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ECONOMIC SUMMIT, BONN, 16/17 JULY 1978: SECOND PLENARY SESSION ON SUNDAY 16 JULY AT 15.15 IN THE PALAIS SCHAUMBURG.

c.c. Master Set

Terrorism

Chancellor Schmidt said that there had been a general feeling among the Heads of Government at lunch in favour of making a second statement at the conclusion of the Summit Meeting, in addition to the main declaration, on a joint effort by the participating Governments to fight terrorism. This would take the form of a joint commitment to prohibit flights by national carriers to countries which had refused to promise to return hijacked aircraft, together with the hijackers, to the country where the crime of hijacking had been committed. Foreign Ministers should instruct their advisers to arrange the drafting of such a statement, which could either be in the form of a simple declaration or in that of a ratifiable agreement. A draft text should be submitted to Heads of Government on the morning of the following day. Premier Trudeau proposed that the statement should cover flights by national carriers to third countries. Chancellor Schmidt added that it should also make it clear that the national carriers of countries which refused to give the necessary undertaking would be prohibited from landing in the countries represented at the Summit. This was agreed.

/Energy

Energy

Premier Trudeau said that the proposed section of the declaration which referred to energy should be made more specific, especially on the question of aid in the energy field to the developing countries. It was important, both from the point of view of the LDCs themselves and from that of the world energy crisis, that a proportion of aid by the industrialised countries should be devoted to the development of renewable energy resources in the LDCs; and that the World Bank should be encouraged to lend money to the LDCs not only for the development of energy resources but also for the exploration of hydro-carbon resources. Aid for the development of hydro-electric power and solar energy could help the balance of trade problems of the LDCs. Signor Andreotti said that paragraph 5 of the declaration should make it clear that the reduction of imported oil should apply only to non-productive uses; a reduction of imports which impeded production would not be helpful. So far as paragraph 12 of the draft was concerned, the environmental point should be strengthened and given greater emphasis.

The Prime Minister said that the OPEC surpluses had been declining quite significantly during the five year period which would end in 1979. If the demand for crude oil were to increase only moderately up to 1985 the point at which an increase in price could be justified would be reached well before then. Nobody wanted to see an increase in the price of oil during the next 12 months; but if faster growth accelerated the development of new sources of energy the oil producing countries would need to consider their position. The Saudis and the Iranians, in particular, would be running short of money well before 1985. The industrialised countries should consider whether it would be better to sit tight and reconcile themselves to a substantial price increase at one fell swoop in, for example, 1982 or whether they should not promote the idea of a gradual rise in the price of oil. Chancellor Schmidt reported on his talks with Crown Prince Fahd of Saudi Arabia two weeks earlier, when the Crown Prince had expressed concern over the economic consequences to the industrialised world of the price increase which he thought likely to occur during the next 12 months. The Saudis were aware that their capacity for absorbing oil revenues would not enable them to balance their exports of oil with imports from the industrialised countries for some time and that they would consequently remain in surplus for the foreseeable future. The Saudis were worried that they might be forced by other OPEC members, as a result of trends in the dollar exchange rate, to raise the price of oil earlier and more significantly than would be prudent. The Saudis were also deeply concerned by Soviet activities in the Horn of Africa and in the Arab Peninsula. Soviet policy, in the Saudi view, had the dual objective of expanding Soviet influence over Africa as a whole and also, in particular, of reinforcing their political influence in the oil producing region in order to ensure their supplies during the period, which would be reached by the mid-1980s, when they expe cted to be heavily dependent on imported oil. Chancellor Schmidt said that, speaking for the FRG, he was himself concerned by the consequences for the industrialised world of a renewed outbreak of war in the Middle East - a possibility which could not by any means be excluded given the current Israeli attitudes. He thought that oil would be used as a means of exerting pressure on Israel, through the Western powers, even more massively than in 1973. In this connection, the Chancellor went on, there was rising irritation and concern in those countries represented at the Summit which had no indigenous energy resources, for example in Italy, over the fact that the development of alternative sources of energy were being increasingly constrained by the high level of public sensitivity and by the environmental policies of Governments. The Chancellor said that he fully agreed that environmental constraints should be given proper emphasis: but nuclear energy was badly needed if Western Europe was not to be at the mercy of foreign pressure and, perhaps, maimed by it. All those round the table were awaiting the results of the INFCE studies but, meanwhile, irritation was growing with, for example, the implications of

/US

US legislation on non-proliferation. The Chancellor said that he would like to know whether what had been said on this subject by the United States at the Downing Street Summit was still valid or whether there were to be new difficulties. If the latter, this would pose very acute economic and, perhaps more importantly, strategic problems . The FRG had no desire to be dependent on the Soviet Union for uranium enrichment; he wanted to protect the FRG's freedom of negotiation and he was sure that others would wish to do the same. The Chancellor said that the FRG would be very stubborn on this issue, for example on Clause 4 of the Non-Proliferation Treaty.

Mr. Fukuda said that he entirely supported Chancellor Schmidt's views on nuclear energy. Nuclear proliferation clearly could not be allowed but, since the world's petroleum supplies were dwindling, industrialised countries had to prepare for this new situation and nuclear energy offered the only means of doing so. Mr. Fukuda said that non-proliferation and the development of nuclear power were separate issues and compatible with each other. Recalling his remarks at the morning session, Mr. Fukuda said that he wished to re-emphasise that the world was living through an age of uncertainty, largely because there was no clear perception of the future in the field of energy. The world should be preparing for the post-petroleum era and should improve its vision of what was to come. If there was a clearer perception of the new era and its problems, the oil producing countries might be more willing to raise the level of production. No time should be lost in studying the implications of the exhaustion of oil resources; and research would be more effective if it was carried out in unison on a co-operative basis. The age of uncertainty could and should be transformed into the age of certainty: otherwise, the end of the oil era would be followed by political chaos.

President Giscard said that far less had been achieved in the OECD programme for the development of nuclear energy than had been envisaged in 1974. This provided part of the explanation for the slow down in growth in the OECD countries: growth had been 0.2 per cent lower than would have been the case if the energy programme was up to schedule. France had decided to build nuclear power stations with a total capacity of 10,000 megawats by 1981, which would put her into second place in the world nuclear energy league. Public opinion in France accepted the national programme for the development of nuclear power and q12 new sites for power stations had been prepared giving the Government a reserve of sites. French public opinion appreciated that France had to have a national source of energy. A better public understanding of the need for the development of a nuclear energy programme might be helpful to other OECD partners, including the FRG. So far as difficulties concerning the supply of nuclear fuel were concerned, agreement had recently been reached with the United States about supplies to EURATUM; could the US now confirm that there would be no further Government intervention until after the conclusion of the INFICE negotiations? President Giscard went on to say that the non-nuclear countries felt that they were being pushed to one side by those countries with a nuclear energy capacity and that it would be important to associate them with the further research undertaken by the nuclear states.

President Carter, admitting that the US was the world's largest consumer of energy, pointed out that the US consumption of 1.46 barrels of oil a day for every thousand dollars of GDP was not significantly higher than the OECD average figure of 1.38 barrels per day: for some OECD countries the figure was higher than that for the US. The US had reduced its rate of imports by 8 per cent since 1972, although there had been a surge in 1976/77, resulting from rapid growth and a reduction in domestic production. Even so, the US increase in consumption had been only 34 per cent of the rise in the US GNP since 1972, even without Federal legislation. The importance of the automobile on the vast US continent created a special problem so far as gasoline was concerned; but the US had tackled it through mandatory fuel efficiency standards, an increase in prices and a mandatory speed limit of 55 mph. The legislation now before Congress

/would cut

would cut imports by 2.5 million barrels per day by 1985 and by nearly as much even if only the non-controversial components of the legislative package were in the event approved. The US aimed to expand its coal production by two-thirds. The ratio between the growth of GNP and the growth of energy consumption was already less than eight-tenths of a percent and the volume of oil imports in 1978/79 would be lower than in 1977. The US intended to use its influence with the OPEC countries to keep prices at their present level until at least the beginning of 1979 and to minimise any subsequent increase. Mr. Blumenthal would be visiting Saudi Arabia in the autumn to discuss these matters. The US was also helping other countries to develop their energy resources and to explore new ones e.g. in Venezuela and China. President Carter said that he agreed with what had been said about the Soviet Union's requirements for imported oil; a figure for Soviet oil resources produced by the CIA 18 months before had been criticised for being too low but had now been confirmed by other evidence.

President Carter went on to say that the US position on nuclear energy had not changed since the Downing Street Summit but if the non-proliferation issue were not tackled effectively, all countries would face serious difficulties. Public opinion in the US did recognise the need to develop nuclear energy but also believed that tight international safeguards were essential. The US had a heavy conscience as a result of its role in the development of nuclear weapons and shared with Canada the responsibility for enabling India to become a nuclear power. Ten or a dozen nations had demonstrated, during the last decade, their desire to transform reprocessed fuel into explosive material - South Africa, Argentina and Taiwan among them. Despite this problem, the US did not wish to impede the development of nuclear power including breeder reactors subject to proper safeguards. He could confirm that there would be no interruption of supplies while the INFICE negotiations continued. The President said that he thought that the national US interest in energy problems was now more compatable with Europe's concerns than had been the case previously. The Americans were aware of the need for conservation and for the expanded production of nuclear power. The President expressed confidence that he would have a success in Congress on the energy issue before the end of 1978.

/Chancellor

Chancellor Schmidt suggested that the wording of paragraph 9 of the draft declaration about nuclear fuel supplies should be strengthened in the light of what President Carter had said. President Carter accepted this.

[The session adjourned at 1615 to enable Chancellor Schmidt to brief the press on behalf of all participants; and reassembled at 1655.]

Premier Trudeau said that he would like to associate Canada with President Carter's guarantee that there would be no interruption of shipments of nuclear fuel, provided that safeguards were respected while the INFICE negotiations continued. Mr. Trudeau said that he was not fatalistic about proliferation; he thought that it could and should be prevented. The list of countries which were close to achieving full nuclear capacity had not altered significantly for several years: several countries which might ha e been expected to cross the threshold had not done so.

Turning to the draft declaration, Chancellor Schmidt said that the new US statement (which President Carter read to the meeting) should now be included in paragraph 5. At President Giscard's suggestion, President Carter agreed to consider a tougher formulation for the sentence about the reduction of US oil imports in 1979/80. Chancellor Schmidt proposed that a passage should be included on the lines of what was said in the Bremen relever de conclusion about energy, reaffirming the EEC's commitment to a substantial reduction of oil imports. This was agreed.

After some discussion, it was decided not to pursue Signor Andreotti's wish to specify that reduction should apply only to non-productive uses. It was agreed that paragraph 9 of the declaration should be amended to make it clear that suppliers of nuclear fuel would honour existing commitments subject to rigid international safeguards. In connection with paragraph 10 concerning coal, Chancellor Schmidt said that he wished to point out on behalf of the FRG that the Federal Government's massive subsidies of the coal industry, designed to maintain coal production in an uncertain period so far as energy was concerned, imposed a very heavy burden on the FRG

/budget

budget; he hoped that nobody would seek to criticise the FRG for applying subsidies. An Italian amendment to paragraph 12 of the declaration about the environment was agreed, as were Canadian amendments to paragraphs 13 and 14. President Giscard proposed that paragraph 14 should allow a role to international bodies other than the World Bank; this was agreed. It was also agreed that a deadline for action would be built into the passage on assisting LDCs in the energy field. The OECD should be instructed to analyse the question and report to participants in time for the next Economic Summit.

Monetary Questions

President Giscard said that the existing paragraphs in the draft declaration on monetary questions were positive put too vague. He said that he would like to explain to the participants in the meeting the efforts which the EEC was making to ensure increased monetary stability. Of the major monetary zones , only the EEC had experienced a high degree of instability, characterised by variations in rates as high as 60 per cent between the highest and the lowest. Between 1974 and 1978, the Japanese economy would have grown by 14 per cent, the US economy by 9-10 per cent and the EEC by less than half that amount. President Giscard said that he believed there to be a definite relationship between monetary stability and growth. The EEC, the world's largest commercial power, carried out half of its foreign trade within itself; greater stability would thus affect a sizeable volume of trade. The method would be to adopt ~~suitable~~ stable exchange rates tied to intervention and to create facilities for the short and medium terms. There would also be mechanisms to regulate long term fluctuations. Twenty per cent of members' currency reserves would be made available to a fund, denominated in ECUs, which would total $50 billion. For Mr. Callaghan's benefit, he would emphasise that no decisions had yet been taken. The objective was that parities would be changed with the agreement of all the parties concerned but infrequently. All the European currencies would move in parallel as against the dollar and the Yen. The system would enable the FRG, for example, to stimulate its economy to a greater extent than would otherwise be possible because the Dm would be weighed down by the weaker

/currencies

currencies. These currencies would, in turn, be buoyed up by the Dm. Fears had been expressed that the system would be hostile to the dollar and the yen. These were unfounded. Greater stability would help growth and exports in the Community and the proposed system was thus fully in line with the objectives set out during the morning session on growth and unemployment.

Mr. Fukuda said that Japan assessed the significance of the outcome of the Bremen meeting very highly. Since the London Summit, Japan's target for economic growth had not been achieved (in common with other countries) largely because international currency instability had played havoc with Japan's economic projections. Japan's failure was primarily due to the appreciation of the yen and the depreciation of the dollar; without this, the target of 6.7 per cent growth could have been achieved. The situation could be similar in Europe where monetary instability had affected the Community's growth projections. It was true that each country had to deal as best it could with the fundamental economic factors of inflation and deficit (or surplus). But it was also important to pay due regard to the effects of abrupt fluctuations in exchange rates. This problem, as well as the fundamental ones, had to be tackled simultaneously. So long as there was instability in the world's key currency, the dollar, it would be impossible to achieve stability in the world economy. Mr. Fukuda urged the United States to do everything possible to prevent excessive fluctuations in the dollar rate.

President Carter said that his knowledge of the details of the proposals put forward at Bremen were limited and he recognised that there was not unanimity on the issue within the EEC. It was a firm policy of the United States to encourage European cohesion and unity in all matters, including monetary issues. The US nevertheless had some concerns about the proposed scheme, which might be based on ignorance. The US was very satisfied with the revised Articles of Agreement for the IMF; President Carter said that he hoped that the European plan would be compatible with these principles and also that it would have no adverse effect on the dollar. The US would like to be kept fully informed of Europe's plans so that American comment could be entered if necessary.

/The President

The President said that the Reserve Fund which was contemplated appeared to be a very large one and he would like to know how it would be used. If a result of the system were to be to put more pressure on the deficit countries than on the surplus countries, this could have a negative rather than a positive impact on growth.

President Carter went on to say that he could not agree that the failure to meet growth targets could be attributed exclusively to the depreciation of the dollar. The fact that some growth targets had been missed by as much as 50 per cent in itself pushed the dollar down. President Carter repeated that the United States would not attempt to interfere in any way in Europe's plans but that he would like to be kept fully informed. Mr. Jenkins expressed strong support for President Giscard's remarks. The period during which Bretton Woods had operated had been more conducive to growth than recent conditions of instability. The Bretton Woods system had come to an end before the major onset of inflation; but the effect of the new currency instability would be more damaging to growth in Europe than in the rest of the world. The situation was as if major exchange rate fluctuations occurred between New York and San Francisco and between Tokyo and Osaka. It would not be right to impose rigidity but the European countries should be held closer together; this would favour growth and confidence. Mr. Jenkins assured President Carter that the proposed scheme was not hostile to the dollar in any way and should, in fact, have a beneficial effect on the dollar's stability since it would be more difficult to speculate against it, moving subsequently into more attractive European currencies. President Giscard said that the EEC's real motivation was a long term one. The current period of uncertainty and new adjustments, particularly in the fields of energy and of the super-competitives, demanded a degree of flexibility in the monetary system. With the exception of the UK, the EEC countries lacked natural energy resources and they had large traditional industries which needed time to adapt to new situations. If the present climate of uncertainty was removed, structural modifications would be easier to achieve. President Giscard said that he had no objection to the open and full exchange of information on these issues with both the United States and Japan.

/Chancellor Schmidt,

Chancellor Schmidt, speaking for the FRG, said that growhh in the FRG was held down by fluctuations not only the dollar rate but by fluctuations in all rates of exchange. Uncertainties on exchange rates had a very adverse effect on the forward planning of manufacturing companies. The situation in Europe was different from that in the huge North American market which enjoyed a single zone of monetary stability. A machinery manufacturer in Canada could not be affected in any way by fluctuations in the European currencies. Even a small machinery manufacturer in the FRG, employing as few as 100 workers, could be expected to export 50 per cent of its production but had no way of forecasting currency fluctuations - this was a major source of unease and one of the main reasons for low investment levels in the FRG. Twenty years after its foundation, the EEC had already achieved a situation in which the borders between its Members were no longer economic borders. The EEC Members were dependent on each other for supplies but suffered because of the existence of five different currencies within the Common Market. Chancellor Schmidt said that the Dm had appreciated against the dollar by 78 per cent since 1969, which represented an increase of 38 per cent in real terms. The FRG's imports had risen much more rapidly than its exports; because of exchange differences imports had in fact grown three times faster than exports. The FRG's exports had risen by three times in real terms during the past three years but her GNP had risen by one-fifth of that. What it came to was that the FRG had exported jobs; the FRG's contribution to world growth had been to tolerate this situation. The Chancellor said that he did not believe that there was any way in which Europe could influence the long term development of the dollar; this depended on such factors as the internal rate of inflation in the US It was a matter of the whole basic balance of the US economy, , not simply one of the balance on the current account. In view of the size of the US domestic market, American companies had too little incentive to export - Europe could exercise no influence on factors such as this. What Europe could influence, however, was the volatility and sensitivity of the reactions to these fundamental factors. The Chancellor said that he was surprised, after all the talks which had taken place between the FRG, France and the US in Washington, that President Carter could still be concerned by the impact of the European scheme on the dollar.

/No member

No Member of the EEC had been able yet to assess all the technical implications of the proposals; but he was himself convinced that if a zone of stability could be created within the Community, the Community's Members would enjoy a higher rate of growth.

President Giscard intervened again to say that he did not think that the Summit meeting should be asked to give any indication of approval for the Community's scheme, which was a matter for the Community. In briefing the press, however, Chancellor Schmidt could say that the Community had taken steps during the meeting to inform her main partners of the Community's intentions. Chancellor Schmidt pointed out that the European scheme for monetary reform constituted only one aspect of monetary issues. He had noted that the dollar assets of the Central Banks of the industrialised countries other than the US had increased by $30 billion over 5 years. The Central Banks had intervened to that extent in order to help to stabilise the dollar; but this process could not continue indefinitely because Central Banks in order to intervene, had to print more of their own national currency. Before long, the Central Banks will conclude that they had no need of any more dollars and that they could not continue to print new money.

President Carter said that his impression of the discussion which had taken place was that the major thrust of the European proposal was not to level out internal exchange rate fluctuations but to curb the fluctuations between the European currencies on the one hand and the dollar on the other. The President said that he was not by any means persuaded that the dollar was currenly undervalued. The US believed that the circumstances of international trade and the prospects for inflation and fuller employment all helped to determine the value of a currency. President Carter said that he had not detected any impact on the levels of the FRG's or Japan's exports from fluctuations in the value of the dollar. The US had not put any obstacles in the way of Europe's exports and had adopted a much more forthcoming approach than Europe in the MTNs. The EEC, on the other hand, had closed out US agricultural products; the US had not protested even against this. The US had not, the President noted, been criticised for excessive imports of manufactured goods but only for high imports of oil. The US had no wish to interfere in Europe's affairs but he felt bound to demonstrate that there were arguments on the other side as well. The US would like to be consulted during the process of decision-making on the monetary scheme as well as on the eventual outcome.

The Prime Minister commented that the discussion of monetary issues had been valuable. He agreed that the industrialists and traders of Western Europe disliked currency fluctuations and did their best to insure against them. But it was nevertheless necessary to seek greater stability: it was absurd that the £ sterling should be able to fluctuate from 1.55 to 1.95 in six months against the dollar. The Prime Minister said that having been bitten on previous occasions, he was now inclined to be sceptical of whether it was possible to beat the market by this kind of arrangement although if the Central Fund were large enough it might be possible. The Prime Minister said that he was strongly in favour of trying to iron out currency fluctuations. This was not the place to explore the differences of emphasis within the EEC. He would only say that if any scheme which might be introduced was conducive to growth, he would applaud it. The Prime Minister said that analogies which had been drawn with the North American market were imperfect. The existence of a single currency had not prevented the drift of industry from the North East United States to the South. The UK's trade with the EEC amounted to 38 per cent of the UK's total trade; this meant that 62 per cent of the UK's trade was conducted outside the Community and this larger percentage would thus be unaffected by whatever advantages a monetary scheme produced. The Prime Minister said that the UK would nevertheless examine the scheme in a constructive manner. It would, however, be essential to bear in mind that the scheme should not implicitly, let alone explicitly, operate against the US dollar. The Prime Minister went on to say that he would like to re-emphasise the point made by Mr. Fukuda that monetary techniques could not tackle fundamental problems effectively. The more important objectives in ending the recession were those of equalising inflation, reducing discrepancies in balances of payments and producing greater convergence so far as growth was concerned. He was confident that all Members of the EEC would wish to keep the United States fully informed of developments, and this should be made clear to the press. The Prime Minister expressed the hope that Europe would be able to arrive at a constructive

/conclusion

conclusion in this matter.

Chancellor Schmidt agreed that the European monetary scheme could not significantly affect the underlying trends of the major non-European currencies, although it might smooth out short term fluctuations in the dollar exchange rate. In the last resort, every country had to observe the discipline which was imposed by its own balance of payments situation. The FRG had allowed the Dm rate to rise, since it was thought that domestic price stability was the first priority. Irritation which fluctuating rates was now rising to an extent which, however, made action necessary. The Chancellor agreed with the points made by the Prime Minister and confirmed that he would be willing to inform the US, Canada and Japan continuously on the refinement of the European scheme. He would make this clear to the press.

It was agreed that no amendments were required to the text on monetary issues as drafted.

Premier Trudeau warned against exaggerating the homogeniety of the North American market. The Canadian dollar had fallen from 103 to 89 in 15 months against the US dollar. Canada's interests were by no means completely parallel to those of the United States. In response to a question from the Prime Minister, Mr. Trudeau said that in due course Canada would favour a fixed rate against the US dollar but only provided there was greater convergence between the Canadian and US economies.

The session ended at 1830.