates have reached record levels in many countries and, if long sustained at these levels, would threaten productive investment.

4. The fight to bring down inflation and reduce unemployment must be our highest priority and these linked problems must be tackled at the same time. We must continue to reduce inflation if we are to secure the higher investment and sustainable growth on which the durable recovery of employment depends. The balanced use of a range of policy instruments is required. We must involve our peoples in a greater appreciation of the need for change: change in expectations about growth and earnings, change in management and labour relations and practices, change in the pattern of industry, change in the direction and scale of investment, and change in energy use and supply.



5. We need in most countries urgently to reduce public borrowing; where our circumstances permit or we are able to make changes within the limits of our budgets, we will increase support for productive investment and innovation. We must also accept the role of the market in our economies. We must not let transitional measures that may be needed to ease change become permanent forms of protection or subsidy.

6. We see low and stable monetary growth as essential to reducing inflation. Interest rates have to play their part in achieving this and are likely to remain high where fears of inflation remain strong. But we are fully aware that levels and movements of interest rates in one country can make stabilization policies more difficult in other countries by influencing their exchange rates and their economies. For these reasons, most of us need also to rely on containment of budgetary deficits, by means of restraint in government expenditures as necessary. It is also highly desirable to minimize volatility of interest rates and exchange rates; greater stability in foreign exchange and financial markets is important for the sound development of the world economy.

7. In a world of strong capital flows and large deficits it is in the interests of all that the financial soundness of the international banking system and the international financial institutions be fully maintained. We welcome the recently expanded role of the IMF in financing payments deficits on terms which encourage needed adjustment.

8. In shaping our long term economic policies, care should be taken to preserve the environment and the resource base of our planet.

RELATIONS WITH DEVELOPING COUNTRIES

9. We support the stability, independence and genuine non-alignment of developing countries and reaffirm our commitment to cooperate with them in a spirit of mutual interest, respect and benefit, recognizing the reality of our interdependence.

10. It is in our interest as well as in theirs that the developing countries should grow and flourish and play a full part in the international economic system commensurate with their capabilities and responsibilities and become more closely integrated in it.

11. We look forward to constructive and substantive discussions with them, and believe the Cancun Summit offers an early opportunity to address our common problems anew.

12. We reaffirm our willingness to explore all avenues of consultation and cooperation with developing countries in whatever forums may be appropriate. We are ready to participate in preparations for a mutually acceptable process of global negotiations in circumstances offering the prospect of meaningful progress.

13. While growth has been strong in most middle income developing countries, we are deeply conscious of the serious economic problems in many developing countries, and the grim poverty faced especially by the poorer among them. We remain ready to support the developing countries in the efforts they make to promote their economic and social development within the framework of their own social values and traditions. These efforts are vital to their success.

14. We are committed to maintaining substantial and, in many cases, growing levels of Official Development Assistance and will seek to increase public understanding of its importance. We will direct the major portion of our aid to poorer countries, and will participate actively in the United Nations Conference on the Least Developed Countries.

15. We point out that the strengthening of our own economies, increasing access to our markets, and removing impediments to capital flows contribute larger amounts of needed resources and technology and thereby complement

official aid. The flow of private capital will be further encouraged in so far as the developing countries themselves provide assurances for the protection and security of investments.

16. The Soviet Union and its partners, whose contributions are meagre, should make more development assistance available, and take a greater share of exports of developing countries, while respecting their independence and non-alignment.

17. We will maintain a strong commitment to the international financial institutions and work to ensure that they have, and use effectively, the financial resources for their important responsibilities.

18. We attach high priority to the resolution of the problems created for the non-oil developing countries by the damaging effects on them of high cost of energy imports following the two oil price shocks. We call on the surplus oil-exporting countries to broaden their valuable efforts to finance development in non-oil developing countries, especially in the field of energy. We stand ready to cooperate with them for this purpose and to explore with them, in a spirit of partnership, possible mechanisms, such

as those being examined in the World Bank, which would take due account of the importance of their financial contributions.

19. We recognize the importance of accelerated food production in the developing world and of greater world food security, and the need for developing countries to pursue sound agricultural and food policies; we will examine ways to make increased resources available for these purposes. We note that the Italian Government has in mind to discuss within the European Community proposals to be put forward in close cooperation with the specialized U.N. institutions located in Rome for special action in this field primarily directed to the poorest countries.

20. We are deeply concerned about the implications of world population growth. Many developing countries are taking action to deal with that problem, in ways sensitive to human values and dignity; and to develop human resources, including technical and managerial capabilities. We recognize the importance of these issues and will place greater emphasis on international efforts in these areas.

TRADE

21. We reaffirm our strong commitment to maintaining liberal trade policies and to the effective operation of an open multilateral trading system as embodied in the GATT.

22. We will work together to strengthen this system in the interest of all trading countries, recognizing that this will involve structural adaptation to changes in the world economy.

23. We will implement the agreements reached in the Multilateral Trade Negotiations and invite other countries, particularly developing countries, to join in these mutually beneficial trading arrangements.

24. We will continue to resist protectionist pressures, since we recognize that any protectionist measure, whether in the form of overt or hidden trade restrictions or in the form of subsidies to prop up declining industries, not only undermines the dynamism of our economies but also, over time, aggravates inflation and unemployment.

25. We welcome the new initiative represented by the proposal of the Consultative Group of Eighteen that the GATT Contracting Parties convene a meeting at Ministerial level during 1982, as well as that of the OECD countries in their programme of study to examine trade issues.

26. We will keep under close review the role played by our countries in the smooth functioning of the multilateral trading system with a view to ensuring maximum openness of our markets in a spirit of reciprocity, while allowing for the safeguard measures provided for in the GATT.

27. We endorse efforts to reach agreement by the end of this year on reducing subsidy elements in official export credit schemes.

ENERGY

28. We are confident that, with perseverance, the energy goals we set at Venice for the decade can be achieved, enabling us to break the link between economic growth and oil consumption through structural change in our energy economies.

29. Recognizing that our countries are still vulnerable and energy supply remains a potential constraint to a revival of economic growth, we will accelerate the development and use of all our energy sources, both conventional and new, and continue to promote energy savings and the replacement of oil by other fuels.

30. To these ends we will continue to rely heavily on market mechanisms, supplemented as necessary by government action.

31. Our capacity to deal with short-term oil market problems should be improved, particularly through the holding of adequate levels of stocks.

32. In most of our countries progress in constructing new nuclear facilities is slow. We intend in each of our countries to encourage greater public acceptance of nuclear energy, and respond to public concerns about safety, health, nuclear waste management and non-proliferation. We will further our efforts in the development of advanced technologies, particularly in spent fuel management.

33. We will take steps to realize the potential for the economic production, trade and use of coal and will do everything in our power to ensure that its increased use does not damage the environment.

34. We also intend to see to it that we develop to the fullest possible extent sources of renewable energy such as solar, geothermal and biomass energy. We will work for practical achievements at the forthcoming United Nations Conference on New and Renewable Sources of Energy.

35. We look forward to improved understanding and cooperation with the oil exporting countries in the interests of the world economy.



EAST-WEST ECONOMIC RELATIONS

36. We also reviewed the significance of East-West economic relations for our political and security interests. We recognized that there is a complex balance of political and economic interests and risks in these relations. We concluded that consultations and, where appropriate, coordination are necessary to ensure that, in the field of East-West relations, our economic policies continue to be compatible with our political and security objectives.

37. We will undertake to consult to improve the present system of controls on trade in strategic goods and related technology with the U.S.S.R.

CONCLUSION

38. We are convinced that our democratic, free societies are equal to the challenges we face. We will move forward together and with all countries ready to work with us in a spirit of cooperation and harmony. We have agreed to meet again next year and have accepted the invitation of the President of the French Republic to hold this meeting in France. We intend to maintain close and continuing consultation and cooperation with each other.

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## CABINET OFFICE PAPER

The following Cabinet Office papers have been taken off the file. If you require access to these papers please contact the Cabinet Office.

<u>Reference</u>	<u>Date Of Paper</u>
PMVL (81) 9 (b) revise	15/07/1981
PMVL (81) 9 (c) revise	15/07/1981
PMVL (81) 15	15/07/1981
PMVL (81) 7 Revise	16/07/1981

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