

Prime Minister

BONN SUMMIT

This is a report on the preparatory meeting in Washington on 27 and 28 May at which I represented the UK accompanied by Sir Michael Palliser and Mr Couzens.

Concerted Action Programme

2. We began with a presentation by Charles Schultze of the paper on the macro-economic aspects prepared at our request by a group under his chairmanship on which Sir Douglas Wass has represented the UK. The summary of this report (much the best of the papers produced for us so far) is at Annex A. It closely mirrored your Five Point Plan since it envisages a package comprising:-

- (i) significantly higher growth by Germany (para 7a and c);
- (ii) significantly higher growth by Japan coupled with measures to reduce her current account surplus (para 7a and b);
- (iii) some stimulus by other countries (para 7c);
- (iv) a commitment by the United States to raise domestic oil prices to world levels (para 6);
- (v) a successful conclusion to the MTN's and measures against protectionism (para 8).

Our main objective was therefore to secure endorsement of this programme as a package and to obtain the necessary commitments for its implementation.

3. We began by putting the United States, Japan and Germany (in that order) to the test.

4. The United States (Owen, Soloman and Cooper) played a skillful, tactical hand. They emphasised throughout the "package" aspect: and, by confirming their willingness to play their part if others did likewise, both eased the

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pressure on themselves and provided the basis on which subsequent leverage could be exerted on Japan and Germany. They confirmed that the President would be ready to make commitment at the Summit to raise domestic oil prices to world levels by 1980 by either legislative or administrative means. When pressed further they indicated that the President would also be ready to commit himself to a date in 1978 when the process would start and also a date in 1980 for its completion. There was a good deal of discussion about the various methods open to the United States to achieve this but also general recognition that, while an oil levy was the least preferred course, the choice must lie with the USA in the light of their domestic political circumstances. The US representatives also said that the President expected to announce further anti-inflationary measures at or before the Summit. (Particularly heavy stress on the need for this had been laid through^{out} the discussion by the Germans). Hiss summed up by saying that there was complete consensus on the need for the US to act on oil prices.

5. The Japanese emphasised their high growth target but wrong-footed themselves by saying that whereas they had a target for growth they had only forecasts for their balance of payments surplus. This led to very strong and concerted pressure indeed on them in which even the Germans played a prominent part. The Japanese were told in no uncertain terms that:-

- (a) no-one believed their growth target was achievable without further measures and that a supplementary budget was necessary;
- (b) they should concentrate on expanding domestic demand, and not go for export-led growth;
- (c) they should take active measures to open their market to imports;
- (d) they should increase their (untied) aid programme more than they planned.

Miyazaki eventually agreed to take this message away. He was also told that he would be expected at the next preparatory meeting at the end of June to

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say (i) what action the Japanese Government would take if they were not achieving their growth target and (ii) what measures they would in any case take to reduce their surplus. He can have been left in no doubt about the strength of feeling on this matter and seemed to accept that he would have to come up with something better next time.

6. It was then the turn of the Germans who put up a surprising and uncoordinated performance which increased the pressure on them. Schulman began by accepting that if they were going to take further stimulatory measures these would have to be significant to be worth-while: while professing unwillingness to be committed to a figure, he indicated his personal acceptance of the figure of an additional 1% of GNP suggested by Schultze as the right order of magnitude. He then talked about growth in a way which everyone interpreted as a nod and a wink. Hiss however clearly felt Schulman had gone too far and intervened himself to say that it was very unlikely that Germany could say anything about additional growth by the time of the Summit. It might be much later in the year before they could assess the position. This caused Owen, with support from the French but for obvious tactical reasons only, to suggest postponing the Summit. Hiss said this would not help. Others took the line that the Americans and Japanese were being asked to commit themselves to difficult things as part of a concerted package: and that the whole thing would fall to bits if the Germans could not get themselves into a position to take decisions by July. After a prolonged discussion Hiss back-tracked and said that as far as Germany was concerned the Schultze package was still on the table as the basis for the Summit package. He then went into an obscure explanation that the difference between us was not over substance or content but only over the nature and timing of the commitment. We interpreted this to mean that Schmidt, who has claimed that he is not convinced of the domestic case for further reflation, is not going to commit himself finally to action for wider international reasons until he has seen what price he has extracted from his Summit partners.

7. So far as reflation by the others was concerned, we stressed the size of the stimulus we had already given and said that the issue for us was whether action by others would be sufficient to make it unnecessary for us to have to offset the Finance Bill amendments consistently with staying within our PSBR limit. The French said action by Germany would add something to their growth and that they might be able to do a little more themselves in the context of a package. The Italians were very worried about unemployment and inflation. They underlined the importance of German action which would help them too quite a bit. But they could do nothing themselves additional to what was already in the pipe-line.

8. We then turned to currency stabilisation. The Americans and Germans, began by taking the line that there was nothing which needed discussion. We stirred the pot a bit. The markets were more settled now, but did people expect it to last? Would we soon be back to emergency patching etc? No-one was suggesting that the Summit should seem to be trying to devise a new international monetary system, but were there not causes for concern still? Eventually we got agreement that the least which the Summit could do would be to say that:

- (i) the measures agreed on fundamental issues like growth, energy etc would make an important contribution to greater exchange rate stability;
- (ii) excessive instability could however still occur while progress was being made on the fundamentals: accordingly the Summit countries would reaffirm their policies of cooperation to avoid excessive instability and to encourage the orderly functioning of the markets. This would itself make a contribution to confidence and to the adjustment process;
- (iii) encouragement should be given to the recent developments in the work of the IMF relevant to exchange rate supervision and to the composition of the reserves underpinning the system.

9. One rather striking point emerged in the monetary discussion. The Americans seemed to be expecting the European Community to reach agreement at the Bremen Council on a European monetary scheme which the Bonn Summit could then commend, (thereby in effect confirming that whatever form it took, it was not seen as anti-American). Doubt was cast on anything specific emerging from Bremen, not least by the Germans.

10. We then turned to energy, trade and north/south issues on all of which we had papers prepared by individuals or groups other than the Schultze group. The main points of interest to emerge were as follows:

Energy

11. Apart from the crucial issue of US domestic oil prices, the mainstress was on conservation, renewable sources, coal and energy for the ldc's. It was felt however that the paper had also managed to represent the lowest common denomination of conventional wisdom and efforts are to be made before our next meeting to find some more specific points for the Summit to consider.

Trade

12. We agreed that there was no point in our discussing the details of the MTN's at present. The log-jam is just beginning to ease and there is some prospect that a reasonable agreement will have been reached before mid-July. If so, the Summit can welcome it and look to the future. If however the negotiations are still stuck, the Summit may be able to give them a push: but it is too early to say if this will be necessary (or desirable from our point of view) or what the outstanding issues would be.

13. We then turned to anti-protectionism which was bound to be a more difficult subject for us. We were helped initially by an inept United States suggestion which found favour with no-one that the Summit should devise a new and much more specific Trade pledge. We then turned to a German paper which

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in effect recommended that any attempt to moderate the progress of structural change should be avoided and that new international machinery should be established to police a declaration to this effect. We began by successfully demolishing the case for new machinery. We then said that no Government could simply ignore the threat posed to whole industries by the emerging industries of the developing countries. It was not good enough to say our economies must adjust. Adjustment takes time and has to be eased: and it may be necessary to pay a price in strictly economic terms to avoid an unacceptable degree of social disruption. As a trading nation we were as against protectionism as anyone else but we had to face realities. The protectionist forces would not be overcome simply by declarations. In taking safeguard measures we would however try to cause the minimum disturbance to the world trading system: and of course the more trade expanded the easier this would be. We gave nothing away at this meeting and got good support from the French. But this is clearly an area where we shall be under heavy pressure for the right sort of language if the other points in the Five Point Plan are realised.

Private Investment

14. There was some discussion of a German suggestion, which received some support from the Americans, that the Summit should express concern about the level of private investment and give encouragement to measures to assist it. The Schultze paper refers to flagging private investment as one of the constraints on growth. There was debate about the relative parts played by low growth, high inflation and low profits in discouraging investment but the conclusion was that the Summit Communique probably ought to refer to the need to create the right environment for an improvement in investment, without going into detail on measures.

Multinational Companies

15. The Americans pressed quite hard their proposal that the Summit should give impetus to new international negotiations on the treatment of multinational companies. One side of this was seeking agreed rules on tax treatment and on

jurisdiction over them of governments of their parent country and of other countries. The other side was seeking protection for their investment in less developed countries. No other country was prepared to give serious support to this proposal which was seen as fraught with technical complexities and inviting difficulty with many less developed countries. We regarded it as against UK interests. It was left that there would be no specific Summit item or communique reference to multinational companies but that a general reference to pursuing international efforts to help private investment could cover any further international discussion on this subject.

North/South Issues

16. The main conclusion of a lengthy and rather diffuse discussion was that credit should be taken for the value to LDC's of the main decisions of the Summit on growth, energy and resistance to protectionism, but that for the rest the scope for fresh initiatives was limited. A reference to more investment in energy production in LDC's might well be possible. There was less support for even a cautious reference to the Common fund and resistance, notably from the Germans, to any new reference to more official development aid. The Japanese were notably silent (resting, presumably on their recent proposal to double their aid in three years) and although the French favoured some reference, the Americans made it clear that for budgetary reasons they could do no more. This left no room for any reference to substantial new transfers of resources to the LDC's and not much scope for our own proposal (repeated by the Americans) of bigger aid transfers from the surplus countries. My impression of this debate was that, realistically, its largely negative conclusions may be right: but, if you and your colleagues endorsed them, the conclusion of the Summit is likely to seem pretty unforthcoming to the LDC's.

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Long Term Questions

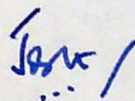
17. There were a number of suggestions from the Canadians and Americans, and to a lesser extent also from the Germans, that part of the discussion time at the Summit, and perhaps part of the Communique, should be devoted to long term or structural questions. Some of this reflected Mr Trudeau's views, and Chancellor Schmidt's interest in the impact on the main industrial countries of the industrial development of the super-competitives and some other LDC's. Some of the proposals on energy are of a long term character, and there was also discussion of the balance between protection of the environment, health and safety on the one hand and the promotion of investment (including energy investment) on the other. An American proposal for the Summit to bless a study of long term food supplies received no support. There was in the end no agreed proposal for allocating time (or Communique space) to long term issues, which were left to take their chance in the discussions under the main headings.

Resume

18. It is still early to forecast with any certainty the content of the ultimate package, and inevitably some parts of the preparations are going better than others. Nevertheless, taking the meeting as a whole, Michael Palliser, Ken Couzens and I were moderately encouraged rather than the reverse. The concept of a package to which all have to contribute and which has a multiplier effect has been firmly established: the report of the Schultze Group has been broadly endorsed: and the contributions sought by the key countries (US, Japan and Germany) have been identified. Whether - and to what extent - they will come up to scratch remains to be seen. However, even if the German tone is distinctly "may be", at least no-one is yet saying "No".

19. Our next preparatory meeting is in Bonn on 27 and 28 June when we shall also be looking at the first draft of a possible Communique.

20. I am sending copies of this minute and its annex to the Chancellor of the Exchequer and the Foreign and Commonwealth Secretary.



Sir John Hunt

29 May 1978