

SUBJECT

Courtesy Translation

The Federal Chancellor  
of the Federal Republic of Germany

March 9, 1977

PRIME MINISTER'S  
PERSONAL MESSAGE  
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Prime Minister.

HS 9/3

Dear Jim,

For your visit in the United States I should like to bring to your notice the enclosed non paper which my personal representative, State Secretary Poehl, will hand over to the Government of the United States while he is in America.

The paper deals with the economic points on the Summit agenda and deals in greater depth with the German attitude towards North-South dialogue questions.

With warm regards

Yours

(signed) Helmut Schmidt

His Excellency  
The Rt. Honorable James Callaghan  
Prime Minister and First Lord  
of the Treasury

Bonn, 8 March 1977

Points

for the Summit Meeting of the Heads of State and Government 7/8  
May 1977

I. World economic outlook

1. Economic situation and prospects

(a) The most recent data on economic developments suggest a somewhat more dynamic growth in most of the industrialized countries. However, the further expansion of the world economy is still fraught with uncertainties.

A sustained world-wide recovery is subject above all to the following risks:

- Another flare-up of national and international struggles over the distribution of wealth with their negative consequences for employment;
- a renewed acceleration and divergence of inflation rates on the basis of already high levels of inflation;
- distortions in the balance of payments structure;
- a stronger trend towards restrictive measures (also in the field of trade), together with increasing payments imbalances.

(b) The crucial economic problems for the future, which cannot be solved overnight but only over the medium term and in conjunction with each other, are therefore

- to combat unemployment;
- to mitigate inflationary tensions;
- to reduce the grave balance of payments problems.

2. Current account balances and prospects for 1977

(a) Within the group of OECD countries the following main problems can be seen for 1977:

- France: despite an improvement of \$ 2,000 million, a continuing high deficit of \$ 4,500 million;
- Italy: some improvement, but, especially with present signs of positive growth, still a deficit;
- Great Britain: the situation will be considerably improved during 1977 owing to the increasing production of North Sea oil; this is particularly to be welcomed from the point of view of the balance of payments situation since this oil replaces imports from the OPEC countries;
- the deficit of the smaller OECD countries is likely to remain about the same, above all in the case of Denmark, Greece, Portugal, Spain and Turkey.

(b) The OPEC countries' surplus will decline by approx. \$ 5,000 million which, however, should be taken as a cautious estimate, since their imports appear to be on the increase again. However, the surplus will be increasingly concentrated on four low absorbers, especially Saudi Arabia. The sound investment of this surplus will therefore be a problem to be negotiated with Saudi Arabia.

- (c) The deficit of the non-oil-exporting developing countries will go up again slightly. The problems of this group are concentrated more and more on individual countries already heavily in debt (e.g. Brazil, Mexico, the Philippines, Peru, Zaire).
- (d) The development of the German balance on current account over the past three years has been as follows:

<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u> <sup>*)</sup>
	(in \$ 1,000 million)		
10	+3.8	3.4	2-2.8

This means that in the course of three years the current account surplus of the Federal Republic of Germany will have fallen to approximately one quarter of the 1974 level, while imports have experienced a very dynamic growth.

Rates of increase in nominal and real imports and exports between 1975 and 1977 for the Federal Republic (as %):

	<u>1975</u>		<u>1976</u>		<u>1977</u> <sup>*)</sup>	
	nominal	real	nominal	real	nominal	real
Imports	+2.5	+2.6	+20.3	+17	+12.5	+11.0
Exports	-3.9	-10.2	+15.6	+14	+13.5	+ 9.5

By way of comparison, the nominal figures for several other countries are as follows (nominal development as %):

	<u>1975</u>		<u>1976</u>	
	Imports to the FRG	Exports from the FRG	Imports to the FRG	Exports from the FRG
USA	+1.8	-24.2	+23.4	+ 9.6
Japan	+23.5	-27.5	+26.5	+19.0
Great Britain	+10.7	- 8.3	+23.1	+20.7
Developing countries (excl. oil-exporting countries)	-15.2	- 9.1	+27.5	+ 5.6

\*) Estimate

This shows that the Federal Republic of Germany, owing to its timely policy for a revival of economic activity, has substantially helped to improve its partners' export opportunities.

3. Internationally concerted economic policy

- (a) Returning to a satisfactory level of employment must continue to be the main objective of the economic policies of the Western industrialized countries. This will require sustained growth and in particular a sustained increase in investment in the years ahead. An intensive effort must therefore be made on the national and international level to create confidence in future economic developments and in the capacity of governments to act. Such a growth of confidence, however, will not be possible without lasting progress towards price stability, especially in those countries with high rates of inflation, and improvements in the balance of payments situation.
- (b) Yet, in principle, the right approach will still be for countries with <sup>a</sup> favourable balance of payments and those with an adverse balance of payments, including those with differing rates of inflation, to pursue different economic policies and to set different priorities as regards the timing of measures: countries with a favourable balance of payments will play a leading role in bringing about a process of sustained growth while countries with an adverse balance of payments should give top priority to curbing inflationary trends and reducing their deficits, with incomes policy playing an important role.

However, the States with a favourable balance of payments do not all find themselves in the same starting position. In countries, such as the Federal Republic of Germany, that are highly dependent on external trade the willingness of companies to invest naturally depends on their export prospects. Thus, almost 50 per cent of German exports go to the countries of the European Community.

Development of wage costs per unit of production in several OECD countries weighted with the balanced exchange rate change in the respective currency (1970 = 100)

	1974	1975	1976
Federal Republic of Germany	161	173	186
USA	96	104	111
Great Britain	124	152	151
Italy	126	161	159
France	135	179	185

Source: official German figures

(c) In considering the role of the Federal Republic in the world economic recovery it should also be remembered that this country has already contributed a great deal towards the revival of economic activity:

- According to OECD statistics the Federal Republic had between 1973 and 1975 with 7.5 per cent the highest swing of all major industrialized countries in its public financing balance.

Public sector deficits in the Federal Republic have been even more expansive than in the United States. The following are the figures of an OECD survey (as a percentage of GNP<sup>a)</sup>):

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977<sup>b)</sup></u>
Federal Republic	+1.5	- 1.2	-5.9	-4.5	-3.75
USA	+0.2	-0.3	-4.5	-2.75	-2.75
Japan	+2.7	+0.2	-4.4	-4.25	-4

- An expansion in the money supply in excess of the 1975 and 1976 targets was tolerated. In 1976, this expansion made possible 5.6 % growth of GNP, a noticeable drop in price growth rates, as well as a reduction in long-term interest rates. In the fourth quarter of 1976 the increase in real GNP was, in terms of the annual increase, 6 %.
- The Federal Republic's rate of discount of 3.5 per cent is the lowest after that of Switzerland. It is now only half the highest level of 7 per cent reached in 1974.

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a) Balance of General government financing, i.e. central government regional administrations and social insurance institutions. Figures from OECD (some unpublished). US economic package and German several-year investment programme not taken into account.

b) estimate

(d) In terms of economic policy the Government of the Federal Republic of Germany foresees the following principal tasks:

- All tendencies to restrict trade must be resolutely countered (renewal of the OECD trade pledge). We note with satisfaction that the OECD countries have on the whole refrained from exchange controls and import restrictions. The negotiations on the liberalization of trade agreed in the Tokyo round of GATT should be successfully concluded before the end of this year in accordance with the Declaration of Rambouillet.
- The demand for a restrictive course to be adopted by countries with an adverse balance of payments should not be pressed too far; social tensions and political, and consequently further economic destabilization might otherwise ensue.
- This means that countries with hard currencies and/or current account surpluses should render balance of payments assistance within reasonable limits and on condition that the recipient countries are prepared to make an effort to help themselves (if possible, this should be done multilaterally within the IMF, with the OPEC surplus countries such as Saudi Arabia participating). In view of the already heavy indebtedness of many countries, confidence in flexible rates of exchange and Euro credits alone will not suffice.



## II. World monetary policy

4. The likely continuation of severe payments imbalances in the years ahead will create financing problems which the markets will not be able to cope with to the extent that they have done in the past. Both the reluctance of creditors to assume risks and the interest burden on debtor countries place limits on borrowing from banks.

Public loans, particularly loans by international institutions (above all the IMF), will therefore continue to have a major role to play. To some extent the imbalances can only be cured through a gradual process of diversification and changes in the structure of production. To help in this process long-term loans, particularly project loans, are necessary. Such loans are awarded by the World Bank, under bilateral financial assistance programmes and by development financing institutions.

5. Outside the IMF the OECD member States concluded in April 1975 an agreement establishing a financial support fund to finance large balance of payments deficits. The aim of the fund is to make it easier for deficit countries to raise loans on the national and international capital markets. The Federal Republic of Germany has ratified that agreement. Nevertheless, the fund has remained inoperative.
6. Although considerable use has been made of the various drawing facilities in the IMF, little use has so far been made of the possibilities for conditional loans. Most countries have made use of the relatively easily accessible special facilities or the first credit tranche. In order to increase

the pressure on countries arising out of the terms of IMF loans to adjust their economic policies, the Federal Government takes the view that steps should be taken to ensure that deficit countries first make full use of the possibilities for conditional IMF loans and that any further loans from central banks and banking institutions, or other agencies should only be granted and disbursed parallel with drawings from the IMF.

7. On the question of extending the IMF's scope for granting loans and also safeguarding the special interests of the oil-exporting countries, the Federal Government's position is as follows:

(a) Possibilities of increasing the IMF's scope for granting loans

The Federal Government is ready to support a reasonable increase in IMF quotas if, in such an event, more account is taken of the IMF's liquidity requirements, and if the quotas of the surplus countries are increased. It does not make sense to provide in the IMF for general quota increases which thus produce ever increasing drawing rights, only for these to be refinanced outside the IMF, for instance on the basis of the General Arrangement to Borrow or by means of bilateral loans to the IMF.

- (b) In cases of special need where countries have large payments deficits, the creation of an IMF special facility could be considered. The Federal Government would be willing to participate, but it feels strongly that this should be on the basis of conditionality.

To refinance such a facility for cases of special need, the oil-exporting countries particularly would have to be asked to participate. This could also help to meet their need to safeguard the exchange rate value of their investments (SDRs).

The special interests of the oil-exporting countries with current account surpluses concerning loan pledges to the IMF can be safeguarded by means of

- the usual denomination in SDRs;
- agreements on the interest to be paid on loans made available to the IMF;
- and the possibility of the oil-exporting countries appointing an IMF director of their own.

### III. North-South Dialogue

#### 8. Conference on International Economic Co-operation (CIEC)

- (a) The CIEC was scheduled to end in December 1976 but this date was put back to the first half of 1977 because there was no sign of a definitive result. The new date is the end of May, by which time solutions acceptable to both developing and industrial countries have to be worked out. Failure must be avoided for this would cause a serious deterioration of the climate between the industrial and the developing world and of relations with the moderate oil-exporting countries. Unless a clear course is charted at the economic summit the CIEC will be unlikely to produce a positive result.

(b) While the CIEC is still in progress, the industrial countries have already made important contributions, e.g.:

- Nearly all development aid appropriations of the Western industrial countries have been increased; help has gone in particular to the poorest developing countries, and the special needs of the countries most seriously affected by increases in the price of oil and world-wide economic developments (MSACs) are appreciated.

Official development aid  
(net contributions)

	1974		1975	
	bill.\$	%	bill.\$	%
OECD (DAC) countries	11.3	75	13.5	80
OPEC countries	2.5	17	2.6	15
COMECON countries	1.2	8	0.8	5
Total	15.0	100	16.9	100

Source: DAC Annual Report 1976

- The readiness to subscribe \$ 7,200 million towards the fifth IDA replenishment (the size of the additional participation of the OPEC countries is still open). Together the OECD members have made available to IDA so far \$ 9,650 mill. - not counting the fifth IDA replenishment, the OPEC countries (Kuwait) contributed \$ 50 mill; the contribution of the COMECON countries has been nil.

- The Lomé Convention between the European Community and 49 African, Caribbean and Pacific States. \*)
- Trade on easier terms within GATT (unilateral tariff reductions for tropical agricultural products, EC customs preferences for industrial goods and semi-manufactures).
- The creation of substantial additional credit facilities for the developing and commodity-exporting countries by the IMF (Kingston/Jamaica, at the beginning of 1976): On account of the widening of the general drawing possibilities within the IMF and the easier facility terms for the compensatory financing of fluctuations in export earnings, borrowing from the IMF has increased considerably.

IMF drawings in 1000 million SDR

	1975	1976 (of which developing countries)
Compensatory financing	0.2	2.3 (1.5)
Other drawings excluding oil facility (net)	0.5	1.0 (0.5)

In addition, member States availed themselves in 1976 of 2,000 million SDRs within the framework of expiring oil facility credits, of which 300 million SDRs went to the developing countries.

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\*) Total \$ 3,800 mill. for 5 years, of which \$ 420 mill. for the commodity export earnings stabilization fund.

The sales of gold by the IMF have up to March 1977 realized a profit of approx. \$ 450 million for the Trust Fund. This amount will go to the poorest developing countries.

- An improvement in the quotas and voting rights of developing countries (oil exporting countries) in the IMF and the World Bank (similarly in Kingston, Jamaica; not yet ratified),
  
- Co-financing of the International Fund for Agricultural Development (IFAD), which has a total volume of approx. \$ 1000 million, of which the industrial countries provide \$ 576 million, the OPEC countries \$ 453 million.

This performance must also be given adequate consideration at the CIEC and UNCTAD. It is necessary that the industrial countries should draw attention to it there publicly. Moreover, the results of the current UNCTAD Conference must also be introduced at the CIEC and vice versa.

- (c) All the demands raised by the developing countries are being debated at the CIEC. From the point of view of the developing countries, the main issues are the creation of new financing instruments and means and the granting of additional official development aid, as well as debt relief. Several aspects of the commodities question are involved, but the substantive aspects of the Integrated Commodity Programme are being dealt with by UNCTAD.

The developing countries demand at the CIEC

- agreement in principle by the industrial countries to play an active part in carrying out the UNCTAD Integrated Commodity Programme;
- The indexation of their oil and commodity prices;
- guarantees with regard to the preservation of the purchasing power, exchange rates, transfers, compensation for expropriation, as well as tax concessions for OPEC investments.

The industrial countries must, in the interest of the world economy as a whole, make additional contributions in the North-South Dialogue conditional upon the maintenance of the world economy's ability to function, improvements in balance of payments structures, and a return to greater stability and greater constancy in world economic relations.

Consequently, we reject the Integrated Commodity Programme in the form proposed by the UNCTAD Secretariat. On both economic (ability of the world economy to function) and financial grounds, it cannot be regarded as a suitable measure.

Like the other industrial countries, we also reject the indexation proposal. This would operate mechanisms which would tend to increase inflation and cause the misallocation of investments; and in the final analysis it would be harmful to the commodity exporting countries themselves in that it would increase the development of substitute products.

The industrial countries (though with France not so determined) also refuse special treatment for OPEC investments on the grounds of principle (although, on account of Saudi Arabia's key role, special solutions are being sought outside the CIEC).

For their part the industrial countries demand:

- Continuous consultations in the energy sphere with a view to establishing greater oil price stability and securing adequate supplies of this commodity. Up to now this proposal has been rejected by the developing countries.
- Protection for their investments in developing countries.

The three groups of countries (industrial countries, developing countries, oil-exporting countries) will have to follow the path of compromise if the CIEC is to be saved. In this respect we expect the COMECON countries to adopt a constructive attitude.

(d) With regard to the debt question, the European Community and the United States, proceeding on the basis of the Nairobi Resolution, have jointly proposed features designed to ease long-term structural financial problems. We presume that these features will not be applied in practice before 1978. They are not sufficient for the developing countries. But in actual fact they constitute a substantial concession to these countries and in the view of major donor countries are a suitable means of resolving the long-term structural problems of developing countries. They enable them to obtain official aid on a case-by-case basis and on the strength of clear-cut criteria. Aid to the LLDCs and MSACs will probably increase in this way.

The Federal Government realizes that in order to achieve the aims of the industrial countries at the CIEC and UNCTAD it may be necessary for them,



prior to the regular application of the features, to mount a non-recurring, speedily effective financial operation. It has not yet concluded its deliberations on this point that starts from the assumption that such an operation would only be proposed in the final stage of the CIEC by all donor countries acting in mutual agreement and that the following conditions would be observed:

- The features must not be prejudiced thereby,
- it must not be regarded as an automatic procedure (retention of the case-by-case principle) and the operation must not be conceived as debt relief,
- the one-time operation must not establish a precedence,
- the OPEC countries must participate.

9. International commodity problems (UNCTAD)

- (a) Pursuant to Resolution 93 (IV) adopted in Nairobi, the discussions on the Integrated Commodity Programme have begun within the framework of the envisaged procedure.

With regard to the Common Fund, the developing countries intend to push through in Geneva in March an international agreement on the basis of the UNCTAD concept. The large majority of industrial countries are not prepared to go along with this but do not wish to reject it altogether. In Geneva, therefore, it will not yet be possible to secure an agreement, so the objective must be to set out the substantive arguments and develop alternatives. This amounts to a postponement of the Conference

which will only be possible without a showdown if at the end of the Conference the developing countries are given a clear indication that the industrial countries are willing to continue the negotiations in a constructive spirit.

- (b) The Federal Government gives priority to commodity sector solutions which are designed to improve market structures and stabilize the development process of the developing countries and which are in conformity with market mechanisms. We reject global controls which would benefit all commodity-rich countries without distinction (including USA, Canada, Australia, South Africa, USSR) and place an additional burden on commodity-poor countries. Our strongest misgivings concern the following:
- Commodity agreements aiming at the transfer of resources;
  - A Common Fund as a world commodity agency to be set up in advance, with management functions and its own funds or government guarantees for borrowing in the capital market;
  - Indexation and real value guarantees;
  - Obligatory co-financing of buffer stocks.
- (c) The Integrated Programme in the form proposed by the UNCTAD Secretariat is not acceptable (commodity controls, estimated cost: up to \$ 40,000 million).

(d) The Federal Government is therefore anxious to find solutions which

- will, on the one hand, help the poorest of the developing countries, and
- on the other, can be kept within financial bounds.

To the Federal Government an alternative suited to this purpose would lie in the stabilization of earnings which, in contrast to the Integrated Commodity Programme, would have the advantage that

- it would afford assistance to the most needy countries,
- it would be financially limitable in accordance with appropriate criteria and on account of its revolving character,
- it would not require any intervention with regard to prices on commodity markets.

The main features of such a system could be, for instance:

- preferential assistance to the poorest developing countries,
- all commodities of these countries (except oil) would be covered;

- longer-term loans at interest rates lower than those of the IMF compensatory financing facility; in special cases also grants;
- losses of earnings would be offset by overall exports of commodities.

Such a model would, both as regards the number of commodities and countries covered, go beyond the scope of the stabilization fund of the Lomé Convention. The compensation for the decline would, as under the Lomé Convention, only begin when certain fixed levels are exceeded.

Possible sources of finance would be the capital market (plus government guarantees) and budgetary funds. The Federal Republic is willing to bear its share of the burden. If possible the mechanism for the stabilization of export earnings should be built into one of the existing international financing institutions.

Along with this, the Federal Government believes, the conclusion of individual commodity agreements could be considered, which

- would serve to avoid extreme price fluctuations on a particular commodity market,
- maintain prices which will make it possible to keep a balance between supply and demand in the long term,
- prove to have a tenable cost/benefit ratio,

- embrace all major producer and consumer countries.

We could agree to a Common Fund at best in the form of a clearing centre for individual commodity agreements, insofar as they make provision for buffer stocks. This would be with the proviso that the fund would have no commodity management function nor funds of its own, and that it would have no government contributions or government guarantees for borrowing on the capital market.

#### IV. Energy policy

##### 10. The development of the world energy market

(a) According to the figures of the OECD's World Energy Outlook just published, the trends on the world energy market do not augur well for the future:

- The OECD countries' consumption of primary energy will increase, taking 1974 as a basis, by 3.6 per cent a year up to 1985.
- The OECD countries' demand for oil imports will increase by some 50 per cent up to 1985, due mainly to a substantial increase in the United States' dependence on imports.
- World demand for OPEC oil will increase by 1985 to 39.3 million barrels per day (in 1976 some 27 million barrels per day), i.e. an increase of approx. 45 per cent.

These figures underline the need for close co-operation by the oil-consuming countries in developing alternative sources of energy to OPEC oil and intensifying efforts to conserve energy.

Despite all the efforts of the consumer countries to develop their own sources of energy (particularly coal and nuclear energy, as well as new forms of energy in the long term), oil will remain the principal source of energy in the medium term.

- (b) The two-tier price system for oil agreed in Doha/Qatar certainly does not mean the end of OPEC. It is also improbable that a system of different price levels for oil can be maintained in the long run. In our view there are good grounds for expecting a reconciliation of views. The price moderation of Saudi Arabia and the United Arab Emirates is primarily due to American influence. However, this success is being put in jeopardy by American companies which, by stepping up their demand for African oil, are supporting the 10 per cent increase in the price of this oil. The price of North Sea oil is, as in the past, also following the rise in price for the qualitatively comparable African oil. Most of the North Sea oil, however, is processed in the integrated supply systems of the big companies.

11. Energy policy of the industrialized countries

The success of the efforts of the consumer countries to safeguard their energy supplies will depend largely on the United States. The United States as the biggest Western energy consumer and producer is in this sense of key importance for the policy of the other consumer countries. We hope therefore for an American policy which will accelerate the development of America's own energy sources, particularly oil and gas, but also nuclear energy and coal, and also strongly promote energy conservation.

Such a policy is an essential precondition for the continued success of the International Energy Agency, which we regard as an extremely important forum of co-operation, since it embraces nearly all the major Western oil-consuming countries.

12. Relations with the OPEC countries

Continuing consultations with the OPEC countries, which are being sought by the industrialized countries in the interest of greater price stability and reliable supplies for all, should be put on an appropriate institutional footing.

V. Trade policy

13. GATT negotiations

- (a) The GATT negotiations which opened in September 1973 in Tokyo have been proceeding at a slower pace than expected. If the aim reaffirmed at Rambouillet and Puerto Rico of concluding the GATT negotiations in 1977 is to be achieved, concrete political impulses will be needed

from the main participants (in the sphere of trade policy competence lies with the European Community). An appropriate platform for this could be a GATT conference of ministers which would be convened to draw up the final negotiating package and to agree on a time-table for negotiations.

(b) The German approach is based on the following objectives:

- Early agreement on the simplest possible formula for tariff reductions, having due regard to the principle of harmonization but also taking full advantage of the United States' negotiating ceiling (up to 60 per cent reductions).
- Agreement on codes for norms, customs value, government purchases, import procedures and subsidies and countervailing duties. General reduction of the remaining import restrictions according to an agreed time-table.
- Reconciliation of the different standpoints particularly of the European Community and the United States in the agricultural sector.
- Revision of the safeguarding clause (improved international control, selective measures where appropriate under particularly serious circumstances).



- Granting of additional preferences in appropriate cases to take account of the trade interests of the developing countries.

We are endeavouring to ensure that these ideas have their place in the policy of the European Community.

14. Trade pledge

- (a) The trade pledge has in general fulfilled its original purpose of preventing countries taking unilateral action in the sphere of trade policy or relapsing into protectionism in order to deal with balance of payments difficulties arising out of the oil crisis.
- (b) The danger of individual States taking unilateral protectionist measures is, in view of the continuing severe payments imbalances in the present state of the world economy, no less acute than during the oil crisis in 1973, which was the main reason for the acceptance of the trade pledge. The maintenance of free world trade and the prevention of restrictive trade measures must continue to have high priority. To achieve these aims it would be appropriate also in 1977/78 to reaffirm the political commitment to the existing trade pledge as a valuable form of international co-operation.