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*Including amendments  
as listed in PRHW to FCO  
letter, dated 11.5.77.*

NOTE OF THE FIRST SESSION OF THE DOWNING STREET SUMMIT CONFERENCE  
AT 10 DOWNING STREET ON SATURDAY 7 MAY 1977 AT 1020

LIST OF PARTICIPANTS

United Kingdom (Chairman)

Prime Minister

Chancellor of the Exchequer

Foreign and Commonwealth  
Secretary

Canada

The Rt. Hon. Pierre Elliott  
Trudeau, PC, MP.  
Prime Minister

The Hon. Donald S. Macdonald PC, MP.  
Minister of Finance

The Hon. Donald C. Jamieson PC, MP.  
Secretary of State for External  
Affairs

Italy

H.E. On. Giulio Andreotti  
Prime Minister

H.E. On. Arnaldo Forlani  
Minister of Foreign Affairs

H.E. Senator Gaetano Stammati  
Minister for the Treasury

France

Monsieur Valery Giscard d'Estaing  
President of the French Republic

Monsieur Raymond Barre  
Prime Minister and Minister  
for the Economy and Finance

H.E. Monsieur Louis de Guiringaud  
Minister of Foreign Affairs

Japan

H.E. Mr. Tadeo Fukuda  
Prime Minister

H.E. Mr. Ichiro Hatoyama  
Minister of Foreign Affairs

H.E. Mr. Hideo Bo  
Minister for Finance

Germany

H.E. Herr Helmut Schmidt  
Federal Chancellor

H.E. Herr Hans-Dietrich Genscher  
Minister of Foreign Affairs

H.E. Dr. Hans Apel  
Minister of Finance

United States of America

Mr. Jimmy Carter  
President of the United States

The Hon. Cyrus R. Vance  
Secretary of State

The Hon. Michael Blumenthal  
Secretary of the Treasury

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Introduction

After some words of welcome, the Prime Minister referred to the previous Summit meetings at Rambouillet and Puerto Rico, and said that he attached some importance to keeping the same group of Ministers together throughout the meeting. President Giscard had a particular problem, however, since Monsieur Barre had to return to Paris later tonight, and his place would be taken by Monsieur Boulin for the Sunday meeting. President Carter might also want to make a change in participants for part of the meeting.

The Prime Minister also recalled that it had been agreed that the European Community should be represented at this meeting by the President of the Council, namely himself on this occasion. So far as the Commission was concerned, it had been agreed that the President of the Commission should attend for matters of Community competence, such as trade, energy and North/South relations, which would be taken on the following day. Meanwhile he proposed that the discussion should start with the World Economic Situation, and that this afternoon's discussion might cover non-proliferation and human rights. He proposed himself to inform Mr. Jenkins of any matters arising during today's discussion which were of Community competence.

The Prime Minister said that the meeting had been well prepared by officials, and that some problems facing the participants would be easier to handle than others. The North/South dialogue was a matter of supreme importance, but he did not think that it was necessary to include specific decisions on this subject in the communiqué. Agreement among themselves was more important.

World Economic Situation

Introducing the discussion on the World Economic Situation, the Prime Minister said that there was a wide range of differing views on the health of the world's economy today. We should however record some successes, e.g. over the extent to which we had resisted protectionism against severe pressures. Some

/examples

examples existed of protectionism and of selective trade measures, but the preceding Summits at Rambouillet and Puerto Rico had played a useful part in resisting protectionist measures.

It was also encouraging that several countries had shown themselves willing to take harsh measures to restrict growth and to keep down inflation. This year, in the United Kingdom, the standard of living would be cut by 5%, and he believed that the Government deserved some credit for having achieved this, in spite of the consequent effect on the electorate.

The question of unemployment was of varying political importance in different countries, but, with the level at about 15 million in the OECD countries, it was of very great importance.

He was glad to hear from President Carter that unemployment in the United States had fallen last month. In contrast, the prospects in the United Kingdom were of rising unemployment, and he believed that this would apply to most of the participants over the next two years. Inflation, which he described as the father and mother of unemployment, was the main enemy. Chancellor Schmidt had said yesterday that you could still beat inflation and nevertheless retain high unemployment levels. If inflation was to be our main target, it was necessary to ask whether we would be able to beat unemployment also.

The Prime Minister said that it was not in his view right for Britain to pressurise others to reflate their economies beyond what they thought necessary or right for their own countries. He had this week received a delegation from a group of international trade unionists who had voiced some very solemn warnings about the dangers of unemployment, and had told him that they were even prepared to consider some rise in inflation if it served to soak up unemployment. We also had to bear in mind that the problem of unemployment could lead us into areas where some of our political systems could be put under considerable strain.

The second problem was that of balance of payments financing. The OPEC surpluses of up to \$45 billion this year had to be matched by equivalent deficits in oil importing countries. This situation was likely to continue, and it called for co-operative

action to ensure that the matching deficits were financed. Individually, countries were unlikely to be able to reduce these deficits, particularly since the growth rate in 1978 was likely to be even less than 1977. Apart from Japan, and possibly the United States, the Prime Minister wondered who was going to be able to meet their projected growth rates. Of all the participants at the Summit, only Japan expected to achieve a higher growth rate in 1977 than in 1976, and he wondered what the prospects would be for next year.

The Prime Minister said that the United Kingdom was moving on the balance of payments, but this was based on a low growth rate towards surplus, and that the IMF had under consideration improved arrangements for financing deficits. He asked whether these would be sufficient, and whether action would be taken in time.

Finally, the Prime Minister referred to Chancellor Schmidt's argument that there was a need to generate confidence. He agreed with this, and also with the need to reach a real assessment of the genuine economic problems facing us.

/After thanking

/After

After thanking the Prime Minister for his welcome and after referring to the two Heads of Government who were participating for the first time, President Carter and Mr. Fukuda, President Giscard said that he hoped that the preparation of documents, and the discussion of communiqués, could be left as far as possible to officials. Meanwhile, he wished to make five comments.

First, he believed very deeply that a profound structural change had taken place in the world economic situation. This was not just a conventional crisis. We had in the past been used to cheap energy; to easy access to raw materials; and to the lack of any threat from the developing countries. This had led both to euphoria and to wastefulness, and we needed both to face the new situation and to adjust the distribution of resources.

Secondly, the unemployment situation in the United States had improved, but the situation in Europe, whether in low-inflation countries like Germany or in high-inflation countries like France, was very serious. Although the East European countries were less efficient than the West, it was remarkable that they had apparently been able to overcome the problem of unemployment. The level of youth unemployment in particular was quite unacceptable. He agreed with President Carter's views on Human Rights, but one right which must be included was the right to work. This was a problem which we needed to tackle in depth.

Thirdly, the industrialised countries still faced a central energy problem. The forecasts for 1980 and 1990 showed no improvement in the situation. We had thought that by breaking the oil cartel in 1974 we would be able to bring down oil prices; but this had turned out to be false. We needed to develop wide-ranging energy policies, and he described the measures taken by President Carter in the United States as very positive.

/Fourthly, there

Fourthly, there was the question of trade and protectionism. It was very striking that we had been able to avoid reverting to protectionist measures. Nevertheless there were causes for concern in some current trade trends. The distribution of international markets, eg in steel, shipbuilding, aerospace and computers, had undergone a remarkable change, and he thought that more organisation was needed.

Fifthly, there was the question of relations with developing countries. He was sure that they did not like this meeting taking place; indeed, it was anathema to them. The West should try to meet their aspirations and to cope with the problems of high indebtedness. The CIEC was shortly to resume, and a failure of that Conference could have very serious consequences. He hoped that his colleagues would agree that this meeting should express some concern about this.

Mr. Fukuda agreed that the present situation was very serious, but believed that all of those present would be able to find a breakthrough. He recalled his time in London between 1930 and 1933, when the situation was in some ways very similar to the present. Depression in the United States had spread to the UK and others were to follow suit. Unemployment had led to social insecurity and an International Economic Meeting had been convened in London in 1933 by Mr. Ramsay Macdonald. World production had fallen between 1929 and 1934 by 30%, and world trade had fallen by 40%. This had created general social instability and many countries had had to choose between fascism or some other totalitarian system. The failure of the 1933 Conference had provided the backdrop to the Second World War.

Mr. Fukuda thought that there was now a better chance of international economic cooperation. Nevertheless the situation was in some ways worse. Energy resources had declined; there was now more tension between East and West; and there was also a rift between North and South. All these reflected a deteriorating structural problem.

/In order to

In order to recover from this we needed to restrain inflation and to promote growth. President Carter needed to do a great deal, since the United States' economy was a central force in stimulating world economic recovery, especially in unemployment. On the North/South issue, there were many concrete measures which needed to be taken, of which perhaps the most effective would be steps to enable the South to export more to the North. So far as deficits and surpluses were concerned, those that could afford to help themselves should take the lead, while taking care not to rekindle inflation.

Mr. Fukuda referred to President Carter's proposed tax rebate, and his subsequent withdrawal of it. There was a risk that this could give the impression that the United States had given up their efforts to stimulate their economy. He did not himself believe this, and hoped it was not true. But many critics in business, politics and economics, felt that there might have been a change of heart in the United States' leadership. There was a "nagging apprehension" that the United States had taken a step backwards, and he would very much welcome a word of reassurance on this from President Carter. The West must not repeat the mistakes of the 1930s.

/Signor Andreotti

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Signor Andreotti said that the present economic situation led one to conflicting conclusions. There was a fairly high rise in GDP, but it was still too low. Unemployment was at a record level, and only a few OECD countries were likely to be in surplus. Ldc indebtedness was at a very high level. All these were structural problems, and short term measures could merely serve to lead to further distortions. Time was needed for adjustment, and he agreed that countries with balance of payments difficulties should aim to reduce their deficits. But they could only do so if the surplus countries gave a lead. The use of exchange rates was limited by institutional factors, and could lead to greater inflation. A balance was needed between adjustment and financing measures, and it was noteworthy that the oil importing countries had turned to private financial markets. Specific steps needed to be taken to change the respective attitudes of creditor and debtor countries; the first were still too cautious, while the second had insufficient resources to put their houses in order. He believed that the IMF had a role to play in this regard, and that it needed a more "symmetrical" attitude towards debtor and creditor countries.

Signor Andreotti said that Italy was playing a part by implementing a stabilisation programme which avoided protectionist measures. On unemployment he agreed with President Giscard that there was a need for a new dimension, and thought that an exchange of information on youth unemployment might be useful. Italy faced a particular problem about graduate unemployment which would persist until the fall in the birthrate took effect in the mid-1980s. He hoped that a special reference to youth unemployment could be included in the final communique, and thought that all our economic problems should be seen against this perspective.

/After repeating

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After repeating President Giscard's welcome to President Carter and Mr. Fukuda, and after thanking the Prime Minister for his hospitality, Chancellor Schmidt said that we were not just facing a business cycle recession; this was also a structural crisis. Both of them reflected a lack of consumer confidence, which was well illustrated by the 14 per cent savings rate in Germany and by the lowest interest rates in history. There was no shortage of money available in Germany, but there was a lack of confidence and a need to create confidence in the ability of Western industrialised governments to follow complementary policies.

He believed that conditions were now in some ways more favourable than they had been at Rambouillet or Puerto Rico. Mr. Fukuda had made a comparison with the early 1930s, but at least international economic cooperation, as exemplified both in the IMF and by the previous economic summits, had avoided economic warfare. The causes of structural crisis were also quite different now from the 1930s. First, inflation had been fuelled by the financing of the war in South East Asia, which had created an enormous flood of liquidity. This had gone hand in hand with homemade inflation and in some cases with domestic protectionist measures. The Bretton Woods System of fixed exchange rates had collapsed, perhaps inevitably, although it was the long-range goal for the Germans, as he believed it was for the French, to get back to this as soon as possible ( he did not think it would be possible for at least three years).

Secondly, the abandonment of the Bretton Woods monetary system and the transition to floating rates has led to a sense of financial uncertainty. It had also created severe financial risks for foreign trade, especially in respect of small firms.

Thirdly, there had been the oil price explosion, which had created a shrinkage of demand and a reduction in international trade which had reached its low point in 1975 and had weakened industrial confidence.

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/Fourthly,

Fourthly, there was a general lack of confidence on the part of industry and the trade unions.

Chancellor Schmidt said that the prospects for OECD growth next year were not bad, and that this year's average was 4.5 per cent. The United States and Japan were likely to lead the list this year, whereas Germany would not attain its unprecedentedly high figures of last year. The Germans would do whatever they could to stimulate their economy, but not by printing money.

/His reasons

His reasons for saying this were partly selfish and partly related to a sense of international responsibility. As a Social Democrat, his first aim was to reduce unemployment, but he could not neglect the question of price stability. Private capital expenditure for creating jobs would not be available unless there was confidence. It would be disastrous to adopt what he would describe (by inverting the normal phrase) as a "go-stop" policy. Without the necessary private expenditure, Governments would need to fill the gap by additional public capital expenditure. The Germans were trying to do this, and had just launched a major capital programme of DM 16 billion.

He thought that the structural upheaval in the balance of payments system was bound to continue for a while, and that energy policies, and increasing research and development, were an important tool in remedying this. For this reason, he very much welcomed President Carter's energy initiative.

On the stabilisation of balance of payments financing, Chancellor Schmidt said that since 1976 Germany had up-valued her currency by 18% against other currencies. The effect on their exports had been considerable, but he thought they had a responsibility to help others. They were in a quite different situation from that of the United States, and had made a major contribution to other economies. There had already been some symptoms of "competitive devaluations" (e.g., in Sweden), but it was not possible to cure the symptoms without curing the causes; these included inflation, uneven exchange rates, and unequal distribution of incomes.

In conclusion, Chancellor Schmidt said that he did not think that the Summit participants needed to present decisions, so much as the impression that they were not going to fight each other, and that they were ready to follow complementary policies.

Mr. Trudeau said that he had noticed some encouraging features from the remarks made so far. President Giscard had referred to the dangers of ideological conflict among youth, and Mr. Fukuda

/ had referred

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had referred to the example of the 1930s. Nevertheless, there was reason for some satisfaction. In Puerto Rico, we had hardly crossed the threshold, and had talked about economic problems without accepting the need to effect structural changes and without even recognising the fundamental changes which had already taken place. He agreed with Chancellor Schmidt that we needed ~~needed~~ to tackle the causes of our present economic problems.

President Giscard had implied that freedom of trade should be organised, and he thought this was an idea that warranted careful attention. To some extent, it was already done, e.g., in relation to OPEC. In our relations with the LDCs, there was a need to intervene in market mechanisms in order to assist the poorer countries. The West's liberal philosophy was undergoing change, and even attendance at this Summit Meeting showed that all those present regarded international economic co-operation as essential. Democracies had to enlist the support and understanding of their citizens, and he did not think that this point had been sufficiently taken into account at Puerto Rico. Problems could be caused by excessive expectations, and he thought that all those represented at the meeting could help each other by instilling a spirit of discipline in their countries. In other words, we should use our democratic institutions to help each other, rather than to allow complete laissez faire.

Mr. Callaghan had referred to the need to create and generate confidence and optimism, but he wondered how this could be done while at the same time telling people that things were going badly (as was clearly the case) without either creating internal revolutions or scaling down expectations. He hoped that the ~~commu~~ communique would make people aware of the potential dangers facing the industrial democracies, if they did not win the ideological war with the Third World. If they came to look to the totalitarian states as an example, this could have very serious consequences for the next generation.

/ Mr. Trudeau

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Mr. Trudeau said that he was not very satisfied with the draft communique, since it did not contain enough warning notes. There was a need to appeal to people's attitudes and to their responsibilities for the health of democracy. Otherwise, all those at the Summit would not only be elected out of office but would have failed in their responsibilities to their people. He thought that there was a need for a collective warning and for a greater awareness of, and readiness to face, change.

President Carter said that he came to the meeting not as an economist but as a student. Most of his colleagues, unlike himself, were ex-Finance Ministers.

He recognised the impact which the United States could have on other countries, and had this constantly in mind. The Americans had set themselves certain targets and would do their best to maintain them. He hoped for a 5.8% increase in GNP, which could have a considerable impact on unemployment; he had hoped that the latter could be brought down from 8.1% to 7% during 1977 and the target had already been reached. There was a surge of confidence in the United States, perhaps reflected in a 6% savings rate (compared with the 14% rate to which Chancellor Schmidt had referred). Even after the withdrawal of the tax rebate, there was still an economic stimulation package of \$20 billion. He was not sure whether it was necessary; but his Administration were paying considerable attention to the problem of youth unemployment, and had already put proposals to Congress, which he expected to pass, for increased employment both for youth and adults. There was also a public works programme of about \$4 billion, which had already been passed. He was nevertheless concerned that the inflation rate was still running at between 6 and 6½% and wholesale price increases at about 12%. The future was uncertain.

President Carter said that there were however some very encouraging indications of business investment, and capital investment was running at about 17%, which represented a growth rate of 10% or more. There were indications of growing business confidence in Government.

There were still strong pressures in the United States for protectionist measures, and several proposals had been put to him by the Trade Commission (e.g. on shoes and textiles) which related to American business interests without any consideration of the effect on international relations. A common declaration by the Summit against protectionism would help him in resisting protectionist pressures in the United States. Although Congress had the power to override him, if he rejected advice from the Trade Commission, he did not think this was likely.

The United States Government was trying to overcome its trade imbalance, and in particular its deficit vis à vis the oil producers. Last year, the deficit had been nil but he expected it to reach \$12 billion this year. The trade balance would be about \$20 billion in deficit, but the economy was strong enough to absorb this. Other nations however had to absorb the trade surpluses of Germany and Japan, and were not strong enough to do so.

Referring to his energy proposals, President Carter said that he hoped to reduce consumption by 1 million barrels per day this year, although this would cause him great difficulties with Congress. The measures were designed to lead to the transfer to gas and coal, but he asked his colleagues to let him know what the United States could do to improve their lot. He also referred to his approval of renewed exports of enriched uranium. He thought that supplies would be adequate, provided steps could be taken to avoid the risk of uranium being used for explosive purposes.

President Carter said that he was confident about the future of the democratic world. There had been a loss of confidence in the United States after Vietnam and Watergate, and he accepted that a re-establishment of confidence could only come from the Americans themselves. If they were timid about admitting the truth and the need for co-operation, the lack of confidence in them could turn out to be justified. He had been much impressed by Mr. Trudeau's remarks about the apparent conflict between speaking frankly in the communiqué and creating confidence.

/He thought

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He thought that there was a need to declare publicly our firm determination to carry out our aims and he hoped that his colleagues would agree to instruct their subordinates to follow this up. Our aim should be to make the Tokyo Round of trade negotiations as successful as the Kennedy Round had been, and to move forward in the fields of energy, nuclear fuels, and the North/South dialogue. We should set our goals high.

President Carter suggested that Foreign Ministers should also consider how far the new leaders who felt excluded at present, such as the Saudis, could be absorbed. He had been very pleased by the Saudi attitude towards the Horn of Africa, energy supplies and the financing of ldes, and it was clear that the Saudis themselves were anxious to be absorbed among the world financial leaders. He did not think that they should regard themselves as a closed group.

So far as strengthening the IMF was concerned, he referred to the stream of foreign statesmen who had visited him in Washington. It was clear from talking to them that the IMF and the World Bank could provide useful guidance and he welcomed the extent to which the IMF required a degree of accountability. There was a need to strengthen the Fund, and here again the Saudis were ready to make a bigger contribution. This had been one of the aims of Puerto Rico, and the Americans were ready to increase their contribution to the Fund in order to implement this.

In conclusion, President Carter said that he hoped his colleagues would not hesitate to draw his attention to any steps taken by the United States Administration which might have an impact on their countries. He believed that his Administration had been guilty of some insensitivity, eg in their handling of the nuclear fuel question, and that they had a lot to learn.

The Prime Minister said that there was a need to reconcile a difference in emphasis between trying to emulate the successes of the Kennedy Round on the one hand, and removing obstacles eg on shipbuilding. Officials might need to have some guidance on this.

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Mr. Macdonald said that, speaking as a lawyer who was surrounded by economists, he agreed that there was a public loss of confidence, and he was not convinced that the professional economic advisers really understood what was going on. Having heard Mr. Fukuda analysing the situation in the 1930s, he had the impression that the old patterns of Hoover economics had not been up-dated. There was insufficient attention to the important problem of allocation of resources, and he thought that we all needed to decide how much of our GDP we were going to allocate to the lds.

Mr. Macdonald shared the concern which had been expressed about youth unemployment and thought that we might face structural problems within the trade union movements in achieving the necessary "inter-generational transfer". He would welcome a reference in the communiqué to the need for reallocating resources to youth. Job creation projects were not necessarily sufficient.

He realised that we could not look for spectacular results from this Conference, but he hoped that the communiqué would produce something more than a reference to "full and frank discussions". He hoped in particular that it would stress the points made by President Carter and would put emphasis on the problem of youth unemployment.

The Chancellor of the Exchequer said that Mr. Fukuda had referred to "nagging apprehension" and Chancellor Schmidt had spoken of a lack of confidence. Apart from the United States, even the strongest economies were suffering from a sense of malaise, reflected both in election losses and in high savings rates. He did not think that confidence could be restored by expressions of complacency, and he believed that the communiqué issued at Puerto Rico had been too complacent.

Economic theory taught us about the relationship between growth and employment, and between inflation and unemployment; but these established relationships seemed to have disappeared.

/Output in Canada



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Output in Canada and France had more than recovered from the recession but they were still facing high unemployment; whereas in the United Kingdom unemployment had fallen slightly in the early part of this year, while we were still suffering badly from inflation and recession. He did not understand the reasons for this, although one reason for high unemployment and high inflation had undoubtedly been the rise in oil prices which had caused demand deflation and price inflation. We needed to find ways of tackling the imbalance between the OPEC surpluses (which could rise even further) and the deficits of the consumer countries. The distribution of balances within OECD was very uneven.

Mr. Healey thought that we had concentrated too much on growth in GDP, rather than its source. If growth was based on higher exports, the burden on weaker economies would be intensified. Speaking as a representative of one of the weaker economies, he hoped that other stronger economies would follow the example of the United States in accepting trade deficits. He hoped at least that it would be possible to stick to the rates of growth which had been announced, and that progress would be monitored. We also needed to find ways of financing deficits without forcing the deficit countries into deflation or creating a strain on the commercial banks.

Mr. Healey said that we had seen, eg in Jamaica and Egypt, the risk of some difficulties being created by too strict conditionality required by the IMF and similar organisations.

/Undue pressure

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Undue pressure could lead either to protectionism, or to revolution, or both. This risk applied not only in the LDCs but also to some European countries, such as Spain, Portugal and Turkey, which were running into very severe financing problems. He hoped at least that we could accept that the IMF should not be so tough on conditionality that its offers of support became meaningless.

Mr. Healey repeated that there was a need to monitor progress, and suggested that this might be done by periodical reports in OECD or the IMF on growth, balance of payments, financing and unemployment.

Dr. Apel said that in spite of a high rate of growth in Germany last year, unemployment had hardly been affected. This had been a new phenomenon in the German economy, which could recur this year. Germany's imports were massive, having increased in real terms from the non-oil LDCs by 30% this year alone. The level of wage costs was high, and yet the Germans had managed to increase their export balance with high-inflation countries. He had, for instance, noticed a very large number of German cars in Britain.

He agreed that the IMF had an important role to play in financing imbalances. The private banking system had reached certain limits, and there was a need to strengthen the IMF. The Germans would do their best to help, and he agreed that there should be close contact with the Saudis. They regarded the IMF as "a good address" and valued the market-related interest rates/<sup>it was offering,</sup> its good security and the hedge it had provided against individual currency fluctuations. The IMF should be strict, but not excessively so.

Turning to energy policy, Dr. Apel said that he was worried by too much emphasis on energy saving, since this could reduce economic growth. He hoped that the Summit would underline the need for increasing concentration on nuclear energy over the next few years, with its effect on employment and future energy resources.

/ On North/South

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On North/South relationships, all of us were in favour of a real transfer of resources to the developing world, but we must persuade them that if their demands became excessive, they would destroy the sources.

Finally, this Conference must serve to stimulate confidence without creating false hopes. He hoped, therefore, that the communiqué would reflect both resources and opportunities, and that all his colleagues would remember that if, as they hoped, they were still in power in 12 months, they would be held accountable for the outcome. In retrospect, Rambouillet had been a great success, but he believed that Puerto Rico had shown a certain degree of complacency.

Mr. Blumenthal referred to Mr. Callaghan's comments about the need to reconcile the aims of the Kennedy Round with the need to remove obstacles, e.g. in shipbuilding. He had been impressed by the general view reflected in discussion that protectionism was not the answer. The Kennedy Round could not be repeated, but he hoped that the goals we set ourselves would be sufficient to equal the impact of the Kennedy Round, bearing in mind that the conditions and the problems for negotiation were now quite different.

The fact that the United States was running a substantial trade deficit of about \$20 billion and a smaller deficit on current account of about \$12 billion tended to conceal the fact that very high investment and currency demand by the Saudis and other oil producers was keeping the American exchange rate artificially high. Chancellor Schmidt questioned whether this was true in relation to the Deutschmark, since the Germans were now paying DM 2.35 for one US dollar compared with DM 3.20 in July 1972.

/Referring

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Referring to remarks about the IMF, Mr. Blumenthal said that he regarded conditionality as important, and it was necessary to retain it. But it should be applied with flexibility. In the final analysis, it was for the political leaders to decide what pressure was tolerable. The United States had shown, in their bilateral relations with such countries as Mexico and Portugal, that other ways could be found of dealing with these problems when the IMF was inappropriate. Mr. Healey said that there was a risk that if other ways were used too often, this would undermine the IMF. The Prime Minister questioned this and said that from the United Kingdom's experience it was right that the IMF should apply strict banking terms. It was for the politicians to point out the dangers, e.g. in Jamaica.

After Mr. Blumenthal had said that the United States energy programme was not confined to conservation and saving, but also referred to alternative sources of energy, President Carter said that the Americans were setting themselves a target of a 60% increase in coal production by 1985, and planned to increase the production of enriched uranium by the construction of a new centrifuge plant. He hoped that the American energy programme would both succeed in reducing their imbalance with OPEC and in avoiding difficulties for others. The development of new supplies, such as solar energy, fusion and the fast breeder, were so costly that he would like ways to be found of sharing the costs. He hoped for instance that there might be co-operation on fusion with the European Community project (JET) and said that he would like to pursue this further.

Mr. Fukuda said that he had been impressed by the way in which every speaker had emphasised the structural problems. One of these was that mankind had come to the end of finite resources, though he was optimistic that alternative sources of energy would be found in the next century. He congratulated President Carter on his energy programme both in terms of its proposals for conservation and development of alternative sources. He agreed on the need for international co-operation, e.g. in nuclear fusion, and that it was not enough for the United States to go forward alone in this field.

Mr. Fukuda said that the most immediate problem was petroleum. If we failed to resolve our differences in the CIEC, there was a risk of further difficulty and unrest. Structural problems would take time to solve, but in the short term he thought that we should address ourselves principally to unemployment, North/South relations and harmonisation between the surplus and the deficit countries. The countries that could afford to do so should co-operate in reflating and stimulating their economies. Otherwise, there was a risk of economic and political chaos, and this was why Japan had taken certain steps to stimulate economic demand and on financing of the deficit countries. This year, about \$36 billion of fiscal expenditure was contemplated and the Japanese were now introducing their largest public works programme ever, of which about 70% would be voted between April and September this year. This was bound to encourage imports into Japan from all countries including imports from the developing world. Japanese imports were likely to become sluggish, so this represented a double contribution to the world economy. The Japanese had set themselves a growth target of 6.7%, which they wanted to achieve at any cost.

/They had

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They had lowered their interest rates, and their exchange rate to the dollar had fallen from 300 Yen to 275 Yen. Other countries that could afford similar stimuli should do so.

He agreed that the communiqué must not be complacent, and that the results of the Conference must be followed up. There was a multitude of international organisations, such as DAC, IMF, CIEC, GATT, etc., all working separately. He thought that they should all be guided to concert their efforts and when Finance Ministers gathered in these fora, something could be done in this direction.

Mr. Fukuda said that Japan had witnessed a torrent of exports last year of various manufactures, including colour television sets. He would personally see that this situation was corrected, but it was important to avoid any inclination towards protectionism. This folly had been committed in 1934, and it must not be repeated. The OECD Trade Pledge had been a very important move, and must be upheld.

Monsieur Barre said that he wished to make three points. First, the Summit had a psychological, as well as a practical, value. It should not raise false hopes, but we were facing a crisis of confidence after twenty-four years of unprecedented prosperity. Some people thought that the present downturn was temporary, and it was essential that we should make public opinion aware of certain fundamental facts. Oil prices had meant a vast transfer of resources, affecting the general standard of living. The CIEC had shown the extent to which the oil importing countries were worried about their fate.

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Secondly, it was important that the fight against unemployment should be waged side by side, and not ahead of, the fight against inflation. The latter must be continued. The conditions and causes of unemployment were not the same as they had been in the Keynesian conditions of the 1930s. Many were now unemployed not because they were just looking for jobs but because they were looking for the right jobs. There had been a structural change in the level of female employment. There was now a need for specific programmes to find long-term employment, rather than part-time jobs. It was essential that the Summit should not give people the impression that we were likely to move forward very fast on any of this.

On the question of international trade, President Giscard had emphasised the structural changes which had taken place, and the need to organise the freedom of international trade. He had himself discussed this with Mr. Blumenthal, and believed that the protection of free trade, and the avoidance of protectionism, had been one of the great tributes of the last few years. But it was not enough just to repeat the set phrases of 1960, 1967 or 1973. The public would not understand it. We needed to show them that we could deal with the new problems by new approaches.

The Prime Minister, summarising the discussion, said that officials would need to be asked to take the following essential points into account in drafting:

1. We wanted a good Declaration which should be both positive and realistic. Mr. Fukuda had talked of his concern that there should not be a repetition of the 1930s, and President Giscard had referred to the structural

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- change which had taken place since before 1973. Mr. Trudeau had pointed out that we needed to educate our people, but there was also a need to educate both the oil producers and the developing countries.
2. He suggested that there should be a short analysis at the beginning of the Declaration setting out these problems as the basis for future action.
  3. On inflation and unemployment, all were agreed on the risk of political consequences. As Chancellor Schmidt had said, our number one aim must be higher employment (and particularly youth employment). The Declaration could then go on to inflation and the ways of meeting it.
  4. On the question of confidence, the Declaration might pick up the point which President Carter and Chancellor Schmidt had made on our intention to carry out the targets to which we were committed for this year. This commitment must be maintained, and there was also the point which Mr. Trudeau had made, that we needed to reinforce each other.
  5. The Declaration should pick up the points which had been made in discussion about the IMF and protectionism.
  6. It should also pick up the point about proliferation of International Institutions, and the need for our representatives to keep a general view on activities in these Institutions in order to maintain our goals and targets. It should perhaps also make clear that participants would be ready to meet again after the OECD and IMF meetings this summer.

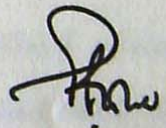
**CONFIDENTIAL** / President Carter



President Carter said that, in talking of unemployment, we should emphasise that it is closely related to inflation. One of the main purposes of this Conference should be to learn from one another, but also to let the world know what the participants thought. The Press often failed to read to the end of communiqués, and he therefore suggested that it should lead off with specific and tangible points, substantiated in later paragraphs. President Giscard agreed with these proposals, though he thought that President Carter's remarks revealed some optimism about the number of those who read communiqués. In general, he believed that this was confined to those who drafted them!

In conclusion, it was agreed that Finance Ministers would be asked to brief senior officials on the drafting of the passages in the communiqué relating to the world economy and other subjects discussed during this session.

The first session concluded at 1310.



Distribution

Private Secretaries to: the Chancellor of the Exchequer  
the Foreign and Commonwealth Secretary  
the Chancellor of the Duchy of Lancaster  
Sir John Hunt

7 May 1977

cc Br Dunnington TW  
Mr McCaffrey  
Sir J. Hunt  
Sir D. Mitchell  
David Tipton

cc. Master Set.  
Manpower, PM's initiative, Dec 76.