

DO-CH/NL/0850  
PART A

Clix  
Lawson

PART A

**SECRET**

(Circulate under cover and  
notify REGISTRY of movement)



PO -CH /NI./ *part*  
0850



G

PART A

CHANCELLOR'S PAPERS ON  
THE MEETING OF THE GROUP  
OF FIVE (G5) FINANCE  
MINISTERS IN LONDON,  
18-19 JANUARY 1985

0850  
/NL/

Begin: 11/11/85

DD: 25 years

Ends: 15/1/86 (CONTINUED)

*[Signature]* 5/9/95

PO -CH

PART A



*mp*

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

11 November 1985

P A Heald Esq MBE  
First Secretary (Economic)  
British Embassy  
No.1 Ichiban-cho  
Chiyoda-ku  
Tokyo 102  
Japan

*Dear Mr Heald,*

... I should be grateful if you could pass the attached letter from the Chancellor to Mr Takeshita.

*Yours sincerely,*

*Philip Wyn Owen,*

P WYNN OWEN  
Assistant Private Secretary



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

8 November 1985

Mr Noboru Takeshita  
Minister of Finance  
Chiyoda Ko  
Kaumigaseki 3-1  
Tokyo  
Japan

A handwritten signature in black ink, appearing to read "Noboru Takeshita".

I thought you would like to be aware of the statements which the United States and the United Kingdom have issued today on unitary taxation, and I am therefore sending you copies herewith.

I am earnestly hoping, after all the disappointments we have had, most recently in California, that progress can now be made towards an acceptable solution.

NIGEL LAWSON

A handwritten signature in black ink, appearing to read "Nigel Lawson".

MINISTRY OF FINANCE  
TOKYO

*b/f 15/1 pl x pl*

11 December 1985

Mr. Nigel Lawson  
Chancellor of the Exchequer  
Treasury Chambers,  
Parliament Street  
AWLP 3AG

| CH/EXCHEQUER |             |
|--------------|-------------|
| REC.         | 17 DEC 1985 |
| ACTION       | FST         |
| COPIES TO    |             |
|              |             |
|              |             |
|              |             |

*17/12*

Dear Mr. Lawson

*X*

Thank you for your letter dated November 8, enclosing copies of the statements which the United Kingdom and the United States issued on that date on unitary taxation.

I am also earnestly hoping that the unitary method of taxation will cease to be applied to foreign companies and that progress will be made towards this goal in the near future.

Sincerely,

*Naoboru Takeshita.*

NOBORU TAKESHITA

SECRET

*File. Perhaps Sir G/L  
at least a word with  
me all stand.*

*C. This looks fine to me and  
X seems a good idea.*

From: Sir G. Littler  
Date: 18 December 1985

*Content for Sir Geoff to write as drafted?*

MR WYNN OWEN

G5 MEETING

*R 18/12*

We need to confirm and give preliminary details in writing.  
One possibility would be a telex from the Chancellor to his  
four colleagues. The attached draft could be turned into this  
very easily.

2. I have in fact drafted as part of a letter from me to my  
four opposite numbers. This is simply because I am in any case  
sending them a paper on how to improve World Bank performance  
which can go through our Embassies. I could add the attached  
text to <sup>my letter</sup> it without the Embassies knowing about it.

(Geoffrey Littler)

SECRET

DRAFT LETTER TO:

Mulford  
Oba  
Tietmeyer  
Lebegue

Following our various telephone conversations in recent days, the Chancellor has asked me to let you know, and ask you to pass on to your Minister and Central Bank Governor, that we now have agreement to a full G5 meeting on January 18/19 in London. It will begin at 7p.m. on Saturday evening, 18 January, resuming the next morning and finishing immediately after lunch. We shall let you know details later, but the venue will be in the Westminster area.

2. Could you please confirm that all three of you can attend? <To Oba and Lebegue only: May I assume you will have your own interpreter as usual?>. We assume you would prefer to make your own accommodation arrangements, but please let me know if you *would* like me to make reservations.

3. Suggested agenda - but grateful for comments if any - might be as follows:

A. Follow-up to Plaza meeting:

- intervention;
- underlying policies and prospects of our countries;
- implications for wider discussions at April meetings.

B. Debt:

- review of general developments since Seoul;
- progress on the three elements of economic policies of debtors, multilateral development banks and commercial banks.

4. In case of need could you personally be available to meet here in advance, earlier on Saturday 18 January, if it seems likely to be helpful to do any preparatory ground-clearing.

5. The Chancellor has asked me to emphasise his wish to keep the fact and nature of the meeting from becoming public if we can. We shall refuse to confirm any rumours and hope you will do the same.

6. We do not regard this as a normal surveillance meeting and are therefore not proposing to invite the Managing Director to join in.

With best wishes.

Geoffrey Littler



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GRS 1000

CULL

RESTRICTED

FM TOKYO

TO DESKBY 190900Z FCO

TELNO 917

OF 190800Z DECEMBER 85

AND TO IMMEDIATE TREASURY, BANK OF ENGLAND, DTI/OTTER

AND TO ROUTINE WASHINGTON, PARIS, BONN, UKREP BRUSSELS, UKDEL OECD.

*b/f 16/1 pl*

THE JAPANESE ECONOMY

SUMMARY

1. OFFICIAL FORECAST FOR ECONOMIC GROWTH NEXT YEAR LIKELY TO BE 4%, COMPARED WITH A REVISED FIGURE OF 4.2% FOR CURRENT YEAR. CURRENT ACCOUNT SURPLUS EXPECTED TO REMAIN UNCHANGED AT USDOLLARS 51 BILLION. NO SUBSTANTIVE TAX CUTS TO BE PROPOSED. GENERAL ACCOUNT BUDGET WILL CONTAIN NO BOOST TO SPENDING BUT FISCAL INVESTMENT AND LOAN PROGRAMME MAY BE INCREASED TO SUPPORT DOMESTIC DEMAND.

DETAIL

OVERALL DEMAND.

2. THE GOVERNMENT'S ECONOMIC FORECAST FOR NEXT YEAR, DUE TO BE PUBLISHED ON 24 DECEMBER, HAS BEEN AUTHORITATIVELY LEAKED TO THE PRESS. ALTHOUGH MINOR DETAILS MAY CHANGE IN THE NEXT FEW DAYS, THE OVERALL PICTURE IS NOW CLEAR. THE ECONOMY IS EXPECTED TO GROW BY 4% IN REAL TERMS, OF WHICH DOMESTIC DEMAND WILL CONTRIBUTE 4.1, REDUCED BY A NEGATIVE EXTERNAL CONTRIBUTION AS EXPORT GROWTH SLOWS. THIS COMPARES WITH A REVISED FORECAST OF 4.2% FOR THE CURRENT YEAR, AN ADJUSTMENT THAT MAINLY REFLECTS THE REBASING OF NATIONAL INCOME FIGURES TO 1980.

3. THE TRADE SURPLUS NEXT YEAR IS EXPECTED TO FALL BY ONLY USDOLLARS 2 BILLION TO USDOLLARS 56 BILLION AND THE CURRENT ACCOUNT SURPLUS WILL REMAIN UNCHANGED AT USDOLLARS 51 BILLION. NO DETAILS ARE YET AVAILABLE OF THE BREAKDOWN BETWEEN IMPORTS AND EXPORTS WITHIN THESE FIGURES, WHICH WILL BE OFFICIALLY CONFIRMED NEXT WEEK.

*14.*

- 1 -

RESTRICTED

## RESTRICTED

4. FORECAST ASSUMES A RISE IN CONSUMER SPENDING NEXT YEAR OF 3.6%, COMPARED WITH 3% THIS YEAR. HOUSING INVESTMENT IS EXPECTED TO RISE BY 4.6% BUT THE MOST DYNAMIC COMPONENT OF DOMESTIC DEMAND WILL AGAIN BE PRIVATE SECTOR INVESTMENT AT 7.5%. CONSUMER PRICES ARE EXPECTED TO RISE AT 1.9% IN THE YEAR, THE LOWEST RATE OF INCREASE FOR 25 YEARS. FINALLY, THE FORECAST ASSUMES AN AVERAGE RATE OF Y204 TO THE US DOLLAR.

### THE BUDGET

5. THERE WILL BE LITTLE SUPPORT TO THE DOMESTIC ECONOMY NEXT YEAR EITHER FROM TAX CUTS OR FROM INCREASED GOVERNMENT SPENDING, UNLESS SUBSTANTIAL CHANGES ARE MADE TO THE NOW VIRTUALLY FINAL DRAFT OF THE BUDGET. THE LDP (GOVERNING PARTY) TAX COUNCIL RECOMMENDED ON SUNDAY THAT THERE SHOULD BE NO SUBSTANTIAL ALTERATION TO TAXATION THIS YEAR, ON THE GROUNDS THAT MAJOR REFORMS WOULD BE INTRODUCED NEXT YEAR. THE COUNCIL'S RECOMMENDATIONS ARE MADE IN BROAD TERMS AND DO NOT, FOR EXAMPLE, INCLUDE DETAILED PROPOSALS ON LIQUOR TAX CHANGES, WHICH WILL NOT BE AVAILABLE UNTIL EARLY IN THE NEW YEAR. NOR HAVE THEY YET BEEN FORMALLY ADOPTED BY THE GOVERNMENT ALTHOUGH THEY ARE UNLIKELY TO BE CHANGED SIGNIFICANTLY. THE EFFECT OF THE RECOMMENDATIONS WOULD BE TO PRODUCE A SMALL NET INCREASE IN TAX NEXT YEAR. NO CUTS IN NATIONAL INCOME TAX ARE PROPOSED, ALTHOUGH THERE WOULD BE A SMALL REDUCTION IN LOCAL INCOME TAX. THE CORPORATION TAX SURCHARGE OF 1.3% WILL REMAIN AND THE RULES PERMITTING CARRY FORWARD OF TAX LOSSES WILL BE TIGHTENED. THE CURRENT (MODEST) TAX INCENTIVES TO BUY IMPORTED MACHINERY WILL BE SLIGHTLY INCREASED. FURTHER DETAILS OF THESE OUTLINE CHANGES BY BAG (NOT TO ALL).

6. THE BUDGET FOR NEXT YEAR, BASED ON THESE RECOMMENDATIONS, WILL NOT BE FORMALLY ADOPTED UNTIL THE MIDDLE OF NEXT WEEK. IT IS UNLIKELY, HOWEVER, THAT ANY INCREASE IN GENERAL ACCOUNT EXPENDITURE WILL BE PERMITTED AND THE MINISTRY OF FINANCE IS CURRENTLY WORKING TO CUT BACK THE PRELIMINARY SUBMISSIONS MADE BY DEPARTMENTS IN THE LATE SUMMER TO PRODUCE A SLIGHT REDUCTION IN SPENDING. OVERALL GENERAL ACCOUNT EXPENDITURE WILL NEVERTHELESS RISE BY 3%, REFLECTING INCREASED DEBT SERVICE COSTS AND AUTOMATIC TAX TRANSFERS TO LOCAL GOVERNMENT. AS A RESULT, IT IS VERY UNLIKELY THAT THE TARGET OF A Y1 TRILLION CUT IN BOND ISSUES WILL BE ACHIEVABLE. THE OUTCOME IS MORE LIKELY TO BE CLOSE TO HALF THAT FIGURE. FURTHER DETAILS IN OUR MONTHLY ECONOMIC REPORT, DESPATCHED BY BAG.

/7.

- 2 -  
RESTRICTED

## RESTRICTED

7. UNCONFIRMED REPORTS SUGGEST THAT ANY INCREASES IN EXPENDITURE WILL BE CONFINED TO THE FISCAL INVESTMENT AND LOAN PROGRAMME, WHICH MAY BE PERMITTED TO RISE NEXT YEAR BY AS MUCH AS 5-10%, AFTER REMAINING UNCHANGED THIS YEAR. IF SUCH AN INCREASE IS ALSO ACCOMPANIED BY ADDITIONAL CAPITAL EXPENDITURE BY LOCAL GOVERNMENT, THE OVERALL IMPACT OF THE BUDGET MAY BE LESS RESTRICTIVE. DETAILS IN THIS AREA WILL NOT BE AVAILABLE UNTIL FIRST WEEK OF NEW YEAR AND WILL BE REPORTED THEN.

### COMMENT

8. THE PROBABLE OFFICIAL FORECAST OF 4% FOR REAL GNP GROWTH NEXT YEAR WILL NOT BE SEEN AS CREDIBLE UNLESS THE GOVERNMENT IMPLEMENTS FURTHER MEASURES TO STIMULATE THE DOMESTIC ECONOMY EARLY IN THE YEAR. THE ECONOMIC PLANNING AGENCY'S INITIAL FORECAST, ON WHICH THE OFFICIAL FORECAST IS BASED, IS BELIEVED TO BE 3.8%, BUT THIS HAS BEEN RAISED IN DISCUSSIONS WITH THE MINISTRY OF FINANCE TO THE MINIMUM LEVEL NECESSARY TO ENSURE A FORECAST THAT DOES NOT INCLUDE AN INCREASED CURRENT ACCOUNT SURPLUS NEXT YEAR. (THE OFFICIAL FIGURES LEAKED YESTERDAY ACKNOWLEDGE THAT THE CURRENT ACCOUNT SURPLUS THIS YEAR WILL BE DOLLARS 51 BN RATHER THAN THE OFFICIAL FORECAST OF DOLLARS 34 BN.) PRIVATE SECTOR FORECASTERS ARE TAKING A MUCH MORE CAUTIOUS VIEW ON GROWTH AND EVEN THE JAPAN ECONOMIC RESEARCH CENTRE FORECAST YESTERDAY, OF 3.2%, WOULD BE REGARDED AS BEING AT THE HIGH END OF THE RANGE. FULL DETAILS OF THIS AND OTHER FORECASTS FOLLOW BY BAG.

GIFFARD

FINANCIAL

FED.

-3-  
RESTRICTED

SECRET



FROM: P WYNN OWEN  
DATE: 19 December 1985

SIR G LITTLER

Debbie  
Any response on  
Monday?

R 20/12

**G5 MEETING**

The Chancellor has seen your minute of 18 December and is content for you to include the attached text in your letter to your four opposite numbers. We will see if we can find 10 minutes for you to have a word with the Chancellor about a possible venue over the next few days.

R.

P WYNN OWEN

Note rec'd back from 2/1.  
letter already sent  
due to urgency of order

Off for folders with letters to Brig Cowan

\* That WPA of course  
with me to contribute  
to make the location  
a bit more prominent



FROM: P WYNN OWEN  
DATE: 24 December 1985

No harm done  
11/7/85

cc Sir G Littler o.r.  
Mr Kuczys o.r.  
Mrs Lester

CHANCELLOR

Thanks.  
Big all news go  
ahead with this on a  
provisional basis.  
I may have to  
split some of  
space there may be  
needed for our  
own dinner  
o.r.  
M.

G5 MEETING

We had a preliminary discussion about administrative arrangements for the G5 on January 18/19. Your inclination was perhaps to use Admiralty House for the dinner on the Saturday, with the Sunday meeting and lunch at No.11. But you have said you will want to discuss with Sir Geoffrey Littler early in the New Year.

2. I have had preliminary discussions with Brigadier Cowan of GHF. They have made a preliminary booking of Admiralty House for the whole weekend, in case we wish to make full use of it. GHF will provide both the dinner on the Saturday and the lunch on the Sunday, though they may have to charge the Treasury for one meal. The dinner would be four courses and the lunch three.

3. Admiralty House has a Music Room in which the meeting could take place, with a small room next door for any Secretariat etc. There is a Drawing Room for drinks and a Dining Room for meals. The Dining Room table takes a maximum of 18. I said I thought that was fine, since we had 15 key participants, plus perhaps two translators.

4. Work needs to be done soon after Christmas on involving the Special Branch, PSA (on administrative arrangements for Admiralty House) and in consulting overseas colleagues about various travel plans. But the first priority is to write to the Brigadier in GHF formally requesting him to lay on the dinner and the lunch.



5. I attach a draft letter which I propose to send if you are content.

*P.O.*

P WYNN OWEN

Draft letter to  
Brigadier Cowan  
GHF

We spoke on the phone and I agreed to write to confirm my request that GHF provides two meals on the weekend of 18/19 January.

The first would be a dinner for up to 18 people, at 7 for 7.30 pm, on the evening of Saturday 18 January in Admiralty House. A separate facility for two support staff to dine in your out-mess would also be appreciated. The Chancellor envisages this being a full, four course dinner, with service and all the trimmings. The location is likely to be Admiralty House.

The second meal will be lunch, 1 for 1.30 pm, on Sunday 19 January, for the same numbers. It is possible that the location for this, and indeed for the full meeting on the Sunday morning, will be No.11 Downing Street rather than Admiralty House. I will confirm details as soon as possible.

In the meantime, perhaps you could confirm that GHF are willing to provide both these meals and whether either will have to be on a repayment basis. I should also be grateful if we could be provided with various alternative menus (perhaps three for each meal) which the Chancellor can study in the New Year.

PWO

85-12-29 07:03

\*  
262405 TRSY G  
MOF J24980

DECEMBER 29 1985

THE RIGHT HONOURABLE  
NIGEL LAWSON, MP  
CHANCELLOR OF THE EXCHEQUER  
H.M. TREASURY  
LONDON

b/f 16/1 for G5  
Folder

YOUR EX

|              |                         |
|--------------|-------------------------|
| CH/EXCHEQUER |                         |
| REC.         | 24 DEC 1985             |
| ✓            | CST, PST, EST, MST      |
| COPIES TO    | SIR P MIDDLETON         |
|              | SIR G LITTLE            |
|              | MR LAVELLE, MR FITCHETT |
|              | MR C KEW, MR S MATTHEWS |

30/12

85-12-29 07:05

\*  
262405 TRSY G  
MOF J24980

DECEMBER 29 1985

THE RIGHT HONOURABLE  
NIGEL LAWSON, MP  
CHANCELLOR OF THE EXCHEQUER  
H.M. TREASURY  
LONDON

YOUR EXCELLENCY,

I AM PLEASED TO INFORM YOU THAT I HAVE BEEN REAPPOINTED  
MINISTER OF FINANCE IN THE NEW NAKASONE CABINET.

I AM DEEPLY HONORED TO BE ABLE TO CONTINUE WORKING WITH  
YOU IN THIS POSITION AND TO TACKLE WITH THE PROBLEMS WE ARE  
NOW FACING IN THE WORLD ECONOMY. I LOOK FORWARD TO A CONTINU-  
ANCE OF THE PRESENT FINE RELATIONSHIP BETWEEN OUR COUNTRIES.

WITH MY BEST WISHES FOR THE NEW YEAR,

SINCERELY YOURS,

NOBORU TAKESHITA  
MINISTER OF FINANCE

END\*  
262405 TRSY G

29/12/85 3 R King





b/f 3/1  
for Sir G  
letter  
may folder

Foreign and Commonwealth Office

London SW1A 2AH

30 December 1985

cc PS / chamberlain } I have  
to P. Middleton } not to do  
to G. Dittler } anything further  
on matters } until they hear  
M. Kelly } from us

Dear Charles,

Letter to the Prime Minister from the Italian Prime Minister

The Prime Minister will wish to be aware that the Italians have today made a demarche over their exclusion from G5 meetings. I enclose a copy of Craxi's message to her, together with the Italian Embassy's rough translation.

The Italian Charge was under instructions to speak to a Minister about this. He therefore contacted Mr Rifkind (in Edinburgh), but in speaking to him did not add any points of substance to those in the message. Mr Rifkind merely took note.

We shall consider this demarche and write again with advice on how best the Prime Minister might reply to it.

Yours ever,

*R N Culshaw*  
(R N Culshaw)  
Private Secretary

C D Powell Esq  
10 Downing Street

*CDP*

*Mr Dwyer 31/12.*  
A copy in immediacy to Hunt & discuss with them how the PM might respond.

*Stigman 31/12*

- ✓ *cg.* PS
- PS/Lady Young
- PS/Mr Rifkind
- PS/PUS
- Mr Derek Thomas
- Mr Brantlwaite
- Mr David
- WED

88 31/12

10/11

TEXT OF MESSAGE ADDRESSED TO THE RT. HON. MARGARET THATCHER, MP  
BY THE PRESIDENT OF THE ITALIAN COUNCIL OF MINISTERS, SIGNOR  
BETTINO CRAXI

ROUGH TRANSLATION

Dear Prime Minister,

It has been some time now, that in our meetings and especially at the economic summits (lately at the Bonn Summit) we discussed ways to improve the international monetary system. It is a need felt by everybody and particularly by the most industrialized countries to which befalls the difficult task of insuring an orderly functioning of the exchange markets.

It was therefore with astonishment that the Italian Government learnt of the meeting in New York of the five Finance Ministers of the United States, Japan, France, Federal Republic of Germany and United Kingdom. On that occasion important decisions were taken with regard to interventions on the exchange markets and commitments were made with regard to the definition of economic policies. Such decisions certainly went in the right direction and had been advocated for some time by the Italian Government.

That does not alter the fact that it is the opinion of the Italian Government that decisions of such nature should not be reached without the participation of the countries called to share the resulting burden and hence Italy. And this for the following three reasons:

First, because Italy is one of the industrialized countries which, within the economic summits of the seven largest industrialized democracies, takes part in the drawing up of the monetary and economic policies designed to contribute to the development of the world economy. We do not therefore understand our exclusion from decisions which will directly bear effect upon

./..

us and which are of the same nature as the ones taken at the economic summits.

Second, because our participation to the European Monetary System binds us to keep in line with the Deutsche Mark, whose position in relation to the US Dollar would be determined by a Forum such as the one of the Group of Five, to which we do not belong. The consequences are for us very serious, since we are the European Country which has had to bear the heaviest burden of the interventions in the exchange market, following the decisions taken in New York on September 22nd.

Third, because the possibility of granting such a mandate to the Group of Five has never been discussed, since it is an informal group and as such not meant to take decisions, especially if they were to have an extensive impact on the economies of other principal partners.

The Italian Government are aware that a second meeting of the Group of Five could take place in January, following the decisions taken on the 22nd of September.

Our exclusion entails the risk of emptying of substance the preparatory works of the next economic summit in Tokyo. We have already given a considerable contribution to the improvement of the international monetary system, after the decisions of the 22nd of September. It would be for us difficult and unjustifiable to continue to do so, if we are excluded from a direct participation to decisions, which, I would like to stress, bear directly upon us.

I look forward, Dear Prime Minister, to an assurance from your part on this matter.

With the expression of my esteem and friendship,

Bettino Craxi



cc Sir G. LITTLER  
Mr. KUCZYS  
Mrs. LESTER

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

Brigadier Alan Cowan MBE  
Government Hospitality Fund  
2 Carlton Gardens  
LONDON SW1

30 December 1985

Dear Brigadier Cowan,

We spoke on the phone and I agreed to write to confirm my request that GHF provides two meals on the weekend of 18/19 January.

The first would be a dinner for up to 18 people, at 7 pm for 7.30 pm, on the evening of Saturday 18 January in Admiralty House. A separate facility for two support staff to dine in your out-mess would also be appreciated. The Chancellor envisages this being a full, four course dinner, with service and all the trimmings. The location is likely to be Admiralty House.

The second meal will be lunch, 1 pm for 1.30 pm, on Sunday 19 January, for the same numbers. It is possible that the location for this, and indeed for the full meeting on the Sunday morning, will be No 11 Downing Street rather than Admiralty House. I will confirm details as soon as possible.

In the meantime, perhaps you could confirm that GHF are willing to provide both these meals and whether either will have to be on a repayment basis. I should also be grateful if we could be provided with various alternative menus (perhaps three for each meal) which the Chancellor can study in the New Year.

Yours sincerely,

*Philip Wynn Owen*

P WYNN OWEN  
Private Secretary

GRS 250

RESTRICTED

RESTRICTED [CULL]  
FM TOKYO  
TO PRIORITY FCO  
TELNO 938  
OF 310700Z DECEMBER 85  
INFO PRIORITY HM TREASURY  
INFO ROUTINE PARIS, WASHINGTON, BONN

1. cc Sir G Litter  
Mr Lanelle ✓  
Mr Culpin 2/1/86  
2. k/f 3/1 for  
Litter M/M on c/

PROPOSED VISIT TO EUROPE AND THE US BY THE JAPANESE  
FINANCE MINISTER

1. IN AN INTERVIEW IN THE YOMIURI ON 30 DECEMBER  
FINANCE MINISTER TAKESHITA HINTED AT PLANS TO VISIT THE UK  
IN MID-JANUARY AS PART OF A SERIES OF CONSULTATIONS TO SECURE  
INTERNATIONAL AGREEMENT ON THE LOWERING OF INTEREST RATES.
2. TODAY'S (31 DECEMBER) PRESS, QUOTING GOVERNMENT SOURCES,  
REPORTED THAT TAKESHITA WOULD VISIT THE UK FROM 16 JANUARY  
PRIOR TO A VISIT TO THE US. ACCORDING TO THE PRESS, HIS  
ITINERARY WAS STILL UNCLEAR, BUT TAKESHITA HOPED TO MEET  
THE CHANCELLOR OF THE EXCHEQUER AND VISIT THE LONDON OFFSHORE  
BANKING CENTRE. THE ARTICLES ALSO SAID THAT TAKESHITA WAS  
CONSIDERING A MEETING WITH THE FRENCH AND GERMAN FINANCE  
MINISTERS BUT ONLY A MEETING WITH THE CHANCELLOR HAD SO FAR  
BEEN ARRANGED. SOME NEWSPAPERS HAVE HINTED THAT THERE MAY  
BE A G5 MEETING IN LONDON ON 19 JANUARY.
3. GOVERNMENT OFFICES ARE NOW CLOSED UNTIL 4 JANUARY.  
AVAILABLE MOF OFFICIALS ARE UNABLE TO CONFIRM THESE REPORTS.  
THE US EMBASSY ARE UNAWARE OF A PROPOSED G5 MEETING IN LONDON:  
NOR DO THEY HAVE ANY DETAILS OF TAKESHITA'S PROPOSED US VISIT.

GIFFARD

FINANCIAL  
FED  
NAD  
WED

THIS TELEGRAM  
WAS NOT  
ADVANCED

RESTRICTED

UNCLASSIFIED  
SAVING TELEGRAM

b/f 17/1 pl

FROM BONN

FRAME ECONOMIC

TO FCO TELNO 19 SAVING OF 31 DECEMBER 1985. Info all EC Posts, UKDel OECD, UKMis Geneva, all Consulates-General in the Federal Republic, Washington, Tokyo, Vienna

FEDERAL GERMAN ECONOMY

Summary

1. Another good month and the year closes on a positive note with nearly all the indicators pointing in the right direction. Production is up 2% on the month as are new orders. Inflation remains low.
2. The Bundesbank announced a slightly less restrictive monetary target for 1986 and gave the go-ahead for the introduction of CDs in an attempt to further liberalize the financial market. Plans for reforms aimed at making the German Stock Exchanges more competitive were also announced during the month.
3. On the labour front, the Cabinet agreed draft legislation to limit further the extent of unemployment benefit payable to strikers.
4. A good year for the FRG economy in 1985; 1986 expected to be even better.

Detail

5. The November IFO survey of business confidence shows a further improvement, with November up on October and good prospects for the next six months. The IFO business climate indicator now stands at levels last recorded in 1979. This optimism is firmly supported by the latest (October) statistics. New orders are up 2% on the month as is production; construction recorded a 7% increase while private consumption in Q3 grew by 2.4% on the year earlier. Prices (cost of living index) remain stable at 1.8% and inflation over the year as a whole is likely to be 2.2%. Only unemployment spoils the picture with a rise of 62,000 in November to stand at 2.21 million.
6. The main event of the month was the announcement by the Bundesbank Council (Bonn telno 1205 of 19 December) that it would raise its CBM target range to 3.5% to 5.5% in 1986 (after 3% to 5% this year) to allow for stronger economic growth without encouraging inflationary pressures. This move will satisfy those who have called for a less restrictive monetary target. On the other hand, it does not meet the demands of those who recommend a medium-term monetary strategy or call for a greater degree of deflation.

7. The Bundesbank also announced that it would allow the introduction of Deutsche Mark Certificates of Deposit in early 1986. The decision is seen as a further attempt to liberalize West German financial markets and increase their competitiveness.

8. However Bangemann, the Minister of the Economy, confirmed that a remaining impediment to liberalization - the Stock Exchange turnover tax - would not be abolished during the current legislative period. In terms of international competitiveness this will leave West German Stock Exchanges at a disadvantage and discourage current efforts to bring about reform. The latest reform measure was announced on 19 December under which the eight regional exchanges will be up-graded into an association with their headquarters in Frankfurt. Although all exchanges will remain independent, voting procedures will take account of the importance of the Frankfurt and Düsseldorf exchanges (which account for over 80% of business). Further plans for reform include the introduction of option dealings in bonds in April 1986 and continued pressure on the government to abolish the Stock Exchange turnover tax.

9. On 18 December the Cabinet approved draft legislation, which will be tabled in early 1986, amending the law affecting strikers' benefits. There has been fierce controversy about the amendment which relates to the practice of paying unemployment benefit to workers laid off as a result of the indirect effects of industrial disputes. Unions (latterly in the 1984 metal workers' strike) have pulled out key workers in selected regions (paying them strike money) knowing that members in other regions would qualify for unemployment benefit if they were thrown out of work because of the strike. The proposed legislation is designed to stop this practice. However the measures fall short of the demands of employers who called for the disqualification from benefit of anyone dismissed or locked out as a result of an industrial dispute, regardless of whether he had a direct or indirect interest in its outcome. On the other hand the unions are likely to exert pressure on the government to tone down the amendment, through a series of "actions" (most likely in the form of demonstrations and marches but not widespread industrial action) in the run-up to the amendment's passage through Parliament.

10. This slightly sour note apart, and despite the continuation of high unemployment figures, the government go into 1986 with growing confidence in their economic policies and performance. They now know that if the forecasters are right 1986 will be an even better year than 1985, with all that that means for the Federal elections in early 1987.

11. They have good reason to be confident. Despite appalling weather in the first quarter, real GNP in 1985 is likely to grow by 2.5%, the third successive year of growth. Since taking office in October 1982 the government have reduced inflation from the levels of 5.3% and 6.3% in 1982 and 1981 respectively to today's level of 1.8%. In the same years real wages fell by 2% while an increase of 2% has been achieved under Kohl's stewardship. Reaching these levels of price stability through the pursuit of a fairly restrictive monetary policy and through budgetary consolidation has

/helped

helped the FRG's international competitiveness. This, together with lower raw material costs and, until recently, a favourable DM/US\$ relationship, have combined to create record surpluses on current account of DM 18 billion in 1984 and an estimated DM 35 billion this year.

12. The one blot on the economic record remains unemployment. But even here the government can point to some success despite the overriding handicap of unfavourable demographic factors. Thus, although unemployment remains around 2.2 to 2.3 million, short-time working has been reduced by about 1 million since the beginning of 1983 and the number in employment in December 1985 has risen by around 235,000 on a year earlier.

13. All commentators are agreed that 1986 promises to be even better than 1985. The economic year will begin with the introduction of the first stage of income tax reform, a reduction of DM 11 billion - the largest in the history of the Federal Republic. The effects of the reform on the economy will be to increase private consumption, and 1986 should see the export-led upturn give way to a new phase of economic growth in which domestic demand will begin to dominate. This process will be helped by higher investment activity and by a pick-up in the construction industry. All forecasters are unanimous in concluding that in 1986 the economic upswing will continue and widen in scope. The economic situation and prospects have not looked so good since 1979, and the upswing has a solid foundation since the economic environment in the FRG is virtually free of tension. The inflation rate is expected to stay below 2% thus creating favourable conditions for an adequate supply of liquidity and for low interest rates. In addition earnings prospects for 1986 continue to be good which means that there is a fair chance for a return to a better distribution of company income.

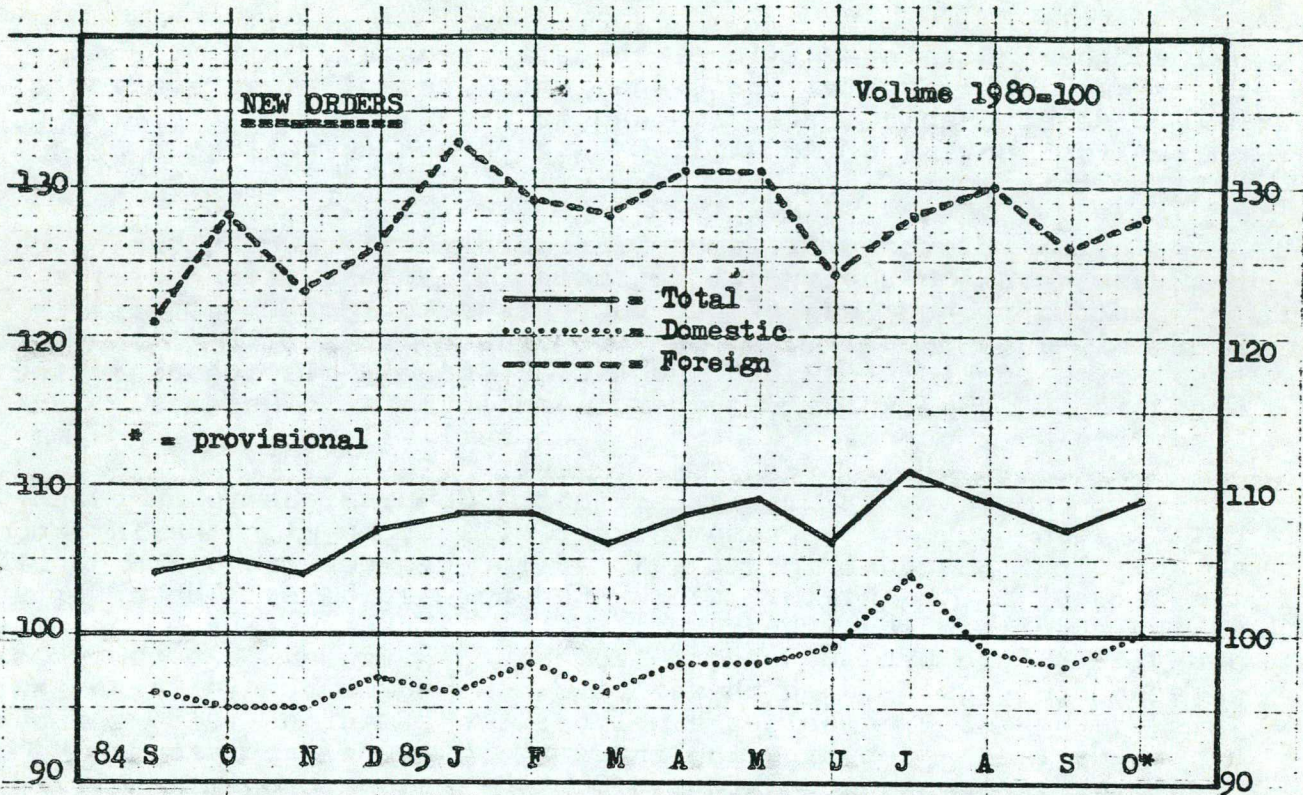
14. Nevertheless the government clearly intend to stick firmly to their policy of budgetary consolidation. This was reflected in a report introduced by Stoltenberg on 19 December entitled "Tasks and Objectives for a New Fiscal Policy", which underlines the need for continued expenditure discipline into the 1990's (rising by only 3%, nominal) to create a framework whereby the tax ratio could be reduced by about 2% to 21.7% and government expenditure (as a percentage of GNP) to 43%, thus allowing further tax relief of DM 60 billion over the period 1989-1995.

#### Prospects and Indicators

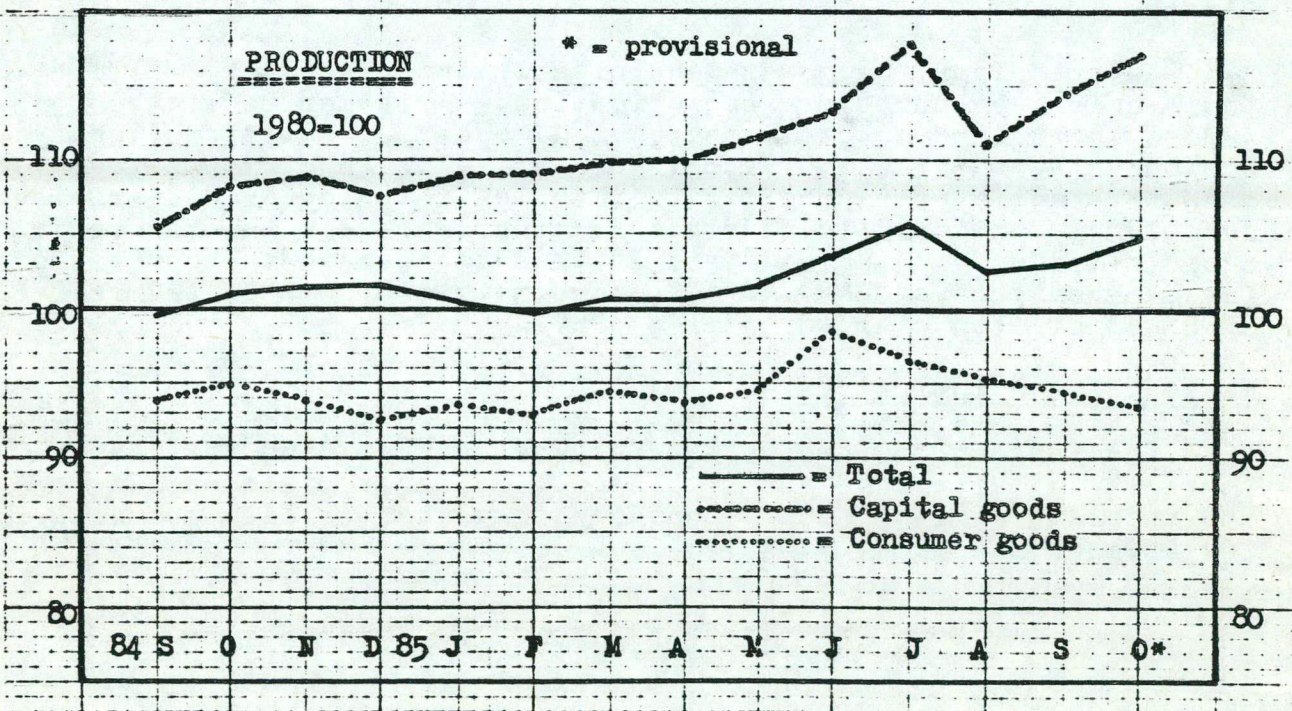
15. Provisional new orders figures for October show a 2% real increase in overall demand with domestic orders rising by 2% and export orders by 1.5%. Compared to a year earlier overall real demand was up by 4.5%

/New Orders





16. Despite the fact that September's production figures were revised upwards by 1%, October's statistics record a further 2% rise on the month, remaining unchanged on a two-monthly comparison. Manufacturing output fell slightly - down 0.5% - while capital goods output recorded a 1% increase.



17. Inflation, cost of living index, remained at 1.8% in November, the same as October's level, and the moving average for the year so far eased to 2.2%.

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:                                     % increase                                     :
:                                     on a year earlier                               :
:                                     :                                               :
: *****                               :                                               :
: FRG - INFLATION                       :                                               :
: *****                               :                                               :
: (Cost of living index)                !2.5!2.5!2.5! Moving average 1985:      :
:                                     !////!////!////!                                     :
:                                     !2.3!////!////!////!2.3!2.3!      :
:                                     !////!////!////!////!////!////!2.2!      :
:                !2.1!2.1!                !2.1!////!////!////!////!////!////!2.1!////!      :
:                !////!////!2.0!////!////!////!////!////!////!////!////!////!      :
:                !////!////!////!////!////!////!////!////!////!////!////!////!      :
:                !////!////!////!////!////!////!////!////!////!////!////!////!1.8!1.8!      :
: !1.7!                !////!////!////!////!////!////!////!////!////!////!////!////!      :
: !////!                !////!////!////!////!////!////!////!////!////!////!////!////!      :
:                !////!1.5!////!////!////!////!////!////!////!////!////!////!////!      :
:                !////!////!////!////!////!////!////!////!////!////!////!////!      :
:-----:-----:-----:-----:-----:-----:-----:-----:-----:-----:-----:
: Aug:Sep:Oct:Nov:Dec:Jan:Feb:Mar:Apr:May:Jun:Jul:Aug:Sep:Oct:Nov:Dec:
=====84=====85=====

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18. Third quarter figures for private consumption show an acceleration, growing by 2.4% in real terms on the same period a year ago. Private consumption as measured by retail trade turnover shows a real increase of 2.2% in October on a year earlier and the latest IFO survey reflects the upturn in turnover with an improvement in the business climate within the consumer goods industry. There is now unanimous agreement among forecasters that 1986 will see a strong upturn in private consumption with growth in 1986 expected to be around 3% real.

19. Current account figures for October show a surplus of DM 6.2 billion. Exports in October reached a record level of DM 49.3 billion, with the trade surplus for the first ten months of the year at DM 58.3 billion already exceeding the record level of 1984. Criticism of the high level of the FRG's current account surplus encouraged the Bundesbank to publish an article in its December report trying to put the surplus into perspective. According to the Bundesbank, in the three months to the end of October the seasonally adjusted current account surplus was only slightly up on the preceding three month period. The visible trade surplus was actually DM 3 billion lower despite lower import prices. The article suggests that this development reflects the broadening nature of economic growth with the emphasis moving to domestic demand.

20. Leading interest rates remained unchanged with the discount rate at 4% and Lombard at 5.5%. Market rates, yield on bonds outstanding, averaged 6.7% in November after 6.6% in October.

/FRG INTEREST RATES

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=====
:
:
:      17.7!
:      1///!
:      17.5!///!
:      1///!///!
:      1///!///!17.3!
:      1///!///!///!
: 17.1!///!///!///!17.1!
: 1///!///!///!///!///!17.0!
: 1///!///!///!///!///!///!
: 1///!///!///!///!///!///!16.8!
: 1///!///!///!///!///!///!///!
: 1///!///!///!///!///!///!///!16.7!
: 1///!///!///!///!///!///!///!16.6!///!
: 1///!///!///!///!///!///!///!16.5!
: 1///!///!///!///!///!///!///!16.4!///!///!///!
: 1///!///!///!///!///!///!///!///!///!///!
:
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Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec*Jan Feb Mar Apr May
=====85=====86=====

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\*\*\*\*\*  
 FRG INTEREST RATES  
 Yield on bonds outstanding  
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§  
 \* = moving monthly average

BULLARD  
 FRAME ECONOMIC  
 ECD (1)

21. Provisional new orders figures for October show a 2 per cent increase in overall demand, with domestic orders rising by 2 per cent and foreign demand by 1.5 per cent. The two-monthly comparison, September/October on July/August, shows a 2 per cent decline in incoming orders with domestic orders down 2.5 per cent and export orders down by 1.5 per cent. Consumer goods demand fell particularly sharply (- 5 per cent) while other sectors recorded falls of 1 per cent. Compared to a year earlier overall demand in real terms was 4.5 per cent higher with domestic demand up by 5 per cent and foreign demand by 3 per cent. Orders for capital goods were 6 per cent higher than a year earlier.

NEW ORDERS  
1980=100

|           | Total |         | Domestic |        | Foreign |        |
|-----------|-------|---------|----------|--------|---------|--------|
|           | Value | Volume* | Value    | Volume | Value   | Volume |
| 1984 July | 119   | 103     | 110      | 95     | 141     | 122    |
| August    | 121   | 104     | 112      | 97     | 139     | 120    |
| Sept      | 121   | 104     | 111      | 96     | 142     | 121    |
| Oct       | 123   | 105     | 111      | 95     | 150     | 128    |
| 1985 July | 132   | 111     | 123      | 104    | 153     | 128    |
| Aug       | 130   | 109     | 118      | 99     | 155     | 130    |
| Sept      | 128   | 107     | 117      | 98     | 151     | 126    |
| Oct (p)   | 130   | 109     | 119      | 100    | 154     | 128    |

\* = at constant prices  
p = provisional

/Production

**Production**  
=====

22. Provisional production figures for October show a 2 per cent increase on September. It should be noted that the September results have been revised upwards by 1 per cent. The two-monthly comparison, September/October on July/August, shows an unchanged level of production. Manufacturing sector output fell slightly (- 0.5 per cent) although capital goods output recorded a 1 per cent increase. Compared to the corresponding two-month period a year earlier overall production was 4 per cent higher, with manufacturing output up by 5 per cent. Capital goods led the field (+ 9 per cent) followed by basic and producer goods (+ 2 per cent) while consumer goods output was unchanged. Construction activity remained below the level of a year earlier (- 3.5 per cent).

PRODUCTION  
1980=100  
=====

|           | Total | Basic & producer goods | Capital goods | Consumer goods | Construction |
|-----------|-------|------------------------|---------------|----------------|--------------|
|           | ===== | =====                  | =====         | =====          | =====        |
| 1984 July | 100.4 | 97.9                   | 105.1         | 96.1           | 95.5         |
| Aug       | 99.6  | 96.9                   | 105.7         | 92.9           | 88.1         |
| Sept      | 99.6  | 97.4                   | 105.2         | 93.9           | 85.2         |
| Oct       | 101.1 | 99.2                   | 108.1         | 94.9           | 86.9         |
| 1985 July | 105.8 | 101.0                  | 117.9         | 96.3           | 89.0         |
| Aug       | 102.4 | 101.0                  | 111.0         | 95.1           | 81.1         |
| Sept      | 103.0 | 99.4                   | 114.3         | 94.3           | 79.1         |
| Oct*      | 104.9 | 101.0                  | 117.0         | 93.4           | 84.7         |

\* = provisional  
=====

/Prices  
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Prices

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23. Inflation, cost of living index, in November remained at 1.8 per cent. Month-on-month prices rose by 0.2 per cent. The moving average for the year so far eased to 2.2 per cent. Food prices in October were 0.1 per cent lower than a year earlier. Inflation over the year as a whole looks set to be 2.2 per cent with forecasts for next year suggesting 2 per cent or below.

24. The annual increase in retail prices in November rose to 1.6 per cent after 1.4 per cent in October. Month-on-month retail prices rose by 0.4 per cent. Other indicators are for October. Industrial producer price rises eased back sharply to 1.3 per cent, compared to 2.0 per cent in September. Import prices continue to fall, standing in October 4.7 per cent lower than a year earlier. Export price rises also eased further, the annual rate currently standing at 1.3 per cent after 2.0 per cent in September. Figures for agricultural producer prices show a month-on-month fall of 1.9 per cent, remaining well down on a year earlier (- 5.3 per cent). Latest Terms of Trade figures for October show a slight decline on the preceding month (- 1 per cent), but they are nevertheless 2.5 per cent up on a year earlier.

PRICES  
1980=100

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|          | Cost of living | Industrial producer prices | Agricultural producer prices | Retail prices | Import prices | Export prices |
|----------|----------------|----------------------------|------------------------------|---------------|---------------|---------------|
|          | =====          | =====                      | =====                        | =====         | =====         | =====         |
| 1984 Aug | 118.2          | 119.3                      | 106.8                        | 115.3         | 123.2         | 116.5         |
| Sep      | 118.3          | 119.7                      | 107.5                        | 115.2         | 124.7         | 117.1         |
| Oct      | 119.0          | 120.3                      | 106.7                        | 115.4         | 125.5         | 117.5         |
| Nov      | 119.2          | 120.3                      | 106.0                        | 115.9         | 124.7         | 117.5         |
| 1985 Aug | 120.7          | 121.9                      | 102.7                        | 117.0         | 122.4         | 119.6         |
| Sep      | 120.9          | 122.1                      | 103.0*                       | 117.3         | 123.0         | 119.5         |
| Oct      | 121.1          | 121.9                      | 101.0*                       | 117.3         | 119.6         | 119.0         |
| Nov      | 121.3          |                            |                              | 117.8         |               |               |

% increase on a year earlier:

|          | C.of L. | Ind.Pr. | Agr.Pr. | Retail | Import | Export |
|----------|---------|---------|---------|--------|--------|--------|
|          | =====   | =====   | =====   | =====  | =====  | =====  |
| 1985 Aug | + 2.1%  | + 2.2%  | - 3.8%  | + 1.5% | - 0.6% | + 2.7% |
| Sep      | + 2.2%  | + 2.0%  | - 4.2%  | + 1.8% | - 1.4% | + 2.0% |
| Oct      | + 1.8%  | + 1.3%  | - 5.3%  | + 1.4% | - 4.7% | + 1.3% |
| Nov      | + 1.8%  |         |         | + 1.6% |        |        |

\* = provisional

/Private Consumption  
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Private consumption

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25. Third quarter figures for private consumption show an accelerating growth rate. While in Q1 and Q2 the comparison with a year earlier showed - 0.2 per cent and + 1 per cent respectively, private consumption in Q3 recorded 2.4 per cent growth in real terms. Growth on Q2 was 1.6 per cent. Forecasters are unanimous that 1986 will see a strong upturn in private consumption with growth on 1985 expected to be around 3 per cent real.

26. Retail trade turnover figures for October show a nominal increase of 3.7 per cent on a year earlier, in real terms a rise of 2.2 per cent. In the first ten months of the year turnover was 2.2 per cent higher in nominal terms compared to the corresponding period 1984, in real terms a rise of 0.5 per cent. The latest Ifo survey reflects the upturn in turnover with an improvement in the business climate within the industry, with prospects for the coming six months also brightening. Price rises are expected to remain moderate in the coming months. In November the index of retail prices recorded an increase of 1.8 per cent on a year earlier, after 1.4 per cent in October.

Labour and Social Affairs

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27. Unemployment rose in November by 62,000 - about double the normal seasonal increase - to 2.21 million or 8.9% against 8.6% in October and 8.8% a year ago. The Federal Labour Institute drew attention to the very severe weather experienced about the middle of November but this seemed to be only a partial explanation of the rise. The increase was the more disappointing because since reaching record levels last January the gap between the 1985 figures and those of the previous two years had narrowed. It had been hoped that this November's figure would be marginally less than that of a year ago. It is estimated that over 200,000 new jobs have been created since the beginning of the year and it is thought that part of the explanation for the increase in registrations lies in the return to the labour market of previously "discouraged" workers and part in demographic factors. The Federal Labour Institute now estimate that the average level of unemployment for 1985 will be 2.3 million compared with previous estimates in the autumn of 2.27 million and in the Spring of 2.25 million. The seasonally adjusted unemployment figures also show their first rise since January to 2.29 million. The detailed figures are as follows:

/ End

|                       | <u>End November<br/>1985</u> | <u>End October<br/>1985</u> | <u>End November<br/>1984</u> |
|-----------------------|------------------------------|-----------------------------|------------------------------|
| a) Unadjusted total   | 2,210,745<br>(8.9%)          | 2,148,819<br>(8.6%)         | 2,189,191<br>(8.8%)          |
| b) Adjusted total     | 2,294,000                    | 2,286,000                   | 2,257,000                    |
| c) Short-time working | 159,527                      | 126,860                     | 257,383                      |
| d) Unfilled vacancies | 110,172                      | 112,045                     | 81,505                       |
| e) Total men in a)    | 1,179,700                    | 1,126,277                   | 1,196,406                    |
| f) Total women in a)  | 1,031,045                    | 1,022,542                   | 992,785                      |

28. There was fierce controversy about a possible amendment of the law relating to the payment of unemployment benefit to workers indirectly affected by industrial disputes. The metalworkers' unions' tactics in 1984 had been to call out key workers in selected regions knowing that their members in other regions, in respect of whom virtually identical claims had been made, would qualify for benefit if they were thrown out of work because of the strike. The government proposed legislation which will disqualify them in the future in such circumstances. The government proposals fall far short of the demands of employers and some sections of the government coalition which would in effect disqualify from benefit anyone who was thrown out of work by an industrial dispute, regardless of whether he had a direct or indirect interest or no interest at all in the outcome. The are nevertheless bitterly opposed by all sections of the union movement. A Bill was approved by the Cabinet on 18 December and is likely to become law in the Spring.

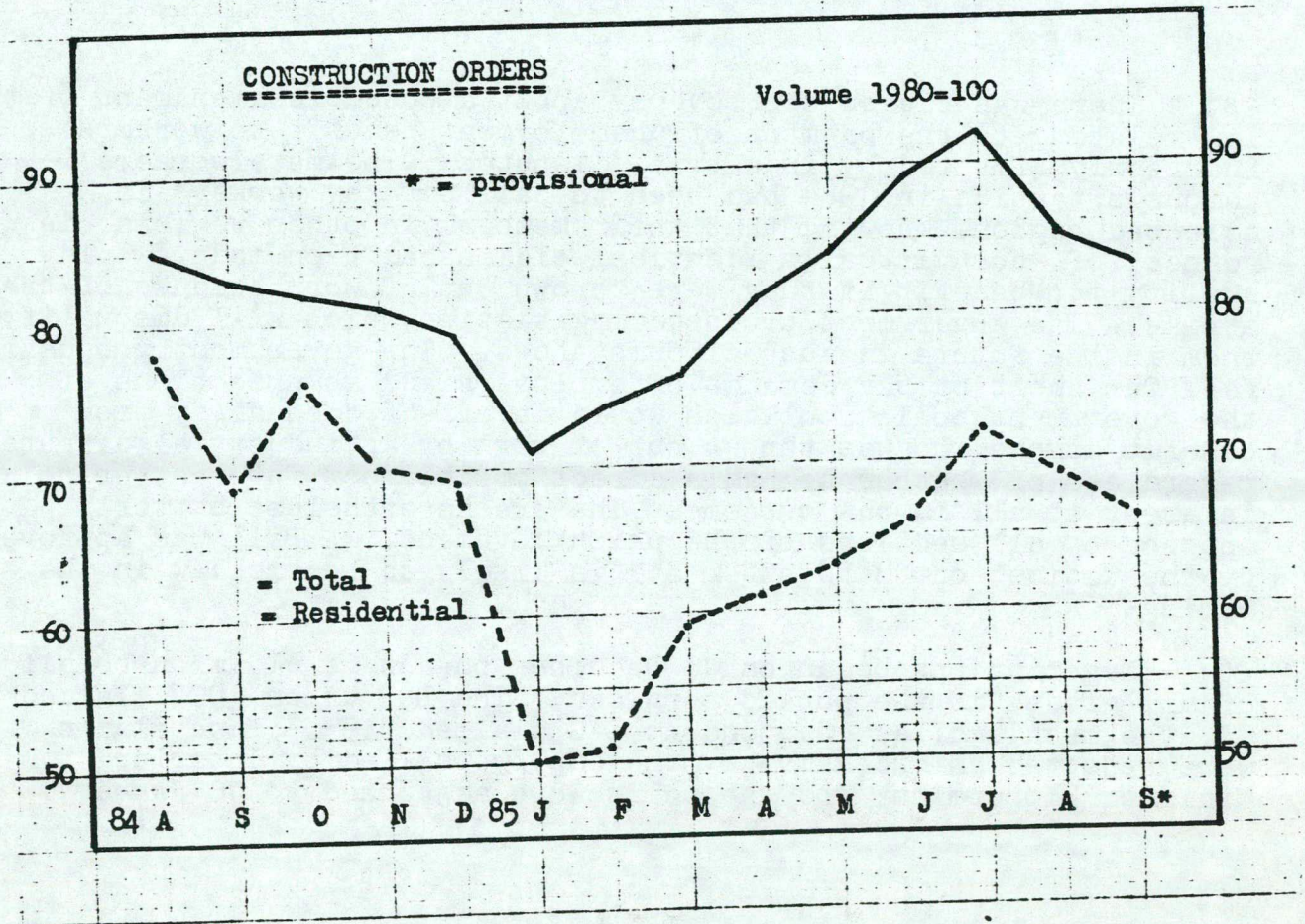
29. Negotiations began on 16 December on a wage claim on behalf of all grades in the public services. The DGB union, ÖTV claimed 6%; the much smaller independent DAG claimed 5.5%. Both claims were rejected as excessive by the employers, led by Interior Minister Zimmermann, and the talks were adjourned to 16 January.

/Construction  
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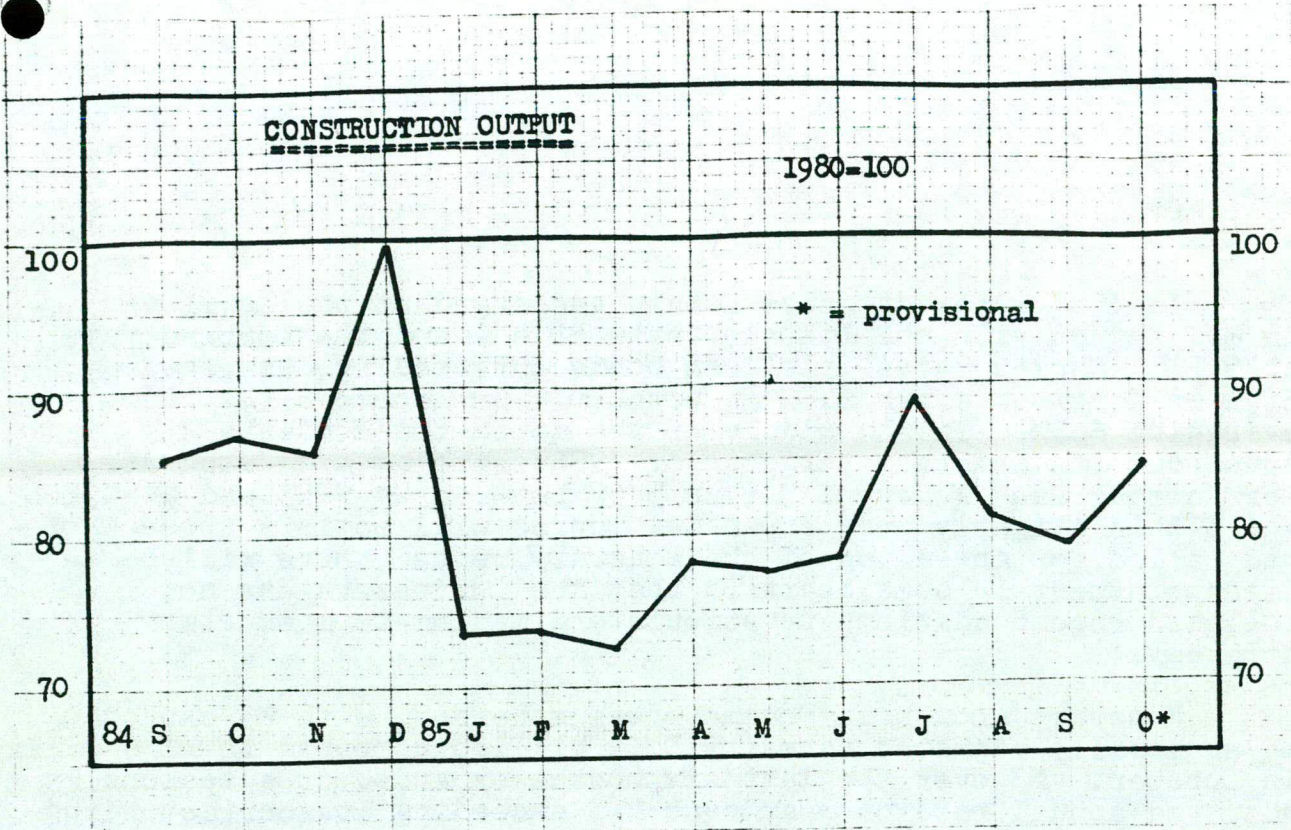


**Construction**  
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30. Construction output recorded a 7 per cent increase in October having fallen in the preceding two months. The two monthly comparison, September/October on July/August, shows a 3.5 per cent decline in output. Compared to a year earlier output was also 3.5 per cent lower. Incoming orders continued to decline in September, with both total and residential demand down on their respective August levels. Nevertheless, overall demand is unchanged on last year's level. The November Ifo survey records further improvement in the mood within the industry for the seventh consecutive month. The length of order books increased slightly to 2.3 months, comparing favourably with a year earlier (1.9), while capacity utilisation at 55 per cent was also higher than a year ago. Prices began to rise with firms now expecting increased upward pressure on price levels in the coming months. The number of employed in the construction sector rose by 0.9 per cent in October to 1,057,600. This was 6 per cent down on the corresponding 1984 level.



/Construction Output  
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Balance of Payments  
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31. Current account figures for October show a surplus of DM 6.2 billion. Exports in October reached a record level (DM 49.3 billion) with the trade surplus for the first ten months of the year (DM 58.3 billion) already exceeding the record level of 1984 as a whole. The DIW predicted a current account surplus of DM 40 billion for 1985.

32. In an article published by the Bundesbank in December there is an attempt to put the surpluses of recent months into perspective. In the three months to the end of October the seasonally adjusted current account surplus was only marginally up on the preceding three-month period, with the visible trade surplus actually DM 3 billion lower despite falling import prices in the wake of the weakening dollar. The Bundesbank report suggests that this development already reflects the broadening of economic growth with the emphasis shifting from foreign to domestic demand.

33. The net foreign asset of the Bundesbank rose by DM 4.6 billion in November, having fallen by DM 1.3 billion in October.

/Monetary  
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## Monetary

34. Leading interest rates remain unchanged at the level set in mid-August, with the Discount rate at 4 % and the Lombard rate at 5.5%. Market rates, yield on bonds outstanding, averaged 6.7% in November after 6.6% in October. In December they were averaging 6.5%. In the middle of the month the Bundesbank announced its monetary targets for 1986, setting a growth rate for Central Bank Money of 3.5 to 5.5% between Q4 1985 and Q4 1986. While this slightly more expansive course will satisfy those who had called for an easing of the monetary reins, there will be disappointment in some quarters that the Bundesbank has not followed recommendations to stipulate a medium-term monetary strategy.

35. Monetary growth in November was moderate, with M3 expanding in seasonally adjusted terms by DM 1 billion compared to DM 4 billion in October. M3 over the last six months expanded at a seasonally adjusted annual rate of just over 4%, exceeding its corresponding 1984 level at the end of November by 4.5%. M2 was 3.5% higher and M1 5.5%. Overall private sector credit in November was stronger than of late, with demand increasing for both long-term and short-term credit. Over the last six months total private sector credit has expanded at a seasonally adjusted annual rate of 5%. Central Bank Money figures for November show expansion on the fourth quarter 1984 of 4.7%, thus near the top of the 3-5% target range for this year.



FRG: Main economic statistics

|  | Q3 84 | Q2 85 | Q3 85 | % change on prev. |       |
|--|-------|-------|-------|-------------------|-------|
|  | ===== | ===== | ===== | qtr/month         | year  |
|  |       | DM bn |       | =====             | ===== |
| <b>1. Expenditure on GNP (current prices)</b>  |       |       |       |                   |       |
| a) Gross National Product                      | 439.3 | 452.7 | 464.5 | 2.6               | 5.7   |
| b) Private consumption                         | 247.8 | 255.3 | 258.8 | 1.4               | 4.4   |
| c) Government consumption                      | 87.3  | 91.1  | 91.6  | 0.5               | 4.9   |
| d) Fixed capital formation                     | 89.4  | 88.2  | 91.7  | 4.0               | 2.6   |
| e) Exports of goods & services                 | 146.9 | 162.6 | 165.8 | 2.0               | 12.9  |
| f) Imports of goods & services                 | 133.7 | 144.5 | 143.1 | -1.0              | 7.0   |
| g) Net exports                                 | 13.2  | 18.1  | 22.7  |                   |       |
| <b>2. Expenditure on GNP (constant prices)</b> |       |       |       |                   |       |
| a) Gross National Product                      | 385.5 | 389.3 | 398.0 | 2.2               | 3.2   |
| b) Private consumption                         | 210.7 | 212.3 | 215.8 | 1.6               | 2.4   |
| c) Government consumption                      | 77.5  | 78.2  | 79.4  | 1.5               | 2.5   |
| d) Fixed capital formation                     | 79.2  | 77.7  | 80.0  | 3.0               | 1.0   |
| e) Exports of goods & services                 | 127.0 | 136.9 | 139.3 | 1.8               | 9.7   |
| f) Imports of goods & services                 | 110.9 | 115.6 | 116.7 | 1.0               | 5.2   |
| g) Net exports                                 | 16.1  | 21.3  | 22.6  |                   |       |
| <b>3. Income of households</b>                 |       |       |       |                   |       |
| a) Gross wages & salaries                      | 197.5 | 203.6 | 205.9 | 1.1               | 4.3   |
| b) Disposable income                           | 284.4 | 291.8 | 294.1 | 0.8               | 3.4   |
| c) Savings as a % of b)                        | 12.9  | 12.5  | 12.0  |                   |       |
| 1976=100<br>=====                              |       |       |       |                   |       |
| <b>4. Productivity</b>                         |       |       |       |                   |       |
| a) In the economy as a whole                   |       |       |       |                   |       |
| i) GNP per working person (1980 prices)        | 107.9 | 108.3 | 110.4 | 1.9               | 2.3   |
| ii) wage and salary costs per production unit  | 108.3 | 110.6 | 109.4 | -1.1              | 1.0   |
| 1980=100<br>=====                              |       |       |       |                   |       |
| Sep 84    Aug 85    Sep 85<br>=====            |       |       |       |                   |       |
| b) In industry                                 |       |       |       |                   |       |
| i) output per employed person                  | 112.0 | 115.0 | 115.0 | 0.0               | 2.7   |
| ii) wage and salary costs per production unit  | 107.0 | 108.0 | 108.0 | 0.0               | 0.9   |
| Oct 84    Sep 85    Oct 85<br>=====            |       |       |       |                   |       |
| <b>5. Industrial production</b>                |       |       |       |                   |       |
| a) Total                                       | 101.0 | 103.0 | 104.9 | 1.8               | 3.9   |
| b) Manufacturing industry                      | 102.9 | 105.7 | 107.3 | 1.5               | 4.3   |
| c) Construction                                | 86.9  | 79.1  | 84.7  | 7.1               | -2.5  |
| <b>6. New orders (volume)</b>                  |       |       |       |                   |       |
| a) Total                                       | 105.0 | 107.0 | 109.0 | 1.9               | 3.8   |
| b) Domestic                                    | 95.0  | 96.0  | 98.0  | 2.1               | 3.2   |
| c) Foreign                                     | 128.0 | 126.0 | 128.0 | 1.6               | 0.0   |

|                                      | Nov 84    | Oct 85  | Nov 85  |      |       |
|--------------------------------------|-----------|---------|---------|------|-------|
| <b>7. Unemployment</b>               |           |         |         |      |       |
|                                      | =====     |         |         |      |       |
|                                      | in 1000's |         |         |      |       |
|                                      | =====     |         |         |      |       |
| a) i) unemployed                     | 2,189.2   | 2,148.8 | 2,210.7 | 2.9  | 1.0   |
| ii) as a % of the working population | 8.8       | 8.6     | 8.9     |      |       |
| b) Short-time workers                | 257.4     | 126.8   | 159.5   | 25.8 | -38.0 |
| c) Vacancies                         | 81.5      | 112.0   | 110.2   | -1.6 | 35.2  |
|                                      | 1980=100  |         |         |      |       |
|                                      | =====     |         |         |      |       |

|   | Oct 84 | Sep 85 | Oct 85 |      |      |
|---|--------|--------|--------|------|------|
| <b>8. Prices</b>                            |        |        |        |      |      |
| a) Cost of living of all private households | 119.2  | 121.1  | 121.3  | 0.2  | 1.8  |
| b) Retail prices                            | 115.9  | 117.3  | 117.8  | 0.4  | 1.6  |
| c) Producer prices of industrial products   | 120.3  | 121.9  | 121.9  | 0.0  | 1.3  |
| d) Export prices                            | 117.5  | 119.5  | 119.0  | -0.4 | 1.3  |
| e) Import prices                            | 125.5  | 123.0  | 119.6  | -2.8 | -4.7 |
| Terms of Trade                              | 96.7   | 100.2  | 99.2   | -1.0 | 2.6  |

|                                | Oct 84 | Sep 85 | Oct 85 |      |     |
|--------------------------------|--------|--------|--------|------|-----|
| <b>9. Balance of payments</b>  |        |        |        |      |     |
| a) Visible trade               |        |        |        |      |     |
| i) exports                     | 47.9   | 43.9   | 49.3   | 12.3 | 2.9 |
| ii) imports                    | 39.0   | 36.5   | 40.6   | 11.2 | 4.1 |
| iii) balance                   | 8.9    | 7.4    | 8.7    |      |     |
| b) Supplementary trade items   | 0.1    | -0.2   | 0.5    |      |     |
| c) Services                    | 0.4    | -1.6   | -0.8   |      |     |
| d) Transfers                   | -3.3   | -1.2   | -2.2   |      |     |
| e) Current account             | 6.1    | 4.4    | 6.2    |      |     |
| 10. Net foreign reserves (+/-) | -1.1   | 0.4    | -1.3   |      |     |

|  | Nov 84 | Oct 85 | Nov 85 |
|--|--------|--------|--------|
| <b>Seasonally adjusted</b>               |        |        |        |
| =====                                    |        |        |        |
| <b>11. Money stock (change in month)</b> |        |        |        |
| M1                                       | 0.0    | 3.6    | -2.9   |
| M2                                       | 2.0    | 2.6    | 0.8    |
| M3                                       | 3.1    | 4.0    | 1.0    |

|                                |     |     |     |
|--------------------------------|-----|-----|-----|
| <b>Unadjusted</b>              |     |     |     |
| =====                          |     |     |     |
| 12. Monetary capital formation | 3.1 | 6.8 | 5.0 |

Bank rates:  
 Since 16.8.85 Discount rate: 4.0%  
 Since 16.8.85 Lombard rate: 5.5%

Sources: Federal Statistical Office, Wiesbaden;  
 Deutsche Bundesbank, Frankfurt  
 Discrepancies in totals due to rounding (78) (32)

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OCMIAN 4900  
CONFIDENTIAL  
PP TOKYO  
PP ROMEE  
FM FCOLN TO BONN  
021500Z JAN  
GRS 160

CONFIDENTIAL  
FM FCO  
TO PRIORITY BONN  
TELNO 002  
OF 021500Z JANUARY 86  
AND TO PRIORITY PARIS, TOKYO, WASHINGTON  
INFO PRIORITY ROME

ITALIAN DEMARCHE OVER EXCLUSION FROM G5 MEETINGS

1. ITALIAN CHARGE DELIVERED LETTER ON 30 DECEMBER FROM CRAXI TO PRIME MINISTER EXPRESSING CONCERN OVER ITALIAN EXCLUSION FROM G5 FINANCE MINISTERS' MEETINGS. CHARGE ALSO SPOKE ALONG LINES OF LETTER TO MR RIFKIND, WHO TOOK NOTE.
2. GRATEFUL FOR CONFIRMATION THAT OTHER G5 COUNTRIES HAVE RECEIVED SIMILAR LETTERS AND FOR INDICATION OF WHETHER AND IF SO HOW THEY PROPOSE TO RESPOND.
3. OUR INITIAL REACTION, IN LINE WITH OUR RESPONSE TO EG SIMILAR COMPLAINTS FROM CANADA, IS THAT ITALY SHOULD NOT BE INVITED TO PARTICIPATE IN FUTURE G5 MEETINGS. THIS WOULD MAKE G5 MORE UNWIELDY AND THUS LESS EFFECTIVE AND ENCOURAGE REQUESTS FROM OTHERS TO PARTICIPATE.

HOWE

MONETARY  
WED

1

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C  
You are meeting with Sir Gegg to discuss GS preparations.

I wrote to GHF fairly promptly after Christmas and have subsequently explained that

- 1) the whole thing might be held at No 11;
- 2) it may be only one meal.

● Sir Gegg gathers from Mulford that Baker has to leave at noon on the Sunday, so dropping the lunch may be no bad thing. You could ask Gegg what he has told other colleagues.

While you are on the GS you might also discuss:

— the recent Jap leak (see Telno of 31/12 below)

— the Italian demarche.

I'll contact PSA and Special Branch once we have a clearer picture of location/duration from this meeting with Sir Gegg.

Ro 3/1





2 CARLTON GARDENS LONDON SW1Y 5AA

TELEPHONE: 01-214 6715

SWITCHBOARD: 01-214 6000

2 January 1986

P Wynn Owen Esq  
Private Secretary to the Chancellor  
of the Exchequer

Treasury Chambers  
Parliament Street  
LONDON SW1P 3AG

*Dear Wynn Owen,*

| CH/EXCHEQUER                               |              |
|--|--------------|
| REC.                                       | 03 JAN 1986  |
| <input checked="" type="checkbox"/> ACTION | SIR G LITTLE |
| COPIES TO                                  | MR LAVELLE   |
|  | MR KUCZYK    |
|  | MRS LESTER   |
|  |              |

Thank you for your letter of 30 December about two meals which the Chancellor wishes to give for A.N. OTHER on the week-end of 18/19 January. I confirm that all is in hand for a dinner on 18 January and for a lunch on 19 January, for 18 people on each occasion. Arrangements are being made at present for both meals to be held at Admiralty House, but I note that the lunch - and the meeting which precedes it on Sunday morning - may be transferred to 11 Downing Street.

While it is in order for GHF to undertake all the arrangements for both meals, I fear that we can pay for only one of them. As it is probable that the dinner will be marginally more expensive than the lunch, I suggest that we pay for the former and charge you for the latter.

A few points of detail as I am writing:-

- a. I note that the dinner on 18 January is to be 7.0 for 7.30. When we spoke before Christmas you surmised that Mr Lawson might be present at Admiralty House as from about 6.30, to meet those of his guests who might need to arrive a little early. From a staffing point of view it would be helpful to know whether or not there is a possibility/probability of drinks being needed earlier than 7.0.
- b. I confirm that draft menus for both meals will be submitted shortly, three in each case.
- c. I also confirm that we will make provision in the out-mess for 2 support staff at dinner on 18 January. Do you wish similar provision for lunch on the 19th?
- d. As discussed on the telephone before Christmas, GHF can make no provision at all for any security men who may be accompanying the Chancellor's guests. Indeed we both hoped that, having delivered their charges to Admiralty House, they would all go away! In the event that some insist on staying, I must remind you that the facilities in the building are very limited and that they would probably have to wait in the Hall (or, as is sometimes the case, in their cars in the courtyard).

- e. Similarly with interpreters, if any. If they sit at table (i.e. are on the guest list), naturally they eat the same meal as everybody else. But if, as is more usual, they are to sit behind the relevant principals then there is no obligation for them to be fed by HMG. Having said this, it is usually possible for GHF to provide sandwiches and a drink for a limited number of interpreters if the sponsor department asks us to do this. It would be helpful to know your wishes in due course.

Finally, there is the question of the meeting on Sunday 19 January. While I confirm that we have booked Admiralty House on your behalf for the whole day (approx 7.0 am - 5 pm), I also confirm that GHF is not in the business of arranging conferences. As we discussed before Christmas, all arrangements for the meeting will need to be made direct between you and PSA, for which purpose we have furnished you with the name of the relevant contact. Bryan Burrough - Head of my Functions Section (on 214-8308) who was away when you first rang but who is now in charge of GHF aspects of events on 18/19 January - will also be in touch with you shortly to discuss the caterers' need for information on such details as times for the provision of coffee during Sunday morning, requirements for mineral waters, etc.

I think this covers most points, but please do not hesitate to contact Bryan Burrough or me if anything else occurs to you.

*Yours sincerely*  
*Alan Cowan*

J A C Cowan

*P.S. I should add that all our planning for Admiralty House on 19 January is on the basis of meeting in the main room; pre-lunch drinks in the Drawing Room and lunch in the Dining Room. If you and/or PSA need any variation to this, we need to be told very quickly, please.*

SECRET



FROM: P WYNN OWEN  
DATE: 6 JANUARY 1976

SIR G LITTLER

cc Mr Lavelle  
Mr Culpin  
Mrs Lomax  
Mr Kuczys  
Mrs Lester

G5

You and Robert Culpin met with the Chancellor at 11.00 am this morning to discuss arrangements for the G5 on 18-19 January. The following points were discussed:

(1) Duration - from 7.00 pm to 10.00 pm on Saturday and from 9.00 am to noon on Sunday. Definitely a dinner, with you to ascertain from colleagues how many (if any) would wish to stay for a lunch, so that GHF can be given forewarning.

(2) Venue - all at No 11.

- me to check that 15, possibly with small gilt chairs from No 10, can be seated round dining-table in Soane Dining Room.

- me to discuss with Peter Taylor at No 10 what table can be procured for main meeting in the State Room.

- drinks to be taken in the Sitting Room downstairs.

- me to ask GHF whether they would bring food ready-cooked or whether they would prefer to use No 10 kitchens. If the latter, this office to talk to Nigel Wicks.

No 10  
kitchens.

SECRET



- (3) Publicity - you to write to colleagues saying we continue to deny - will make an official statement nearer the time - statement likely to confirm routine meeting and venue. Possibly photographers in street if requested. Communique for meeting to decide, but would not imagine there would be one. UK to put draft press statement to G5 meeting simply confirming that certain matters had been discussed.
- (4) UK objectives - the Chancellor asked you for a note on the UK's objectives with a view to a further meeting either towards the end of this week or early next week.
- (5) Italian demarche - the Italian demarche should be refused. The Chancellor would like to see the draft letter for the Prime Minister to send to Mr Craxi, before it goes to NO 10.
- (6) US Proposals - you said the US were contemplating circulating two, short papers for the meeting - on achievements since Plaza and 'strengthening the process of cooperation amongst G5 members'. The Chancellor asked you to consult German and French colleagues and to tell the US that a majority view was there should be no papers circulated apart from a short statistical aide memoire from the UK at the meeting on movements since Plaza. Any other papers would be changing the nature of G5.

SECRET



(7) Press on Takeshita - if asked about reports Takeshita will be in London on 18/19 January, IDT to say the Chancellor would be delighted to see Takeshita if he was in London, but there were no arrangements at the moment.

A handwritten signature in cursive script, appearing to read "P. Wynn Owen".

P WYNN OWEN

SECRET

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From : G E Fitchew

Date : 7 January 1986

CHANCELLOR

cc Sir P Middleton  
Sir G Littler  
Mr Lavelle

*C. US now intend to reply before the G5 in similar terms to us. Content with draft for PM? This office to send it to No 10? (rather than Fed). If so, G. Fitchew will provide a PS letter. Rm 8/1*

G5 MEETINGS : LETTER TO THE PRIME MINISTER FROM THE ITALIAN PRIME MINISTER

I understand you had asked to see the draft of any reply to S. Craxi's letter of 30 December, complaining about Italy's exclusion from the Plaza meeting of the Group of Five.

### Proposed Response

2. We propose to recommend that the Prime Minister should politely, but firmly, refuse S. Craxi's request that Italy should participate in future G5 meetings. This is fully accepted by the FCO. We have had confirmation from Washington, Bonn and Tokyo that they too agree that the Italian request should be resisted and that there are good arguments for doing so. There is no reason to believe that the French will want to take a different line. There is, however, no sign that any of the other capitals are yet in a position to send a reply. There are some signs that the US and Japan are looking to the European G5 members to take the lead in replying. The timing of the reply is in any case a somewhat awkward matter, because of the G5 meeting planned for the weekend of 18-19 January and the options are further discussed in paragraphs 4-7 below.

3. I attach below the draft of a reply for the Prime Minister to send to S. Craxi, which I have worked up with the FCO. The main line of argument to be deployed is simply that periodic consultations between the five countries whose currencies are most widely held and traded are both natural and useful. It is helpful that this was in fact recognised in the Communique of the Versailles Summit in 1982. (It would be a mistake to invoke other criteria, such as level of GNP, where the case for excluding Italy is much less convincing). The rest of the letter is addressed to soothing wounded Italian feelings. I have not, however, included in the draft any reference to the fact that you gave S. Goria some advance

warning of the Plaza meeting, since the Italians would not regard that as a substitute for full participation and in any case it may not be practical or desirable to give them similar advance notice on all future occasions.

Timing Considerations

*See para 3 of Sir G. Little's shorter G5 minute of today.*

4. The timing of the Prime Minister's reply to S. Craxi needs to be considered in relation to :-

- the proximity of the 18-19 January G5 meeting;
- the timing of replies from other G5 members.

5. There are three options :-

- to send a reply immediately before any press announcement has to be made about the meeting on 18-19 January;
- to send a reply in co-ordination with other G5 members immediately before the 18-19 January meeting itself;
- to send a reply in co-ordination with other G5 members immediately after the 18-19 January meeting.

6. I recommend against the first of these options. First, there is now very little time available. Given the leaks in the Tokyo press, we may have to make a press statement before the end of this week. More important, there is no prospect of other G5 members lining up their Heads of Government to reply before the end of this week. If we replied straightaway and on our own, we would incur the odium of having taken the decision to exclude Italy from next week's meeting.

7. The choice is therefore between co-ordinated replies towards the end of next week, leaving no time for the Italians to return to the charge before the meeting takes place or co-ordinated replies

Ch?

Start on page 2

immediately after the meeting has taken place. The advantage of the second course is that the replies could then make it clear that the Italian request had been considered by the G5 partners and a conscious decision taken not to enlarge the group any further. The disadvantage is that the Italians might deem themselves as having been doubled by the fact that a further G5 meeting had taken place before S. Craxi's complaint had been acknowledged. Whichever course is adopted, I am inclined to recommend that, if possible, you might try to speak to S. Gorla to inform him of the G5 meeting shortly before or simultaneously with any press announcement of it. If this is not feasible, then it might be helpful if Sir Geoffrey Littler could speak to Dr Sarcinelli.

X

Recommendations

8. We recommend that the Prime Minister should be advised to reply to S. Craxi along the lines of the attached draft. We suggest that the reply should be sent, in co-ordination with other G5 members, either immediately before the meeting on 18-19 January or immediately after, with a slight preference for the second of these options. We should be glad to know that you are content with the draft letter and grateful for your views on the timing of the reply.

G E FITCHEW





b/f 9/1  
for TK

TK Phil  
I've done (a) + (b) but  
not (c) T.

My letter to Brigadier at GHF  
below. A few points:-

- a) GHF should put 3 menus for each  
meal to you by end of this week.  
Pl's put in to C. for this weekend so  
he can choose.
- b) Pl inform Nigel Wicks of the GS  
(he may well know) + ask if caterers can  
use No 10 kitchens.
- c) If time, pl ask Peter Taylor at  
No 10 if he can provide an adequate  
conference table for 16 people for use in  
the No 11 State Room.
- d) I've asked Debbie to write to Gov't  
Care conjuring that they'll provide 4  
Cars for the visitors.

Rs 8/1



Phil  
Dome  
T.

~~T.K.~~

C. will ask you  
to tee up Stoltensberg  
Call on TIN.

I've suggested he also raise  
Stolt' arriving at 6pm  
(an hour early) on 18 Jan'  
for a private word. If he  
omits to do this, pl' ring  
Alex Kohler (Stolt's PPS) after  
and make the invite.

Thanks.

Ros 8/1



cc Sir G Littler  
Mr Lavelle  
Mr Culpin  
Mrs Lomax  
Mr Kuczys  
Mrs Lester

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

8 January 1986

Brigadier Alan Cowan MBE  
Government Hospitality Fund  
2 Carlton Gardens  
LONDON  
SW1

*Dear Brigadier Cowan,*

Many thanks for your letter of 2 January.

Since you wrote the Chancellor has given further thought to the meeting on 18/19 January. He has decided that the venue will now be exclusively No.11 Downing Street. I have suggested to Bryan Burrough that he call me on Monday 13 January and I arrange to show some of you around No.11. In short, the duration will be from 7.00 pm to around 10.00 pm on the Saturday and from 9.00 am to noon on the Sunday. The Chancellor definitely intends to offer a dinner, 7.00 for 7.30, on the Saturday and is most grateful for your kind offer to fund this meal. Lunch would be served at 12.30 for 1.00 on the Sunday. Both meals would probably be for 16 people, though we have had indications that some parties may wish to leave prior to the lunch. We are trying to clarify numbers and will let you know as soon as possible. I should be grateful if you could arrange for sandwiches to be made available for two interpreters for each meal, since they will be having to sit behind their Ministers while they eat. I should also be grateful if two additional meals could be laid on for support staff in your out-mess.

Within No.11, the intention is to have drinks in the Sitting Room on the ground floor, with meals in the adjacent Soane Dining Room. The State Room on the first floor will be used for the meeting on Sunday morning. We are discussing with No.10 whether their kitchens can be made available to your caterers.

Two door men will be on duty at No.11 and they can provide conference teas, though I should be grateful if you could arrange for pre-prandial drinks to be served by your butlers.



The security position is much simpler with Downing Street as the location and we will be discussing that with No.10. There is no longer a need for PSA involvement.

I look forward to receiving the draft menus shortly.

Thank you for your help today with this function and will discuss further details with yourself or Bryan Burrough early next week.

Yours sincerely,

*Philip Wynn Owen*

P WYNN OWEN  
Private Secretary



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*b/s 15/1 p*

|              |                  |
|--------------|------------------|
| CH/EXCHEQUER |                  |
| REC.         | 08 JAN 1986      |
| ACTION       | SIR G. LUTLER    |
| COPIES TO    | CSI, EST         |
|              | SIR P. MIDDLETON |
|              | MR LAVELLE       |
|              | MR MOUNTFIELD    |

*8/11*

SUMMARY

*MRS CASE  
MR FITCHEW  
MR C.W. KELLY*

THE UNITED STATES : A DEBTOR NATION AND A NATION OF DEBTORS

1. The United States has for the last five years arguably been the worst run of all the important industrialised countries. For the first time since 1914 the US has become a net debtor nation. And there has also been a large increase in domestic indebtedness - private sector as well as government borrowing from financial institutions and other lenders - resulting in high real interest rates. (Paragraphs 1-4).

2. There is a clear link between budget and overseas deficits; and the new - and more pragmatic - Baker/Darman team at the Treasury Department clearly recognises this link, and the fact that the overseas deficit will not be corrected without a sizeable depreciation of the dollar. (Paragraphs 5-8).

3. The President has put his weight behind the new Gramm-Rudman legislation which stipulates a progressive reduction in the budget deficit to zero by 1991. But many observers question whether the legislation will work as intended, though at least Administration and Congress have recognised that there is a problem. (Paragraphs 9 and 10.)

4. The level of indebtedness in the business sector probably gives more cause for concern than the level of household debt. Business debt should not be growing rapidly at this stage of the economic cycle because corporate profits are high and investment is not particularly strong. (Paragraphs 11-17.)

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5. There are certain sectors where the combination of heavy indebtedness and high real interest rates has caused particularly serious problems : agriculture, real estate, energy and (on the overseas side) Third World debt: the Four Horsemen of the Apocalypse. As a result, parts of the US financial system - including the Farm Credit System and the "thrifts" - are in serious difficulties. (Paragraphs 18-26.)

6. Deregulation of financial markets in recent years has increased their efficiency, but has also contributed to the current fragility of the system. Though the Administration and Congress seem unwilling to push for fundamental reforms, there has been some welcome movement - by the Federal Reserve and others - to tighten up the system of financial supervision and to improve the prudential position of the banks and thrifts. (Paragraphs 27-29.)

7. Progress on correcting the underlying imbalances in the economy, however, is slow - and is likely to remain so in election year 1986. This must inevitably increase the risk of a major collapse at some stage, whether of the dollar or of one or more of the big banks, or of a resurgence of protectionist pressures, but this is still more a possibility than a probability. (Paragraphs 30 and 31.)

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BRITISH EMBASSY,

WASHINGTON, D. C.

TELEPHONE: (202) 462-1340  
20 December 1985

FROM THE AMBASSADOR

The Right Honourable  
Sir Geoffrey Howe QC MP  
Secretary of State for Foreign  
and Commonwealth Affairs  
LONDON SW1

Sir,

THE UNITED STATES: A DEBTOR NATION AND A NATION OF DEBTORS

Introduction

1. With its Budget deficit now running at around \$200 billion a year and its trade deficit at about \$150 billion a year, the United States has for the last five years arguably been the worst run of all the important industrialised countries. In a despatch sent this time last year on the prospects for President Reagan's second term, I pointed out the unsustainability of an economic policy dependent on the richest country in the world sucking in capital to finance a huge current account deficit. The financial markets believed then, as they do now, that the solution lay in reducing the budget deficit. Last year I predicted there would be talk about expenditure cuts, but precious little real action. Although the now famous - or infamous - Gramm-Rudman amendment perhaps marks the beginning of a change in direction, that prediction has turned out all too correct.

2. The budget deficit was a record \$212 billion in the fiscal year which ended this autumn, and is likely to be not far short

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of \$200 billion in the current fiscal year. For the first time since 1914 the USA has become a net debtor nation. And within the next twelve months it will overtake Mexico and Brazil in the size of its foreign debt.

3. At the same time there has, over the past few years, been a large increase in domestic indebtedness - private sector as well as government borrowing from financial institutions and other lenders.

4. The purpose of this despatch is to assess the background to America's growing indebtedness, the risks that it entails, and the prospects for alleviating action.

#### The Overseas and Budget Deficits

5. America's growing overseas indebtedness has as its counterpart the burgeoning current account deficits. These deficits in turn have been associated with the difficulties faced by a number of industries, which have seen their share of domestic and overseas markets decline. The consequent loss of jobs in those industries has set off strong pressures for protection, which - despite the Administration's welcome determination to resist them - still pose a serious risk to the liberal trading system. Furthermore, the continuing rapid increase in foreign holdings of dollar assets has raised the risk that at some stage there will be a flight out of the dollar, turning its present measured decline into a precipitous fall, leading in turn to sharply higher interest rates here and elsewhere and conceivably a world-wide recession.

6. Until recently, the Administration's view was that the current account deficit was not its fault. The guilty parties were America's trading partners, with their sclerotic economies, low growth rates, protectionist practices, high taxes, cautious

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policies, and general wimpishness. This line, so often propounded by the Regan/Sprinkel team at the US Treasury, as the counterpart to their refusal to recognise any causal link between high budget deficits and high interest rates, served as an alibi for Administration inactivity. But the Baker/Darman team is very different, and in recent months, the Administration has belatedly recognised that the overseas deficit will not be corrected without a sizeable depreciation of the dollar. This new-found recognition was reflected in the Important Group of Five Plaza Agreement signed in the Plaza Hotel in New York in September. Since then intervention in the exchange markets by central banks, which the Agreement presaged, has clearly had some success.

7. But the Plaza Agreement did not include any concrete action to reduce the budget deficit, which a growing body of opinion here regards as essential if dollar depreciation is to be sustained and the overseas deficit corrected. Federal Reserve Chairman, Paul Volcker, has been a persistent exponent of this view. This last month, in forwarding to the Senate a report on the growth of indebtedness in the US, he once again argued that the number one priority was a reduction in the budget deficit.

8. Volcker is clearly right; but President Reagan has yet to concede publicly the connection between the budget and overseas deficits. I doubt whether he will, or sees any need to do so. The development of such good sense as is now discernable in Washington is largely the result of the Treasury Department, under its new leadership, doing what good it can by stealth.

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This may help to explain why the President supported proposals put forward by Senators Gramm and Rudman, and now passed into law, which stipulate a progressive reduction in the budget deficit to zero by 1991. A balanced budget was, after all, part of the original credo; the only snag was that it was incompatible with reducing taxes and increasing defence spending, two other equally important components of Reaganomics; and it is tax reduction (or promises of tax reduction) and stronger defence, since both are popular, which so far have won the day. On the other hand, neither the Administration nor Congress have offered any clear ideas as to how deficit reduction would be achieved, and many doubt whether the legislation will ever be implemented. Gramm/Rudman is a declaration of good intentions - little more, but it does at least recognise that there is a problem.

9. Though the fact that legislative proposals for tax reform are still alive provides a vehicle that could conceivably be used for tax increases, the crux of the deficit problem lies in the failure to control spending. Tax revenue is much the same percentage of GNP now as it has been for the last decade, but the share of spending in GNP has been on an upward trend: the electorate has been accustomed to its entitlements and is resistant to suggestions that they should be reduced (the Farm Bill, recently signed by the President, with a cost of \$52 billion over three years, is a good example of Congress and the Administration failing to come fully to grips with the major problem of spending on agricultural support). The consequent rising deficits have had to be met by additional borrowing, which has kept real interest rates at historically very high levels.

10. It might have been possible for the US Government to run large deficits without this effect on interest rates if the American public were naturally thrifty or if other sectors of the economy

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were reining back their credit demands. In fact, the opposite has been true. The indebtedness of the private sector, as well as State and local governments, has also been increasing rapidly.

#### Household Debt

11. The growth in household debt reflects in part the increased availability and convenience of borrowing, and the favourable tax treatment that allows most interest payments to be deductible. US banks have perforce ceased their orgy of lending to the Third World and in search of higher quality borrowers have found willing customers at home. The saving-income ratio has fallen to an all-time low of about 2%. Manufacturers of durable goods and cars are increasingly using cheap financing offers as methods of stimulating sales. But one of the main sources of growth has been in the area of "revolving" credit-card debt, about half of which is paid off monthly and which is simply substituting for cash. Attempts to restrict the scope of interest deductibility particularly on mortgages for second homes, seem to have foundered.

12. The ratio of household debt to net financial wealth is still close to its average level over the last decade. Yet an increasing proportion of household wealth is in illiquid form - that is to say, pension funds. So the ability of borrowers to cope with unexpected loss of income or rising interest rates is not as great as it was.

13. One notable change which is relevant to this has been the increase in adjustable as opposed to fixed rate mortgages. From the standpoint of lending institutions, which - as in the UK - rely primarily on floating rate deposits, this has been a welcome development. Many of the difficulties experienced in recent years by the "thrifts" (the rough equivalent of our building societies) have been due to "interest mismatch". But variable rate lending of course leaves the borrowing more exposed, and the Federal Reserve

/have

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have expressed their concern on account of this. As noted below, mortgage delinquencies are already on the rise.

14. Nonetheless, as of now, household indebtedness does not seem to constitute a major problem. That could, however, change if interest rates again rise sharply.

#### Business Debt

15. The level of business debt is causing rather more concern. It should not be growing rapidly at this stage of the cycle because company profits are high and investment is not particularly strong. The fact that it is rising so fast is due partly to the extraordinary growth in mergers, leveraged buy-outs and share repurchases. And to deter corporate raiders, businesses have been converting equity into debt. In market value terms, the average debt-equity ratio of non-financial corporations increased from 63 per cent. in 1983 to over 76 per cent. in the third quarter of 1985. In addition, there has been a growing tendency to borrow short to take advantage of lower short-term interest rates.

16. The rise in debt-equity ratios and the shortening of debt maturities have left companies more vulnerable to a down-turn in business and to increases in interest rates. To some extent, this extra vulnerability may not be as great as it seems - because of the enormous growth in hedging and the overall impression is that the corporate sector is relatively badly placed to cope with a future recession.

17. There are, in addition, some sectors where the combination of heavy indebtedness and high real interest rates have already caused serious problems, and these are in some cases getting worse.

/Problem



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Problem Sectors: The Four Horsemen of the Apocalypse

18. The sector most badly hit has been agriculture. In the late 1970s farmers anticipated continued export growth, increasing commodity prices and rising land values. They borrowed heavily to finance expansion and farm debt doubled from 1976 to 1981 during a period of high inflation. Unfortunately for those farmers, the expectations of the 1970s never materialised in the 1980s, and land values began to decline together with net farm incomes. By January 1985, the Department of Agriculture reckoned that 214,000 farmers were both losing money and had accumulated debt exceeding 40 per cent of their assets. Most managed to obtain short-term credit to get them through the spring planting season but a bumper crop this summer has reduced agricultural prices even further and there is a very real concern that as many as 15 per cent of all US farmers will not get through the coming winter with their loans renewed. The steady erosion of farm prices has undermined the value of the land which provides the collateral for most farm debt. In Iowa, farmland has declined in value by 49 per cent since 1981 and throughout the mid-West falls of more than one-third are typical.

19. The real estate industry has also been badly affected. There are signs, particularly in the South West, of a substantial over-supply of commercial office and other types of property development. High vacancy rates in some parts of the country and the significant reduction in the rate of inflation have resulted in declining real estate values. Moreover, mortgage delinquencies have been steadily rising and now stand at

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6.2 per cent, the highest rate for 24 years. Nearly one-third of all bank lending is to the real estate sector and there is growing concern about the deteriorating quality of such loans and the growing number of foreclosures. Many are also concerned that the problems of the farmers will lead to a flooding of the market of land for sale, with consequent effects on all real estate values.

20. Energy is a third main problem sector. Downward pressure on world oil prices coupled with the deregulation of energy prices has led to an increasing number of defaults. Several major South Western banks reported severe losses on energy loans for the first quarter of 1985 and the recent \$5 fall in world oil prices - though in broader economic terms, beneficial to the US as a net oil importer - places a question mark over the quality of many of the loans made since 1981. Moreover, problems in the energy sector are not confined to oil and gas. In 1983, Washington Public Power Supply System defaulted on \$2 1/4 billion of municipal bonds following a series of disasters with its nuclear plant programme.

#### Consequences for Lenders

21. As a result of these problems - third world debt is the Fourth Horseman - parts of the US banking industry are now in serious difficulties. Over 100 banks have closed in 1985, albeit out of a total of 14,000 or so. This is more than double the number in 1982 and 1983. In addition over 250 banks with total assets of \$153 billion are now regarded as "problem banks" with low credit ratings.

22. Most of these banks are small community banks which are over-exposed in their lending to one particular sector. But it is by no means exclusively a "small bank" problem; some of

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the large Californian and mid-Western banks have also been affected.

23. The problems of the farmers in areas such as Ohio have hit the Farm Credit System (FCS), a nationwide network of 37 farmer-owned banks and hundreds of cooperative associations, especially hard. The FCS holds about \$70 billion of farm debt (about 40 per cent of the total) of which \$3.5 billion is in loans on which payments have been stopped. This total could rise to over \$10 billion over the next five years.

24. In legislation approved by Congress and which the President will shortly sign, FCS will be provided with a line of credit, for an unspecified amount, to be used when the system can no longer rely on its own resources to keep functioning. The legislation will force the stronger banks in the FCS to help the weaker ones. And it will give the FCS stronger regulatory powers.

25. By contrast, the big US banks have been much less affected by these domestic lending problems, and they have generally fared rather well this year. Their main worry has been related not to US indebtedness but to the indebtedness of Latin America. The latter falls outside the scope of this despatch: suffice it to say that risks to the US banks were in the Administration's eyes sufficient, along with concern over the political dangers in some of the debtor countries, to justify the new "debt initiative" announced by Secretary Baker in Seoul.

26. The thrifts have, if anything, experienced even greater difficulties, and there have been many failures, though these have been concentrated in certain areas of the country, Maryland for example. Quite apart from falling property values and the problems

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of "Interest mismatch" mentioned earlier, many of thrifts have indulged in highly risky lending.

27. These developments have proved a major challenge for bank and thrift supervisors, which in some ways they have not been well placed to meet. Five different Federal agencies regulate them and there is a lower layer of State regulation as well. The consequential fragmentation and duplication inevitably creates problems. There is growing concern about this state of affairs, as reflected for example in Vice-President Bush's Task Force on Regulation of Financial Services last year; but the Administration and Congress seem unwilling to push for fundamental reforms, partly because the various financial institutions and regulatory bodies strongly resist any attempt to change the status quo.

28. Despite the shortcomings of organisation, however, particular crises have been successfully dealt with and contagious chain reactions avoided. Furthermore, a number of measures have been taken to reduce the risks to the banking system - for example, by requiring higher provisions against doubtful loans and higher capital ratios. And steps are belatedly being taken to tighten the regulation and improve the prudential standing of the thrifts; another example is the Fed's proposal to restrict the use of "junk bonds" in corporate takeovers. But the whole system is still fragile.

29. These moves in the direction of improved supervision are in contrast to deregulation of the financial markets which started with legislation in President Carter's last year of office but which proceeded very rapidly during President Reagan's first term. That deregulation has in many ways made for a more efficient provision of financial services. But it also seems to

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have made the system still more fragile. Under Chairman Volcker's leadership, we are now seeing a necessary redressing of the balance between liberalisation and prudence.

### Conclusion

30. If any other country had run its economy the way the United States have run theirs, it would have had the IMF broker's men in long ago. That the United States can survive so gung-ho a management of its economic affairs is due to the sheer size and resilience of its economy, the spirit of enterprise which still permeates society and, of course, the considered judgment of the outside world that the US is a good haven for its savings. Nonetheless the mounting level of external and domestic debt poses considerable risks. Arguably, the growing external indebtedness is the more serious, and not only because of the protectionist forces it encourages. Without it, interest rates and the dollar would be lower; and this would make life much easier for the heavily indebted domestic sectors and for the banks and thrifts. But as things stand, domestic indebtedness is a cause for concern.

31. The efforts of the Fed and other regulators to improve the prudential position of the banks and thrifts, and to tighten supervision, are to be welcomed. Progress in correcting the underlying imbalances in the economy is slow, and inevitably this must increase the risk of a major collapse at some stage, whether of the dollar or of one or more of the big banks, or of a resurgence of protectionist pressures. My own estimate is that these dangers are still more possibilities than probabilities. But it is right for us to be worried, and to continue to press our concerns on the Administration - especially for an early reduction in the budget

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deficit and for resistance to protectionism. With the mid-term elections next November already looming, and 22 Republicans up for re-election (16 of them first-termers many of whom were swept in on the Reagan 1980 coat-tails), it is hard to avoid the conclusion that measures found unpalatably draconian by Easter 1986 will then be postponed until 1987, or perhaps until 1989, unless the roof really falls in.

32. I am sending copies of this despatch to the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Minister of Agriculture, Fisheries and Food, Her Majesty's Representatives at UKRep Brussels, UKMis Geneva, UKDel OECD Tokyo, Paris, Bonn, Berne, Canberra and Ottawa, and to Her Majesty's Consuls-General in the United States.

I have the honour to be,  
Sir,  
Your obedient servant,

Oliver Wright

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From: Sir G.Littler  
Date: 8 January 1986

CHANCELLOR

*Thanks.  
(For Monday's mtg)*

c.c. Sir P.Middleton  
Sir T.Burns  
Mr Lavelle  
Mr Fitchew  
Mr Mountfield  
Mr Scholar  
Mr Culpin

### G5 MEETING

A proposed agenda for the meeting is attached. Full briefing will be submitted next week. This minute considers likely major points and objectives.

2. I would expect the main interest to lie in:
  - 1(a): Intervention;
  - 1(b): Policies and prospects of G5 economies;
  - 2(b/c): What we do next on debt.

I am not clear (but hope to find out more) what the U.S. have in mind under "strengthening the process of G5 co-operation". Here and elsewhere we shall need to watch relations with non-G5 countries and other fora.

### Intervention

3. We can all take satisfaction from what has happened, but there will be different attitudes for the future. It should be easy to agree to resist any renewed appreciation of the dollar, because that would suit everybody. But in the other direction:
  - France and Germany: will both be predominantly concerned to avoid threats to internal ERM arrangements before the late-March French elections; they will want to resist any further depreciation of the dollar for the time being.

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- **Japan:** reckon that around the 200-Yen dollar they have gone as far as they can without domestic complaint from some important industrial interests (well beyond the few marginal producers who are already said to be affected); their Central Bank Governor has recently said publicly that they would like a pause "until the Summit" (which may indirectly have helped ease ERM tension a little).
- **United States:** may have divided views but, as long as depreciation does not get out of hand, they ought to be looking for more.

4. **U.K. Interests.** Our own short-term interest is to avoid developments which make the management of our own exchange rate more difficult. Whether this argues for a period of calm among other currencies is uncertain: it might have a steadying effect on markets generally; or it might uncomfortably focus attention on sterling. I think we cannot look at this usefully in isolation: at least equally important to us is what happens to U.S. and other domestic interest rates in the coming weeks.

5. **Longer-term** I think we should urge further appreciation of the Yen/Dollar rate and the DM/Dollar rate, hoping that sterling would stay pretty close to the DM and broadly keep in its recent effective range around or not far short of 80. The arguments I see for this are:

- the Japanese cannot stick at a point which avoids effects on their major producers: we need those effects to help redress the trade imbalance;
- the same point applies for dollar depreciation generally;

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what has happened so far is not enough;

- the threat of protectionism in Congress could easily come back: we shall want to hear more on this from Baker;
- but the problem will never be solved by exchange rate manipulation alone: we should find common ground with others in pressing the need for more and faster measures of adjustment by the United States.

**Policies and Prospects**

6. Baker will want to press the case for others to move into faster growth, and will meet general resistance.

7. **U.K. Interests:** I think you are in a strong position to defend existing U.K. policies - relatively good growth record; a "good neighbour" trade and payments balance; the need still to keep the attack on inflation at the forefront; and also your line from the 1985 Budget of responding to favourable external factors by broadly maintaining money GDP growth and taking benefit of an improved output/price split.

8. On other countries, I would recommend:

- join in pressure on the Japanese: their need to adjust further is clear; we suspect their recently announced Budget of being tighter than appropriate; they are in general dragging their heels on liberalisation; they are the prime target for U.S. protectionist feelings;
- the case against Germany is much weaker if their own forecasts are accepted; but some predictions give them a current external surplus as high, relative to GNP, as of Japan, which would suggest scope for further action.

6. What Germany (and Japan) could reasonably argue is that significant expansion by them while the U.S. domestic imbalance remains would threaten inflation; they should see a stronger case for the future if and when the U.S. demands on world savings are slackening.

*Down*

**Interest Rates**

7. There should be some discussion of interest rates. The idea of concerted downward moves could well surface. Mulford tried it out tentatively among Deputies in November (rebuffed by me and Tietmeyer and only Lebegue showing interest). Oba offered no comment then, but there has been a report subsequently that the Japanese might be interested.

~~8. I cannot see merit in attempts to reduce interest rates by concerted Government fiat while the underlying supply and demand conditions remain unchanged, and I would recommend resisting. As far as the U.K. is concerned I doubt if we could command solid credibility for our part in joint action.~~

9. At the same time, it might be worth exploring a variant. It seems to me that we ought to encourage the U.S. authorities to seek lower U.S. rates (helpful for their own domestic activity; helpful impact on their exchange rate; helpful to third world dollar debtors; indirectly helpful to others - unhelpful in the risk of adding to domestic inflationary pressures in the U.S., but they and the rest of us could stand their taking marginal risks in the process of getting out of their own imbalances). If U.S. rates could be eased, some others might also be able to ease their rates. The effect might begin to look like concerted intervention

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but I think it important that the U.S. should take the lead and that others should have the option, not the obligation, to follow.

**International Debt**

10. I see two or three main strands of discussion:

- in reviewing countries, we shall want to focus on the reality of the "go it alone" threats (i.e. deliberately avoiding the IMF) from Nigeria, Peru, etc;
- we need to help the IBRD into its enhanced role under the Baker initiative: when I found that the U.S. had done no real homework on this, I circulated to fellow-deputies a note prepared here, which was welcomed and which we aim to discuss together at end-January (I attach a copy for you to get the flavour, but do not suggest this as right for substantive discussion among Ministers);
- we need more consistent G5 (and wider) co-ordination of attitudes towards export credit for debtors: this should include **both** re-opening credit for those who reschedule with good adjustment programmes (this was your proposal at the 1984 Annual Meetings!) **and** collectively stopping credit in cases of bad behaviour; we have been pursuing both at official level but if you could give a boost with your colleagues it could help overcome the reluctance of some countries to commit themselves.

*After fall price collapses*  
**U.K. Objectives**

11. We have planned this as a routine, stocktaking meeting and do not intend a significant communique. We should hold to that, with probably Baker as the only threat - and even if he agrees

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procedurally he may want to make some splash back home.

12. This means that our immediate publicity interests are:

- credit as host of a smooth meeting;
- avoidance of damaging exchange rate speculation;
- that you arrange press guidance here which sets the right agreed tone.

13. More privately, my summary of objectives would be:

- to get a clearer understanding of Baker's expectations and intentions on the fiscal front post Gramm-Rudman;
- to influence U.S. interest rates downwards, without tying our own hands in formal concertation or otherwise;
- to keep up pressure on the Japanese;
- to help (and take credit for it subsequently) in getting a sensible form of the Baker initiative off the ground;
- and, given the special responsibility of the host, to do our best for relations with Italy and Canada.



(Geoffrey Littler)



## AGENDA

## 1. Follow-up to Plaza Meeting:

- (a) intervention;
- (b) underlying policies, **performance** and prospects of the G5 countries;
- (c) strengthening the process of co-operation among G5;**
- (d) implications for wider discussions of G10 Report in the April IMF/IBRD Meetings.

## 2. International Debt:

- (a) review of general developments since Seoul;
- (b) progress on the three elements of the debt initiative:
  - economic policies of debtors;
  - multilateral development banks;
  - commercial banks;
- (c) next steps in implementing the debt initiative.**

## 3. Other:

- (a) Presidency of the I.B.R.D.;
- (b) Italian and Canadian interest in G5.

## NOTES:

- The above is as circulated by JGL to other Deputies except:
- **Bold type** in first two groups indicates additions at U.S. request which have been made known to others.
  - The last two points under "Other" are small additions not yet notified to others.



W: Mullan  
N: Dawson, but  
W: SM.

C

Two key notes from Sir Geog here, along with a copy of a good paper on the IBRD role he earlier sent to deputy colleagues.

A few points to address:-

- content with a US team of 4? (para 5 of top note)
- no press conference? *right*
- do you want a meeting on the main "UK objectives" ppr? *yes*
- if so, should Debbie try to fix perhaps for next Monday (with the sort of cast in Sir Geog's copy list)?

Yes, but  
Shall we  
ask. (deputies) *not*  
Manning, or *no* *read*  
Ward for *Schulz*  
Ro 8/  
(over)

SYSTEM  
2.12.78  
G.L.  
G.L.  
R. Wilson

PS. Re X, the answer  
is clearly 'No': just  
magic, no Italian  
reaction!

By the Father of  
reconciliation writing  
after the only, ~~and~~  
I am pleased to agree

PPS. I take it Baker  
wishes that I will  
do as he wishes.

FROM: SIR G. LITTLER  
DATE: 8 JANUARY, 1986

CHANCELLOR

cc Mr. Fitchew  
Mr. Culpin

G.5 MEETING

Mulford has been out of town for much of this week, and I have only just managed to have a further conversation with him. We covered the following points.

Circulation of Papers

2. Probably none. Of the two they had in mind:

- one was simply designed to review what has happened since the Plaza meeting: they (and we) have just been told that the IMF Managing Director will be letting us have within a day or so a short paper against the possibility of a G5 meeting, and we reckon this will suffice (incidentally I have ensured that Mr. Lankester explains what we are doing to the Managing Director and am told it is understood and there is no resentment over his not being invited);
- the US ideas on "strengthening the process of G5 coordination" are something Baker would like to be invited to speak on, but they will not offer a paper. Apparently the substance is simply a discussion of whether what the G.5 are now seeking to do can be improved and presented as meeting the kinds of surveillance requirements envisaged by the G10 Report, and the real US objective is to ward off campaigns for "target zones", etc.

Italians (And Canadians)

3. The US take the same view that we do and are working on a draft reply which they think should be sent before we hold the meeting. We each ran over briefly the lines in our present drafts and found them very closely similar.

Publicity

4. Agreement that there should be no significant press communique and the suggestion that we should also make clear - and in advance of the meeting - that there will be no press conference. I said that I thought that this was what you had in mind and I would confirm. I also said that we were thinking of having a very brief agreed line for use with the press of which I would have a draft when we meet.

Attendance

5. Tiresomely, Baker has asked (and explicitly asked that you be asked) whether he could have a team of 4 (Darman and Mulford as well as himself and Volcker. I am not happy about this, because of the risk that it becomes a habit and others try to do the same. As I said to Mulford, there was a special reason which induced us all to accept the extra man at the Plaza, because of the nature of the operation our hosts were running. I said that we were not proposing a larger than usual team. But I undertook to put the question to you.

6. If you felt reluctant to offend Baker by refusing, I think we could probably get away with it. There would be no natural extra whom the other visiting teams might want to include. Probably the loudest objection would come from Tietmeyer, who has once or twice tried to mobilise Stoltenberg to press Baker to designate Darman, rather than Mulford, as his Deputy!



(J. G. LITTLER)

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TO DESKBY 080900Z TREASURY  
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OF 080708Z JANUARY 86  
AND TO PRIORITY FCO, PARIS, WASHINGTON, BONN

*When I was this  
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control*

1. FOLLOWING IS OUR TRANSLATION OF A STORY APPEARING TODAY IN NIKKEI (LEADING ECONOMIC DAILY):

IT WAS LEARNED YESTERDAY THAT THE UNITED STATES HAS PROPOSED THAT JAPAN, WEST GERMANY, THE UK AND FRANCE SHOULD HOLD ANOTHER MEETING OF THE G5 SOME TIME BETWEEN THE MIDDLE AND THE END OF THIS MONTH. JAPAN HAS ALREADY CONVEYED TO THE US ITS INTENTION TO PARTICIPATE. OTHER EUROPEAN COUNTRIES ARE ALSO INTENDING TO PARTICIPATE PROVIDED THEIR FINANCE MINISTERS CAN CONVENIENTLY MEET TOGETHER. IT IS THEREFORE HIGHLY LIKELY THAT A MEETING COULD BE HELD IN LONDON, POSSIBLY AS EARLY AS 18 OR 19 JANUARY. LIKELY MAIN TOPICS FOR THE MEETING ARE:

(1) FOLLOW-UP TO THE SEPTEMBER G5 AGREEMENTS ON CONCERTED EXCHANGE MARKET INTERVENTION AND POLICY CO-OPERATION; AND

(11) FURTHER WORK ON THE DETAILS OF US TREASURY SECRETARY BAKER'S PROPOSAL ON LENDING TO MEDIUM INCOME DEVELOPING COUNTRIES BY COMMERCIAL BANKS FROM JAPAN, THE US AND EUROPE.

IT IS ALSO POSSIBLE THAT THE MEETING WILL PREPARE THE GROUND FOR CONCERTED INTEREST RATE REDUCTIONS.

2. FINANCE MINISTER TAKESHITA IS SCHEDULED TO VISIT THE UNITED STATES AND EUROPE ON 16-25 JANUARY TO ATTEND A COLOMBIA UNIVERSITY DEGREE CEREMONY, TO EDUCATE HIMSELF ON OFF-SHORE MARKETS OVERSEAS AND ON OTHER BUSINESS. THE US HAS THEREFORE SUGGESTED TO THE THREE EUROPEAN COUNTRIES THAT A G5 MEETING COULD BE HELD DURING THIS PERIOD.

3. INTERNATIONAL FINANCIAL SOURCES SAID "THERE IS A 90% PROBABILITY OF A MEETING". IT IS HIGHLY LIKELY THAT THE MEETING WILL BE A SECRET ONE. (SIC). NO JOINT COMMUNIQUE WILL BE ISSUED. THE VENUE FOR THE MEETING IS STILL FLUID BECAUSE MINISTERS' DIARIES WILL HAVE TO BE CO-ORDINATED BUT EITHER LONDON ON EITHER 18-19 JANUARY OR WASHINGTON ON 25 JANUARY IS LIKELY, AS FOREIGN EXCHANGE

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STARTING...  
but this was...  
MARKETS.*

MARKETS WILL BE CLOSED ON ALL THOSE DATES. IF A G5 MEETING IS HELD, THE GOVERNOR OF THE BANK OF JAPAN AND THE VICE MINISTER OF FINANCE FOR INTERNATIONAL AFFAIRS (OBA) WILL ALSO ATTEND FROM JAPAN.

4. THE MEETING WILL PROBABLY BEGIN WITH A REVIEW OF FOREIGN EXCHANGE MARKET DEVELOPMENTS SINCE THE OCTOBER MEETING IN SEOUL, FOLLOWED BY AN EVALUATION OF THE EFFECTS OF CONCERTED INTERVENTION BY CENTRAL BANKS. THE MEETING IS ALSO EXPECTED TO CONFIRM THE CONTINUATION AND STRENGTHENING OF A CO-OPERATIVE STANCE ON ECONOMIC POLICY. AS FOR MR BAKER'S PROPOSAL, THE CO-OPERATIVE STANCE OF INDIVIDUAL COUNTRIES COMMERCIAL BANKS TOWARDS IT WOULD BE CONFIRMED AND DETAILS SUCH AS THE LOAN AMOUNTS FOR EACH COUNTRY WILL BE WORKED OUT.

5. THE NIKKEI STORY CONCLUDES BY COMMENTING THAT PRIME MINISTER NAKASONE HAD EARLIER PROPOSED CONCERTED INTEREST RATE REDUCTIONS BY JAPAN, THE US, AND MAJOR EUROPEAN COUNTRIES. (MY TELNO 9). THE US, AND JAPAN ARE CURRENTLY CONSIDERING THE POSSIBILITY OF AN OFFICIAL DISCOUNT RATE CUT. FOR THESE REASONS IT IS ALSO LIKELY THAT THE G5 MEETING WILL PREPARE THE GROUND FOR CONCERTED INTEREST RATE REDUCTIONS.

6. OTHER (ENGLISH LANGUAGE) NEWSPAPERS CARRY TODAY A SHORT FACTUAL ACCOUNT OF A PRESS CONFERENCE GIVEN BY TAKESHITA YESTERDAY IN WHICH HE CONFIRMED THAT HE WILL BE VISITING THE US AND UK FROM 16-25 JANUARY AND THAT HE HOPED TO DISCUSS MONETARY ISSUES AND POSSIBLE CONCERTED CUTS IN INTEREST RATES WITH THE CHANCELLOR AND THE US SECRETARY OF THE TREASURY.

GIFFARD

MONETARY

FED  
NAD  
WED

|              |                 |
|--------------|-----------------|
| CH/EXCHEQUER |                 |
| REC.         | 13 JAN 1986     |
| ACTION       | SIR G. MITCHELL |
| COPIES TO    | MR LAVELLE      |
|              | MR S. MATTHEWS  |
|              | MR CULPIN       |

LE MINISTRE

✓ 13/1  
Paris, le

-9 JAN. 86 - 000546

Note. Asked  
Ps/Sr G. Litter for his  
advice. Ro 14/1

✓ C. To see. We want Sir Gegg's  
advice, but my initial reaction is that  
the French could be interfering in a much  
more harmful way than  
this, Ro 13/1

Cher Collègue,

Lors de leur récente réunion à Paris, mon suppléant, Monsieur Daniel LEBEGUE, a remis à ses collègues du G.5 les grandes lignes de deux propositions françaises en vue de renforcer la coopération entre le Fonds Monétaire International, la Banque Mondiale et les banques commerciales dans leurs intentions sur les grands pays débiteurs.

En substance, ces deux propositions - qui sont dans le même esprit que l'initiative prise par Monsieur BAKER à Séoul, visent deux objectifs essentiels :

- un meilleur emploi de l'argent frais apporté par les banques commerciales pour financer des investissements rentables et productifs dans les pays en développement

- la mise en oeuvre de programmes conjoints " d'ajustement - développement " par le Fonds et la Banque, pour assurer enfin une coopération réelle et efficace entre les deux institutions de Bretton-Woods, dont le rôle et les objectifs spécifiques seraient bien entendu préservés.

Il m'a été dit que ces deux propositions avaient suscité un réel intérêt, et ses collègues ont demandé à Monsieur LEBEGUE de préciser à leur intention le concept et les modalités de mise en oeuvre de ces programmes conjoints " d'ajustement-développement" en faveur des pays très endettés.

Etant donné l'importance cruciale que revêt cette question dans les circonstances actuelles, j'ai pensé que vous souhaiteriez peut-être l'approfondir vous-même avant que nos suppléants poursuivent leur réflexion, en vue de parvenir à une position commune. Je serais heureux d'en discuter avec vous de manière plus précise, si vous le jugez utile, peut-être à notre prochaine réunion commune.

A cet effet, vous trouverez ci-joint une note explicative sur notre proposition de programmes concertés "d'ajustement-développement" FMI-BIRD et copie de la note qui avait été remise à votre suppléant, en octobre dernier, à Paris.

Veillez agréer, Cher Collègue, l'expression de ma considération distinguée.

*Cordialement vôtre,*

*P. Béregovoy*

Pierre BÉRÉGOVOY

Monsieur Nigel LAWSON  
PC. MP  
Chancellor of Exchequer  
H.M. Treasury Parliament Street  
LONDON SW 1P 3 AG



*Le Ministre de l'Economie  
des Finances et du Budget*

TRADUCTION OFFICIEUSE

Dear Colleague,

In the course of their recent meeting in Paris, my Deputy, Mr Daniel LEBEGUE, handed out to this G5 Colleagues a broad outline of two french proposals to strenghten the cooperation between the International Monetary Fund, the World Bank and the commercial banks towards major debtor countries.

In essence, these two proposals - which are in line with the Seoul initiative of Secretary Baker - aim at two objectives :

- a better use of the "new money" provided by commercial banks, towards financing sound and productive investments in developing countries.

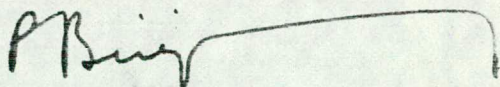
- the setting-up of joint "ajusment-development programs" by the Fund and the Bank as a means of ensuring at last a real and efficient cooperation between the two Bretton-Woods institutions, whose specific roles and objectives would of course remain unchanged.

Both of these proposals were - I think - received with a good deal of interest, and Mr LEBEGUE was asked especially to elaborate and to provide some further detail on these joint "adjustment-development programs" towards major debtor countries.

Given the crucial importance of this subject in the present circumstances, I thought you would wish to consider it yourself before our Deputies exchange some further views and try to reach a common position. I would be happy, if necessary, to discuss this proposal in more detail with you, possibly at our next common meeting.

To this effect, I enclose a note and proposal on the basic thrust and implementation procedure of these joint IMF-IBRD "adjustment-development programs" and copy of the note which was distributed at the last G5 Deputies meeting in Paris.

Sincerely yours,



Pierre BÉRÉGOVOY

CONFIDENTIAL

G.5 Deputies Use Only

Subject : Major debtors - Follow-up of the Seoul Meetings.

The purpose of this paper is to :

- provide you with first reactions to the proposals by our U.S. colleague,

- outline the risks which in our view are involved in solutions like guarantees, capitalization of interest or setting-up of new international organizations,

- share with you some proposals for the strengthening of the cooperation between the Bank, the Fund and the commercial banks in their efforts towards principal debtors.

1 - Preliminary reactions to the outline of Assistant Secretary Mulford :

This contribution is highly appreciated : for the substance and because it helps keeping the "momentum" which has been developed in Seoul.

Most of the proposals outlined by Assistant Secretary Mulford deserve our strong support. I could mention, for instance :

- a strengthening and an increased role of the World Bank, including the need for reforms in the internal procedures of the institution and for a larger share of non-project loans.

- a better coordination between the Fund and the Bank, in order for both institutions to focus on the promotion of sustained growth.

- the need for continued adjustment efforts by debtor countries with the help of the IMF.

- a sustained effort by commercial banks towards these countries, and the need for a closer coordination with the financing provided by the IBRD.

It appears nevertheless that some issues need to be clarified, as for instance :

- the "fifteen countries which are the focus of the proposals". Any list of beneficiarries can only be a sample and illustrate the case : some of them - which are now included - may not become eligible for the joint effort, some others - not yet included - may implement adjustment measures and join at a later stage.

.../

- the "formation of a new steering group composed of the leading Bank advisory group institutions". The questions raised by such a new body lead to some reluctance on our part : what is the added value of such a new "super-structure" of commercial banks in the country-by-country approach ? Would it not give the wrong signal in suggesting that a global approach to the debt problem is desirable ? What is meant by "pooling mechanisms" and "indirect participation" in the lending arrangements ?

- the "Latin share of lending" by the IBRD : the increase beyond 30 per cent could be inconsistent with the growing needs of other regions and the increased reliance of the Asian blend countries (India and China) on IBRD loans instead of IDA credits. A more realistic approach would therefore be to expand the overall commitments and disbursements of the World Bank and to increase substantially the lending to Latin America in absolute terms.

- the "economic policy content" of structural programs by the World Bank : most of the reforms mentioned should be implemented in close cooperation with the IMF. All of them should be considered on a case by case basis, not as a generally applicable rule.

- IDB voting majorities : the objective should be to find a middle ground between borrower control and a veto by "non-borrowing countries".

- role of the IMF : it needs to be strengthened, insofar as we all agree that IMF involvement and financing is and will remain essential in the adjustment efforts of debtor countries. It is all the more important to state it very clearly that the IMF is engaged in difficult negotiations with most important countries like Brazil.

Mentioning "structural reforms" and "supply-side policies" could lead to confusion with the role of the World Bank. The best solution to achieve sustained growth is rather to strengthen the cooperation between the two Bretton-Woods institutions.

- G.5 action : it is essential for a successful program, but it should be channeled and implemented through existing mechanisms.

- International institutions (in conclusion) : the general capital increase of the IBRD, which will be needed in the short term, should be supported by all of our governments.

- 2 - The risks involved in some options :

. Guarantees : for instance, guarantees or cross default clauses provided by the World Bank to commercial banks in the framework of cofinancing operations (B - loans).

The main risk is that commercial banks could be tempted to provide all or part of their new money only under a public and official guarantee. Insofar as the risk would be assumed by governments - which are the shareholders of the IBRD -, such an option could run against the legitimate objective of a sustained lending by commercial banks to principal debtors.

. Capitalization of interest. This solution, even applied on a partial basis, would put into question one of the most important rules of the debt strategy : the prior payment of interest before any rescheduling and "new money" financing. It would furthermore weaken the position of creditors and jeopardize the delicate balance which prevails in the negotiations : the debtor agrees to meet its obligations in terms of interest, the creditor on the other hand agrees to provide new financing - the amount of which is subject to discussion.

. Setting-up of a new international organization : Cooperation between the Fund, the Bank and the commercial banks is already difficult to achieve. Adding a new organization - with its own structure and financing - could complicate and lengthen procedures instead of clarifying and speeding up the joint effort towards major debtors.

- 3 - Proposals for the strengthening of the cooperation between the Bank, the Fund and the commercial banks :

The joint efforts undertaken until now by the IMF, the IBRD and the banks suffered two major weaknesses :

. The Fund and the Bank programs are not coordinated in the same time frame : IBRD structural loans are usually committed after the setting-up of IMF programs, and World Bank loans in general are not put together in a consistent "package" of financing.

. The "new money" provided by commercial banks is not used in an optimal way. It is not sufficiently intended to finance - beyond the immediate needs of the balance of payments - well-targeted development projects in the productive sectors of the economy. Commercial banks could benefit from the expertise which the World Bank has developed in this field.

This leads to the following proposals :

- the setting-up of a new instrument : the joint "adjustment-development programs" by the Fund and the Bank :

The objective would be to set up as a "package" the new financing provided by the two institutions, for instance in the course of the "gap filling" exercises. The new feature would be the designing and simultaneous implementation of a joint program, through an IMF adjustment program and an IBRD structural program : in the latter case, through structural or sectoral adjustment loans, and even project loans aiming at the same objective. The IBRD program would be supported by increased long-term financing.

Disbursements by the Bank and the Fund would of course not have to follow the same time pattern, which is specific to each institution, but they would be part of a joint program of action.

- a better use of the "new money"

The objective would be to use the additional financing provided by the commercial banks, not only to relieve the balance of payments, but also to develop the economy of the recipient countries. By financing productive and sound development projects (in industry, infrastructure, agriculture...), the "new money" would directly contribute to the growth of exports and GDP - as was the case in the post-war Marshall plan, and contrary to large amounts of "new money" which in the past have vanished in public and private consumption and capital flight.

In practice, the World Bank could provide its expertise to select -in close cooperation with the borrowing country and the commercial banks- the soundest and most profitable investment projects which could be financed by the "new money".

These new "packages" could be implemented either by the existing institutions or, as far as the Bank and the Fund are concerned, by some new and very light common structure between both institutions. This common IMF-IBRD structure would not commit any new financing and would rely on existing and seconded Fund and Bank staff. But it could promote efficient cooperation between the two institutions.

Other essential elements for a successful implementation of this program are :

- the actions taken by creditor governments themselves : mainly growth of GDP, fight against protectionism and level of interest rates.

These policy measures are actually far more important than all the others. For instance, a rise of two per cent in interest rates would almost completely set out the efforts developed by commercial banks (given the level of debt owed by fifteen selected debtors : 280 billions \$).

- the reform of the "new money" exercises

To ensure that every creditor participates effectively in the "new money" exercises, the best solution would probably be to develop a new "financial center" approach : each main center or bank community (i.e. New-York, London, Frankfurt, Tokyo, Paris...) would take the responsibility of providing its share of "new money" and, to this end, device the procedures best adapted to each case.

- the reform of the World Bank :

. the internal procedures : the time needed for processing a loan (internal consultations and complexity of layers) has become a major obstacle to an efficient and enhanced role of the IBRD.

Concrete and far reaching measures need to be taken in order to simplify the organization of the institution and speed up its internal procedures. The task force set up internally to this end, under the chairmanship of its Senior Vice President of Operations, should be closely monitored by major shareholders and not entirely remain in the hands of Management - as is now the case.

. the loan features : the share of non-project loans has been less than 15 % in FY 85. This is clearly not enough to respond effectively to the new role designed for the World Bank.

At least a doubling of this percentage, over the three or four next years, would not only be appropriate but perfectly feasible. It would consist of structural adjustment loans, program loans and sectoral adjustment loans.

December 9<sup>th</sup> 1985

AIDE MEMOIRE

Proposal for joint "adjustment-development programs" by the International Monetary Fund and the World Bank.

The purpose of this note is to provide you with some detail on the basic thrust and the implementation procedure of the joint "adjustment-development programs" by the Fund and the Bank, whose broad outline my Deputy, Mr Lebègue, the Director of the French Treasury, handed out to his G5 colleagues last month in Paris. Our explanation will proceed along the following lines :

- the deficiencies of the present system,
- a new concept, through the reform of the Fund and Bank interventions,
- the preparation and implementation of the joint adjustment-development programs,
- the advantages for all parties involved.

In essence, the idea would not be to set up any new organization or to devise any new financing mechanism, but to ensure that the Fund and the Bank do at last engage in a real and fruitful cooperation with regard to major debtor countries. These "adjustment-development programs" would constitute the main channel through which would flow the additional financing the World Bank is going to provide to developing countries in the years to come.

1 - The deficiencies of the present system : lack of timely coordination and lack of consistency between the interventions of the two Bretton-Woods institutions :

A "minimal" coordination has of course been established between the Fund and the Bank : IBRD financing is fully available only to those indebted countries which implement the kind of adjustment and economic reform measures which the Fund is usually advocating and supporting. Conversely, the IMF in its programs is looking more and more for the kind of structural reform measures the IBRD is best able to implement : public sector investments and enterprises, sectoral or structural adjustment ...

But this "minimal" cooperation is clearly not strong enough to respond to present circumstances, because of two major weaknesses :

- the lack of timely coordination between the financing and the programs of the Fund and the Bank : IBRD loans are usually extended well after the financing by the Fund is put in place. This means that the commitments of both institutions are disconnected, they may be inconsistent and, in any case, their intervention doesn't reach its full efficiency.

For the same reason, there is no common or joint "signal" to the other partners, and especially the commercial banks. It is either inexistant or even contradictory.

- moreover, World Bank loans are not put together in a comprehensive "package" of financing. They are usually spread over several projects and programs, which are committed and disbursed separately : their global consistency is not always established or at least well perceived by the borrowing country.

2 - The concept : a new "facility" through the early and simultaneous setting-up of an IMF adjustment program and an IBRD structural program :

The idea would be to put together as a "package", at the earliest stage of their intervention, the new financing provided by both institutions. In other words, the Fund and the Bank would bring simultaneously to their respective Boards the aid and financing program which is specific to each organization, but would have been prepared in closest cooperation with the sister institution. It goes without saying that compliance with the program by the borrowing country - which would have negotiated it with the Fund or the Bank - would determine its smooth and continued implementation.

In practical terms :

- the IMF program would outline the global economic and financial conditions which lead to a sustained restoration of the main internal and external equilibria . This Fund commitment would have to be supported by adequate and substantial financing.

- the IBRD program would outline the structural and sectoral reforms (public investment and enterprises, prices and tariffs...) which lead to renewed growth and development on solid foundations. Increased long-term financing by the World Bank would support this action : structural adjustment loans, program loans, sectoral adjustment loans, and even project loans aiming at the same objective.

3 - The preparation and implementation of the joint adjustment-development programs :

The objective is an ambitious and constraining one, but the ways and means of preparing and implementing the programs are to remain flexible.

a) The preparation : in order to put together, in such a short period, a consistent "package" of measures to be announced simultaneously, the two institutions would have to develop and implement a particularly efficient cooperation. The setting-up of joint Fund-Bank missions is the most appropriate way to achieve this objective. These missions could organize their work in the field on a "practical" basis : the distribution of work would be in accordance with the programs (or projects) which are specific to each institution.

In the end, the absolute necessity to set up joint and agreed programs -and the time pressure (a few months instead of a few years, as it now happens sometimes for the World Bank)- would constitute an efficient stimulus towards optimal coordination between the Fund and the Bank.

b) the implementation of the programs, which would have been jointly prepared and committed, should pay due regard to the ultimate and specific objective of each institution : direct and urgent balance of payment financing, on the one hand, development aid over the medium and long-term, on the other hand. Disbursements in particular do not always follow the same time pattern in the case of the Fund and the Bank : IBRD non-project loans are already and, in any case, should be as quick-disbursing as Fund financing, but specific project loans do of course take more time to disburse and follow a different pattern.

In other words, the most important is that a consistent and global "package" has been put in place at the earliest stage. It will best ensure that quick and well coordinated action will be taken by the Fund and by the Bank.

c) the follow-up :

This joint program of action will of course have to be adapted and adjusted in the light of evolving circumstances, in agreement with the borrowing country. Conversely, in case of a major departure from either one of both programs, negotiations would have to be initiated immediately between the authorities concerned and the Fund or the Bank, in order to put the program "back on track".

This legitimate constraint would not change anything with regard to the present situation : the need for consultations or renegotiations is already well established in case of a departure from performance criteria on the Fund side or when a World Bank program fails on a major point.

More generally, the perspective and objective of this new "facility" - renewed growth on the basis of "sound" foundations - has of course nothing to do with "cross conditionality" or "ganging-up" of the Bretton-Wood institutions, which are a particularly sensitive matter for some major debtor countries. Moreover, the joint adjustment-development programs would be backed by significant and increased long-term financing, which the World Bank is to commit over the next years in developing countries.

4 - The advantages for all parties concerned :

a) the debtor countries :

The joint adjustment-development programs would be offered only to those countries which :

- implement adequate economic policy measures and reforms ;
- and accept this new "facility" and procedure.

This last point is of utmost importance : it is out of question to "impose" the adjustment - development programs to any country. They are attractive enough to be entered into on a voluntary basis :

- The IMF adjustment programs would be clearly put into the perspective of renewed growth,
- The IBRD would have to speed-up and simplify loan and disbursement procedures : to achieve this legitimate objective, a major reform of internal bureaucracy and layers is unavoidable.
- the numerous and separate projects and sectoral programs of the World Bank would be prepared, negotiated and committed as a "package", in the framework and perspective of a real "development program" : it would be perceived as such by the borrowing country.



- this development program would be supported by additional and substantial financing, which the World Bank is to provide over the years to come.

- more consistency between Fund and Bank programs is, in any case, preferable for the beneficiaries to the present loose, occasional and case-by-case coordination, which depends on good personal relationship between the staff concerned and leads sometimes to conflicting requirements.

b) the Fund and the Bank : a renewal and strengthening of their cooperation, and a reinforcement of both institutions :

- the absolute necessity to set up joint programs in a short period is probably the only way to ensure at last close and efficient cooperation between the Fund and the Bank, without imposing any rigid framework for preparing and implementing those programs.

- this new approach would lead away from any duplication and confusion of roles - which may arise in the system as it works - towards a better and well coordinated distribution of work. It is not desirable and it probably would be counterproductive to set up a rigid delimitation in this respect, but exchange rate, external payments, monetary policy and interest rates are rather the "province" of the Fund, whereas investment programs, management of the public sector, structural and sectoral reforms are best dealt with by the Bank. Other fields of competence, like prices and tariffs, are of common interest and require joint decisions.

- the setting-up of adjustment development programs makes sure that the IMF conditionality - together with a program of structural changes prepared by the IBRD - remains a key element in the channeling of increased multilateral resources towards major debtor countries. It also would illustrate the fact that it makes no sense to oppose, or to disconnect, "short term adjustment" under IMF leadership and "long term development" financed by the World Bank, since both actions are to be closely linked and combined to achieve a sustained recovery of the economy.

c) a new impetus to the indispensable reform of the World Bank, in two directions :

- the internal procedures : the time needed for processing a loan (internal consultations and complexity of layers) has become a major obstacle to an efficient and enhanced role of the IBRD. Concrete and far reaching measures need to be taken in order to simplify the organization of the institution and speed up its internal procedures.

The constraint built in by the setting-up, at the earliest stage, of joint programs with the IMF would provide new impetus in this respect and push into the right direction. There is no reason why non-project loans by the IBRD could not be prepared and committed in time with IMF loans. With regard to specific project loans, they definitely could be outlined and announced at an early stage, the details of preparation and implementation being worked out afterwards.

- the loan features : the share of non-project loans has been less than 15 % in Fiscal Year 1985. This is clearly not enough to respond effectively to the new role designed for the World Bank.

At least a doubling of this percentage, over the three or four next years, would not only be appropriate but perfectly feasible. It would consist of structural adjustment loans, program loans and sectoral adjustment loans.

The comprehensive structural adjustment loans are best suited in most cases. For major debtors nevertheless, sectoral adjustment loans may be easier-in a first stage-to put together and implement in the most efficient way.

d) A better coordination with the commercial bank loans :

The representatives of international commercial banks insist that their loans be better coordinated and disbursed in time and in parallel with those of the IBRD, whose procedures they all consider as being too bureaucratic.

The new approach, we are proposing to put in place, would not only lead to speeding-up of IBRD procedures, but it would give to its partners of the commercial banks - at the initial stage - a clear and consistent overview of the World Bank's development programs.

It also would provide them with the needed and precise "signal" for action, and it is in fact the only way for commercial banks to check if disbursements by the IBRD increase in line with their own interventions.

Baker wants  
not Mulford  
but sorry  
smth.



I will give  
Baker  
summary on  
Sunday. No  
need for an  
expert  
push

GS BAKER BICATG 92

Sir Geoff reports that Mulford was suggesting a private word between you and Baker early on Sunday (8:30am?), so Baker could explain the Libyan sanctions measures to you more fully. A US expert on the sanctions could come along and help to explain them.

Sir Geoff discussed this with Sir Peter in front of me after your meeting this afternoon. The general view was it would be better to make this a private, general bilateral rather than specifically on US/Libyan sanctions.

So no need for the expert to be present and a chance to discuss the US, IRPD chair etc as well.

OK on that basis?

Tete-à-tete like Stoltenberg

probably  
tete-a-tete  
with  
R13/1

SECRET



FROM: P WYNN OWEN  
DATE: 9 JANUARY 1986

NOTE FOR THE RECORD

cc Sir G Littler  
Mr Lavelle  
Mrs Lomax  
Mr Kuczys

## TELEPHONE CALL FROM SECRETARY BAKER

Secretary Baker rang the Chancellor at 9.45 pm on 8 January. He said the US President had announced some forty minutes earlier that the US had frozen Libyan bank accounts in US banks and in their branches. But this had been drawn narrowly to avoid the sort of objections that arose when Jimmy Carter did the same during the 1979 Iranian crisis. The measures only concerned branches of US banks, not subsidiaries, and did not touch upon private accounts - merely Libyan Government deposits. The US saw this as a small insurance policy, since they were very concerned that the Libyans would soon be expropriating US property in Libya.

2. The Chancellor asked for clarification as to the location of branches of US banks that would be involved. Secretary Baker confirmed that it meant branches wherever they were located, but not subsidiaries. He understood that action on the latter had caused some concern under Carter. He emphasised that the US were not seizing these deposits, merely freezing them. The Chancellor said it sounded like a pretty drastic step, but he would reserve judgement until he saw the proposals in detail. Secretary Baker said he would welcome the opportunity to explain the ample justification for these measures privately to the Chancellor. He very much hoped that the UK would not have any objections on grounds of extra-territoriality once it had seen the terms of the announcement. As far as the UK was concerned, he thought that only two banks - Manufacturers Hanover and Bankers Trust - were principally involved. He asked the Chancellor to inform the Bank of England. The Chancellor agreed to do so.



3. We subsequently rang the Duty Officer at the Bank, Mr Wicks and Mr Lavelle to inform them of the conversation.

G5

4. Secretary Baker said the US had been subject to fair pressure from the Italians over G5. The US view was that the G5 had existed since 1973 and it should continue as such. But it should be discussed at the next meeting. The Chancellor agreed with all these points.

5. The Chancellor asked where the US stood on the Presidency of the IBRD. Secretary Baker said he was not quite ready to make a decision, but was making progress. He hoped to recruit someone who he thought was very good, and with whom he thought the Chancellor would also be happy. Other Finance Ministers did not appear to be as interested as the Chancellor. He would therefore be willing to have a private word in confidence about the likely appointment soon. The Chancellor said he would welcome that.

*Re*

*PP.*

P WYNN OWEN

SAVING TELEGRAM  
UNCLASSIFIED  
FRAME ECONOMIC  
FROM PARIS SAVING TELNO 1 OF 9 JANUARY 1986  
TO FCO

REPEATED FOR INFORMATION TO : BONN, BRUSSLES, DUBLIN, THE HAGUE,  
COPENHAGEN, ATHENS, ROME, LUXEMBOURG, UKREP BRUSSELS, MADRID,  
WASHINGTON, LISBON, TOKYO, UKDEL OECD, UKDEL STRASBOURG,  
CONSULATES GENERAL FRANCE

b/f 17/1  
for GS folder

FRANCE : ECONOMIC REPORT FOR DECEMBER 1985

#### SUMMARY

1. Results for the French economy published in December show that the improvement visible since the beginning of the autumn has continued. Unemployment has fallen again; the annual rate of inflation continues to decrease; there is a moderate improvement in the balance of trade, and, according to industrialists, the trend of industrial production is still rising. But there has been press speculation about a reduction in the parity of the franc.

2. Industrial production continues to increase and demand both in France and from abroad remains firm. Industrialists are optimistic. Turnover in the retail trade is substantially higher than a year ago.

3. Unemployment continues to diminish and the number of job losses in 1985 was significantly less than in 1984. The annual rate of inflation has decreased again and is below the EC average.

4. There was only a small balance of trade deficit in November and INSEE forecast that following a deficit of around F22 billion in 1985 there will be a small surplus in 1986 HI.

5. In December there was renewed speculation that the franc might soon be devalued against the deutschmark. Eurofranc interest rates thereupon increased.

6. The Stock Exchange had a bumper year : the value of transactions increased by a third and the CAC index rose by 45%.

/DETAIL

## DETAIL

### Foreign Trade and the Balance of Payments

7. In November there was a balance of trade deficit FOB/FOB of only F0.486 billion s.a. following a surplus of F0.982 billion in October. The results for October and November are an improvement over those for the first 9 months of 1985. The slight deterioration in November is due to a drop in the surplus on manufactured goods to F6.3 billion CIF/FOB s.a. from F8.4 billion in October. (Only CIF/FOB figures are available so far for goods.) The surplus on food and agricultural products and the deficit in energy remained virtually unchanged. There is a trade deficit for the first 11 months of 1985 of F20.351 billion.

8. In early December (before the November trade figures were available) INSEE had already forecast that there would be an improvement in the trade figures in the fourth quarter and that there would be a balance of trade deficit for 1985 of F22 billion, which is only just over F1 billion more than the deficit for the first 9 months of the year. INSEE predicted that the balance of trade would improve because of an increase in the surplus on food and agricultural products and manufactured goods and a decrease in the deficit on energy. In October and November as a result of a good harvest the monthly average trade surplus on food and agriculture rose to F4.2 billion CIF/FOB s.a. from F2.2 billion during the first 9 months of 1985. Over the same periods the monthly average deficit on energy fell to F14.0 billion from F15.4 billion because of the fall in oil prices and the depreciation of the dollar. In October the surplus on manufactured goods improved but the size of the November surplus was disappointing.

9. INSEE forecast that the improvement in the balance of trade will continue during the first half of 1986, to give a surplus of F2.7 billion, compared with a deficit of F14.4 billion for the first half of 1985. Their forecast is based on the franc/dollar exchange rate of mid-November of F8 (by the beginning of January the rate had fallen to around F7.50) and «spot» North Sea oil prices of \$27 per barrel in Q1 and \$26 in Q2.

10. INSEE predicts that in 1986 HI food and agricultural exports will continue at a high level and the value of energy imports will be F22 billion less than during the same period of 1985. They also predict that the export of manufactured goods will increase to the level of 1985 HI, because arms contracts signed for a record value in 1984 and a recovery in the level of contracts for large civil projects abroad signed in 1985 will begin to show in the export figures.

11. However, in December two of the largest French banks, the «Banque Nationale de Paris» and the «Banque de Paris et des Pays Bas» both pointed out that France's share of the world market in manufactured goods is slowly but steadily diminishing.

/They

They comment that this is because French export prices are often too high and that French goods are not always adapted to market needs.

12. Figures published by INSEE in December show that during the first 9 months of 1985 the average value of exports was 5.6% higher than the average value for the whole of 1984, but the volume of exports was only 1.9% higher. The average value and average volume of imports over these periods both increased by 3.4%.

### Industrial Production

13. INSEE's industrial production index (seasonally adjusted and excluding building and public works) rose by 1 point in October to 134. The increase is due to a 16.4% increase in the production of capital goods which cancels their fall in September. INSEE's three month moving average index, August to October, remained unchanged at 134, the same level as in August to October 1984 and therefore at the level of mid-1980, before the industrial recession of 1981 - 83. Industrialists replying to an INSEE survey, completed in December, report that production continues to increase and that there has been a marked increase in demand following the fall in demand reported in the previous survey. Industrialists are very optimistic about prospects.

14. Production of capital goods has increased again, continuing a trend begun in the spring. Orders from France and abroad are increasing, except in mechanical engineering, and stocks are near normal levels. Industrialists expect production to continue to increase in electrical engineering, electronics, and the aircraft industry and to fall in mechanical engineering.

15. Production of consumer goods has increased for the sixth consecutive month although at a slow rate. Export demand remains stable, but demand in France for household equipment, leather goods and furniture is increasing. Stocks are generally below normal levels. Industrialists expect production to increase during the coming months.

16. Following an increase over 2 months car production has stabilised. Stocks are above normal levels but orders, particularly from abroad are at a high level. Industrialists expect production to increase during the coming months.

17. The increase in the production of semi-finished goods which began in April continues to slow, but there is a marked increase in demand and stocks are below normal levels. Industrialists forecast that production would diminish over the holiday period.

18. The French federation of motor car manufacturers estimates new car registrations in 1985 at around 1.8 million, just above

/the 1984



the 1984 figure which was the lowest since 1975. It also estimates that foreign cars took 37% of the market compared with 35.9% in 1984 and 32.7% in 1983. However, French car exports have remained stable at just below 60% of total production. The press comments that for the first time in 20 years the French car market is not the second largest in Europe after West Germany's - having been overtaken by the UK and, almost but not quite, by Italy.

#### Industrial Sector : Agricultural Machinery

19. The French agricultural machinery industry had a turnover in 1984 of F14.5 billion, down 2% in real terms from 1983. The workforce was some 30,000 at the end of 1984, compared with 46,000 ten years earlier, and has reduced by several thousand more during 1985. The main difficulty faced by the industry is declining agricultural investment in France, with the tractor market declining by 2.8% in 1984 to just over 54,000, of which only 36,000 were produced in France. Activity was maintained in 1984 by an increase in exports of almost 20%, including a 71% increase to the US and 15% to the FRG, accompanied by some success in distant markets such as Australia and Canada. While these increases were due more to strategy changes by the large multinationals operating in France than to the local industry's inherent dynamism, they nevertheless took the coverage of imports by exports to 76%, up from 62% in 1982. The UK was still France's main client in 1984, taking 16.7% of French exports, despite reduced purchases. The UK also provided 8% of French imports.

20. Figures for 1985 are not yet available but preliminary indications are that the French domestic market declined further by at least 5%. Exports remained at a high level but production nevertheless almost certainly declined also.

21. Losses continue to be the order of the day for most of the main manufacturers. For example Renault's agricultural machinery division, which has the biggest share of the French tractor market at 18.6%, lost some F140 million in 1984; International Harvester/Case (13.6%) lost F350 million; and John Deere (8.2%) lost F40 million. Separate figures are not available for Fiat, who had 15.3% of the market in 1984.

22. 1985 has seen further changes in the structure of the industry in France, with Tenneco being induced by considerable government help to maintain most of International Harvester's French operations; Masset Ferguson finally closing a large factory in the north; and Renault's agricultural machinery division being turned into a separate subsidiary with the aim of break-even in 1987, preferably with the help of new foreign partners. The government has maintained its desire to see a greater French part in what is regarded here as a strategic industry via a regrouping of French capacity, e.g. under Renault's leadership, but is no nearer a plan capable of realising this objective.

/Demand

## Demand

23. Turnover in the retail trade, s.a., in October returned to the level of August following a sharp fall in September. In real terms it was 7.4% higher than in October 1984. Turnover s.a. in the food trade was 5.3% higher than a year ago and in the remainder of the retail trade 9.2% higher. INSEE reports that a survey of the retail trade completed in November showed that shopkeepers were generally optimistic about prospects and that their financial situation had eased.

24. INSEE also report that the consumption of manufactured goods by households increased sharply in October and November following a decrease in September and that it is now at its highest level since March 1983 when the government introduced its policy of economic rigour. The increase in October and November was chiefly due to increased purchases of leather and textile goods.

25. A six monthly survey of households by INSEE completed in November shows, as in the two previous surveys, that they have a slightly less pessimistic assessment of their current financial situation than in the previous survey. However they are cautious about the future when in general they expect their financial situation to remain unchanged. But farmers and agricultural employees are more pessimistic about their prospects than they were at the time of the previous study in May 1985.

26. INSEE estimate that the purchasing power of gross disposable income increased by 0.7% in 1985 following a decrease during the two previous years.

## Prices and Wages

27. The annual rate of inflation (over 12 months) decreased to 4.8% at the end of November from 4.9% at the end of October. During the six months to the end of November prices have risen at an annual rate of 3% (for the trend see the graph in the annex). In November the retail price index rose by 0.2%.

28. The annual rate of inflation in November was the lowest in France since 1968. Although it is below the average for the European Community of 5.1% it is still significantly higher than in West Germany, France's most important trading partner, where the annual rate of inflation in November was 1.8%, but the gap is slowly narrowing.

29. On 1 January the government abolished price controls on a few more industrial products, increasing the proportion of industrial products free of controls to 85% from 80%. Price controls are nevertheless still an important feature of government policy because around 55% of the retail price index is subject to controls.

30. The government authorised increases in a small number of controlled prices on 1 January. Rents are up by between 2.7% and 2.96%; Air Inter fares by 2.5%; television and video licences by 2.9%; and fuel oil for heavy industry up by 5.6%. There is also an additional tax on gas supplied to industry of 0.95 centimes per kilowatt hour. The number of authorised price increases is smaller than normal at the beginning of a year, but the Ministry of Finance has rejected suggestions by journalists that its choice has been influenced by the imminence of Legislative elections in March.

31. INSEE comments that the fall in inflation in France has been helped by the decreased inflation in the economies of France's main trading partners and the stability of the franc within the exchange rate mechanism of the EMS, but it has calculated that the fall in the price of imported raw materials has had a particularly important effect. It forecasts that inflation will increase by 2.0% during the first half of 1986. (It has not forecast the rate of inflation for the whole of 1986.) The government target for 1986 is 2.9% (increase during 12 months).

32. In pay guidelines issued to its members at the end of November the CNPF urged them to award increases lower than those agreed in 1985, and to take the country's economic situation as well as company performance into account. It suggested that particular attention should be paid to individual merit payments and to the continued dismantling of pay indexation systems.

33. The guidelines do not quantify these recommendations as the CNPF is barred by statute from negotiating wages. Industry level employers' federations which have published pay guidelines include the engineering employers (UIMM) who have called for increases under 3% (November MER para 25). The chemical industry federation (IUC) has recommended an increase of 2.9% on basic pay rates over the year, payable in two stages (1 March and 1 September), and has added that companies who can afford it should aim at a 2% increase in real pay over 1986.

34. Average monthly earnings of non-manual employees were F8,978 in April 1985, 6.1% up on April 1984.

#### Employment and Industrial Relations

35. The number of unemployed s.a. fell in November by 12,400 to 2,355,100. This is 28,000 less than in November 1984 and the lowest monthly figure since August 1984. The unadjusted figure fell in November 1985 by 14,800 to 2,495,100. This was the first fall in the unadjusted figure since school-leavers came on to the market in the summer. (The unemployment figures for October 1985 have been revised to 2,367,500 s.a. and 2,509,900 unadjusted.)

36. The fall in unemployment reflects the effects of the government's special measures, and in particular the TUC scheme (work of community benefit for the under 25s) which had 170,000 participants at the end of November. In November 1985 there were 108,000 fewer under 25s unemployed than in 1984, and 98,600 more unemployed between the ages of 25 and 49. There was little change in the number of over 50s unemployed with 3,500 less in November 1985 than in November 1984: early retirements continue to have an effect on the participation rates of this age group.

37. Employment continues to decline but more slowly than in 1984. INSEE year-end estimates were that there were 95,000 fewer jobs at the end of 1985 in the non-agricultural trading sector compared with a net loss of 247,000 in 1984. INSEE's estimate of job losses and jobs created in 1985 compared with 1984 is:

|                           | 1984      | 1985      |
|---------------------------|-----------|-----------|
| Industry                  | - 165,000 | - 130,000 |
| Building and Public Works | - 87,000  | - 17,000  |
| Services                  | + 5,000   | + 52,000  |
| <hr/>                     |           |           |
| Total                     | - 247,000 | - 95,000  |

38. The draft law on flexible working patterns (para 33, November MER) was chosen by the Communist Party as a peg on which to hang an all-out pre-electoral attack on the government. As a result it failed to complete its passage through Parliament by the end of the session, on 22 December. The President has called an extraordinary session before the March elections in order to push the bill through. The CFDT are in favour of the proposed law while all the other unions and the employers are against.

39. Laws passed at the end of the 1985 session increased rights to training leave for trade union representatives, extended rights to consultation to employees of companies with less than 200 employees (extension of one of the 'Lois Auroux'), and provided for pensions to be paid at 60 to self-employed farmers.

40. The Employment Minister announced measures to encourage employers to employ young people on employment/training contracts (adaptation and qualification): reduction of the minimum length of an adaptation contract to 12 months from 16 and an increase to 50 francs a day in the reimbursement of allowances available to employers. Qualifications obtained in the course of training are to be recognised by industry associations.

41. In October 222,600 days were lost in 291 establishments in strikes originating within the establishment concerned. The sharp increase on September results from strikes at Renault and Ducellier early in the month. Official estimates of days lost during the CGT's general day of action are not yet available.

42. The pre-Christmas period was marked by a number of strikes affecting transport. A wildcat strike by metro and suburban train drivers paralysed Paris on 20 December. Like the wildcat strike which brought the railways to a halt at the beginning of October, this was related to safety considerations: the drivers were reacting to news that one of their colleagues had been given a prison sentence following the death of a passenger. Townsend Thoresen and French Sealink strikes caused some disruption to cross Channel traffic and a threatened strike by air traffic-controllers on 20 December was called off at the eleventh hour, but still caused some disruption. The air-traffic controllers dispute continues: they took strike action on 6 January.

#### The Situation of Companies

43. In November 1985 the number of company bankruptcies recorded s.a. fell for the fifth consecutive month to reach 1,654 but INSEE cautions that the figures have been distorted by an increasing delay in the publication of court decisions. For the first 11 months of 1985 23,369 bankruptcies have been recorded, 453 more than during the same period in 1984, but INSEE's comment suggests that the real increase is higher.

44. Industrialists replying to a survey completed by INSEE in November estimated that on average the volume of their investment in 1985 would increase by 8% and forecast an increase of between 3% and 4% in 1986. (Industrialists' forecasts for 1984 and 1985 were below the level attained.)

45. In 1985 the change in the volume of investment varied significantly between companies of different size and between different sectors as follows:

| <u>Company size</u>                       | Volume change in investment in 1985 |
|---|-------------------------------------|
| Large companies                           | + 13%                               |
| Medium companies                          | + 5%                                |
| Small companies (less than 100 employees) | + 1%                                |

/Sector

| <u>Sector</u>                   | Volume change in investment<br>in 1985 |
|---------------------------------|--|
| Land transport (including cars) | + 18%                                  |
| Semi-finished goods             | + 15%                                  |
| Capital goods                   | + 10%                                  |
| Consumer goods                  | + 4%                                   |
| Food and agricultural products  | - 6%                                   |

### Social Security

46. On the basis of the twice yearly accounts, published on 19 December, the government announced an end of year surplus in the general regime of 5 billion francs, a balance in hand of 20 billion francs and an expected deficit at the end of 1986 of 10 billion francs. The opposition claim that these results were achieved by manipulation of the figures was supported by the trade union Force Ouvrière, which has the presidency of the sickness benefit fund.

47. Social security contribution ceilings and allowances were uprated by varying amounts with effect from 1 January 1986 (see attached table).

/Tables

SOCIAL SECURITY GENERAL REGIME

| Risk                                      | Calculation of Contribution |          |       |                       |          |       |  |          |       |
|---|-----------------------------|----------|-------|-----------------------|----------|-------|--|----------|-------|
|   | Contribution Rates          |          |       | On Total Remuneration |          |       | On Remuneration up to Ceiling<br>(9.220 Francs wef 1/1/86) |          |       |
|   | Employer                    | Employee | Total | Employer              | Employee | Total | Employer   | Employee | Total |
|   | %                           | %        | %     | %                     | %        | %     | %  | %        | %     |
| Sickness, Maternity,<br>Invalidity, Death | 12.60                       | 5.50     | 18.10 | 12.60                 | 5.50     | 18.10 | -  | -        | -     |
| Pension                                   | 8.20                        | 5.70     | 13.90 | -                     | -        | -     | 8.20   | 5.70     | 13.90 |
| Widows                                    | -                           | 0.10     | 0.10  | -                     | 0.10     | 0.10  | -  | -        | -     |
| Family Allowances                         | 9.00                        | -        | 9.00  | -                     | -        | -     | 9.00   | -        | 9.00  |

| Benefits (francs) | 1/7/85<br>31/12/85 | 1/1/86<br>30/6/86 | 1/7/86<br>31/12/86 |
|-------------------|--------------------|-------------------|--------------------|
|-------------------|--------------------|-------------------|--------------------|

|  |        |        |        |
|--|--------|--------|--------|
| 1. Sickness insurance maximum daily rates    |        |        |        |
| - ordinary rate                              | 151,00 | 153,66 | 158,00 |
| - rate for families with 3 or more children. | 201,33 | 204,88 | 210,66 |
| Maternity benefit: maximum daily rate        | 253,68 | 258,16 | 265,44 |
| 2. Compensation payable for loss of salary   |        |        |        |
| - called to a place within local commune     | 151,00 | 153,66 | 158,00 |
| - called to a place outside local commune    | 302,00 | 307,32 | 316,00 |

/Accidents

|    |  |            |            |            |
|----|--|------------|------------|------------|
| 3. | Accidents at work, Maximum daily benefit :   |            |            |            |
|    | up to 28th day off work                      | 543,60     | 553,20     | 568,80     |
|    | from 29th day off work                       | 724,80     | 737,60     | 758,40     |
|    | funeral expenses                             | 4,530,00   | 4,610,00   | 4,740,00   |
|    | Rehabilitation grant (minimum)               | 3,261,60   | 3,319,20   | 3,412,80   |
|    | Rehabilitation grant (maximum)               | 8,697,60   | 8,851,20   | 9,100,80   |
|    | Ex-gratia payment                            | 195,696,00 | 199,152,00 | 204,768,00 |
| 4. | Invalidity pension                           |            |            |            |
|    | First group                                  | 32,616,00  | 33,192,00  | 34,128,00  |
|    | Second group                                 | 54,360,00  | 55,320,00  | 56,880,00  |
| 5. | Pensions                                     |            |            |            |
|    | maximum                                      | 54,360,00  | 55,320,00  | 56,880,00  |
|    | Widow/ers maximum                            | 39,682,80  | 40,383,60  | 41,522,40  |
| 6. | Death grant                                  |            |            |            |
|    | Maximum                                      | 27,180,00  | 27,660,00  | 28,440,00  |
|    | Minimum                                      | 1,087,20   | 1,106,40   | 1,137,60   |
|    | Funeral expenses                             | 4,530,00   | 4,610,00   | 4,740,00   |
| 7. | Supplementary pension: managers contribution |            |            |            |
|    | A (monthly)                                  | 9,060,00   | 9,220,00   | 9,480,00   |
|    | B (monthly)                                  | 36,240,00  | 36,880,00  | 37,920,00  |
| 8. | Supplementary pensions( (non-managers)       |            |            |            |
|    | Monthly contribution                         | 27,180,00  | 27,660,00  | 28,440,00  |
| 9. | Unemployment benefit                         |            |            |            |
|    | monthly contribution                         | 36,240,00  | 36,880,00  | 37,920,00  |



## Monetary Policy

48. M2R, the main French money supply measure in 1985, grew by 1.7% in June (a downward revision from the previously published figure of 1.8%), diminished by 0.1% in July and grew by 1.0% in August. The Bank of France estimates that this is equivalent to an annual growth rate of 6.6%. The government's target for M2R growth in 1985 is between 4% and 6%.

## The Exchange Rate

49. During December because of a small appreciation of the deutschmark against the franc and the approach of the French Legislative elections in March, there was a muted speculation in the French press that there would be a realignment within the EMS. Some journalists have suggested that as part of a realignment the deutschmark could be revalued against the French franc, and the weaker currencies such as the Belgian franc devalued against the French franc. This would enable the French government in the run up to the March elections to present the franc as a stable currency, but would restore price competitiveness to French exports to West Germany, France's most important trading partner.

50. According to «Le Monde» the deutschmark began to appreciate against the franc during the first half of December when the Bank of France had to support the Belgian franc because the French franc was the top rate currency within the exchange rate mechanism of the EMS and the Belgian franc was at its floor rate and weakening. The deutschmark rose above its median rate with the French franc of F3.066 just before Christmas for the first time since December 1984. At the same time there was a marked increase in Eurofranc interest rates up to and beyond the March elections. The deutschmark continued to appreciate slowly against the French franc until limited intervention in the markets by the Bank of France halted it at F3.07. During December the French franc remained at or near its ceiling rate with the ECU. Eurofranc interest rates have remained at their higher level.

51. «Le Monde» points out that the Bank of France now has considerable reserves available for use in defending the franc and adds that a significant part of these reserves are «camouflaged» in French commercial banks.

## The Stock Exchange

52. The CAC index of French shares rose by 6.4% in December to give an increase for the whole of 1985 of 45%. This follows increases in the index of 16.5% in 1984 and 60% in 1983.

53. The index rose steadily during the first 5 months of 1985, fell between June and September and increased by almost 30% between the beginning of October and the end of December, chiefly because of substantial buying from the UK and particularly from the United States. The increases in the price of many French shares have been spectacular. For example, Michelin up by 135%, Peugeot by 103%, and Thomson CSF by 80%.

54. Total share transactions increased in 1985 compared with 1984 by F31.3 billion to F128 billion. New share issues increased by F9.3 billion to F16 billion.

55. In 1985 there was also a surge in the bond market. Total transactions increased by F224 billion to F650 billion and total bond issues by F60.2 billion to F310 billion. Bond issues by the Trésor increased by F15 billion to F100 billion, but decreased as a proportion of total bond issues to 32.3% from 34% in 1984.

56. The capitalisation of the Stock Exchange, including the Second market (similar to the USM), increased to F620 billion at the end of 1985 from F413 billion at the end of 1984.

#### Interest Rates

57. The Bank Base Rate remained unchanged in December at 10.60%.

FRETWELL

FRAME ECONOMIC

ECD (1) [-]

FRANC VALUES IN PARIS IN DECEMBER 1985

(Weekly average closing prices)

|        | 6/12   | 13/12  | 20/12  | 27/12  |
|--------|--------|--------|--------|--------|
| US\$   | 7.72   | 7.70   | 7.73   | 7.62   |
| 100 SF | 366.27 | 365.62 | 365.54 | 364.87 |
| 100 DM | 305.28 | 305.91 | 307.01 | 306.87 |
| £      | 11.39  | 11.09  | 11.00  | 10.91  |

(Seasonally adjusted, except as noted)

1984

1985

|  |  |  |
|--|--|--|
| 1. GDP, annual growth  | 1.5%                                       | 1.5%<br>(Govt forecast)                    |
| 2. Industrial production index<br>Base 100: 1970   | 134<br>(October)                           | 134<br>(October)                           |
| 3. Total unemployed  | 2,383,100<br>(November)                    | 2,355,100<br>(November)                    |
| 4. Exports   | F 74.557 bn<br>(November)                  | F 75.18 bn<br>(November)                   |
| 5. Imports   | F 73.754 bn<br>(November)                  | F 75.666 bn<br>(November)                  |
| 6. Trade balance   | F 0.803 bn<br>(November)                   | -F 0.486 bn<br>(November)                  |
| 7. Balance on Current Account  | -F 7.2 bn.<br>(Jan - Sept)                 | F 0.4 bn<br>(Jan - Sept<br>Govt forecast)  |
| 8. Exchange rate against US\$<br>(last working day of the month)                                       | F 9.59<br>(December)                       | F 7.56<br>(December)                       |
| 9. Official reserves   | F408.216 bn<br>(20 December)               | F426.312 bn<br>(26 December)               |
| 10. Growth in money supply (M2R)   | 5.2%<br>(annual rate Jan-Aug)              | 6.6%<br>(annual rate Jan-Aug)              |
| 11. Rise in retail prices  | 0.3% (Nov)<br>6.9% (change over 12 months) | 0.2% (Nov)<br>4.8% (change over 12 months) |
| 12. Rise in hourly wage rates of manual workers  | 1.0%<br>(Q3)                               | 1.2%<br>(Q3)                               |
| 13. Industrial disputes<br>Working days lost<br>Firms affected<br>(Cumulative totals to end September) | 988,300<br>2,489                           | 983,500<br>2,230                           |
| 14. French exports to UK FOB<br>French imports from UK CIF<br>(Jan - Sept)                             | F46.0 bn<br>F51.8 bn                       | F53.1 bn<br>F59.56 bn                      |

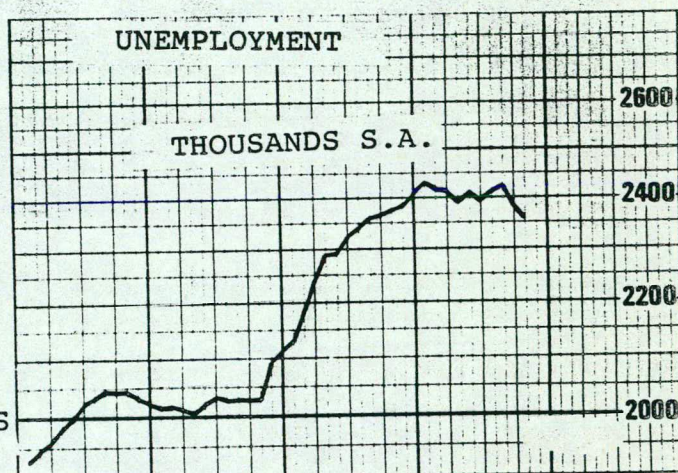
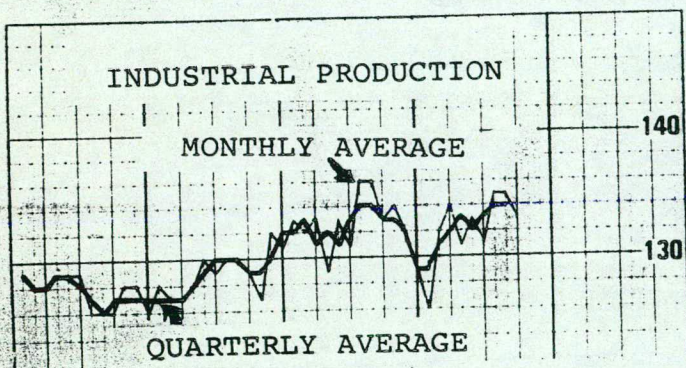
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SUPPLEMENT N°12  
5 DECEMBRE 1985

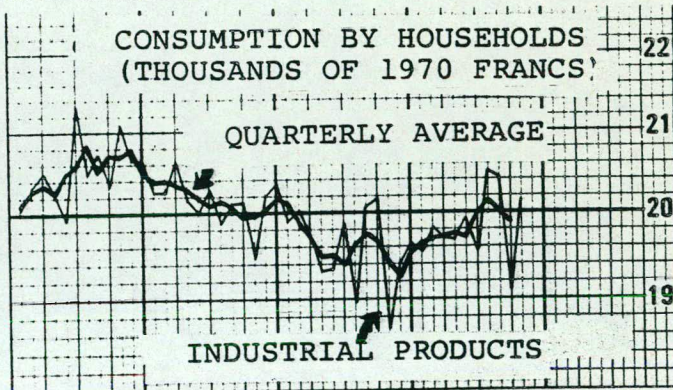
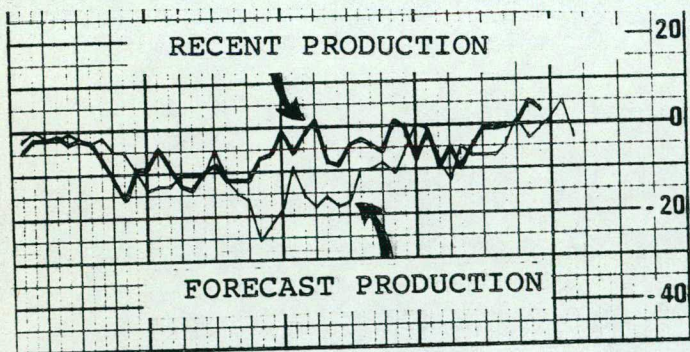
## GRAPHIQUES DU MOIS

MISES A JOUR  
DE NOVEMBRE 1985

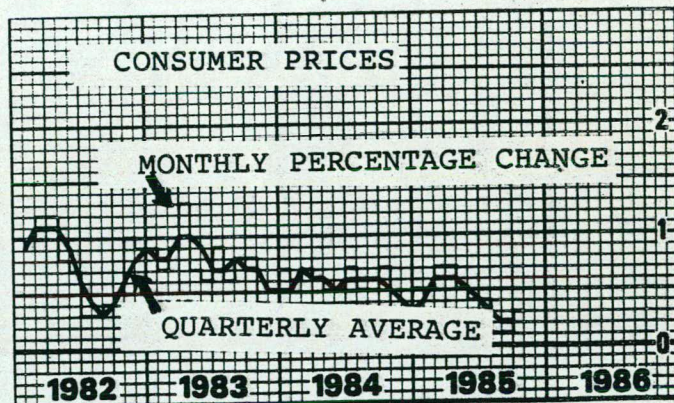
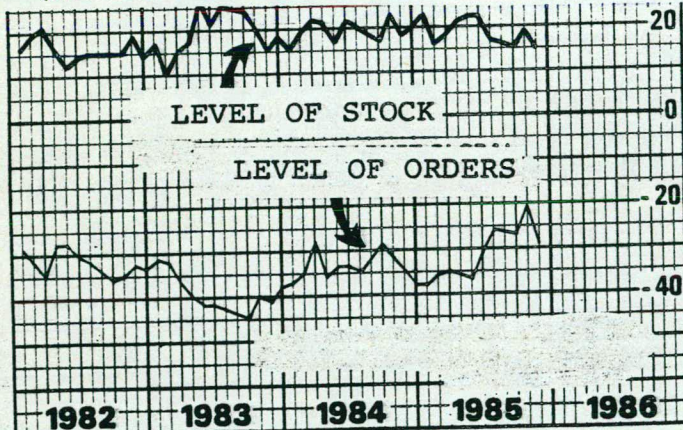
Selon l'enquête mensuelle de Conjoncture de novembre, la croissance de l'activité industrielle devrait se ralentir au cours des prochains mois. En particuliers, la production baisserait dans les biens d'équipement. La demande globale se réduit sauf dans l'automobile, mais le niveau des stocks est toujours jugé peu élevé. La consommation des ménages en produits industriels retrouve en octobre un bon niveau après la baisse de septembre due à un aléa climatique. Le solde du Commerce Extérieur devient positif en octobre grâce à l'amélioration du solde des produits manufacturés. Le chômage est en léger recul comme en septembre. La hausse des prix à la consommation a été de 0,3%. Le cours du dollar a poursuivi sa baisse et est passé en-dessous de 8 F.

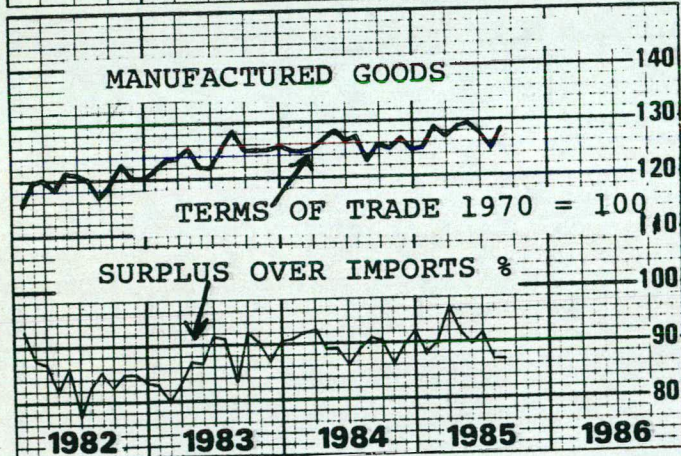
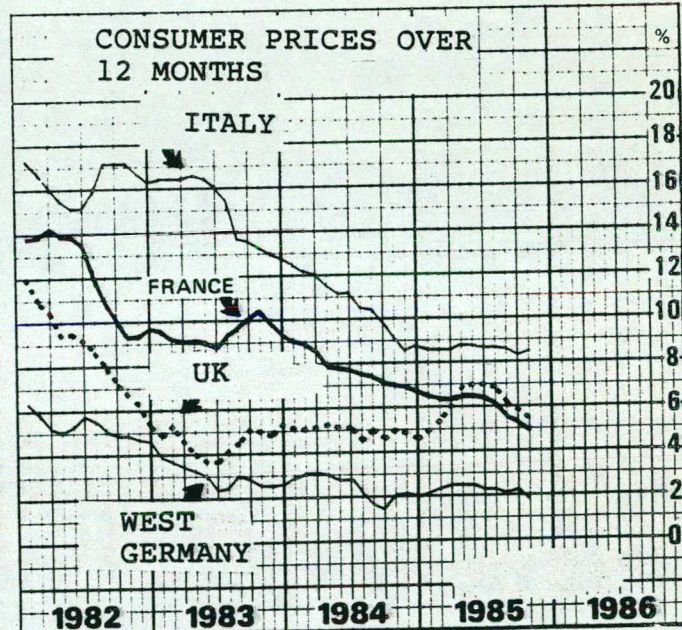
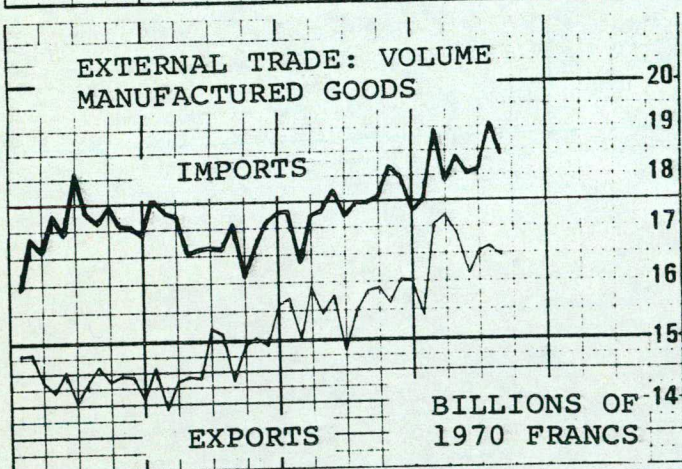
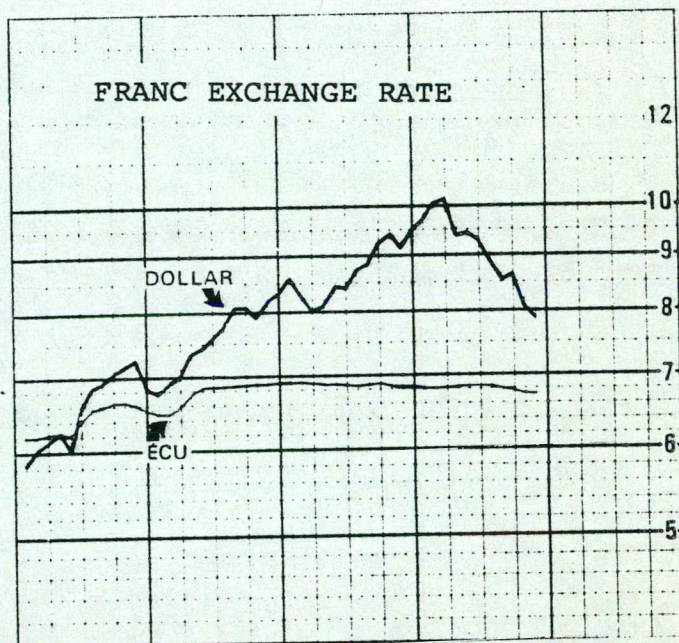
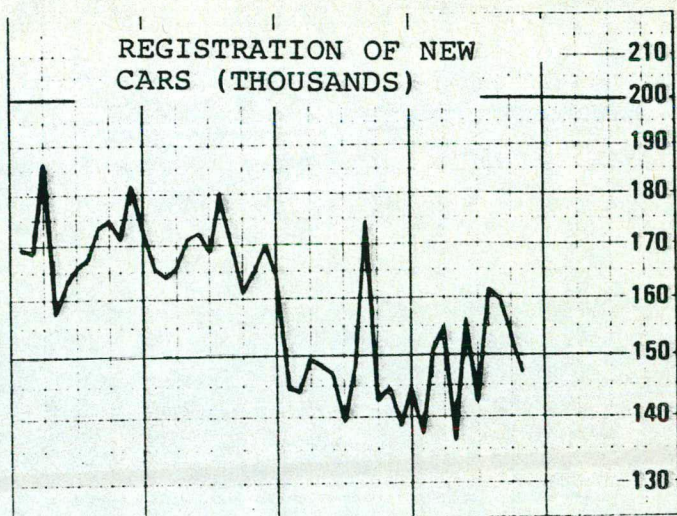
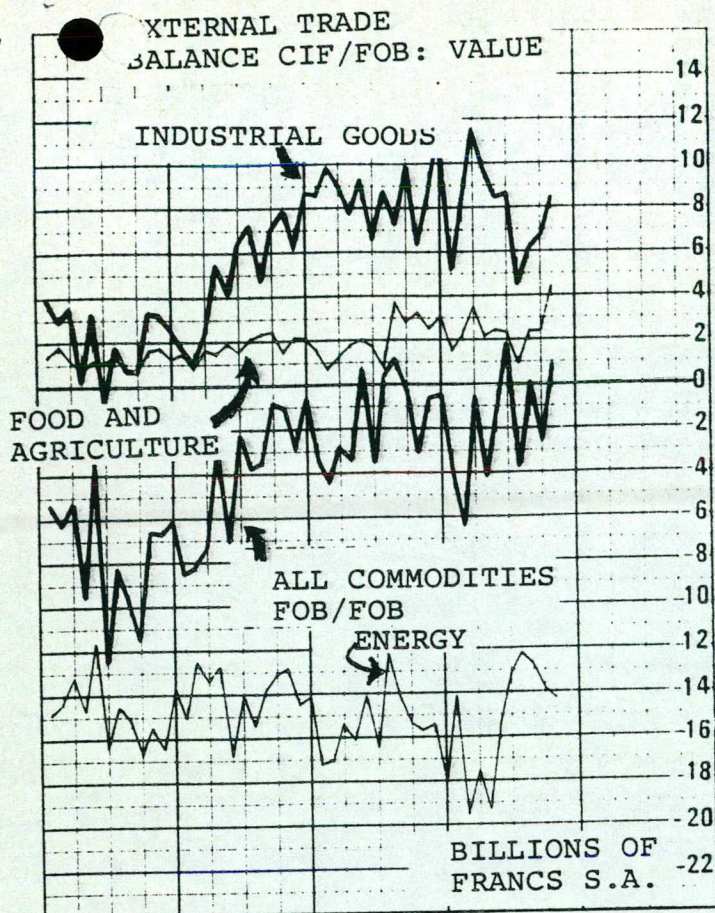


INSEE'S MONTHLY SURVEY OF INDUSTRIALISTS



INSEE'S MONTHLY SURVEY OF INDUSTRY (SEASONALLY ADJUSTED)





\* Le solde CAF-FAB est calculé avec les importations CAF (coût, assurances, fret) relevées directement par les Douanes. Le solde FAB-FAB s'obtient en prenant les importations FAB (franco à bord) qui sont calculées en appliquant un coefficient de 95,7 pour 1984 aux importations CAF. La "fabisation" des importations vise à les rendre homogènes avec les exportations qui sont, elles, toujours FAB. Ce calcul n'est valide que pour les importations globales. En chiffres bruts pour 1984 le solde CAF-FAB est de - 58,7 milliards de francs et le solde FAB-FAB de - 19,8 milliards de francs.

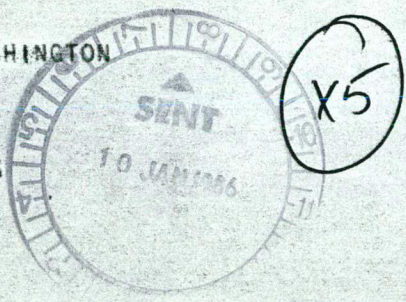
I N D E X

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IMMEDIATE

RC  
HD ERD  
PS/CHANCELLOR EXCHEQUER  
MR LITTLER TSU  
SIR TICKELL ODA  
MR LOEHNIS B/GVAND

CONFIDENTIAL  
FM UKDEL IMF/IBRD WASHINGTON  
TO IMMEDIATE FCO  
TELNO 10  
OF 092359Z JANUARY 86



WORLD BANK PRESIDENT  
1 MIDST GROWING SPECULATION ABOUT WHO WILL BE THE NEXT WORLD BANK PRESIDENT, THE ADMINISTRATION HAVE NOT YET DECIDED WHOM THEY WILL NOMINATE THOUGH THE MATTER IS LIKELY TO BE DISCUSSED AT A MEETING OF THE CABINET'S ECONOMIC COMMITTEE NEXT WEEK.

2 THE TWO CANDIDATES MOST FAVOURED BY TREASURY ARE NOW SAID TO BE WHITEHEAD (DEPUTY SECRETARY, STATE DEPARTMENT) AND ROBINSON (CHAIRMAN OF AMERICAN EXPRESS). WHITEHEAD HAS THE STATURE AND THE INTERNATIONAL BANKING BACKGROUND (HE WAS SENIOR PARTNER AT GOLDMAN SACHS) FOR THE JOB, BUT AT 63 HE WOULD BE LESS THAN PERFECT IN GALVANISING THE BANK'S SOMEWHAT SCLEROTIC ORGANISATION. ALL THE MORE SO SINCE HE HAS SAID HE DOES NOT WANT THE JOB. BUT HE HAS ALSO MADE IT KNOWN THAT, IF ASKED BY THE PRESIDENT, HE WOULD TAKE IT.

3 ROBINSON, WHO IS 50, HAS A FINE REPUTATION AS MANAGER OF A LARGE ORGANISATION AND BESIDES HIS INTERNATIONAL BANKING BACKGROUND HAS SHOWN INTEREST IN DEVELOPMENT ISSUES. BUT HE IS SAID TO HAVE POLITICAL AMBITIONS AND TO BE UNLIKELY TO ACCEPT IF ASKED.

4 THE FOLLOWING SEEM TO BE THE TREASURY'S RESERVE LIST: DEBS (MANAGING DIRECTOR, MORGAN STANLEY), PETTY (CHAIRMAN, MARINE MIDLAND), HENNESSY (FIRST BOSTON, LONDON) AND SCHMEELK (HEAD OF CORPORATE FINANCE, SALOMONS).

5 BY EXPERIENCE AND ABILITY, DEBS WOULD SEEM THE STRONGEST CANDIDATE AMONGST THESE. BUT WITHOUT THE STATURE OF WHITEHEAD OR THE MANAGEMENT FLAIR OF ROBINSON, HE WOULD SEEM LESS WELL SUITED THAN EITHER OF THEM THOUGH HE MIGHT DO AN ADEQUATE JOB. NONE OF THE OTHERS BY ALL ACCOUNTS SEEM QUITE GOOD ENOUGH FOR WHAT WILL BE, POST-BAKER INITIATIVE, AN IMMENSELY CHALLENGING ASSIGNMENT.

6 WHETHER IF ONE OF THE LATTER THREE WERE NOMINATED WE SHOULD WANT TO ASK THE AMERICANS TO THINK AGAIN IS ANOTHER MATTER. TO DO SO WOULD BE UNPRECEDENTED AND WOULD NOT DOUBT CAUSE DIFFICULTIES IN OUR RELATIONS WITH THEM. THOUGH WE WOULD OBVIOUSLY NEED TO CONSIDER FURTHER, I DOUBT WHETHER ANY OF THE NAMES MENTIONED WOULD JUSTIFY SUCH A MOVE ON OUR PART.

7 THE SAME CANNOT BE SAID OF ONE OTHER NAME THAT HAS BEEN MENTIONED, NAMELY MIDDENDORF (CURRENTLY AMBASSADOR TO THE EEC). FROM EVERYTHING I HAVE HEARD, HE WOULD BE THOROUGHLY ILL-SUITED AND I HOPE WE WOULD OPPOSE HIS NOMINATION. TALK OF HIS CANDIDACY MAY IN ANY CASE BE PARTLY DUE TO HIS OWN LOBBYING BUT HE DOES SEEM TO COMMAND SOME REAL SUPPORT IN THE WHITE HOUSE.

8 FCO PLEASE ADVANCE TO PS/CHANCELLOR, LITTLER (HMT), TICKELL (ODA), LOEHNIS (BOE) AND TAIT (ERD).

LANKESTER

b/f 16/1  
for GS  
folder





~~Phil~~

CARS

Arthur has spoken to the police about parking this weekend.

They will arrange for the Foreign Office gates to be open so that if there are too many cars to be parked in Downing Street itself, they will be directed into the FCO.

D  
17/11



C

I understand that you have agreed to have breakfast with Secretary Baker on Sunday morning.

Is 8.00 for 8.15 am convenient, given that the meeting starts at 9.00 am?

Shall we approach the Government Hospitality Fund to ask if they can provide breakfast or will <sup>it</sup> be in the private flat?

C/GHF tell me they could do it, but only on a strictly formal basis (silverware, butlers etc)!

R 14/1

D  
14/1  
OK  
r

SECRET



2 CARLTON GARDENS LONDON SW1Y 5AA

TELEPHONE: 01-214 6715

SWITCHBOARD: 01-214 6000

|           |              |
|-----------|--------------|
| EXCHEQUER |              |
| REC.      | 10 JAN 1986  |
| ACTION    | Sr G. LITLER |
| COPIES TO | McLAVELLE    |
|           | Mr CULPIN    |
|           |              |
|           |              |

10/1

9 January 1986

P Wynn Owen Esq  
 Private Secretary to the Chancellor  
 of the Exchequer  
 Treasury Chambers  
 Parliament Street  
 LONDON SW1P 3AG

*Dear Wynn Owen,*

Many thanks for your further letter, of 8 January, about events during the week-end 18/19 January.

In principle the change of venue to 11 Downing Street poses no significant problems for GHF - although I feel bound to mention in passing that 16 persons will be a little more cramped there than at Admiralty House.

On points of detail:-

- a. I note that the dinner on Saturday is to be 7.0 for 7.30 and the lunch on Sunday at 1230 for 1.0, each meal being for 16 people at this stage although there is a possibility that numbers will fall away on the Sunday. There is no problem over the serving of pre-meal drinks.
- b. I confirm that arrangements have been made, on Saturday and Sunday, for 2 support staff to eat in the outmess and for 2 interpreters to be given sandwiches at the appropriate time.
- c. As to the kitchen, I note your reference to No 10. In point of fact the No 11 kitchen is a good deal more convenient for a meal being served in the Soane Dining Room and I understand that it is the one more likely to be declared available.
- d. On security I take your point that it will be simpler than at Admiralty House. However we may still be faced with the problem of "minders" who decline to leave their charges. Where would you have it in mind to put them? It remains the case, as at Admiralty House, that GHF can make no provision for them.
- e. The draft menus should have reached you by now.

No doubt you and Bryan Burrough will be in touch again early next week. In the meantime I confirm that all is well in hand to meet the Chancellor's requirements.

*Yours sincerely  
Alan Cowan*

J A C COWAN

SECRET

UNCLASSIFIED



Sir G. LITTLE

cc

Sir P. MIDDLETON

Sir T. BURNS

Mr FITCHER

Mr CULPIN

Mr WYNN OWEN

G5 MEETING

Please attached the  
telegram below to  
Mr Keezy's minute to you  
dated today.

Many thanks.

L. Sears.

X 5512

10/1/86

GRS 650  
UNCLASSIFIED

FM TOKYO

TO DESKBY 020900Z TREASURY

TELVO 002

OF 080709Z JANUARY 86

AND TO PRIORITY FCO, PARIS, WASHINGTON, BONN

1. FOLLOWING IS OUR TRANSLATION OF A STORY APPEARING TODAY IN NIKKEI (LEADING ECONOMIC DAILY):

"IT WAS LEARNED YESTERDAY THAT THE UNITED STATES HAS PROPOSED THAT JAPAN, WEST GERMANY, THE UK AND FRANCE SHOULD HOLD ANOTHER MEETING OF THE G5 SOME TIME BETWEEN THE MIDDLE AND THE END OF THIS MONTH. JAPAN HAS ALREADY CONVEYED TO THE US ITS INTENTION TO PARTICIPATE. OTHER EUROPEAN COUNTRIES ARE ALSO INTENDING TO PARTICIPATE PROVIDED THEIR FINANCE MINISTERS CAN CONVENIENTLY MEET TOGETHER. IT IS THEREFORE HIGHLY LIKELY THAT A MEETING COULD BE HELD IN LONDON, POSSIBLY AS EARLY AS 18 OR 19 JANUARY. LIKELY MAIN TOPICS FOR THE MEETING ARE:

(I) FOLLOW-UP TO THE SEPTEMBER G5 AGREEMENTS ON CONCERTED EXCHANGE MARKET INTERVENTION AND POLICY CO-OPERATION; AND

(II) FURTHER WORK ON THE DETAILS OF US TREASURY SECRETARY BAKER'S PROPOSAL ON LENDING TO MEDIUM INCOME DEVELOPING COUNTRIES BY COMMERCIAL BANKS FROM JAPAN, THE US AND EUROPE.

IT IS ALSO POSSIBLE THAT THE MEETING WILL PREPARE THE GROUND FOR CONCERTED INTEREST RATE REDUCTIONS.

2. FINANCE MINISTER TAKESHITA IS SCHEDULED TO VISIT THE UNITED STATES AND EUROPE ON 16-25 JANUARY TO ATTEND A COLUMBIA UNIVERSITY DEGREE CEREMONY, TO EDUCATE HIMSELF ON OFF-SHORE MARKETS OVERSEAS AND ON OTHER BUSINESS. THE US HAS THEREFORE SUGGESTED TO THE THREE EUROPEAN COUNTRIES THAT A G5 MEETING COULD BE HELD DURING THIS PERIOD.

3. INTERNATIONAL FINANCIAL SOURCES SAID "THERE IS A 90% PROBABILITY OF A MEETING". IT IS HIGHLY LIKELY THAT THE MEETING WILL BE A SECRET ONE. (SIC). NO JOINT COMMUNIQUE WILL BE ISSUED. THE VENUE FOR THE MEETING IS STILL FLUID BECAUSE MINISTERS' DIARIES WILL HAVE TO BE CO-ORDINATED BUT EITHER LONDON ON EITHER 18-19 JANUARY OR WASHINGTON ON 25 JANUARY IS LIKELY, AS FOREIGN EXCHANGE

MARKETS WILL BE CLOSED ON ALL THOSE DATES. IF A G5 MEETING IS HELD, THE GOVERNOR OF THE BANK OF JAPAN AND THE VICE MINISTER OF FINANCE FOR INTERNATIONAL AFFAIRS (ODA) WILL ALSO ATTEND FROM JAPAN.

4. THE MEETING WILL PROBABLY BEGIN WITH A REVIEW OF FOREIGN EXCHANGE MARKET DEVELOPMENTS SINCE THE OCTOBER MEETING IN SEOUL, FOLLOWED BY AN EVALUATION OF THE EFFECTS OF CONCERTED INTERVENTION BY CENTRAL BANKS. THE MEETING IS ALSO EXPECTED TO CONFIRM THE CONTINUATION AND STRENGTHENING OF A CO-OPERATIVE STANCE ON ECONOMIC POLICY. AS FOR MR BAKER'S PROPOSAL, THE CO-OPERATIVE STANCE OF INDIVIDUAL COUNTRIES COMMERCIAL BANKS TOWARDS IT WOULD BE CONFIRMED AND DETAILS SUCH AS THE LOAN AMOUNTS FOR EACH COUNTRY WILL BE WORKED OUT.

5. THE NIKKEI STORY CONCLUDES BY COMMENTING THAT PRIME MINISTER NAKASONE HAD EARLIER PROPOSED CONCERTED INTEREST RATE REDUCTIONS BY JAPAN, THE US, AND MAJOR EUROPEAN COUNTRIES. (MY TELNO 9). THE US, AND JAPAN ARE CURRENTLY CONSIDERING THE POSSIBILITY OF AN OFFICIAL DISCOUNT RATE CUT. FOR THESE REASONS IT IS ALSO LIKELY THAT THE G5 MEETING WILL PREPARE THE GROUND FOR CONCERTED INTEREST RATE REDUCTIONS.

6. OTHER (ENGLISH LANGUAGE) NEWSPAPERS CARRY TODAY A SHORT FACTUAL ACCOUNT OF A PRESS CONFERENCE GIVEN BY TAKESHITA YESTERDAY IN WHICH HE CONFIRMED THAT HE WILL BE VISITING THE US AND UK FROM 16-25 JANUARY AND THAT HE HOPED TO DISCUSS MONETARY ISSUES AND POSSIBLE CONCERTED CUTS IN INTEREST RATES WITH THE CHANCELLOR AND THE US SECRETARY OF THE TREASURY.

GIFFARD

MONETARY

FED

NAD

WED



FROM: A W KUCZYS

DATE: 10 January 1986

cc Sir P Middleton  
 Sir T Burns  
 Mr Fitchew  
 Mr Culpin  
 Mr Wynn Owen

SIR G LITTLER

**G5 MEETING**

The Chancellor has seen your minute of 8 January (not copied to all).

2. In paragraph 2 you say the US would like to discuss whether what the G5 are now seeking to do could be improved and presented as meeting the kinds of surveillance requirements envisaged by the G10 Report. The Chancellor has commented that the answer is clearly "No" - imagine the Italian reaction!

3. In paragraph 3 you say the Americans think the replies to Sr. Craxi should be sent before the meeting. Mr Fitchew's note of 7 January recommends writing after the meeting, and the Chancellor is inclined to agree with that.

4. On publicity, the Chancellor agrees there should be no press conference. On attendance, he is not content for the Americans to have a team of four - they can have Mulford or Darman, but not both. (The Chancellor takes it that Secretary Baker realises that the UK will be in the chair?)

5. The Chancellor would like a meeting on Monday to discuss UK objectives and other arrangements, and Mrs Lester will be in touch to arrange this (now fixed for 3.45 pm).

*Ch/* Geoff has conveyed (x)  
 to Mulford. It is just  
 possible Secretary  
 Baker may ring you to  
 press this point.

*AWK*  
 10/1

*X*



6. The Chancellor has also been reading the attached telegram from Tokyo. The NIKKEI article says "the United States has proposed that" there should be a G5 meeting. The Chancellor has commented that this will not do. We cannot allow it to be thought that the US convenes G5 meetings. We will need to correct this impression in our own press briefing in due course. (The fact is that we all speak to each other a fair amount, and plans for meetings emerge from these occasions - or some such line: the Chancellor will discuss this with you.) He can certainly recall that the January 1985 G5 was Stoltenberg's idea in the first instance, but that was never presented as a German proposal.

7. In talking to Stoltenberg last night about tin, the Chancellor went on to discuss G5 briefly with him. Stoltenberg agreed to come early (at 6.00 pm) to No.11, for a private chat. As far as the Italian request was concerned, Stoltenberg said he was opposed to any enlargement of G5 - it would soon come to be a group of 8 or 9. He thought it might be helpful to beef up G10 discussions, starting with a more thorough discussion - say about 3 hours - in Washington in April. He had already proposed this to Ruding (as Chairman of G10) and he would talk to Baker. The Chancellor said the Italian request would have to be discussed next weekend, but he was sure Stoltenberg was right to resist.

A handwritten signature in dark ink, appearing to be "AWK".

A W KUCZYS





b/f 15/1  
for GS  
folder

SUMMARY

UNITED STATES : ANNUAL REVIEW 1985

1. The President with a massive victory in 1984 behind him and the Congress with the 1986 mid-term elections ahead, started 1985 with different political agenda. The Congress has won on policy but the President has retained his popularity. (para 1)
2. The Congress won on the budget. The President wanted increased defence spending, lower domestic outlays and a reduction in the deficit. The Congress gave him a nil increase in the defence budget, maintained entitlements, including farm subsidies, and no reduction in the deficit. The Gramm-Rudman amendment a "deus ex machina designed to make the choices the politicians are afraid to make". Tax reform, a yawn in Middle America, set the White House against the House Republicans. (paras 2-5)
3. A bad year for the White House, caused by the direct swap between Baker and Regan. Mike Deaver missed. Regan, Prime Minister to the President, with his Merrill Lynch style of management, lacks the political touch. But he gets on well with the President and that is the main thing. (paras 6-8)
4. The President had a better year on the foreign scene, defeating protectionist pressures at home, seeking "fair" trade abroad and getting agreement to a new GATT round. A successful meeting with Gorbachev. But Congress and events in South Africa pulled the rug from under "constructive engagement"; Central America remained a curate's egg; on the Middle East violence paralysed action. (paras 9-12)

/5.

|              |  |
|--------------|--|
| CH/EXCHEQUER |  |
| REC.         | 10 JAN 1986  |
| ACTION       | SIR G LITTLE   |
| COPIES TO    | CST, EST, SIR P MOUNTFIELD<br>MR PER BUCK<br>MR LANE<br>MR MOUNTFIELD<br>MR KITCAT |

|              |               |
|--------------|---------------|
| CH/EXCHEQUER |               |
| REC.         | 10 JAN 1986   |
| ACTION       | SIR G. LITTLE |
| COPIES       | ...           |

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5. A good year for Anglo-American relations, apart from the MSE disappointment, from the Prime Minister's triumphal speech to both Houses of Congress to celebrate 200 years of diplomatic relations in February to the visit of the Prince and Princess of Wales for the "Treasure Houses of Britain" exhibition in November. RAF Tornados continue to carry off the prizes. The reputation of Britain stands high (paras 13-16)

6. 1985's problems postponed for solution to 1986. Protectionism scotched not killed; the arms race addressed but not stopped. The four horsemen - farm, real estate, energy and Third World debt - out there, but with growth, good luck and good management, apocalypse likely to be postponed once more. Reagan's America remains self-confident - and self-centred. (paras 17-20)

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FROM THE AMBASSADOR

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BRITISH EMBASSY,

WASHINGTON, D. C. 20008

TELEPHONE: (202) 462-1340

6 January 1986

The Right Honourable  
Sir Geoffrey Howe QC MP  
Secretary of State for  
Foreign and Commonwealth Affairs  
LONDON SW1

Sir,

UNITED STATES : ANNUAL REVIEW 1985

1. The President returned to Washington for his second term at the beginning of 1985 with the wind of a 49 state victory in his sails. The Congress, Republican-controlled Senate and Democratic-controlled House of Representatives alike, returned with the mid-term elections of 1986 in their sights. American politics and policies in 1985 were determined by the differing political agenda of those two co-equal branches of the United States Government. The upshot was that the Congress usually won on policy, but the President's personal standing soared : aided by his courage in the face of cancer and by a successful meeting with Gorbachev, his approval rating after 5 years in office reached an astonishing 70%.

/The

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The Domestic Scene

2. Since politics is about priorities, particularly about how to raise and spend the tax-payers' dollars, the budget deficit and tax reform dominated the domestic scene. Before November 1984, the budget deficit was unmentionable. Afterwards, it was the nation's highest priority. At \$200 billion, it kept interest rates high, contributed to the overvalued dollar and the trade deficit of nearly \$150 billion, and stimulated demands for protection from uncompetitive industries, including even semi-conductors as well as the declining sectors of steel, footwear and textiles. During the first 200 years of the independent existence of the United States, the national debt had reached \$1 trillion. It reached its second trillion during the first five years of the Reagan Presidency. The President's economic policy - Reaganomics - meant spending more on defence, raising less in taxes, and yet balancing the budget, all popular and desirable objectives. The only snag was that they were incompatible - in George Bush's immortal phrase "voodoo economics". Their incompatibility became clearer in 1985 when the United States became a debtor nation for the first time since 1914. "These imbalances are unsustainable and must be corrected" said George Shultz in a majestic speech at Princeton in April. Fortunately Paul Volcker stayed at the Fed, one of the few people in America who both understood what was happening and was in a position to prevent the worst.

3. The President, in accordance with his agenda, sent a Budget for Fiscal 1986 to Congress in February 1985 proposing a further 6% real increase in defence spending, drastic cuts in entitlements, an effort to make the farm belt respond to market factors and a modest decrease in the deficit. The Congress, true to its agenda, reduced the growth in the

/defence



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defence budget to zero, failed to tackle entitlements and prevented any cuts in farm programmes. "The farmers beat the President" was the opinion of the New York Times, as the President signed into law a 3 year \$53 billion proposal. So the USA and the European Community continue level-pegging at subsidising their farmers. The President's only victory was Pyrrhic : he avoided tax increases.

4. Enter Senators Gramm and Rudman, Republicans both. Conscious that everybody wanted the budget reduced but that nobody could agree on how to do it, they introduced the Gramm-Rudman amendment which called for a statutory reduction of the deficit to zero by 1991, by fixed amounts each year, to be culled equally from the defence and domestic outlays, unless there were agreement between the two branches of government as to where the axe should fall. Almost 50% of the budget was held to be sacrosanct, notably social security, following a Presidential commitment during the 1984 campaign. The President signed the bill into law on December 12. The New Yorker wrote : "The Gramm-Rudman is a deus ex machina designed to make the choices that the politicians are afraid to make". Secretary of Commerce Baldrige described it to me as "the only game in town". All is to play for in Fiscal 87 and could involve the third co-equal branch of government, The Supreme Court, for the Gramm/Rudman Amendment may be unconstitutional. But Wall Street seems to like the prospect. Aided by declining interest rates, the Dow Jones, having traded side-ways for 2 years, has in the course of 1985 leapt successively through the 1300, 1400 and 1500 barriers, mostly in the last quarter.

5. The President's pet domestic project to mark his second term is a revenue-neutral Tax Reform. The original idea was to reduce the tax bands from 14 to 3, abolish write-offs like State and City taxes and make corporate America pay about \$120 billion more so as to enable the citizen

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to pay about \$120 billion less. The idea hit 2 snags. First, despite much expenditure of Presidential time and energy selling the project in speeches up and down the country, Middle America yawned. Secondly, Tax Reform, being about money, had to start in the House which is Democratic-controlled. Secretary of the Treasury Baker, to get reform started, cut a deal with the Chairman of the House Ways and Means Committee, Dan Rostenkowski, but that infuriated the House Republicans. It required a Canossa-like visit to the Hill by the President and the Vice-President at the year's end to save the Bill for at least another six month's wrangling in the Senate.

6. All in all, the White House has had a bad year, starting with and caused by the direct swap of Baker and Regan. Baker left the White House for the Treasury, taking his deputy Richard Darman and his sophisticated political skills with him. The direct results have been modest but beneficial : the G5 agreement in September on reducing the value of the dollar against the yen, the D-mark and sterling, and the Seoul proposals about Third World Debt. The dollar started the year at \$1.15 to the pound and ended at \$1.45, thus exactly reversing its 1984 performance.

7. Regan came to the White House bringing his Merrill Lynch style of corporate management with him and proclaiming himself to be Prime Minister to the President. Mike Deaver is reported to have conducted Regan into the Oval Room with the words : "I found someone your own age to play with". The result has been unhappiness all round. Deaver got out in good time, to make several times more money as a consultant than as a practitioner. He is still around, giving occasional advice on the presentation of the President. It was his idea that the President should circumvent the 3000 journalists at Geneva and, after briefing the Allies in Brussels, return to Washington to report direct to the Congress and the nation. But his sure touch - Bitberg apart - is missed on an everyday basis.

/8.

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8. Regan for his part seems to have no touch at all : with Congress, with his subordinates or with his peers. The "promotion" of a tearful Secretary of Health and Human Services, Margaret Heckler, to be Ambassador to Ireland, his monopoly of the stage during the President's operation for cancer, are but two instances of his method of operation. The retirement of Bud McFarlane from the post of National Security Adviser, while sheer exhaustion and family problems played a role, must also be laid at his door. "Disarray under Regan" was the end of the year verdict of Lou Cannon, the Washington Post's percipient White House correspondent. So far, Regan still seems to do the most important thing : get on well with the President. The personal chemistry is right and they swap Irish jokes; but the First Lady will not be best pleased if the heavy hand of his Chief of Staff starts to tarnish her Ronnie's reputation.

#### The Foreign Scene

9. The President had a better year on the foreign scene. The Congress returned to Washington in September, convinced that the United States traders were playing on a playing field tilted against them, and calling for fair trade and protection against foreign imports. Some 300 protective trade bills were said to be in draft. The President, true to his gut feelings that "in trade wars there are no winners only losers", disregarded an international Trade Commission recommendation for import quotas on footwear and vetoed a bill from the Congress which sought to cut textile imports. The votes for an override gradually disappeared as the autumn progressed and as the President's determination increased in credibility.

10. The President counter-attacked by seeking to open foreign markets to American goods. Japan was the principal target. Rows with the European Community were gradually defused. A steel agreement was concluded and

/agreement

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agreement was reached on the opening of a new GATT round to include services. The by now traditional end of year meeting in Brussels between members of the US Cabinet and EC Commissioners was deemed on both sides to have been the best yet. For that we have Shultz's moderate and steadying hand to thank. Shultz had a good year all round.

11. The event of the year, however, was the meeting at Geneva of the two Superpowers. Many of the more intellectual commentators, scornful of the President's brain power and attention span, feared that he would be no match for Gorbachev : they remembered that he had been an actor, forgot that he had been President of a Trade Union, the Screen Actors Guild, and therefore an experienced and skilled negotiator. The Alliance was fully consulted beforehand and allied pre-occupations absorbed into the US negotiating brief. At Geneva, the President sought, in one-on-one meetings, to establish the fact that he was in charge, to explain his views on SDI, and to set a process of dialogue in train. The most tangible result was agreement to meet again, in Washington in 1986 and in Moscow in 1987, future events which should concentrate the minds of the negotiators wonderfully. The President returned to a rapturous reception on the Hill.

12. Elsewhere, things did not go his own way. In South Africa, television reporting of riots in South Africa and the impact on Congress of initially modest demonstrations outside the South African Embassy in Washington, pulled the rug from under the feet of Chester Crocker's policy of "constructive engagement". The President had to impose a modest programme of sanctions by executive order to forestall more far-reaching legislation by the Congress. In Central America, results were patchy. Congress reversed itself on Nicaragua when Ortega went to Moscow. The Contadora process made little progress. The Contras kept up

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their fight. Guatemala returned to civil, democratic government. Latin Americans are torn between their resentment of "American imperialism" and their fear of the establishment of a Soviet satellite in their midst : the result of this dilemma is paralysis of will. A similar fate befell the Middle East peace process; and Americans became uneasily aware that their interests in the Philippines are increasingly threatened. On terrorism, the interception of the Egyptian aircraft carrying the Achille Lauro hijackers brought praise for Administration resolve; but the year ends with increasing pressure to deal equally resolutely with Qadaffi.

#### Anglo-American Relations

13. A pretty good year, despite an important disappointment. We lost the MSE programme to a less sophisticated but considerably cheaper French-American competitor, despite the best efforts of the Administration to run and re-run computer programmes to make the sums come right for us. The Prime Minister reinforced the Camp David 4-point agreement on SDI of December 1984 by announcing to Congress in February that HMG wished to take part in SDI research. And the two Secretaries of Defence signed an MOU in London on 6 December, making us the first of the Allies to give concrete form to their support for such research. I believe that our ability to influence US policy-making on defence and deterrence is thereby enhanced. RAF Tornados continued to carry off the bombing trophies in competition with the USAF.

14. The settlement of the miners' strike and the continued good performance of the British economy added to Britain's already high reputation in America, which was only marginally affected by the riots in the inner cities. The similar American experience is too recent to permit the expression of anything but sympathetic concern. The

/supplementary

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supplementary extradition treaty was negotiated without too much difficulty with the executive branch of the government, but ran into problems with the legislative branch : the advice and consent of the Senate being necessary. When I observed to Senator Lugar, Chairman of the Senate Foreign Relations Committee, that the Treaty had had a good press throughout the United States, he pointed out gently that journalists do not vote in the United States Senate, but Senators representing Irish-American constituencies do. The Hillsborough agreement was widely welcomed here : its consequences will be watched with keen concern.

15. The Prime Minister visited the US three times; and her Churchillian speech to Congress in February aptly marked the 200th anniversary of Anglo-American diplomatic relations. The spectacular "Treasure Houses" exhibition and the visit of the Prince and Princess of Wales in November put the seal on what had been a very good year. The advance publicity was greater than anything in my experience, with cover stories on practically every magazine from coast to coast. "The British have landed and Washington is conquered" was the front page headline on the New York Times. The British interest was greatly served.

1986 : A Turnaround Year?

16. 1985 left 1986 a lot of unfinished business to cope with and the mid-term elections will mean that there is less time and perhaps less enthusiasm to tackle it. Nonetheless the instruments are in place to deal at least with the budget deficit at home and the arms race abroad. 1986 could therefore be a turnaround year. But will it?

17. The President will have a tough decision to take on the Budget. It is difficult to see how he can avoid either accepting a reduction in

/defence

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defence spending or an increase in taxation : my guess is that unless he can come up with a "user fee", for example, an oil import tax, he will prefer to swallow a reduced defence budget, and blame it on the Congress, than propose tax increases which the Congress has made it clear will have to come from the White House.

18. 1986 will also see the second Reagan/Gorbachev Summit in the United States and the world's expectations, based on the common sense view that both sides have more weapons than they need or could conceivably use, that the two superpowers must begin to show results. 1986 will probably be too early, but the process which started in Geneva in November 1985 will obviously have to show itself capable of producing the answers.

19. The consensus of leading US economists is for growth of 2 1/2% to 3 1/2% in 1986 - a little above the disappointing 2 1/2% achieved in 1985. Inflation should remain low, and the decline in the dollar should also lead to an improved trade performance in the latter half of 1986. If that is so, and if the economies of the rest of the industrialised world continue to grow, then the likelihood is that the world will survive 1986, as it did 1985, without catastrophe. But the problems "out there", like the protectionist pressures at home and a slog-out between farm products abroad, and the Four Horsemen - farm, energy, real estate and third world debt - have not gone away. Neither have they struck : and with a little bit of good luck and good management in 1986, Apocalypse may once more be postponed.

20. Certainly there is no sense of impending doom. Reagan's America remains self-confident, occasionally self-satisfied, always self-centred. Though the renewed dialogue with Moscow is popular, the national mood was

/caught

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caught by complaints that the screening of Gorbachev's message to the American people interrupted their viewing of the Rose Bowl football. One complainant was quoted as saying : "if I wanted to see a Russian on my television, I would have bought a Russian television."

21. I am sending copies of this despatch to the Chancellor of the Exchequer, the Secretary of State for Defence and the Secretary of State for Trade and Industry; to HM Ambassadors in NATO posts, Dublin, Moscow and Tokyo and to HM Permanent Representatives to the United Nations in New York and to the European Community in Brussels and to HM Consuls-General in the United States.

I have the honour to be  
Sir  
Your obedient servant

A handwritten signature in dark ink, appearing to read 'Oliver Wright', with a long, sweeping flourish extending to the right.

Oliver Wright

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CALENDAR OF EVENTS 1985

JANUARY

- 1 Interior Secretary William Clark announces his resignation
- 2 President Nakasone of Japan meets President Reagan in Los Angeles
- 3 99th Congress convenes
- Deputy White House Chief of Staff Michael Deaver announces his resignation
- 7 - 8 Secretary of State George Shultz and Soviet Foreign Minister Andrei Gromyko meet in Geneva and agree that there should be US/Soviet negotiations on "the complex of questions concerning space and nuclear arms"
- 8 President Reagan announces that Treasury Secretary Donald Regan and White House Chief of Staff James Baker will switch jobs
- 9 President Reagan gives first full news conference for 6 months
- 10 Donald Hodel (Energy Secretary) nominated to succeed William Clark as Interior Secretary
- John Herrington (White House Personnel Director) nominated as Energy Secretary
- William Bennett (Chairman of National Endowment for Humanities) nominated to succeed Terrel Bell as Education Secretary
- 14 Prime Minister Wilfred Martens of Belgium visit Washington
- 20 President Reagan and Vice-President Bush sworn in for second term
- 21 President Reagan delivers Inaugural Address



JANUARY (contd)

- 25 - 28 The Rt Hon Lord Young of Graffham, Minister without Portfolio, visits New York and Washington
- 26 Simultaneous announcements in Washington and Moscow that the new US/Soviet arms control negotiations will open in Geneva on 12 March
- 27-12 February Royal Shakespeare Company in Washington
- 30 UN Ambassador Jeane Kirkpatrick announces she is leaving the Administration
- 31 Western European governments decide in principle to participate in US project to launch a permanently manned space station in 1992

FEBRUARY

- 4 President Reagan presents a \$973.7 billion budget to Congress
- Secretary of State George Shultz announces creation of "Overseas Security Advisory Council" to combat international terrorism
- 4 Zulu Chief Buthelezi meets President Reagan during his visit to Washington
- 4 - 5 French Foreign Minister Dumas visits Washington
- 4-8 Mr John Lee MP, Parliamentary Under Secretary of State (Defence Procurement) visits East Coast Naval Dockyards
- 5 US cancels participation in ANZUS naval exercise in response to New Zealand's Labour Government's refusal to allow USS Buchanan to dock - US would not say whether the ship was carrying nuclear weapons
- 6 President Reagan delivers State of the Union address to Congress
- 10 - 14 King Fahd of Saudi Arabia visits Washington



FEBRUARY (contd)

- 12                    Opening of Stubbs Exhibition at Yale Centre  
for British Art
- 19                    Opening of Leonardo Drawings from Windsor  
Castle at the National Gallery of Art
- 19 - 21              The Prime Minister, the Rt Hon Margaret  
Thatcher FRS MP, visits Washington accompanied  
by the Foreign Secretary, the Rt Hon Sir  
Geoffrey Howe QC MP and the Secretary of State  
for Defence, the Rt Hon Michael Heseltine MP
- 20                    The Prime Minister addresses joint meeting  
of Congress
- 21                    President Reagan holds first press conference  
of his second term.
- 23                    Edwin Meese confirmed as Attorney General
- 25                    Mr Adam Butler MP, Minister of State (Defence  
Procurement) visits San Francisco and Los  
Angeles

MARCH

- 3                    Secretary of State George Shultz holds talks  
with Nicaragua's President Ortega in  
Montevideo
- 4 - 10               Vice President Bush visits Sudan, Niger and  
Mali
- 5                    Chief Minister of Turks and Caicos Islands  
arrested in Miami on drugs charges
- 5 - 6                Prime Minister Bettino Craxi of Italy visits  
Washington
- 7                    President Reagan vetoes Emergency Farm Credit  
Relief Bill
- 12                    US/Soviet arms control negotiations open in  
Geneva
- US vetoes UN Security Council resolution  
condemning Israeli policy in Southern Lebanon
- 12 - 14              President Hosni Mubarak of Egypt visits  
Washington



MARCH (contd)

- 13 Vice President George Bush and Secretary of State George Shultz attend the funeral of President Chernenko in Moscow and deliver an invitation to talks to new Soviet leader General Secretary Gorbachev from President Reagan
- 14 Vice President Bush visits Grenada
- 15 Labor Secretary Raymond Donovan announces his resignation
- 17 - 18 President Reagan visits Canada for talks with Prime Minister Brian Mulroney
- 17 - 21 President Alfonsin of Argentina pays a state visit to Washington and addresses a joint meeting of Congress (20 March)
- 20 President Reagan nominates US Trade Representative William Brock as Labor Secretary
- Administration announces Cabinet-level trade talks between US and USSR to be held in May
- 24 US Army officer shot and killed by Soviet sentry in East Germany
- 24 - 2 April The Rt Hon Douglas Hurd CBE MP, Secretary of State for Northern Ireland, visits the United States
- 26 - 2 April House of Commons Select Committee on Defence visits USA
- 27 Secretary of Defense Caspar Weinberger invites NATO Defence Ministers at the NPG meeting in Luxembourg to submit proposals within 60 days for non-US NATO involvement in the SDI research programme
- Senate adopts unanimous resolution calling for trade measures against Japan, following Japanese announcement of increase in permitted car exports to the US
- 27 - 28 Mr John Stanley MP, Minister of State (Armed Forces) visits Washington





MARCH (contd)

28

Final Congressional approval for production of 21 further MX missiles in FY 1985

APRIL

1 - 4

Visit to Washington and Boston by Lord Carrington, Secretary-General of NATO

2

Clayton Yeutter nominated as US Trade representative

2 - 4

Visit to Washington by President Betancur of Colombia

2 - 4

Visit to Washington by Turgut Ozal, Prime Minister of Turkey

8

Indian Government files suit for damages in New York federal court against Union Carbide over the poisonous gas leak in Bhopal in December 1984

9

Linda Chavez nominated as White House Director of Public Liaison

10

Delegation of 13 Congressmen headed by Speaker Tip O'Neill visit Moscow

11

White House announces that President Reagan will visit Bitburg Cemetery in Germany, where SS soldiers were buried. Protests from American Jewish groups

13 - 17

Visit to Washington by President Diouf of Senegal

16

In a speech to the National Press Club Secretary of State George Shultz appeals for support for the Administration's policy on South Africa

16 - 4 June

Smithsonian lecture series on Britain

16 - 19

Visit to Washington by President Chadli of Algeria

18

Deputy Secretary of State Kenneth Dam resigns; John Whitehead is nominated as his successor



APRIL (contd)

22

US and Israel sign free trade area agreement

22 - 23

Visit to Washington of M Jacques Delors, President of the EC Commission

24

House rejects President's proposal for funding Nicaraguan Contras.

25 - 27

Visit to Washington by President Chun of Korea

MAY

1

Imposition of US trade sanctions against Nicaragua

2 - 4

President Reagan attends Economic Summit in Bonn

5

President Reagan visits Bitburg Cemetery and the memorial at Bergen Belsen

6 - 8

President Reagan visits Spain

8

40th anniversary of V-E Day: President Reagan makes speech to European Parliament

8

President Reagan visits Lisbon

10

Senate approves budget resolution freezing social security entitlements but allowing inflation increase in defence

12

US International Trade Commission finds unanimously that imports have been injuring the US footwear industry; Commission subsequently recommends the imposition of quotas

12 - 14

Visit to Washington by the Rt Hon Peter Walker MP, Secretary of State for Energy

14 - 18

Visit to Washington by Sir Antony Acland KCMG, Head of the Diplomatic Service, for Heads of Post Conference



MAY (contd)

- 15 Agriculture Secretary Block announces \$2 billion export enhancement programme designed to counter EC agricultural export subsidies
- 18 - 22 Mr Malcolm Baldrige, US Secretary of Commerce, visits Moscow for talks on US-Soviet trade.
- 20 Radio Marti starts broadcasting to Cuba
- John Walker (former Naval officer) arrested and charged with espionage activities
- 22 - 26 Visit to Washington by Air Chief Marshal Siddhi, Foreign Minister of Thailand
- 23 House approves budget resolution freezing defence but retaining cost-of-living increase in entitlements
- 28 - 31 Visit to Washington by King Hussein of Jordan
- 29 - 4 June Visit to Baltimore by HRH Prince Andrew with HMS Brazen

JUNE

- 1 Bicentennial of UK/US diplomatic relations
- 2 - 4 Visit to Washington by Israeli Defence Minister Yitzhak Rabin
- 2 - 4 Visit to Washington by the Rt Hon David Owen MP, leader of the Social Democratic Party
- 10 President Reagan announces continuing compliance with the terms of SALT II
- 11 - 15 Visit to Washington by Prime Minister Gandhi of India
- 12 House approves US humanitarian aid to Contras
- 12 - 14 Visit to Washington of Brazilian Foreign Minister Setubal
- 13 President Reagan launches campaign for tax reform package in New Jersey



JUNE (contd)

- 14 Hijacking of TWA flight 847 en route from Athens to Rome by Shiite gunmen; one American killed
- 14 - 26 Visit to Washington by President Bourguiba of Tunis
- 19 6 US citizens (including 4 marines) murdered in San Salvador
- 23 - 4 July Vice President Bush visits seven West European countries (UK, Germany, France, Italy, Belgium, Netherlands, Switzerland)
- 25 Signature in Washington of UK-US Supplementary Extradition Treaty

JULY

- 2 - 3 Vice-President Bush visits London for talks with the Prime Minister and others
- 6 - 16 Secretary of State George Shultz visits Hong Kong, Thailand, Malaysia (for ASEAN Foreign Ministers' Conference), Australia and Fiji
- 9 David Stockman announces his resignation as Director of the Office of Management and Budget
- Admiral Crowe nominated as Chairman of JCS (General Vessey due to retire on 1 October)
- 13 President Reagan undergoes surgery to remove a malignant tumour
- 15 Air Force Secretary Verne Orr announces intention to resign
- 15 - 20 American Bar Association holds first annual convention in London for 14 years. Attorney General Edwin Meese attends. The Prime Minister addresses convention on international terrorism
- 17 Administration drops nomination of William Bradford Reynolds as Associate Attorney General



JULY (contd)

- 19 James Miller III nominated as Director of the Office of Management Budget in succession to David Stockman
- 22 The Rt Hon Mr Michael Heseltine, Secretary of State for Defence, pays one-day visit to Washington
- 22-30 President Li Xiannian of China pays state visit to the United States
- 25 - 26 The Prime Minister attends the IDU conference in Washington
- 29 President Reagan invites the USSR unconditionally to attend and monitor a US underground nuclear test and rejects Soviet proposal for unverified 5-month moratorium on nuclear weapons testing
- 30 The Rt Hon Sir Geoffrey Howe, Secretary of State for Foreign and Commonwealth Affairs, and Secretary of State George Shultz meet in Helsinki
- 31 Secretary of State George Shultz meets Soviet Foreign Minister Shevardnadze in Helsinki in margins of CSCE review conference

AUGUST

- 1 Congress approves FY 1986 budget resolution with zero real increase for defence before rising for summer recess
- 2 Delta Airlines flight 191 from Fort Lauderdale to Los Angeles crashes at Dallas/Fort Worth, killing 133
- 5 President Reagan discloses that a small piece of cancerous tissue has been removed from his nose
- 8 President Reagan signs first Foreign Aid Authorisation Bill since 1981
- National Security Adviser Bud McFarlane and Assistant Secretary Chester Crocker meet Foreign Minister Pik Botha of South Africa in Vienna



AUGUST (contd)

- 11 Toxic gas leak at Union Carbide's plant in West Virginia
- 19 Senator Paul Laxalt, General Chairman of the Republican Party, announces decision to retire from Senate in 1986
- 20 President Reagan informs Congress that US will conduct first test of an anti-satellite system against a target in space
- 20 - 22 Mr John Butcher MP, Parliamentary Under Secretary of State for Industry, visits Washington to receive on behalf of HMG an award from the Design Foundation
- 21 United States charges Soviet authorities with using chemical substances to track US diplomats
- 27 - 6 September The Rt Hon Nicholas Edwards MP, Secretary of State for Wales, visits San Francisco, Seattle, Minneapolis, Chicago and New York
- 28 President Reagan announces that he will not award import relief to US footwear industry

SEPTEMBER

- 7 President Reagan announces unfair trade cases against certain products from Korea, Brazil and Japan, and more urgent action on existing complaints against the European Community
- 8 - 19 Field Marshal Sir Edwin Bramall, Chief of Defence Staff, visits USA and Canada
- 9 President Reagan announces limited economic sanctions against South Africa
- 9 - 11 Visit to Washington by Prime Minister of Denmark
- 12 - 17 HRH Princess Alexandra visits Minneapolis/St Paul for Minnesota British Festival
- 13 US carries out first ASAT test against a target in space
- 13 - 16 Gala Opening of Minnesota British Festival in presence of HRH Princess Alexandra



SEPTEMBER (contd)

- 13 - 17 Mr John Stanley MP, Minister of State (Armed Forces) visits Hawaii and Washington
- 14 Rev. Benjamin Weir (one of US hostages held in Lebanon) released
- 20 Visit to Washington by President Machel of Mozambique
- 22 - 26 The Rt Hon Sir Geoffrey Howe, Secretary of State for Foreign and Commonwealth Affairs, visits New York for the 40th session of the UN General Assembly
- 23 President Reagan announces new trade policy initiative, maintaining commitment to free trade, but establishing unfair trade "strike force"
- 27 President Reagan welcomes Canadian initiative to explore possibilities for freer bilateral trade
- 29 - 4 Mr Michael Spicer MP, Parliamentary Under Secretary of State for Transport, visits Los Angeles, Dallas, Washington and New York

OCTOBER

- 1 Health and Human Services Secretary Margaret Heckler agrees to give up cabinet post to become US Ambassador to Ireland
- 1 Settlement of the Laker Liquidators Anti-Trust case against British Airways approved by the DC District Court
- 2 - 11 Lord Carrington, Secretary General of NATO, visits the United States
- 7 US announces termination of acceptance of compulsory jurisdiction of the ICJ
- 10 US intercepts aircraft carrying terrorists who had hijacked the "Achille Lauro" ship and been responsible for the death of a US citizen
- 14 - 18 TRH The Duke and Duchess of Kent visit New York and Los Angeles for JC Penney "Best of Britain" promotion



OCTOBER (contd)

- 17 Visit to Washington by Prime Minister Shimon Peres of Israel
- 22 - 24 The Prime Minister, the Rt Hon Margaret Thatcher FRS MP, visits New York for 40th anniversary of UN and summit meeting
- 24 President Reagan addresses UN
- 28 - 30 The Rt Hon Leon Brittan MP, Secretary of State for Trade, visits New York and Washington
- 28 - 31 Admiral of the Fleet, Sir John Fieldhouse, Chief of Defence Staff (Designate) visits Washington
- 30 - 2 Mr Richard Luce MP, Minister for the Arts, visits Washington
- 31 Opening of "Treasure Houses of Britain" Exhibition at National Gallery of Art
- 31 - 3 November The Rt Hon Kenneth Baker MP, Secretary of State for the Environment, visits Washington
- Visit to Washington and Miami of President Duarte of El Salvador

NOVEMBER

- 4 Secretary of State George Shultz visits Moscow
- 8 - 13 TRH The Prince and Princess of Wales visit Hawaii, Washington and Palm Beach
- 13 Mr Terry Waite in Beirut for contacts with captors of American hostages
- Mrs Reagan's Chief of Staff, James Rosebush, resigns. (Succeeded by Lee Verstandig, Under Secretary at HUD)
- President Reagan's televised pre-Summit speech
- 15 Statements by President Reagan and Speaker Tip O'Neill welcoming the Anglo-Irish Agreement on Northern Ireland





NOVEMBER (contd)

19 - 20

President Reagan and Soviet leader Gorbachev meet in Geneva

21

Prime Minister and Secretary of State attend President Reagan's briefing for the North Atlantic Council in Brussels on the summit meeting with Gorbachev

Arrest of US citizen in Washington on charge of spying for Israel

23

National Security Adviser Bud McFarlane visits Chequers to debrief Prime Minister and Secretary of State on Geneva summit

US citizen killed during hijack to Malta of an Egypt Air flight en route Athens-Cairo

DECEMBER

2

NASA Administrator James Beggs indicted on charges of trying to defraud the government on the development of an ill-fated Army weapon

2 - 5

Secretary of State George Shultz attends OAS meeting in Columbia

4

National Security Adviser Bud McFarlane resigns. President Reagan appoints Vice-Admiral John Poindexter to succeed him

5 - 6

Secretary of Defense Caspar Weinberger visits London

6

UK and US sign Memorandum of Understanding on British participation in SDI research

8

Commerce Secretary Malcolm Baldrige visits Moscow for US/Soviet "business summit"

10

Secretary of State George Shultz visits London

11

EC ratifies extension of EC/US Carbon Steel Arrangement following US assurances on BSC

11 - 18

Secretary of State George Shultz visits Brussels, Bonn, Berlin, Bucharest, Budapest, and Belgrade



DECEMBER (contd)

- 12 Congress passes debt-ceiling legislation incorporating Gramm-Rudman-Hollings amendment mandating balanced budget by 1991
- Charter plane carrying 257 US troops from Sinai force crashes in Newfoundland - no survivors
- 16 President vetoes (protectionist) textile quota bill
- 17 - 19 President-elect Venicio Cerezo of Guatemala visits Washington
- 17 House of Representatives passes Tax Reform Bill, forwarding it to the Senate
- 18 Congress approves Farm Bill maintaining agricultural price supports
- Administration bill to reform Unitary Taxation introduced in Congress
- 19 Congress adjourns after passing Continuing Resolution to fund government departments for FY 1986
- 31 US announces unilateral imposition of quota on imports of EC semi finished steel

SECRET

FROM: H P EVANS

DATE: 10 January 1986

CHANCELLOR

cc Chief Secretary  
Financial Secretary  
Economic Secretary  
Minister of State  
Sir P Middleton  
Sir T Burns  
Mr Butler  
Sir G Littler  
Mr Cassell  
Mr Lavelle  
Mr Monck  
Mr Monger  
Mr Odling-Smee  
Mr Peretz  
Mr Scholar  
Mr Turnbull  
Mr Davies  
Mr Mowl  
Miss Peirson  
Mr Cropper  
Mr Lord  
Mr H Davies

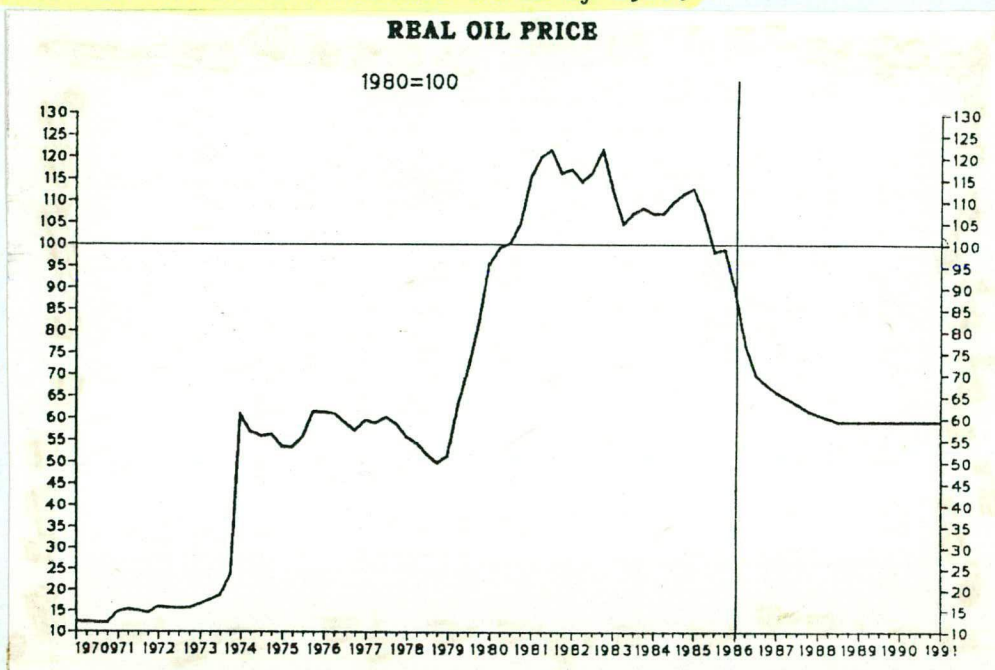
**WINTER FORECAST: PRELIMINARY INDICATIONS**

The winter forecast is under way and as usual I am sending you a note, which may be useful background for the Chevening discussions, on the main changes we anticipate. The numbers are summarised in a table at the end. A separate note is being circulated on the **policy assumptions**, which are broadly unchanged from those in earlier forecasts.

*to separate below folder*

Oil prices

2. The Autumn Statement forecast allowed for a fall in North Sea oil prices, to about \$24 a barrel by the end of 1986. In the event prices have already fallen to about \$25 and future markets are currently pointing to an oil price below \$22 a barrel by the end of this year, reflecting not only the continuing excess supply in the market but also Saudi Arabia's changed position. We have reduced our forecast of oil prices accordingly (though by less than the Department of Energy proposed) and are working through the implications for the world and UK economies. The chart below shows real oil prices falling back almost to their mid seventies level by 1988.



Exchange rate and interest rates

3. The rise in base rates this week has led us to raise our forecast of short rates for the immediate future. Sentiment could now swing either way: current interest differentials in favour of sterling are very high. Nevertheless, we assume that interest rates will have to stay high over the spring and summer because of the fall in, and uncertainty over, oil prices. By the end of 1986, mainly as a consequence of lower oil prices, we have a lower exchange rate and higher interest rates than in the previous forecast:

|         | Effective exchange rate |              | Short-term interest rate |              |
|---------|-------------------------|--------------|--------------------------|--------------|
|         | Autumn Statement        | January 1986 | Autumn Statement         | January 1986 |
| 1985 Q4 | 81                      | 80           | 11½                      | 11½          |
| 1986 Q4 | 81                      | 75-79        | 10½                      | 11-12        |



Phil  
Not good  
news.

D  
20/12

2  
I understand that you  
wanted to see Geoff Huttler  
for 10/15 minutes tomorrow  
to discuss the GS meeting  
in mid-February.  
He is out of the country  
tomorrow.

You are seeing the FST at 5.30  
today - if that only lasts for  
15 minutes you could perhaps  
see Geoff at 5.45 for 15  
minutes.

The other possibility would  
seem to be 10/15 minutes  
for GS on Monday.

Shall I put Sr Geoff and  
Philip on call for 5.45 pm?

Spencer Alex Huttler.

M.

D

19/12

4. As far as we can see, the revised path of the exchange rate and interest rates is consistent with the Autumn Statement/MTFS path for growth in nominal income: see table at end. M0 growth is likely to continue to be slow.

#### Inflation

5. There is very little change in the RPI forecast for the end of 1986, with the effects of a lower exchange rate being offset by lower oil and other commodity prices. There is considerable uncertainty about the monthly figures, but not about the downward trend in the early months of 1986. The path below does not allow for any rise in mortgage rates (each 1 per cent adds 0.4 per cent to the RPI). A rise is likely unless there is some fall back in base rates within the next 2-3 months. The immediate prospect has worsened slightly, and we now expect the next few months RPI to look as follows:

#### RPI per cent changes on a year earlier

|               |           |                            |
|---------------|-----------|----------------------------|
| November 1985 | Published | 5.5                        |
| December      | Forecast  | $5\frac{3}{4}$             |
| January 1986  | "         | $5\frac{1}{2}-\frac{3}{4}$ |
| February      | "         | $5\frac{1}{4}$             |
| March         | "         | $4\frac{1}{2}$             |
| April         | "         | $3\frac{1}{2}$             |

6. The increase in prices between May 1985 and January 1986 (the basis for the social security uprating in July) is now expected to be  $1\frac{1}{4}$  per cent, rather than the 1 per cent allowed for in the PFWP.

#### Activity

7. There have been some changes and revisions to the estimates and statistics for 1985. With a downward revision to GDP in the first half of the year and a weak third quarter, the growth rate for 1985 as a whole may be a little lower, though it should still round to  $3\frac{1}{2}$  per cent. (Subsequent revisions by the CSO to output statistics are more likely to be up than down.) Within the total fixed investment has been weaker than expected: the annual figure may be no more than 2 per cent, compared with 4 per cent in the Autumn Statement. For 1986, output growth at 3 per cent still looks likely, led by

consumer demand growth of 4 per cent - of which about  $\frac{1}{2}$  per cent reflects the fiscal adjustment. Unemployment is again forecast not to change much, though there may be a slight decline.

Current account

8. Upward revisions to the services balance in the first half of 1985 and lower than expected import prices have compensated for a slightly disappointing export performance in recent months and the expectation of a £0.6 billion write-off on Sohio reducing the IPD balance in the fourth quarter. For 1986, a sizeable surplus is still expected. Beyond 1986, partly because of lower oil prices, the surplus is expected to decline.

Fiscal prospects

9. With the monthly PSBR figures coming out below expectations the 1985-86 financial year PSBR may be in the range £7-7 $\frac{1}{2}$  billion. The main factors are higher receipts from VAT and stamp duty, and puzzlingly low borrowing by local authorities.

10. For 1986-87, oil revenues are down again, but non-oil revenues provide a major offset. A PSBR of £7 $\frac{1}{2}$  billion still appears to offer scope for a fiscal adjustment of £2-3 billion if public expenditure can be held close to the level planned.

11. Our assessment of public expenditure in 1986-87 is that the £4 $\frac{1}{2}$  billion Reserve will all be needed to cover likely claims, with nothing to spare. We are allowing for £0.2 billion extra spending on selective employment measures. For 1987-88 and 1988-89, with claims on the Reserve mounting rapidly, especially by local authorities, the published Reserves continue to look inadequate.

*If no, check  
to find out  
projection for how  
long?*

*1. 1st 2/86  
MR*

H.P.E.

H P EVANS

## SECRET

## SUMMARY TABLE

|  | FSBR<br>March 1985 | AUTUMN<br>STATEMENT<br>November 1985 | PRELIMINARY VIEW<br>January 1986 |
|--|--------------------|--------------------------------------|----------------------------------|
| <b>Effective exchange rate</b><br>1975 = 100                 |                    |                                      |                                  |
| 1985 Q4  | 74                 | 81                                   | 80                               |
| 1986 Q4  | 74                 | 81                                   | 75-79 77                         |
| <b>Nominal GDP</b><br>(per cent change on<br>a year earlier) |                    |                                      |                                  |
| 1985-86  | 8½                 | 9                                    | 9                                |
| 1986-87  | 6½                 | 7                                    | 6-7 6½                           |
| <b>GDP volume</b><br>(per cent change on<br>a year earlier)  |                    |                                      |                                  |
| 1985   | 3½                 | 3½                                   | 3½                               |
| 1986   | 2                  | 3                                    | 3                                |
| <b>RPI (per cent change on<br/>a year earlier)</b>           |                    |                                      |                                  |
| 1985 Q4  | 5                  | 5½                                   | 5½                               |
| 1986 Q4  | 4                  | 3¾                                   | 3½-4 3¾                          |



SECRET

FSBR  
March 1985

AUTUMN  
STATEMENT  
November 1985

PRELIMINARY VIEW  
January 1986

Oil prices (Brent, \$ per barrel)

|         |     |     |    |
|---------|-----|-----|----|
| 1985 Q4 | 26½ | 27½ | 28 |
| 1986 Q4 | 26  | 24  | 21 |

Current balance, £ billion

|      |    |   |        |
|------|----|---|--------|
| 1985 | 3  | 3 | 3      |
| 1986 | 2½ | 4 | 3-4 3½ |

PSBR, £ billion

|         |    |    |         |
|---------|----|----|---------|
| 1985-86 | 7  | 8  | 7-7½ 7¼ |
| 1986-87 | 7½ | 7½ | 7½      |

Fiscal adjustment, £ billion

|         |    |   |        |
|---------|----|---|--------|
| 1986-87 | 3½ | 3 | 2-3 2½ |
|---------|----|---|--------|

Interest rates, short-term,  
per cent

|         |     |     |           |
|---------|-----|-----|-----------|
| 1985 Q4 | 11½ | 11½ | 11½       |
| 1986 Q4 | 10  | 10  | 11-12 11½ |

hpe59b

Tables

1. Money GDP at Market Prices
2. Real GDP at Factor Cost
3. GDP Deflator (Market Prices)
4. Growth in the Monetary Base (M0)
5. Growth in £M3
6. Short Term Interest Rates
7. Public Sector Borrowing Requirement
8. Real Earnings Growth
9. Productivity Growth: Manufacturing
10. Published Monetary Growth Ranges

TABLE 1

Money GDP at Market Prices

| % changes   | 1979-80 | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 | 1985-86 | 1986-87 | 1987-88 | 1988-89 |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| 1980 MTFS   | 17.5    | 17.1    | 12.0    | 9.6     | 10.7    |         |         |         |         |         |
| 1981 MTFS   |         | 13.0    | 10.5    | 9.6     | 9.7     | 9.9     |         |         |         |         |
| 1982 MTFS   |         |         | 10.5    | 9.8     | 9.7     | 9.6     |         |         |         |         |
| 1983 MTFS   |         |         |         | 8.3     | 7.9     | 8.5     | 7.6     | 6.6     |         |         |
| 1984 MTFS   |         |         |         |         | 8.0     | 7.9     | 6.8     | 6.1     | 5.6     | 5.2     |
| 1985 MTFS   |         |         |         |         |         | 6.9     | 8.3     | 6.5     | 5.8     | 5.0     |
| Latest Estimate<br>(Strike-adjusted<br>estimate in<br>brackets) | 19.8    | 14.0    | 10.1    | 9.4     | 7.8     | 7.3     | 8.7     |         |         |         |
|   |         |         |         |         | (7.9)   | (8.7)   | (7.5)   |         |         |         |

Annual Money GDP projections have been given since 1982.

TABLE 2

Real GDP at Factor Cost

| % changes                                    | 1979-80 | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 | 1985-86 | 1986-87 | 1987-88 | 1988-89 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| 1980 MTFS                                    | 0.7     | -2.2    | -0.2    | 1.2     | 2.9     |         |         |         |         |         |
| 1981 MTFS                                    |         | -3.9    | -0.4    | 1.4     | 2.3     | 2.2     |         |         |         |         |
| 1982 MTFS                                    |         |         | -0.9    | 1.7     | 2.6     | 2.6     |         |         |         |         |
| 1983 MTFS                                    |         |         |         | 0.9     | 2.4     | 2.6     | 2.3     | 1.8     |         |         |
| 1984 MTFS                                    |         |         |         |         | 2.5     | 3.2     | 2.4     | 2.0     | 2.0     | 2.0     |
| 1985 MTFS                                    |         |         |         |         |         | 2.2     | 3.5     | 1.9     | 2.0     | 1.9     |
| Latest Estimate                              | 2.7     | -3.8    | -0.1    | 2.3     | 3.2     | 2.5     | 3.7     |         |         |         |
| (Strike adjusted<br>estimate in<br>brackets) |         |         |         |         | (3.3)   | (3.7)   | (2.5)   |         |         |         |

Projections for real GDP at factor cost have been given in all published MTFS. However the annual path has not been made explicit and an average figure has always been given.

TABLE 3

GDP Deflator (Market Prices)

| % changes   | 1979-80 | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 | 1985-86 | 1986-87 | 1987-88 | 1988-89 |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| 1980 MTFS   | 16.4    | 19.5    | 12.1    | 8.2     | 7.5     |         |         |         |         |         |
| 1981 MTFS   |         |         | 10.8    | 8.0     | 7.2     | 7.5     |         |         |         |         |
| 1982 MTFS   |         |         | 11.2    | 7.8     | 6.9     | 6.7     |         |         |         |         |
| 1983 MTFS   |         |         |         | 7.2     | 5.4     | 5.6     | 5.1     |         |         |         |
| 1984 MTFS   |         |         |         |         | 5.2     | 4.6     | 4.2     | 3.9     | 3.5     | 3.1     |
| 1985 MTFS   |         |         |         |         |         | 4.4     | 5.0     | 4.4     | 3.5     | 2.9     |
| Latest Estimate<br>(strike-adjusted<br>estimate in<br>brackets) | 16.8    | 18.6    | 10.2    | 7.1     | 4.4     | 4.5     | 5.1     |         |         |         |
|   |         |         |         |         |         | (4.7)   |         |         |         |         |

Annual Projections of the GDP deflator have been given since 1982, but nothing in earlier years.

TABLE 4

Growth in the Monetary Base, MO

| % change<br>(on previous Q1) | 1981Q1 | 1982Q1 | 1983Q1 | 1984Q1 | 1985Q1 | 1986Q1 | 1987Q1 | 1988Q1 | 1989Q1 |
|------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| 1982 MTFS                    | 6.1    | 3.9    | 8.6    | 9.9    | 9.1    | 9.4    |        |        |        |
| 1983 MTFS                    |        | -2.7   | 7.1    | 6.4    | 5.9    | 4.9    | 3.9    |        |        |
| 1984 MTFS                    |        |        | 8.1    | 5.1    | 6.3    | 5.6    | 5.4    | 3.7    | 2.6    |
| 1985 MTFS                    |        |        |        | 4.8    | 5.0    | 3.5    | 5.1    | 5.2    | 4.1    |
| Latest Estimate              | 5.7    | -2.7   | 9.3    | 4.9    | 5.9    | 3.9    |        |        |        |

Projections for the monetary base have been given in the 1984 and 1985 versions of the MTFS.

TABLE 5

Growth in £M3

| % change<br>(on previous Q1) | 1980Q1 | 1981Q1 | 1982Q1 | 1983Q1 | 1984Q1 | 1985Q1 | 1986Q1 | 1987Q1 | 1988Q1 | 1989Q1 |
|------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| 1980 MTFS                    | 12.0   | 9.4    | 8.0    | 7.0    | 6.0    |        |        |        |        |        |
| 1981 MTFS                    |        | 17.9   | 8.0    | 7.0    | 6.0    |        |        |        |        |        |
| 1982 MTFS                    |        |        | 15.5   | 11.6   | 9.2    | 7.3    |        |        |        |        |
| 1983 MTFS                    |        |        |        | 9.7    | 9.0    | 8.8    | 7.5    |        |        |        |
| 1984 MTFS                    |        |        |        |        | 8.7    | 9.2    | 8.2    | 7.9    | 7.0    | 6.0    |
| 1985 MTFS                    |        |        |        |        |        | 9.5    | 8.0    | 7.2    | 6.2    |        |
| Latest Estimate              | 14.3   | 17.9   | 16.4   | 13.3   | 8.1    | 12.2   | 14.3   |        |        |        |

Illustrative ranges for £M3 were published in all MTFS.

TABLE 6

Short Term Interest Rates  
(3 Month Interbank Rates)

| Per cent        | 1979-80 | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 | 1985-86 | 1986-87 | 1987-88 | 1988-89 |
|-----------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| 1980 MTFS       | 14.9    | 14.0    | 9.3     | 9.0     | 8.5     |         |         |         |         |         |
| 1981 MTFS       |         | 15.5    | 12.2    | 11.5    | 9.9     |         |         |         |         |         |
| 1982 MTFS       |         |         | 14.2    | 13.5    | 11.9    | 10.2    |         |         |         |         |
| 1983 MTFS       |         |         |         | 11.3    | 9.6     | 7.8     | 7.4     |         |         |         |
| 1984 MTFS       |         |         |         |         | 9.7     | 8.7     | 7.8     | 6.8     | 6.1     | 5.8     |
| 1985 MTFS       |         |         |         |         |         | 10.9    | 11.9    | 10.0    | 9.3     | 8.5     |
| Latest Estimate | 14.9    | 15.5    | 14.2    | 11.5    | 9.7     | 10.9    | 11.7    |         |         |         |

No forecasts of these interest rates have been published.



TABLE 7

Public Sector Borrowing Requirement

£ million and per cent of GDP in brackets

|                            | 1979-80        | 1980-81        | 1981-82       | 1982-83       | 1983-84       | 1984-85        | 1985-86      | 1986-87      | 1987-88      | 1988-89      |
|----------------------------|----------------|----------------|---------------|---------------|---------------|----------------|--------------|--------------|--------------|--------------|
| 1980 MTFS                  | 9120<br>(4¾)   | 8500<br>(3¾)   | 7429<br>( 3)  | 6331<br>(2¾)  | 4638<br>(1½)  |                |              |              |              |              |
| 1981 MTFS                  |                | 13455<br>( 6)  | 10584<br>(4¾) | 8879<br>(3¾)  | 5991<br>( 2)  | 3263<br>( 1)   |              |              |              |              |
| 1982 MTFS                  |                |                | 10627<br>(4¾) | 9509<br>(3½)  | 8428<br>(2¾)  | 6734<br>( 2)   |              |              |              |              |
| 1983 MTFS                  |                |                |               | 7510<br>(2¾)  | 8193<br>(2¾)  | 7993<br>(2½)   | 6968<br>( 2) | 6437<br>(1¾) |              |              |
| 1984 MTFS                  |                |                |               |               | 10000<br>(3¾) | 7190<br>(2¾)   | 7034<br>( 2) | 7032<br>( 2) | 6828<br>(1¾) | 7237<br>(1¾) |
| 1985 MTFS                  |                |                |               |               |               | 10498<br>(3¾)  | 7070<br>( 2) | 7536<br>( 2) | 6985<br>(1¾) | 7320<br>(1¾) |
| Latest Estimate            | 10020<br>(4.8) | 12680<br>(5.4) | 8629<br>(3.3) | 8865<br>(3.1) | 9735<br>(3.2) | 10238<br>(3.1) | 8000<br>(2¾) |              |              |              |
| [Adjusted for coal strike] |                |                |               |               |               | [2.3]          | [ 2]         |              |              |              |

Projections of the PSBR ratio have been given in all MTFS versions

TABLE 8

Real Earnings (Average Earnings/RPI)

Index 1980-81 = 100

|                 | 1979-80 | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 | 1985-86 | 1986-87 | 1987-88 | 1988-89 |
|-----------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| 1980 MTFS       | 99.3    | 100.0   | 100.4   | 100.3   | 100.5   |         |         |         |         |         |
| 1981 MTFS       |         | 100.0   | 99.0    | 95.5    | 98.6    |         |         |         |         |         |
| 1982 MTFS       |         |         | 99.2    | 100.8   | 101.9   | 103.2   |         |         |         |         |
| 1983 MTFS       |         |         |         | 100.9   | 103.1   | 104.4   | 105.5   | 106.1   |         |         |
| 1984 MTFS       |         |         |         |         | 103.4   | 106.4   | 109.5   | 110.8   | 111.6   | 111.9   |
| 1985 MTFS       |         |         |         |         |         | 105.4   | 107.8   | 110.0   | 111.5   | 112.8   |
| Latest Estimate | 98.4    | 100.0   | 99.5    | 101.7   | 104.7   | 105.7   | 108.3   |         |         |         |

No forecasts for real earnings have been given.

TABLE 9

Productivity Growth: Manufacturing Sector

| Percentage     | 1979-80 | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 | 1985-86 | 1986-87 | 1987-88 | 1988-89 |
|----------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| 1980 MTFS      | -       | 0.8     | 1.3     | 2.6     | 2.9     |         |         |         |         |         |
| 1981 MTFS      |         | -4.7    | 6.0     | 2.8     | 1.3     |         |         |         |         |         |
| 1982 MTFS      |         |         | 8.2     | 6.2     | 1.9     | 1.7     | 1.9     |         |         |         |
| 1983 MTFS      |         |         |         | 4.5     | 4.7     | 3.2     | 1.6     | 1.2     |         |         |
| 1984 MTFS      |         |         |         |         | 6.5     | 4.2     | 2.6     | 2.8     | 2.7     | 2.7     |
| 1985 MTFS      |         |         |         |         |         | 4.5     | 1.5     | 0.5     | 0.6     | 1.7     |
| Latest Outturn | 1.1     | -5.0    | 7.2     | 5.8     | 8.2     | 5.0     | 3.2     |         |         |         |

No projections for productivity growth have been published.

TABLE 10

Published Ranges for Monetary Growth

| Percentage     | 1980-81 | 1981-82 | 1982-83 | 1983-84 | 1984-85 | 1985-86 | 1986-87 | 1987-88 | 1988-89 |
|----------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| <u>(a) £M3</u> |         |         |         |         |         |         |         |         |         |
| 1980 MTFS      | 7-11    | 6-10    | 5-9     | 4-8     |         |         |         |         |         |
| 1981 MTFS      |         | 6-10    | 5-9     | 4-8     |         |         |         |         |         |
| 1982 MTFS      |         |         | 8-12    | 7-11    | 6-10    |         |         |         |         |
| 1983 MTFS      |         |         |         | 7-11    | 6-10    | 5-9     |         |         |         |
| 1984 MTFS      |         |         |         |         | 6-10    | 5-9     | 4-8     | 3-7     | 2-6     |
| 1985 MTFS      |         |         |         |         |         | 5-9     | 4-8     | 3-7     | 2-6     |
| <u>(b) M0</u>  |         |         |         |         |         |         |         |         |         |
| 1984 MTFS      |         |         |         |         | 4-8     | 3-7     | 2-6     | 1-5     | 0-4     |
| 1984 MTFS      |         |         |         |         |         | 3-7     | 2-6     | 1-5     | 0-4     |

In the 1982 and 1983 versions of the MTFS, the published ranges for £M3 were also intended to apply to M1 and to PSL2.



C/

TIN

The German delegate at the TIC has told the UK that French and German Finance ministers are going to the Hague tomorrow to discuss tin.

Sir G. Lillier is ringing his French and German deputy colleagues to put a shot across their bows by warning them that you may raise tin at the GS.

John

Ra 15/1

COMMITTEE OF GOVERNORS OF THE CENTRAL BANKS  
OF THE MEMBER STATES  
OF THE EUROPEAN ECONOMIC COMMUNITY

THE CHAIRMAN

Basle, 14th January 1986

Express - Confidential

The Rt. Hon. Nigel Lawson, P.C. M.P.  
Chancellor of the Exchequer  
Great George Street  
London SW1

| CH/EXCHEQUER      |                    |
|-------------------|--------------------|
| REC.              | 16 JAN 1986 ✓ 16/1 |
| <del>ACTION</del> | Mr C. Kelly        |
| COPIES TO         | EST, MDT           |
|                   | Sir P. Middleton   |
|                   | Sr G. Littler      |
|                   | Mr Lavelle         |

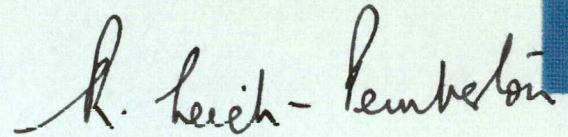
Mr FITCHER  
Mr MOUNTFIELD

Mr MATTHEWS  
Mr LETT

My dear Minister,

I have pleasure in enclosing a copy of the brief report on developments during December 1985 on the foreign exchange markets of the countries whose central banks participate in the concertation procedure. This report was approved by the Committee of Governors at its meeting on Tuesday, 14th January 1986.

Yours sincerely,



R. Leigh-Pemberton

Enclosure

BRIEF REPORT ON  
DEVELOPMENTS ON THE FOREIGN EXCHANGE MARKETS OF THE COUNTRIES  
WHOSE CENTRAL BANKS PARTICIPATE IN THE CONCERTATION PROCEDURE

---

DECEMBER 1985

---

This report summarises developments on the exchange markets of the countries whose central banks participate in the concertation procedure\* and briefly describes their interventions during December and the first few days of January 1986.

I. DEVELOPMENT OF EXCHANGE RATES

The main features of the foreign exchange markets in December were:

- a further weakening of the dollar;
- a continued pressure within the EMS;
- downward pressure on sterling and the Canadian dollar.

The US dollar traded steadily against most other major currencies until late December. It then declined to its lowest levels in two and a half years against the Deutsche Mark and five years against the Japanese yen and closed the month about 2 per cent. lower on balance. The dollar was supported early in the period by the widespread view among market participants that the G5 monetary authorities wished to avoid further declines in the near term. At the same time the dollar was expected to fall over the longer term, mainly because slowing economic growth was thought likely to

---

\*The central banks of the EEC, Norway, Sweden, Switzerland, Japan, Canada and the United States.

provide scope for continued interest rate declines in the United States. In fact during December the domestic capital markets again rallied strongly, with the yield on the 10-year treasury bond dropping about 75 basis points to slightly over 9 per cent. by mid-month. In these circumstances the dollar fell sharply in the final week of the year when some light commercial selling in seasonally thin trading pushed it through the bottom of its trading range.

Market speculation over a near-term realignment kept EMS exchange rate relationships under pressure in December and brought about significant changes in relative positions. The band's 2 1/4 per cent. required limit was reached in the middle of the month as the Belgian franc touched its floor against the French franc. During the month the Deutsche Mark and the Dutch guilder rose gradually to join the French franc at the top of the system.

The Deutsche Mark firmed vis-à-vis all major currencies; only against the Italian lira did its exchange rate remain unchanged. Vis-à-vis the US dollar it strengthened from around DM 2.51 to around DM 2.46, despite considerable intervention sales of Deutsche Mark, mainly by EMS central banks. Deutsche Mark sales against US dollars were also made by the Bundesbank in the forward market, thus closing its open position arising out of forward dollar sales carried out several months earlier. In the EMS the Deutsche Mark rose to the top of the exchange rate band, having held a middle position at the end of the previous month. On 30th December its trade-weighted index stood at an all-time high of 156.6 (1972 = 100).

While appreciating against the major floating foreign currencies, the French franc felt the strength of the Deutsche Mark and gave way slightly within the Community's band, declining to third place in the middle of the period. Some disinvestment on the part of non-residents was observed and there was a rise in euro-franc market rates for maturities of one month and longer.

The Belgian franc weakened against most Community currencies. In the case of the Deutsche Mark the differential increased from 1 3/8 per cent. to over 2 per cent. Several times it reached its floor vis-à-vis the French franc. The National Bank of Belgium increased short-term interest rates and also intervened in substantial amounts.



The Dutch guilder moved in line with the Deutsche Mark as both currencies rose within the EMS to join the French franc near the top of the intervention band.

The Danish krone remained in the upper part of the narrow EMS band. It was supported by continued private capital imports despite a decline in interest rates.

The Irish pound continued to weaken in the EMS band, reflecting heavy commercial demand for foreign currency. The Central Bank of Ireland undertook significant intervention support throughout the month.

The Italian lira moved in a narrow range within the upper part of the band, firming during most of the month as the Bank of Italy stabilised the rate of their currency vis-à-vis the Deutsche Mark. Because of rumours in the markets of an impending EMS realignment the Bank of Italy intervened, selling large amounts of dollars and Deutsche Mark.

Sterling weakened sharply over the month as a whole. After reaching a 26-month high of US\$ 1.5020 on 2nd December, sterling fell against all major currencies as concerns re-emerged over future oil prices and the spot oil price fluctuated widely. Although sterling continued to draw some support from the perception that UK interest rates would remain firm, the pound remained sensitive to oil price developments. Sterling's trade-weighted index fell by 4.2 to 77.9.

During December the Greek drachma rose 0.8 per cent. against the dollar, declined 0.4 per cent. against the ECU, and depreciated 0.4 per cent. on an effective basis.

In an uneventful market the Swiss franc continued its weakening trend, especially against the Deutsche Mark. On a trade-weighted basis it lost 0.7 per cent.

Supported by a continued currency inflow - although somewhat smaller than in recent months - the Swedish krona stayed firm against its currency index around the level of 130.6.

The Norwegian krone weakened by about 0.5 per cent. in effective terms and the Bank of Norway sold US dollars to cover the deficit in the exchange market.

The Canadian dollar remained under downward pressure in December, closing 1.2 per cent. down over the month against the US dollar. Market

sentiment remained negative with the year-end remittance of profits and dividends to foreign corporations and sales of Canadian securities by foreign investors tending to dominate a thin and volatile market. Leads and lags on commercial settlements and speculative sales added to the downward pressure on the currency. The spread on short-term money market rates in Canada and the United States widened by about 0.75 percentage point in Canada's favour during the month.

The Japanese yen was relatively stable against the US dollar during December. Early in the month, it weakened to around Yen 204 in response to an anticipated decline in yen interest rates. However, at that level, expectations of further intervention by the authorities kept the yen from weakening further. Later in the month the yen hovered around the Yen 203 level as concerns over declines in yen and dollar interest rates tended to offset one another. At the end of the month it benefited from the sudden firming of the Deutsche Mark and rose to Yen 200. The yen also showed stability against other currencies.

## II. INTERVENTIONS

### A. Interventions in US dollars

In December net dollar sales by central banks amounted to US\$ 2.8 billion, the same amount as in November. The principal sellers during the last month were the central banks of Italy, Canada and Norway. The Deutsche Bundesbank was the largest buyer.

### B. Interventions in Community currencies

Gross intervention in Community currencies and ECUs amounted to US\$ 4.3 billion equivalent and principally reflected intramarginal sales of Deutsche Mark by the Bank of Italy and the Bank of France.

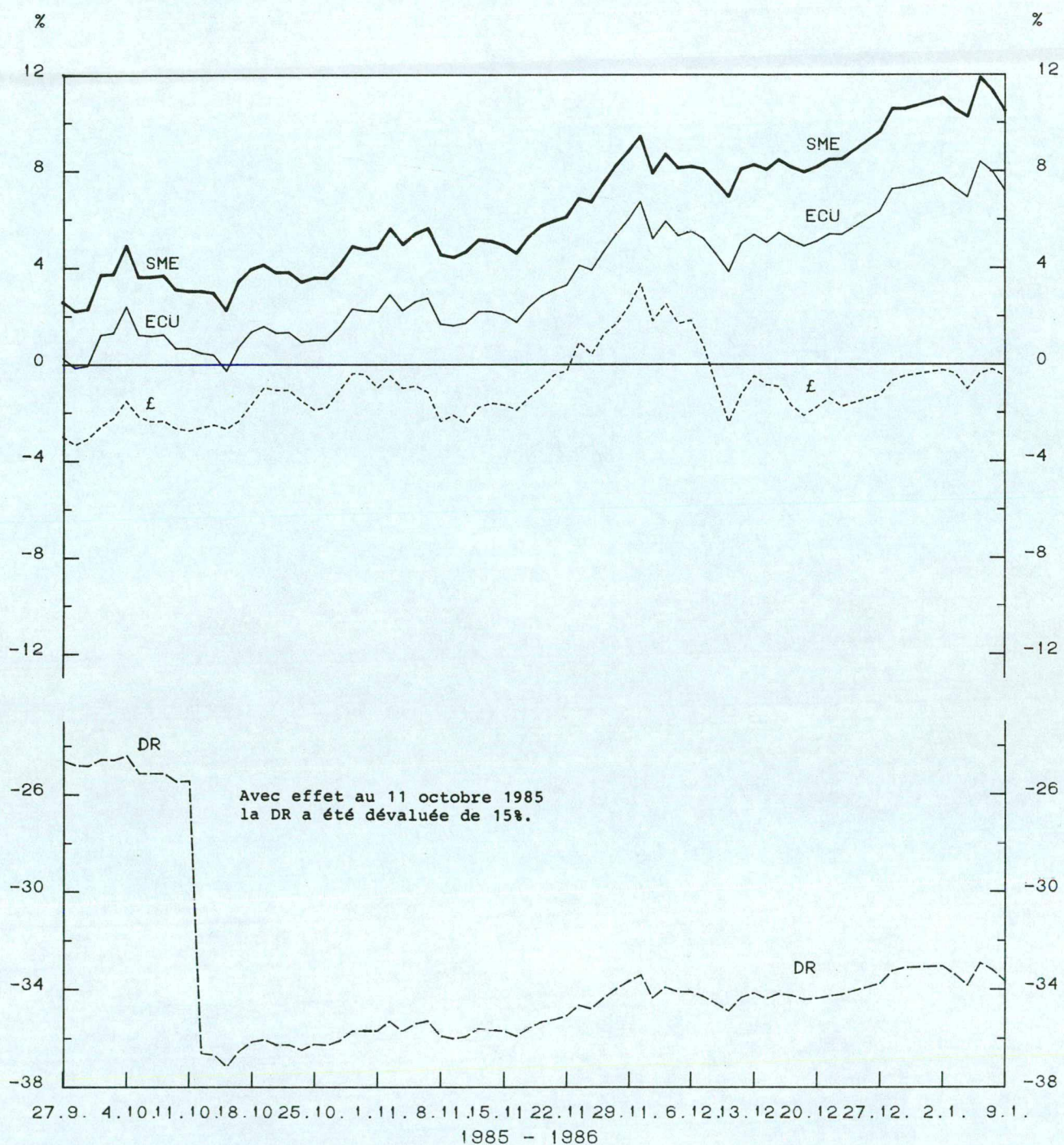
## III. THE FIRST FEW DAYS OF JANUARY 1986

The dollar fluctuated widely in the early days of January. After falling to new lows, the dollar rallied, particularly after news of

stronger-than-expected employment data led to a reassessment of the performance of the economy and of the outlook for interest rates in the United States. Rumours of Arab disinvestment out of the United States, especially after the announcement of a freeze of Libyan government assets, precipitated a sharp but short-lived fall in the dollar.

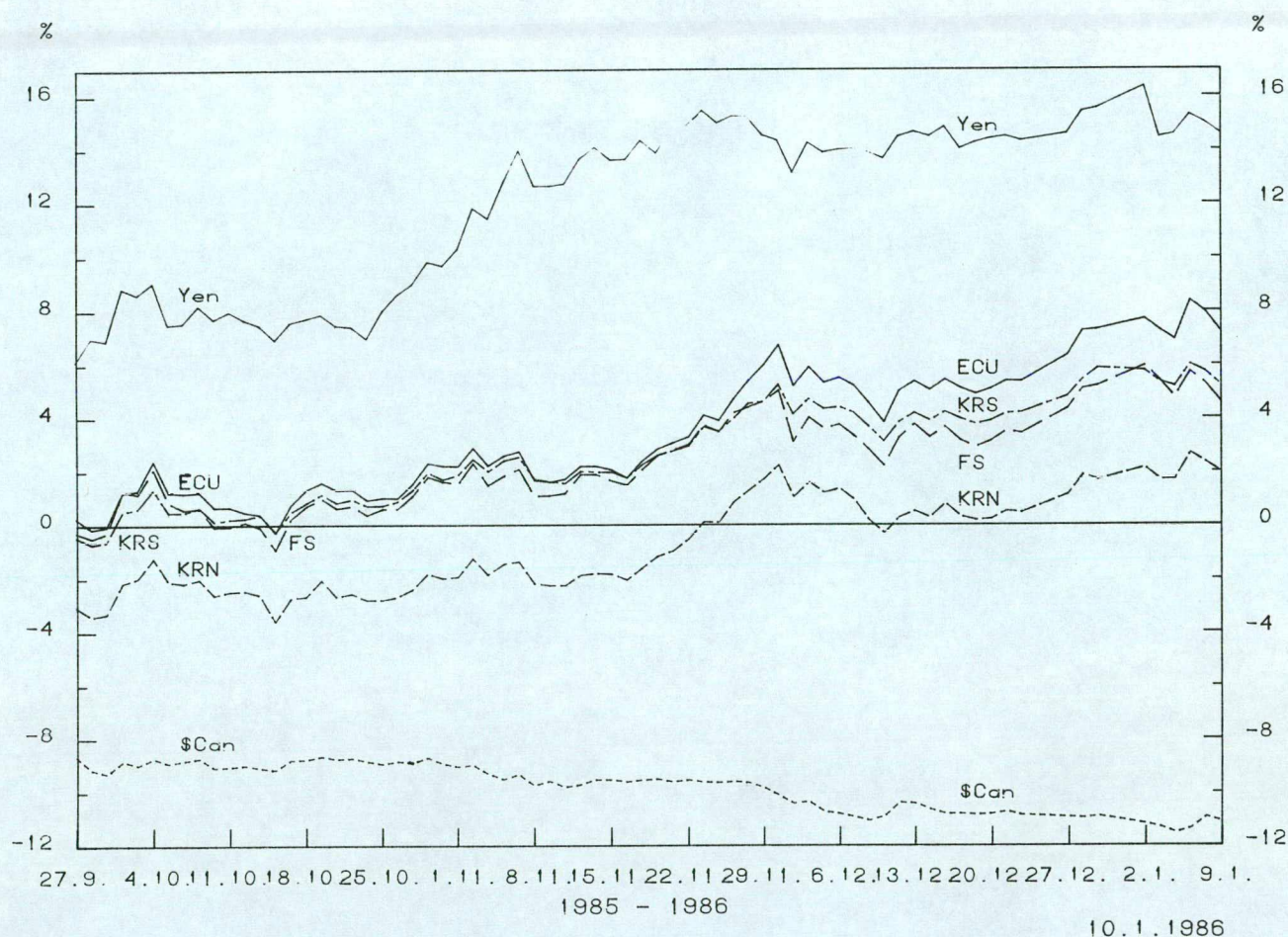
Both sterling and the Canadian dollar remained under downward pressure at the start of the year but then recovered in response to sharp UK and Canadian interest rate increases. In the EMS, several participating central banks continued to sell sizable amounts of Deutsche Mark and dollars to keep their currencies steady against the Deutsche Mark.

EVOLUTION DE L'ECU, DU COURS MEDIAN DES MONNAIES PARTICIPANT AU MECANISME DE CHANGE DU SME ET DES MONNAIES DES BANQUES CENTRALES DE LA CEE NE PARTICIPANT PAS A CE MECANISME, SUR LA BASE DES COURS RELEVES LE 30 DECEMBRE 1983 VIS-A-VIS DU \$EU \*



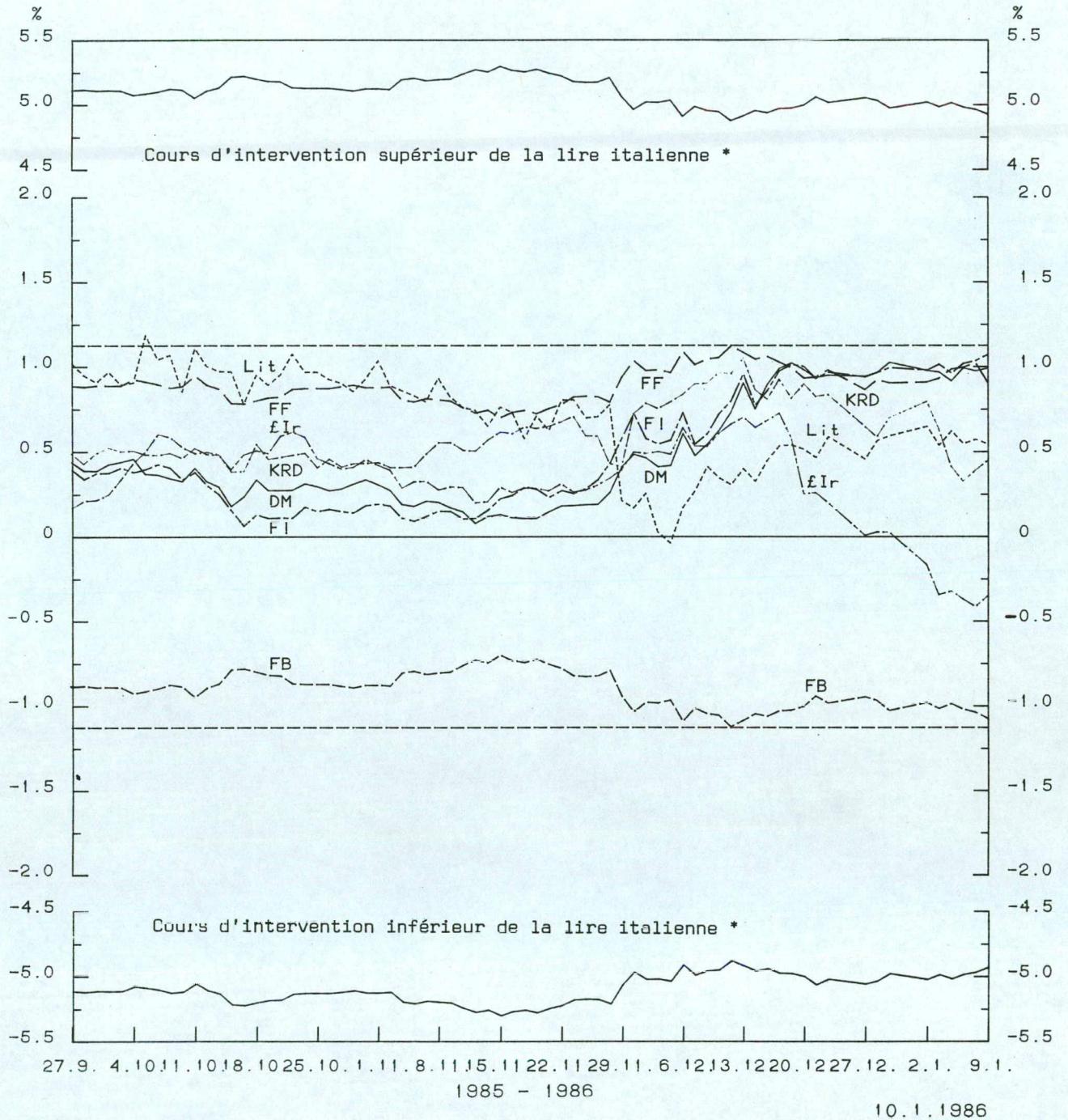
\* voir page suivante

EVOLUTION DE L'ECU ET DES MONNAIES DES BANQUES CENTRALES HORS CEE  
PARTICIPANT A LA CONCERTATION, SUR LA BASE DES COURS RELEVES LE  
30 DECEMBRE 1983 VIS-A-VIS DU \$EU \*



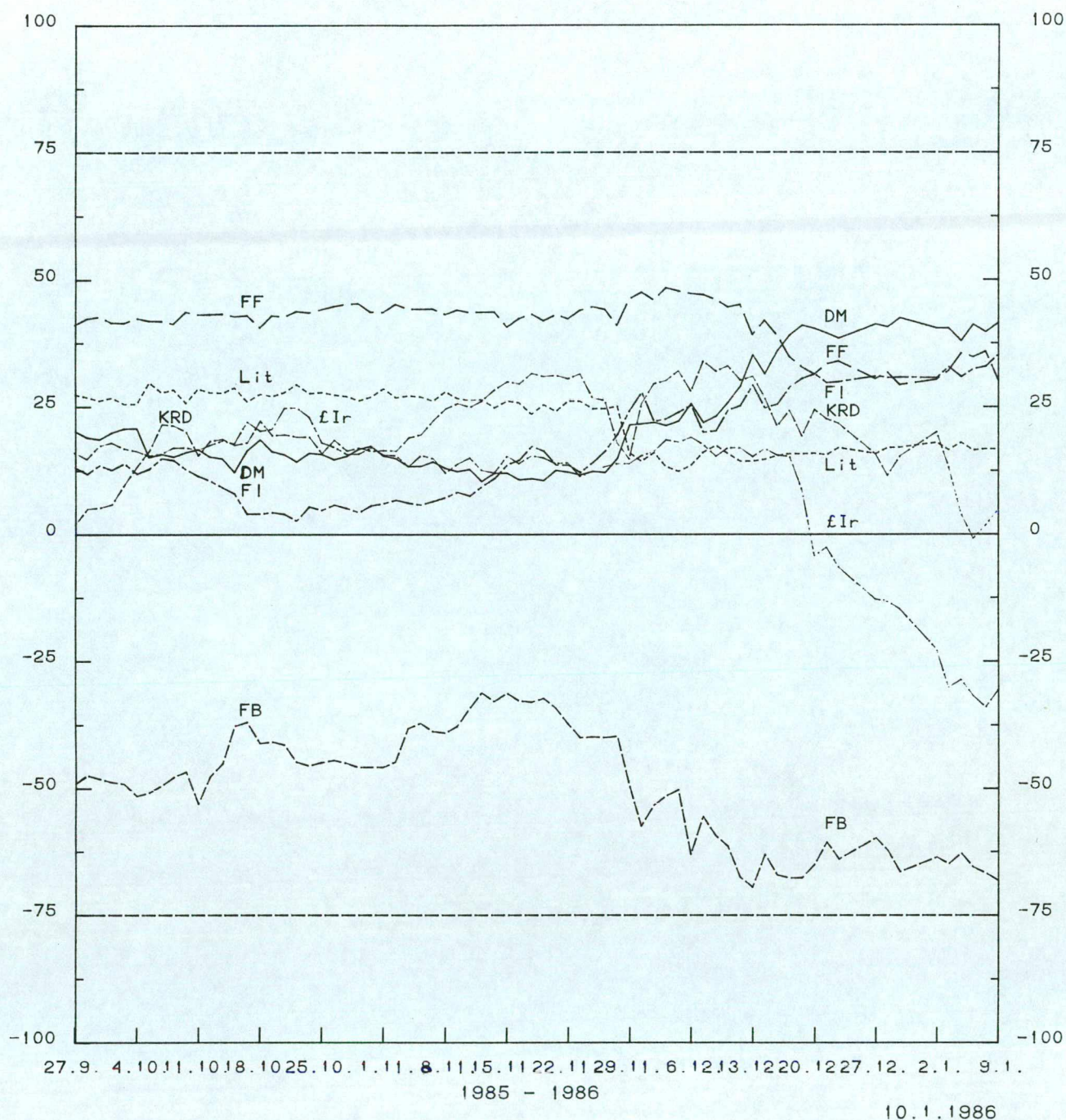
\* ECU 0,82737; £ 0,68970; DR 98,8401; \$Can 1,2452; FS 2,1805;  
Yen 231,75; KRS 8,0085; KRN 7,7125; cours médian des monnaies  
participant au SME 0,8149. Le cours médian des monnaies participant  
au SME représente la moyenne journalière des cours des deux  
monnaies à marge de fluctuation de 2,25%, exprimés en dollars EU,  
qui se sont éloignés le plus de leurs cours-pivots bilatéraux  
actuels.

MOUVEMENTS A L'INTERIEUR DE LA GRILLE DE PARITES DU SME CALCULES SUR LA BASE DES COURS DE L'ECU DANS LES DIFFERENTES MONNAIES PARTICIPANTES



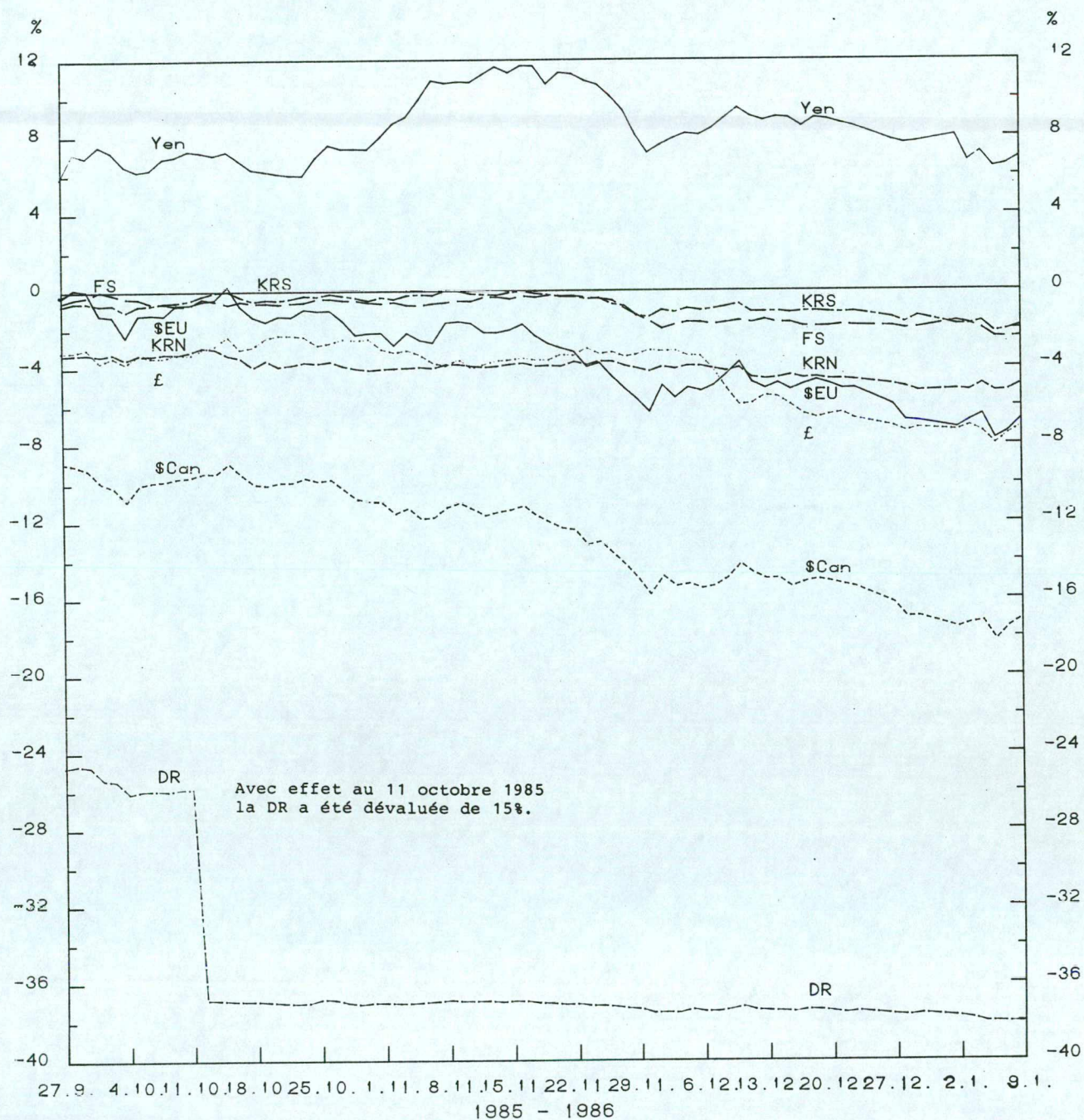
\* Les cours d'interventions supérieur et inférieur de la lire italienne représentent l'écart maximal théorique par rapport à la monnaie la plus faible respectivement la plus forte dans la bande de fluctuation étroite de  $\pm 2,25\%$ .

## EVOLUTION DE L'INDICATEUR DE DIVERGENCE \*



\* L'indicateur de divergence a pour but de mesurer, sur une base comparable pour toutes les monnaies participant au mécanisme de change européen, la position d'une monnaie vis-à-vis de son cours-pivot ECU. L'écart maximal de divergence est le pourcentage maximal par lequel le cours de marché de l'ECU dans chaque monnaie peut s'apprécier ou se déprécier par rapport à son cours-pivot ECU; il est exprimé par  $\pm 100$ , le seuil de divergence étant  $\pm 75$ . Les données qui ont servi de base à l'établissement de ce graphique sont les cours de l'ECU exprimés en termes de diverses monnaies, cours qui sont toutefois corrigés des effets des fluctuations de la lire italienne et de la livre sterling au-delà de la marge de 2,25% vis-à-vis des autres monnaies participant au SME.

EVOLUTION DE LA LIVRE STERLING, DE LA DRACHME ET DES MONNAIES DES  
BANQUES CENTRALES HORS CEE PARTICIPANT A LA CONCERTATION PAR RAPPORT A  
L'ECU SUR LA BASE DES COURS DU MARCHÉ RELEVÉS LE 30 DECEMBRE 1983 \*



\* £ 0,5706; DR 81,7773; \$EU 0,82737; \$Can 1,03024; FS 1,80408;  
Yen 191,743; KRS 6,62599; KRN 6,38109.

10.1.1986



SECRET



SIR G LITTLER

FROM P WYNN OWEN  
DATE 14 January 1986cc Sir P Middleton  
Sir T Burns  
Mr Fitchew  
Mr Culpin

G5

You and copy recipients attended a meeting with the Chancellor at 2.30 pm on 13 January 1986 at No.11.

The Chancellor said IDT confirmation of the G5 meeting had been most unfortunate. It set an awful precedent and put him in a very awkward position with his G5 colleagues. One lesson might be that such knowledge should be confined to the head of IDT in future. Sir Geoffrey Littler and Mr Culpin would consider ways in which this might be done, so as to ensure it did not reoccur.

On press handling, the press had already been told it would be a routine, private meeting, with no press conference and no significant communique. The press were not yet aware of the venue. It was agreed that they should be told on Saturday morning, with requests to send photographers being granted.

Treasury First Order Questions on Thursday included a question on the next G5 which was likely to be reached. The Chancellor would seek to agree with the Conservative backbencher concerned that he would give a fairly non-committal answer, but follow up with a full answer to the supplementary, if the backbencher would inform him of it in advance.

On US attendance, the Chancellor asked Sir Geoffrey Littler to check with opposite numbers in Germany, France and Japan,



but he was strongly of the view that the US G5 party should be restricted to three in total, not four. It would be most unfortunate if an ugly scene arose with Baker arriving with both Mulford and Darman. Sir Geoffrey Littler confirmed his invitation was explicitly for three, plus an interpreter in the French and Japanese cases.

On exchange rates it was agreed that the UK view would be that the appreciation of the yen and depreciation of the dollar both had further to go, although that did not necessarily mean action here and now. Sir Geoffrey Littler reported that the Bank story from the bankers' meeting at Basle was that the Fed wanted a pause. But Volcker's line might not be the same as Baker's.

On US policy the Chancellor said he would ask Baker to report on US protectionist prospects and progress in reducing the budget deficit. Baker would ask in return for compensatory increases in deficits by the others, which meant Germany and Japan. This was a non sequitur. But the UK should support him in putting pressure on the Japanese, though he was not so sure as regards the Germans. He would like to remind the Japanese and Germans of their Plaza promises that their domestic demand would be internally, rather than externally, generated. Some key basic figures on respective countries deficits, growth etc. would be most useful, covering recent years not simply months.

On interest rates, the Japanese, French and also possibly Secretary Baker would be interested in concerted interest rate reductions. The Germans would be against but the UK line should be more positive. It might well be possible to suggest, without taking the lead, that the US might be able to reduce interest rates a little ahead of the forthcoming reductions in its budget deficit. Reductions in US rates were necessary to lead the



rest down. The US could afford to take a slight risk this year with inflation, given falling commodity and oil prices. The UK could do with a little such short-term relief.

The UK should try to focus the meeting more on interest rates than fiscal deficits. On deficits, the US deficit must come down, and if so, the Japanese and Germans should be encouraged not to reduce further their deficits. On exchange rates, the yen was still too low and the dollar too high.

Several other issues were discussed:

(i) Japanese trade liberalisation - primarily for the US to lead, though the UK should support.

(ii) International debt - doubtless this would figure and briefing would be necessary.

(iii) Oil price risks - the G5 meeting should discuss the effect that any oil price collapse would have on the world economic scene. The purpose should be to warn the US there should be no comments about substantial oil price reductions being a good thing. Indeed, it would be useful if the US could be persuaded to say they had no wish to see an oil price collapse (because of the consequences for major debtors and hence US banks).

(iv) Expansion of G5 - this should be discussed at the G5, more in terms of handling Italian and Canadian requests for membership, since it seemed unlikely that any present members would want to enlarge the group.

(v) Tin - bilaterals may be necessary, depending on the state of play.



(vi) South Africa - the Chancellor was not inclined to raise this, but he would need a brief in case someone else did.

(vii) Channel Fixed Link - given that the Prime Minister was to meet Mitterand on 20 January, the Chancellor wondered whether it was worth having a word with Monsieur Beregovoy to see whether the two Finance Ministers had some common interest in sanity. Sir Geoffrey Littler agreed to check on this and arrange a brief as appropriate. Obviously government, guarantees, either express or implicit, had to be avoided at all costs, but it was also vital to ensure that a drive-through element was avoided.

A handwritten signature in cursive script, appearing to read "P. Wynn Owen".

P WYNN OWEN



FROM: P WYNN OWEN

DATE: 14 January 1986

SIR G LITTLER

**G5 - BAKER BILATERAL**

I spoke to the Chancellor about a bilateral with Secretary Baker. He has decided to give Baker breakfast on the Sunday. There is no need for a US expert on their sanctions against Libya to be present, and the Chancellor thinks the bilateral would probably be best tête-à-tête, but if Baker wants to bring Mulford the Chancellor would not object and would then ask you to attend too.

A handwritten signature in dark ink, appearing to be "P. Wynn Owen".

P WYNN OWEN

CONFIDENTIAL

GPS 190

CONFIDENTIAL

FM ROME

TO PRIORITY FCO

TELNO 026

OF 140800Z JANUARY 86

INFO PRIORITY BONN, PARIS, TOKYO, WASHINGTON

MYTELNO 005: G5 MEETINGS

1. SATURDAY'S ITALIAN PRESS CARRIED A REPORT THAT A TREASURY SOKESMAN HAS CONFIRMED THAT THERE WILL BE A MEETING OF G5 FINANCE MINISTERS ON 18/19 JANUARY IN LONDON TO FOLLOW UP THE 22 SEPTEMBER MEETING IN NEW YORK.

2. IT IS A PITY THAT THIS MEETING HAS BEEN PUBLICLY ANNOUNCED. GIVEN ITALIAN SENSITIVITIES ON THIS QUESTION I WOULD NOT BE SURPRISED TO BE SUMMONED TO RECEIVE A FURTHER ITALIAN PROTEST ABOUT THEIR EXCLUSION.

3. IN THAT CASE AND UNLESS I HEAR TO THE CONTRARY, I PROPOSE TO TAKE THE GENERAL LINE THAT THE EXTENT TO WHICH THEIR CURRENCIES ARE TRADED INTERNATIONALLY AND THE INFLUENCE WHICH THEIR FINANCIAL MARKETS SHARE DOES GIVE THE FIVE A SPECIAL RESPONSIBILITY AND COMPETENCE IN THE CONDUCT OF WORLD MONETARY AFFAIRS. NEITHER THE LIRA NOR THE ITALIAN FINANCIAL MARKET HAS A SIMILAR ROLE.

4. HAVE ANY OF OUR G5 PARTNERS YET REPLIED TO CRAXI'S RECENT MESSAGE?

BRIDGES

MONETARY  
WED  
ERD

CONFIDENTIAL

**SECRET**

From: Sir G.Littler  
Date: 15 January 1986

**CHANCELLOR**

c.c. Sir P.Middleton  
Sir T.Burns  
Mr Fitchew  
Governor (B/E)

**G5 MEETING: STEERING BRIEF**

I attach:

- Annex 1: a programme
- Annex 2: the agenda as given so far to our visitors
- Annex 3: a fuller annotated agenda for you
- Other Annexes on particular subjects.

**Bilateral Meetings**

2. You have arrangements for all Ministers except Beregovoy. The one point you thought you might want to mention to him in the margins of the meeting is the Fixed Link (I believe Mr Gilmore is letting you have a note separately). Other Ministers are included in the attached programme.

**Prior Meeting of Deputies**

3. I am holding a short meeting with other Deputies Saturday afternoon (3 p.m. in my office, ending by 4.45 p.m.) which will enable me:

- to check the agenda and warn you later of any special points raised by others;
- if you agree: to show them a draft line to take for the press, emphasising that this is not a communique;
- again if you agree: to show them our draft letter for the Prime Minister to send to Signor Craxi, and see whether they have any comments.

## Agenda

3. For your introductory remarks, after appropriate welcome, you may want to say a few words about publicity:

- regret early outbreak of publicity: our confirmation last Thursday was a response: we have given line of this meeting being private, routine, with no press conference and no significant press communique;
- hope reporters will not trouble us during meetings: and obviously no comment if they do;
- discuss line to take under Item 3: do we agree now that there should be no communique?

4. All have typed agenda (Annex 2). Pause to ask if agreed and whether any additional points. Suggest we can take more or less in order given, but note that Items 1 (c) and (d) will need to be linked with Item 3. Suggest aim to get as much as we can of Item 1 covered Saturday night.

### Substantive Discussion

5. The special annotated agenda (Annex 3 - which others do not have) and the subject briefs mentioned in it cover the main ground. But you might just like to have a check-list of our U.K. objectives as set out immediately below.

(Geoffrey Littler)



Dawson (Baker/Vischer?)

111

SECRET

ANNEX 1

PROGRAMME

Friday 17 January:

11.45 a.m. - Bilateral with Takeshita (+ Oba and Littler)  
(Separate brief being submitted)

Saturday 18 January:

*5.30 pm* *Sr G. Littler?*  
6.00 p.m. - Bilateral with Stoltenberg (alone)  
(No separate brief proposed)

7.00 p.m. - General arrivals: drinks in small sitting-room  
*(word with Baker to stop grass idea)*  
7.30 p.m. - Dinner and discussion at table: aiming to end  
around 10 p.m. (visitors know this)

Sunday 19 January:

*8 for 8.15* 8.00 p.m. - Bilateral breakfast with Baker (alone)  
~~8.00 p.m.~~  
No separate brief proposed - among other things a good opportunity to raise the issue of the IBRD Presidency;  
*Group for 4 (but probably 2) confirm after drinks*  
9.00 p.m. - Main meeting resumes in drawing-room upstairs (Baker to leave not later than 12.15 p.m. and others know this)

*12.30 for 1?* 12.15 p.m. - Drinks and buffet lunch, probably for all but the U.S. team (subject to confirmation)  
*12.15 for 12.45*

Departures:

*\* Coffee in sitting room?*  
U.S. team leave Heathrow about 1.30 p.m. for Washington

Japanese leave by 7.00 p.m. Concorde for New York

Germans probably private flight early afternoon

French probably same as Germans

AGENDA FOR 18/19 JANUARY MEETING

**1. Follow-up to Plaza Meeting:**

- (a) intervention;
- (b) underlying policies, performance and prospects of the G5 countries;
- (c) strengthening the process of co-operation among G5;
- (d) implications for wider discussions of G10 Report in the April IMF/IBRD Meetings.

**2. International Debt:**

- (a) review of general developments since Seoul;
- (b) progress on the three elements of the debt initiative:
  - economic policies of debtors;
  - multilateral development banks;
  - commercial banks;
- (c) next steps in implementing the debt initiative.

**3. Press and de-briefing:**

- (a) Agreed line to take with the press;
- (b) Special de-briefing arrangements (Italy, Canada, IMF, European Colleagues)
- (c) Replies to Italian (and ? Canadian) representations.

## AGENDA FOR 18/19 JANUARY MEETING

## Introduction

Host's proposals for handling agenda (Steering Brief)

## 1. Follow-up to Plaza Meeting:

- (a) intervention: (Annex 4: Spare copies of table of figures with Littler for circulation if needed);
- (b) underlying policies, performance and prospects of the G5 countries: (Annex 5);
- (c) strengthening the process of co-operation among G5: (Annex 6 - invite Baker to open, take comments, but possibly arrange to revert in context of Item 3);
- (d) implications for wider discussions of G10 Report in the April IMF/IBRD Meetings: (Annex 6 - this also may need to be merged with Item 3);

## 2. International Debt: (Annex 7)

- (a) review of general developments since Seoul: (Invite Baker and Volcker to open and lead into immediately following points);
- (b) progress on the three elements of the debt initiative:
  - economic policies of debtors (Annex 7a);
  - multilateral development banks (Annex 7b);
  - commercial banks (Annex 7c);
- (c) next steps in implementing the debt initiative (Annex 7d).
- (-) not on circulated agenda: oil price prospects and the impact on debtors and major economies (Annex 8); and tin might be worth mention here (see below)

**SECRET**

**3. Press and de-briefing:**

- (a) Agreed line to take with the press: (Annex 9);
- (b) Special de-briefing arrangements for, e.g. Italy, Canada, IMF, European Colleagues: this links with -
- (c) Replies to Italian (and ? Canadian) Prime Minister and Finance Minister: (Separate Brief)

**4. Other Points (not on circulated agenda):**

- (a) Tin: (Annex 10) - perhaps over lunch on Sunday if all but U.S. (not in the ITC) are to be present - but worth touching on earlier in presence of U.S. who might well support the argument against anything resembling a "default";
- (b) Defensive Points: in case others raise these points we have short notes (Annex 11) on South Africa and Libya.

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**IMMEDIATE**

US ECONOMY: UPDATE

SUMMARY

1. LATEST FIGURES SUGGEST SLIGHTLY BROADER-BASED RECOVERY. REPORTS THAT BAKER WANTS A CONCERTED REDUCTION IN INTEREST RATES ARE BEING PLAYED DOWN BY TREASURY SEMI-COLON VOLCKER SEEMS UNLIKELY TO SUPPORT ANY EARLY CUT IN US RATES.

## TAIL

2. BASED ON PROVISIONAL ESTIMATES OF FOURTH QUARTER GROWTH, US REAL GNP GREW BY 2.5 PERCENT IN 1985, CONSIDERABLY BELOW THE LEVEL EXPECTED BY MOST PRIVATE FORECASTERS AND THE ADMINISTRATION. THE ECONOMY WAS VERY WEAK IN THE FIRST HALF OF 1985 BUT PICKED UP CONSIDERABLY IN THE SECOND HALF. THERE ARE MIXED VIEWS ABOUT WHETHER THIS RESURGENCE IS LIKELY TO CONTINUE. THE ADMINISTRATION BELIEVE THE ECONOMY IS DOING WELL AND THE COUNCIL OF ECONOMIC ADVISERS ARE PREDICTING 4 PERCENT REAL GROWTH IN 1986. THE CONSENSUS OF PRIVATE FORECASTS IS THAT GROWTH WILL BE A LITTLE OVER 3 PERCENT BUT THERE IS A WIDE DIVERGENCE OF VIEWS. THE LATEST UNEMPLOYMENT AND RETAIL SALES FIGURES PUBLISHED OVER THE PAST WEEK HAVE BEEN TAKEN BY MANY TO SUGGEST A SOMEWHAT MORE BROADLY BASED RECOVERY.

3. INFLATION IS LIKELY TO AVERAGE AROUND 3.5 PERCENT IN 1985, A LITTLE UNDER 1 PERCENT LESS THAN IN 1984. THE DECLINING RATE OF INFLATION REFLECTS FALLING WORLD COMMODITY AND INTERMEDIATE INPUT PRICES AND SUCCESS IN HOLDING DOWN LABOUR COSTS. THE DECLINING REAL COST OF LABOUR HAS CONTRIBUTED TO AN ENVIABLE PERFORMANCE IN THE LABOUR MARKET: IN 1985 CIVILIAN EMPLOYMENT INCREASED BY 2 MILLION, WITH EMPLOYMENT RISING BY 320,000 IN DECEMBER ALONE. THE UNEMPLOYMENT RATE FELL BELOW 7 PERCENT IN DECEMBER FOR THE FIRST TIME SINCE 1980.

4. THE FEDERAL GOVERNMENT RAN A DEFICIT OF DOLLARS 210 BILLION IN FY 85 AND A REPORT BY THE CBO AND THE OMB OUT TODAY PREDICTS THAT THE FY 86 DEFICIT WILL BE DOLLARS 220 BILLION IN THE ABSENCE OF ANY CUTS.

5. GRAMM-RUDMAN REQUIRES THE DEFICIT TO BE REDUCED TO ZERO BY FY 91. THE REQUIRED CUTS FOR FY 86, WHICH ARE LIMITED TO DOLLARS 11.7 BILLION, HAVE JUST BEEN ANNOUNCED AND MAY NOT BE TOO DIFFICULT TO ACHIEVE. THE CRUNCH WILL COME WITH THE FY 87 BUDGET, DUE TO BE PUBLISHED ON 5 FEBRUARY. CUTS OF OVER DOLLARS 50 BILLION ARE REQUIRED TO MEET THE G-R TARGET. THE PRESIDENT IS SAID TO HAVE PREPARED A BUDGET THAT MEETS THIS GOAL DESPITE INCREASES IN DEFENCE SPENDING, BY A COMBINATION OF CUTS IN NON-DEFENCE PROGRAMMES AND ASSET SALES. CONGRESS IS LIKELY TO PRESS THE PRESIDENT TO RAISE TAXES RATHER THAN LET ALL THE BURDEN BE TAKEN ON SPENDING. THE CONSTITUTIONALITY OF THE G-R LEGISLATION IS CURRENTLY BEING DISPUTED IN THE COURTS. MOST COMMENTATORS EXPECT THAT, WHILE PARTS OF G-R MAY BE DEEMED UNCONSTITUTIONAL, THE FALL-BACK PROVISIONS WILL ALLOW THE LEGISLATION TO BE IMPLEMENTED.

6. THE MERCHANDISE TRADE DEFICIT IS LIKELY TO BE AROUND DOLLARS 50 BILLION IN 1985. THE 20 PERCENT FALL IN THE DOLLAR DURING 1985 HAS SO FAR HAD NO PERCEPTIBLE EFFECT.

#### FINANCIAL DEVELOPMENTS

7. LONG INTEREST RATES AT 9.5 PERCENT ARE NOW ABOUT ONE PERCENT-AGE POINT BELOW THEIR LEVEL FOUR MONTHS AGO, LARGELY AS A RESULT OF EXPECTATIONS OF LOWER FUTURE BUDGET DEFICITS FOLLOWING GRAMM-RUDMAN. 3 MONTH TREASURY BILLS ARE BACK TO THE 7 PERCENT LEVEL REACHED LAST SUMMER AFTER DRIFTING UP TO 7.25 PERCENT IN NOVEMBER. BUT WITH INFLATION RUNNING AT 3.5 PERCENT, REAL INTEREST RATES ARE STILL AT HISTORICALLY HIGH LEVELS.

8. INTEREST RATES HAVE HARDENED A LITTLE OVER THE PAST WEEK MAINLY IN RESPONSE TO THE BETTER THAN EXPECTED UNEMPLOYMENT FIGURES. UNTIL THEN, THE MARKETS HAD BEEN EXPECTING AN EARLY CUT IN THE FED DISCOUNT RATE BY HALF A PERCENTAGE POINT. HENRY KAUFMAN'S VIEW, SHARED BY MOST MARKET PARTICIPANTS, IS THAT THE CHANCES OF A DISCOUNT RATE CUT IN THE NEAR FUTURE ARE SIGNIFICANTLY REDUCED.

9. FOLLOWING A MEETING WITH BAKER, GERMAN ECONOMICS MINISTER BANGEMANN IS REPORTED HERE TODAY AS SAYING THAT BAKER FAVOURS A CONCERTED REDUCTION IN INTEREST RATES AND WANTS THIS DECIDED BY THE G5 THIS WEEKEND. TREASURY HAVE REFUSED TO COMMENT PUBLICLY SEMI-COLON BUT MINISTER (ECONOMIC) HAS BEEN TOLD THAT, WHILE BAKER MIGHT WISH TO DISCUSS THE POSSIBILITY OF INTEREST RATE REDUCTIONS AT LEAST BY THE US, JAPAN AND GERMANY, HE WOULD NOT BE PUSHING FOR THIS AGGRESSIVELY. TRUMAN (DIRECTOR, INTERNATIONAL FINANCE AT THE FED) HAS TOLD US THAT VOLCKER IS NOT AMUSED BY THESE REPORTS AND, GIVEN THAT THE RECOVERY SEEMS TO BE MOVING AHEAD, IS NOT DISPOSED TO A FURTHER LOWERING OF US RATES AT THIS JUNCTURE EVEN IF IT WERE A CONCERTED MOVE. (VOLCKER INCIDENTALLY HAS SHOWN THAT HE IS STILL WELL IN CONTROL AT THE FED. DESPITE SOME VIGOROUS ADVERSE LOBBYING BY THE ADMINISTRATION, HE HAS RECENTLY PUSHED THROUGH NEW REGULATIONS GOVERNING THE ISSUE OF JUNK BONDS TO FINANCE TAKEOVERS).

10. FCO PLEASE ADVANCE TO PS/CHANCELLOR, LITTLER, FITCHEW (TREASURY), LOEHNIS (BANK) AND TAIT (ERD).

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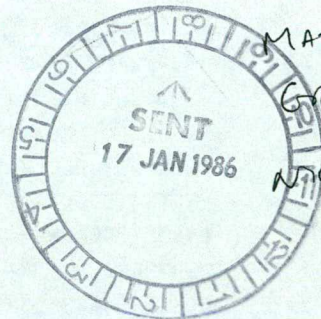
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AND TO PRIORITY TOKYO, ROME, PARIS, BONN, OTTAWA, UKDEL OECD MODUK

GRAMM-RUDMAN CUTS IN FY 86

SUMMARY

1. JOINT OMB-CBO REPORT PUBLISHED ON 15 JANUARY PREDICTS A BUDGET DEFICIT OF DOLLARS 220.5 BILLION FOR FY 86 ON BASIS OF CURRENT POLICIES AND LEGISLATION, THEREBY TRIGGERING A SEQUESTRATION ORDER FOR THE MAXIMUM CUT OF DOLLARS 11.7 BILLION. UNDER THE ORDER NON-EXEMPT DEFENCE SPENDING WOULD BE REDUCED BY 4.9 PERCENT AND OTHER NON-EXEMPT SPENDING BY 4.3 PERCENT. CONGRESS AND THE PRESIDENT HAVE UNTIL 1 MARCH TO AGREE AN ALTERNATIVE DEFICIT REDUCTION PLAN BUT IF UNSUCCESSFUL, THE ORDER WILL BE IMPLEMENTED.

DETAIL

2. THE FIRST STAGE OF THE GRAMM-RUDMAN PROCESS WAS IMPLEMENTED WITH THE PUBLICATION ON 15 JANUARY OF THE JOINT OMB/CBO REPORT PROJECTING THE FY 86 BUDGET DEFICIT ON THE BASIS OF CURRENT POLICIES AND LEGISLATION. THE DEFICIT ESTIMATES PREPARED BY THE TWO BODIES ARE NOT SIGNIFICANTLY DIFFERENT (DOLLARS 220.1 BILLION (OMB), DOLLARS 220.9 BILLION (CBO)) DESPITE THE CBO ASSUMING A GROWTH RATE FOR FY 86 OF 3 PERCENT, HALF A PERCENTAGE POINT BELOW THAT USED BY THE OMB. (THE OMB HAVE AS EXPECTED USED THE COUNCIL OF ECONOMIC ADVISERS' FORECAST OF 4 PERCENT REAL GROWTH FOR BEGIN UNDERLINING CALENDAR END UNDERLINING 1986). THE MAIN ECONOMIC ASSUMPTIONS ARE COMPARED BELOW:

OMB CBO  
(PERCENTAGE  
INCREASE,  
FISCAL YEAR  
1986 ON



FISCAL YEAR  
1986 ON  
FISCAL YEAR  
1985)

|  |     |     |
|--|-----|-----|
| NOMINAL GNP  | 6.9 | 6.5 |
| REAL GNP   | 3.5 | 3.0 |
| CONSUMER PRICES (WHOLESALE)                          | 3.3 | 3.3 |
| CIVILIAN UNEMPLOYMENT RATE<br>(FISCAL YEAR AVERAGE ) | 6.9 | 6.9 |
| INTEREST RATES<br>(FISCAL YEAR AVERAGE)              |     |     |
| 3 MONTH TREASURY BILLS                               | 7.3 | 6.9 |
| 10 YEAR TREASURY NOTES                               | 9.2 | 9.2 |

3. THE DEFICIT PROJECTIONS WERE PREPARED ON THE ASSUMPTION THAT EXPIRING PROVISIONS, SUCH AS THE 8 CENTS CIGARETTE EXCISE TAX INCREASE AND THE TEMPORARY REDUCTION IN FEDERAL EMPLOYEES RETIREMENT CONTRIBUTIONS, WILL TERMINATE AS SCHEDULED.

4. THE DOLLARS 11.7 BILLION CUT IN OUTLAYS WOULD BE OBTAINED AS FOLLOWS: DOLLARS 1 BILLION FROM WITHOLDING COST OF LIVING ADJUSTMENTS, DOLLARS 5.35 BILLION FROM A 4.9 PERCENT REDUCTION IN NON-EXEMPT DEFENCE SPENDING AND DOLLARS 5.35 BILLION FROM A 4.3 PERCENT UNIFORM CUT IN NON-DEFENCE NON-EXEMPT PROGRAMMES. DOLLARS 5.35 BILLION REPRESENTS A CUT OF ABOUT 2 PERCENT IN THE TOTAL DEFENCE BUDGET. BUT THE PRESIDENT CHOSE TO EXERCISE THE FLEXIBILITY GIVEN TO HIM FOR FY 86 ONLY TO EXEMPT THE BULK OF MILITARY PERSONNEL ACCOUNTS AND ALL SDI EXPENDITURE. THE REMAINING DOLLARS 110 BILLION OF THE DEFENCE BUDGET WOULD THEREFORE HAVE TO BE CUT BY 4.9 PERCENT.

5. THE SEQUESTRATION ORDER APPLIES TO BUDGETARY AUTHORITY WHICH IN MANY CASES WOULD HAVE TO BE CUT BY LARGER AMOUNTS TO PRODUCE THE REQUIRED YTXEDNVLSRZJNQARS 13.9 BILLION.

COMMENT

6. CONGRESS AND THE PRESIDENT HAVE UNTIL 1 MARCH TO AGREE ON AN ALTERNATIVE METHOD OF REDUCING THE DEFICIT. IT IS NOT CLEAR WHETHER CONGRESS WILL HAVE THE TIME OR THE INCLINATION TO COME UP WITH SUCH A PACKAGE, PARTICULARLY SINCE THE FY 87 BUDGET IS DUE TO BE PRESENTED BY THE PRESIDENT ON 5 FEBRUARY, AND WILL BE RATHER MORE CONTROVERSIAL, AS IT MUST CUT THE PROJECTED DEFICIT BY OVER DOLLARS 50 BILLION. IT IS POSSIBLE THAT THE METHOD BY WHICH G-R CUTS ARE IMPLEMENTED, I.E. THE SEQUESTRATION ORDER, MAY BE DEEMED UNCONSTITUTIONAL BUT THE LEGISLATION PROVIDES FOR AN ALTERNATIVE (BUT LESS AUTOMATIC) METHOD OF IMPLEMENTING THE CUTS. FURTHER DISPUTES MAY ARISE OVER THE WAY IN WHICH THE LEGISLATION HAS BEEN INTERPRETED BY THE CBO AND THE OMB, BUT AT THE MOMENT MOST COMMENTATORS EXPECT THE CUTS LISTED IN THE ORDER TO BE IMPLEMENTED.

7. FCO PLEASE ADVANCE TO DAUNT, BROADBENT (EA), TAIT (ERD), FITCHEW AND MATTHEWS (TREASURY), GREEN (BANK) AND NICHOLLS (DUS, POLICY, MOD).

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ROME TELNO 026: G5 MEETINGS

1. IT IS NOT OUR NORMAL PRACTICE TO ANNOUNCE G5 MEETINGS. BUT IN THIS CASE THERE HAVE ALREADY BEEN DETAILED PRESS LEAKS IN TOKYO (TOKYO TELNO 002, NOW COPIED TO ROME) AND THE AMERICANS TOO TOLD US THAT THEY INTENDED TO COME INTO THE OPEN. AS THERE WERE ALSO REPORTS EMANATING FROM REUTERS WHICH INACCURATELY DESCRIBED THE G5 MEETING AS PART OF THE PREPARATION FOR THE ECONOMIC SUMMIT, WE FELT IT BEST TO CONFIRM THAT THE MEETING WILL BE TAKING PLACE BUT STRESSED THAT IT WILL BE ROUTINE AND PRIVATE AND ITS PURPOSE WILL SIMPLY BE STOCKTAKING.
2. WE ARE CONTENT WITH THE LINE YOU PROPOSE TO TAKE IF YOU ARE SUMMONED TO RECEIVE A FURTHER PROTEST. YOU SHOULD ALSO KNOW THAT THE ITALIAN AMBASSADOR FOLLOWED UP THE ORIGINAL DEMARCHE DURING A CALL ON THE PUS ON 9 JANUARY (RECORD ON ITS WAY TO YOU BY BAG). THE PUS WAS NON-COMMITTAL, ADDING THAT THE PRIME MINISTER WOULD BE REPLYING SHORTLY.
3. NONE OF OUR PARTNERS HAS YET REPLIED TO CRAXI'S MESSAGE. THERE IS NO ENTHUSIASM FOR INCLUDING ITALY IN THE G5. THIS SUBJECT WILL BE DISCUSSED FURTHER AT THIS WEEKEND'S MEETING AND WE HOPE TO AGREE THERE ON THE LINES OF A COORDINATED RESPONSE TO CRAXI.

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MR FITCHEN, HM TREASURY

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FROM: P WYNN OWEN  
DATE: 15 January 1986

SIR G LITTLER

cc: Mr Lavelle  
Mr Fitchew

G5

The Chancellor has seen today's article in the FT by Stewart Fleming. He notes that he will have to have a word with Baker to warn him off the crass approach taken in the final paragraph. He wonders whether you have spoken to Mulford about this.

A handwritten signature in cursive script, appearing to be "P. Wynn Owen".

P WYNN OWEN

FINANCIAL TIMES

# G5 'not likely' to act on US dollar

By Stewart Fleming in Washington

3

THE FINANCE ministers of the five major industrial countries (G5) are unlikely to take any new initiatives to drive down the value of the US dollar at their meeting in London this weekend according to Dr Onno Ruding, the Dutch Finance Minister and chairman of the policy making interim committee of the International Monetary Fund (IMF).

Characterising the G5 agreement to drive down the dollar's value reached in New York in September of last year as "to a large extent a success." Dr Ruding said "There is a growing feeling among Europeans that the larger part of the drop (in the dollar) has taken place. To the best of his knowledge no concerted action in that direction is to be expected, he said.

Dr Ruding, who is holding a series of meetings in Washington with top officials including Mr James Baker, US Treasury Secretary, and Mr Paul Volcker, federal reserve board chairman, said the decline in the dollar is already quite sharp. European governments are worried that if there were to be a substantial further drop in the dollar "it might create the impression of a hard landing and could lead to panic reactions which could drive up US interest rates," he said.

Such reactions would not be in the interests of the US and the industrial countries or the developing world, he said, adding "for the US the major objective should be a reduction of US interest rates," which he linked to progress on the Federal budget deficit.

He conceded however that the fall in the dollar so far might not have a major impact on the huge US trade deficit in 1986, but that he was not too concerned at present about the danger of a protectionist upsurge in the US as a result. "I sense that much of the steam has gone out of protectionist pressure," he said.

Officials close to the G5 meeting are making it clear that they are hoping that weekend's session should not be a repeat of the public relations spectacular staged in New York in September when the US made dollar devaluation a top economic priority.

At the meeting the US is expected once again to urge West Germany and other nations to try to accelerate their rate of economic growth, something which West Germany is reluctant to do.

The US is also seeking to establish the G5 as the major forum for economic policy making discussions among the industrial countries, something Dr Ruding indicated yesterday is not being well received by the other six countries who make up the so called G10 industrial nations. Dr Ruding is proposing that G10 should meet for half a day before the April meetings of the interim and development committee meetings in Washington.

*I will have to have a word with Baker warning him of this cross approach when I see him. The G5 is spoken to by the G10 etc this?*

2/5

*1-R-to see +  
return to me pl:  
Roo 15/1*

FROM: SIR G. LITTLER  
DATE: 15 JANUARY, 1986

MR. WYNN OWEN

cc Mr. Fitchew

REQUEST BY TAKESHITA FOR MEETING WITH P.M.

I thought it might be worth recording my understanding of what happened over this. No action, unless you dissent or have anything worth adding to the record.

2. Mr. Takeshita asked for a courtesy meeting with the Prime Minister during his forthcoming visit to London. The request came to us late last week in two ways: through diplomatic channels, and through a personal telex to me from Oba, backed by a visit on instructions from the Financial Minister at the Japanese Embassy here on Friday morning. The point was made that Mr. Takeshita was particularly anxious for the privilege because it had already been accorded in anticipation for the slightly later visit of his Japanese rival, Mr. Abe.

3. FCO and I recommended parity of treatment and therefore that a meeting should be granted, and I think it was Mrs. Lomax who contacted No.10 and reported to me that they would try to fit Mr. Takeshita in but did not yet have a fixed time. I passed this on - in those terms - to the Japanese Embassy, promising to try to telephone them on Monday with exact times, both for a meeting with the Prime Minister and for the bilateral meeting with the Chancellor which had been asked for separately.

4. Understandably we could not get any commitment from No.10 yesterday, but when you reported your difficulty in getting any confirmation I spoke to Mr. Braithwaite at the FCO. He, after consultation with his Japanese experts, got the Foreign Secretary's Private Office to approach No.10, to press the importance of trying to fit in a meeting with Mr. Takeshita as a possible future Japanese Prime Minister.

5. After a series of contacts, No.10 told the FCO (and I think also told you) that the Prime Minister would be out of town for the whole period of Mr. Takeshita's visit, and would therefore not be able to see him. I know that the FCO went back again on this, insisting that, while embarrassment could be avoided if the Prime Minister was genuinely out of town, they would strongly recommend her seeing Mr. Takeshita if she was available for part of the time. This led to confirmation that she plans at present to leave London early on Friday morning for an engagement in Bedford, and that she does not plan to return to London until late on Sunday.

6. When I had confirmed this, I told the Japanese Embassy, with apologies, and explaining that the Prime Minister's diary had been much upset this week. I also confirmed the meeting with the Chancellor for 11.45 a.m. on Friday (I also confirmed that he will be accompanied by Mr. Oba, so I propose to make myself available to join the meeting).

7. We shall include in the note for the bilateral meeting a reminder to the Chancellor to present apologies on behalf of the Prime Minister.



(GEOFFREY LITTLER)