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## INTERNATIONAL CONFERENCE AT PUERTO RICO 27-28 JUNE 1976

Those present:

### Canada

The Rt.Hon. Pierre Elliott Trudeau,  
P.C., M.P.  
The Hon. Allan J. MacEachen, P.C.,  
M.P., Minister for External Affairs.  
The Hon. Donald S. MacDonald, P.C.,  
M.P., Minister of Finance

### Italy

Signor Aldo Moro, Prime Minister  
Signor Mariano Rumor, Minister  
for Foreign Affairs  
Signor Emilio Colombo, Minister  
of the Treasury

### France

President Valéry Giscard d'Estaing  
M. Jean Sauvagnargues, Minister of  
Foreign Affairs.  
M. Jean-Pierre Fourcade, Minister of  
Economy and Finance

### Japan

Mr. Takeo Miki, Prime Minister  
Mr. Masayoshi Ohira, Minister  
of Finance  
Mr. Kiichi Miyazawa, Foreign  
Minister

### Federal Republic of Germany

Chancellor Helmut Schmidt  
Herr Hans-Dietrich Genscher,  
Federal Foreign Minister  
Dr. Hans Apel, Minister of Finance

### United Kingdom

The Rt. Hon. James Callaghan, M.P.,  
Prime Minister  
The Rt. Hon. Denis Healey, M.B.E.,  
M.P., Chancellor of the  
Exchequer  
The Rt. Hon. Anthony Crosland,  
M.P., Foreign and Commonwealth  
Secretary

### United States of America

President Gerald Ford  
Dr. Henry Kissinger, Secretary  
of State  
The Hon. William Simon,  
Secretary of the Treasury

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NOTE OF THE FIRST SESSION OF THE INTERNATIONAL CONFERENCE AT  
PUERTO RICO ON SUNDAY 27 JUNE 1976 AT 1615 HOURS

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INTERNATIONAL ECONOMIC PROBLEMS

After welcoming those present, President Ford said that they faced the formidable task of considering over the next two days ways of improving the well-being of the citizens of their countries and of fulfilling hopes for a more prosperous world. International conferences tended to arouse exaggerated hopes of new initiatives. But as at Rambouillet, what was needed was a continuing attempt by the industrialised countries to consider ways of improving the prosperity of the industrialised world, and a continuing effort to concert policies to shape the future rather than react to crises.

All those present shared mutual political and security responsibilities. They had a strong commitment economically to find ways of broadening the relationships between them. Interdependence meant that none of us was likely to solve his problems alone, and he called for a renewed political will to strengthen the relationships between the industrialised countries and to agree on sound policies for the future. Given sufficient vision and a shared purpose, the conference would be able to deal positively, as they had at Rambouillet, with the problems before them.

President Giscard thanked President Ford for his welcome. He recalled that when they had met at Rambouillet, it had not been clear that the world economy was committed to a recovery. Today, the situation was quite different. Most of the major industrialised countries had experienced a strong recovery in economic activity, even compared with the forecasts made at Rambouillet. 1975 had seen a negative growth rate of minus 1.6 per cent, whereas the estimate for the seven major industrialised countries was now 4.25 per cent and the hypothesis of the experts for the future was as high as 5.6 per cent. The essential problem today was how to transform this recovery into a continuing and lasting expansion.

/There were two

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There were two particular risks. The first was increasing inflation; the second was the increased risk that balance of payments difficulties would lead to restrictive or protectionist policies and practices which would produce a lag in recovery. Recovery was nevertheless continuing in spite of a high degree of inflation. The latter was not surprising, given the earlier economic crisis and higher commodity prices and support mechanisms. The situation raised questions both of domestic policy and of international monetary relationships.

On the domestic side, President Giscard called for an active fight against inflation and a search for full employment. Recovery in most countries had not led to full employment. Virtually nowhere was there a lack of supply; on the contrary, there was still unused capacity in most of the industrialised countries. Inflation had resulted from rising commodity prices and corporate profits, as well as the pursuit of programmes designed to stimulate public demand. The need to cut down the monetary expression of demand led to more restrictive monetary policy, and there was a need for close cooperation between our respective Treasuries. In the area of public finance, there was a need to cut deficits. He did not know whether it would take one or two years to restore the financial balance, but that should be the joint aim of those represented here. Wages and prices were somewhat different and called for individual policies. There was, however, a need for a convergence of monetary policy, and the monetary movements since the beginning of this year had, for some of our countries at least, been closely related to a disparity in inflation rates. The balance of payments of the industrialised countries was likely to be much less favourable in 1976 than in 1975, and there was a need to involve the import capacities of the oil-producing countries.

The situation of the developing countries would also be difficult, and he hoped that we could continue our efforts to consolidate aid for development. This problem had been raised at Rambouillet and had led to a relatively satisfactory level of monetary coordination. Rambouillet, and the resulting cooperation between central banks, had led to a period of relative stability in the past six months. The future situation was likely to be different, and a deficit of \$20 billion for the OECD countries had been forecast.



President Giscard drew the conclusion that the industrialised countries must accept a deterioration in their balance of payments while still maintaining exports of capital; they must use new mechanisms to finance the deficits of industrialised countries, including some present at Puerto Rico. The United States had already made some suggestions in this context. At the level of the International Monetary Fund, we should make readier use of drawing rights and of the oil-producers' surpluses (estimated at about \$40 billion).

In the currency markets, President Giscard did not think that any further action needed to be taken, but he thought that those present should renew instructions to their central bankers and currency boards to cooperate together on rates. He also wondered whether an expert study should be called for to determine whether the classical procedures of the capital markets were still viable.

Chancellor Schmidt said that part of the reason for the improvement and recovery since Rambouillet had been the cooperation between the industrialised countries in combatting recession and in creating increasing demand. It was still essential to avoid measures in the trade field which might help one country but harm others, and it was also important that there should be continuing cooperation in combatting balance of payments problems.

He shared President Giscard's general impression that the world recession, with some exceptions, was a thing of the past. There were eight points which he wished to consider.

- (1) Demand had not risen evenly in all sectors.
- (2) The upturn of the world business cycle was still the result of private consumption rather than fixed investment.
- (3) Fixed investment was still playing too small a part in recovery.
- (4) The prospects of full employment were still not adequately assured.
- (5) Final victory over inflation was not yet in sight.



- (6) The balance of payments structure of most of the countries of the world still showed a marked disequilibrium.
- (7) Disturbances in North/South relationships were not to be excluded, even though they might not be on the scale of the oil crisis in 1973.
- (8) East/West relationships now played a greater role than before, not just in terms of exports of fixed investment but also because of the extent to which the Soviet Union and other East European countries depended on the monetary markets of the West. The level of dependence was higher than at any time since Lenin's day.

His conclusion was that we should aim to prevent further price increases and that we should act to increase the confidence of investors. Long-term expansion was unlikely unless prices were checked, and a further reduction in unemployment was impossible if we still had galloping inflation. Each country must decide its own policies, but all of us needed a budgetary policy and an incomes policy. The business sector must show restraint on prices to avoid excessive pressure from the trade unions on wages.

Chancellor Schmidt said that there were some encouraging examples, and he referred in particular to the British Governments wage agreement with the trade unions. This represented a successful process of re-thinking amongst different social groups. The only way to restore stability in exchange rates was to find a stable basis of narrowing gaps in economic performance. The financial authorities had been quite successful in dealing with differing velocities, but the overriding need was to stabilise the level of prices and to check inflation. The dynamics of exchange rates could be described as a factor of differing inflation.

Chancellor Schmidt said that all eight points which he had listed earlier represented the danger of further economic destabilisation. He expressed concern at the number of institutions and conferences who claimed to take decisions on these matters, and he recalled the then British Prime Minister's remarks at Rambouillet about the proliferation of international institutions. Meetings to deal with the world economy had been held in Geneva, Paris, Nairobi, Kingston and so on. One could scarcely follow all these meetings, let alone send instructions to one's representatives. He doubted however whether anything could be done to curb this proliferation. President Ford said that, following Mr. Wilson's remarks at Rambouillet, the United States had done



some research on the question and had produced a list of international bodies concerned with these matters.

The Prime Minister said that there was no doubt that this meeting witnessed a very different atmosphere from that at Rambouillet. There had then been no feeling of optimism about the chances of recovery, whereas now the discussion was on ways of stopping the recovery ending in six months time. He hoped that this did not mean that economic cycles were likely to get shorter and shorter.

Mr. Callaghan made three points. The first was that however far recovery had gone the growth rates were still not exceptional. Secondly, at this stage of the economic cycle, inflation was too high, and thirdly, unemployment was much higher than at any previous stage. He agreed with President Giscard that it was for individual countries to fashion their own policies for dealing with inflation and unemployment. It was also for individual countries to determine the degree of priority they attached to reducing unemployment. But recent experience showed that it was difficult for individual countries to pursue courses which differed markedly from those of other countries.

The Prime Minister said that we were not ourselves as deeply into recovery as some other countries. There was no need for him to convince his colleagues of his agreement on the need to contain inflation. The Chancellor of the Exchequer would say that recovery was already in sight. What he could assure his colleagues was that if the Trade Union agreement stuck, as he thought it would (and it had been carried by 18:1), by 1977 we should be able to look our partners in the face. Inflation in Britain should by then be well down to single figures.

/The Prime Minister



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The Prime Minister saw unemployment as a major social evil. It was not just a matter of economics; it was also a question of politics and philosophy. In his view, industrial countries should not lightly undertake policies which would keep unemployment at its present level into the 1980s. Even the recent growth projections of the OECD secretariat were worrying and pre-supposed a politically unacceptable level of unemployment which could produce politically undesirable effects. The only possible justification, in his opinion, for continuing unemployment at the levels contemplated, (if it was a justification), was that nothing else could deliver us from the perils of higher inflation. Chancellor Schmidt, for obvious historical reasons, attached great importance to the need to restrain inflation; for similar historical reasons, we attached equal importance to the need to restrain unemployment.

The Prime Minister believed that there were other policies which could make a contribution. He believed that the best hope for a satisfactory outcome over the rest of the decade, in terms of inflation and unemployment, lay in a policy of maximum co-operation between the Social Partners - Government, Trade Unions and Employers - with the Trade Unions in particular recognising that restraint on their part was a prerequisite for satisfactory progress in reducing unemployment. This might seem to be a parochial British view. But for us co-operation with the Social Partners, and in particular with the Trade Unions, was a vital element in restoring economic stability.

Policies of this kind must, of course, be pursued in conjunction with an appropriate degree of fiscal and monetary restraint. There had for the shorter term been suggestions that the recovery might be moving too fast with potentially serious consequences for inflation; and that further

/restrictive

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restrictive measures might be needed beyond those already contemplated. He wished however to issue a warning. Except in the case of Japan, the exceptionally high rates of growth over periods of a quarter or two, and in several countries recently, were due in large part to the turn round of stocks. There was no lasting source of stimulus here, and rates of growth could be expected to moderate accordingly. Some fiscal and monetary tightening was already in the pipeline, with tax increases already announced in Germany and the Netherlands and public commitments by many governments, including the United States and France, to reduce or eliminate their public sector deficits. There was likely to be a further tightening as the public works programme ran out, and fiscal drag would also contribute to a tightening of policies in many countries.

If the OECD forecasts were to be believed, the GNP of the OECD countries would grow at a rate of only about 5 per cent this year and would represent a modest up-turn compared with earlier cycles. Moreover, a 5 per cent growth outcome would lie below the 5½ per cent growth path envisaged for the rest of the decade - a growth path which pre-supposed a very high level of continuing unemployment into the 1980s.

In conclusion, the Prime Minister expressed the hope that, although export-led growth was likely to be our salvation, and it was certainly our wish to keep our growth based on exports, we should not jeopardise it by over-reaction or restrictions on the part of the stronger economies. The Central Bankers had managed to avoid a lot of problems, and there was a good degree of co-operation between them. He agreed with President Giscard that it might perhaps be time to renew instructions to them to maintain and develop this co-operation. But he did not think too much should be made of this point publicly.

/The Italian



The Italian Prime Minister said that the recovery had been delayed in some countries, like Italy, and that when it had come it had produced inflation and balance of payments deficits. Such countries needed to be able to count on continuing export expansion and world economic growth if they were ever to get out of the vicious circles they were in and to reduce unemployment. The ability to deal with unemployment, which was a social evil, and a source of unrest, was a test of society. They must find ways of dealing with the dangers of inflation, and not rely exclusively on monetary methods of demand management, if they were ever to get unemployment down to acceptable levels.

At Rambouillet he had been able to point to improvements in Italy's balance of payments and prices, though output had been low. But recovery had brought inflation which was made worse by depreciation of the lire. Their present programme contained both structural and short-term measures; they planned to tackle the problems of public finance, both on the expenditure and revenue side; to restrain inflationary wage demands; and to use selective investment incentives to raise productivity and reduce dependence on imports. To achieve this they would need social consensus at home and cooperation and support from abroad, particularly in a form which would allow them to make further big export increases.

The Japanese Prime Minister said that, at the time of Rambouillet, world trade had been slack and unemployment high. Moreover, the governability of some countries was in doubt. They had decided to stimulate their economies and a recovery in output and trade was now under way. This had restored confidence in the ability of governments to manage their economies. The task now was to sustain growth while avoiding inflation. This called for flexible policies by individual countries and cooperation between countries. It was significant that the invitation to this forum for international collaboration had come from the United States which had started with the recovery. It was valuable to have candid exchanges between countries at this delicate stage of the recovery and he hoped that similar conferences would be held in future.

/The combined



The combined GNPs of the countries represented were 60 per cent of the world total and their trade was 50 per cent of the world total. Moreover they were liberal democracies, facing challenges from left and right.

On the Japanese economy, Mr. Miki said that the reflationary measures had accelerated growth which was now estimated to be 6 per cent in real terms in 1976. Although recovery had started with exports, domestic demand had become increasingly important as a source of expansion. The prices prospect was less satisfactory: consumer and wholesale prices were expected to rise by 8 per cent and 5 per cent respectively. He hoped that wage increases would be moderate without a formal incomes policy. Their trade was at present in surplus, mainly as a result of rising exports to the USA and also because imports had been slow to rise as stocks had been run down to low levels. But they expected a deficit in future, partly because of prospective increases in oil prices.

Mr. Miki said that his Government welcomed the reform of the world monetary system and the agreement which had been reached at Jamaica. It was now important to ratify and implement it. On exchange rate policy his Government did not intervene except to prevent disorderly market disruption.

Finally, Mr. Miki said that Japan had ratified the OECD safety net at the end of May and he hoped that the USA and other countries would do the same.

The Prime Minister of Canada said that even if economists did not agree on policies they agreed on causes. It now seemed clear that Governments collectively had overdone the reflation in the early 1970s. They therefore had a collective responsibility for producing this inflationary push, though it had been made worse by the increase in oil prices. Although national economic cycles had coincided last time, they would not necessarily do so again - for example, Mr. Callaghan was more cautious than other countries about restraining growth. It would probably be safer if the different economies were not in phase this time.

/Mr. Trudeau



Mr. Trudeau said it was important for the different countries to keep in touch because they could learn from each other's experience. He had been struck by Herr Schmidt's reference to discipline and Mr. Callaghan's to philosophy, as a way of responding to the revolution of rising expectations which all Governments faced. All groups in our societies wanted more and fiscal and monetary policies, though essential, did not go to the root of the problem since they did not change these expectations. Indeed, it was possible for certain groups, by asking for bigger money incomes, to offset fiscal measures. He felt it was important to make people understand that, if they had free health services or improved pensions, they needed less income than if these services or benefits were not provided. So far the Governments had not managed to get this message across, but they could make use of other countries' experience to do this. For example, Canada had been helped by the incomes policies which other countries had adopted and President Giscard might also benefit from the fact that other countries had capital gains taxes.

President Ford said the problem was how to ensure a balanced recovery. Unemployment was now receding, rates of inflation were lower, and pre-recession output levels had been restored. The recovery so far reflected the ability of countries to avoid over-stimulating their domestic economies and to refrain from restrictions on trade. But it was a sobering thought that an inflationary climate, stemming in large part from over-commitment by governments to increased public expenditure, had lasted for a decade. It was important now to set realistic goals for public expenditure which would be accepted by the people. The lesson of the past was that inflation created recession and thus high unemployment. He had been heartened by the support at the OECD ministerial meeting in the previous week for the view that recovery would not be sustainable unless further progress in combatting inflation was made. While inflation was high, consumers increased their savings and business curtailed investment. In his view, a lasting turn-around in inflationary expectations was crucial to maintaining the recovery. Those expectations could be quickly revived and this made it doubly necessary to get fiscal and monetary policy right and, if anything, to err on the cautious rather than on the expansionary side. In



the United States, many expenditure programmes were inflexible and planned expenditure would rise faster than the tax base. Because of the long lead times involved, it was necessary to act early to avoid excessive strain. It was also necessary to bring about a reorientation towards private investment to ensure that the capital stock was increased. The financial climate must generate adequate flows of saving and channel them into investment. This was possible only if the claims of central and local government were reduced.

President Ford said that in making their domestic economic decisions governments must take account of economic interdependence and the effect that their measures would have on world demand. However, the early rise in commodity prices during this cycle, even though producer stocks were still high, showed that the emergence of real inflation could not be discounted. In his view, stable conditions at home in the USA would make a major contribution to preventing such a revival of inflation. The external effects of these domestic policies must be taken into account but could not override the requirements of the fight against inflation.

President Giscard said that in the discussion some had laid greater stress on the need to fight inflation than others. To Mr. Callaghan's question, whether there were policies that could check inflation without causing unemployment, he answered that there was no such animal. It was, however, necessary simultaneously to fight inflation and also to try to make structural changes in the field of employment. Secondly, Mr. Callaghan had suggested that restrictive policies on public finance could put the brakes on too early and harm the economies which had started their recoveries late. To this he replied that it was possible for countries to reduce their public sector deficits without sacrificing growth. In France they would be reducing the deficit from 38 billion to 15 billion francs, but the economy would still be growing rapidly.

Finally, President Giscard said that the OECD countries would have an external deficit of \$20 billion and he hoped that the conference would discuss how this could be financed in ways that would not act as a brake on expansion.

/Chancellor Schmidt



Chancellor Schmidt said that Rambouillet had been a real success since it had increased confidence. He hoped that this meeting too would raise confidence, including that of countries in different situations from the rest, for instance because of structural problems. He hoped the Communique would note the success of the recovery so far, and go on to look towards additional success which would benefit those countries which at present felt a little behind the rest in their recoveries. The difference between countries should not be papered over but all could share confidence in the recovery including, for example, Italy, Canada and Britain.

It would however be important to stress that this did not mean that they were entering heaven on earth. The fact that everything had to be paid for was worth stressing to all audiences, whether they were Socialist, Conservative or Liberal.

So far as the relationship between inflation and unemployment was concerned, Herr Schmidt thought that there had been some difference between the remarks of Mr. Callaghan, Mr. Trudeau, President Giscard and himself. All of them had now raised domestic demand in varying degrees by monetary and fiscal measures but he thought that there was a danger of overdoing the increase, for example through the super-tranche.

/ An increase



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An increase in monetary demand was not now needed. The attempt by such countries as Saudi Arabia and Iran to spend the enormous increase in their incomes was ridiculous. It had created inflation at a rate of up to 40 per cent in their own countries and had added to world inflation. These countries would soon be asking for higher oil prices on the grounds that industrial goods cost more. But the real reason was the impossibility of spending so much money very quickly. Other countries which produced, for example, copper or sisal had tried to do the same. His fear was that if everyone tried to consume all their income at once they would give up saving or investing for the benefit of the future generation. He felt that the propensity to invest was a key element in achieving the goal of high employment, let alone full employment. If such investment was not forthcoming from the private sector the only remedy was for the State to do it. This would transform society. The State did of course invest in roads or cities, but investment for increasing the ability of economies to add value should be done by enterprises. The key point was that they would only do so if inflation was low. The long range answer to unemployment therefore did have something to do with limiting inflation. It should not be suggested that the Germans were less sensitive to unemployment than other countries. It was a period of high unemployment that had allowed Hitler to take power. The fact that this had been accompanied by rapid inflation did however help to make it easier to persuade the unions to act to prevent rapid price increases.

Herr Schmidt thought, if he understood the Italian situation correctly, that it was right to limit cost push inflation through the restraint of pay. But if for example the Chancellor of the Exchequer's target for 1977 was reached, it would be necessary to reduce public expenditure which was the second source of inflation. He was not speaking ideologically. He really believed that if inflation was over 10 per cent, investment would not be forthcoming. He was not asking for public expenditure to be reduced in the current year but the pressure for doing that next year should be stepped up.

/The Chancellor

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The Chancellor of the Exchequer said that economics was a branch of social psychology and it was not possible to predict economic behaviour on the basis of past relationships. One example of this was that, contrary to expectations, the savings ratio had risen despite the increased rate of inflation. As to the relationship between unemployment and inflation, the striking thing was that in the fifteen years to 1968 the inflation rate for the industrialised countries as a whole had averaged 2 per cent a year, though employment in this period had been higher than ever before. Since 1968 unemployment and inflation had both risen and reached their peak in 1975. All this made nonsense of the conventional idea that the only way to slow down inflation was to reduce employment. The unions in Britain however realised that it was impossible to get employment up without getting inflation down. Since the middle of 1975 the rate of inflation had been falling and unemployment had either been rising more slowly or in some countries, like Germany and the USA, had actually been falling. He hoped that unemployment would also begin to fall in other countries, including the United Kingdom, by the end of 1976.

Unfortunately there were now signs that inflation might be taking hold again as the recovery got under way. For the EEC, prices had been rising at an annual rate of 13 per cent in the first half of 1976, compared with 6 per cent in the second half of 1975. The causes of inflation were not properly understood. But it was clear that there was not a single cause but many, and that appropriate policies had to be followed in a number of different fields, such as prices and incomes, fiscal and monetary policies, and industrial issues. The situation in different countries differed widely; there was no single uniform cure which all countries should seek.

/Turning to the



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Turning to the United Kingdom, Mr. Healey said that public expenditure was now growing more slowly than the GDP. In the current year its real growth would be about 1½ per cent compared with 4 per cent for the GDP. For future years public expenditure would be stable in real terms, though the aim was to increase GDP at a rate of 5 per cent. This meant that public expenditure would fall considerably as a percentage of the national income and very few countries represented round the table could say the same.

The public sector borrowing requirement in the first two quarters of 1976 had been running at a rate equivalent to about £9 billion, compared with £10½ billion in 1975/76. So far this deficit had been financed by borrowing from outside the banking system. In the last year the money supply had increased by about 8 per cent despite a very high rate of inflation.

But the key element in the fight against inflation was a new type of social consensus. The unions had accepted a restrictive pay policy which would reduce their real take-home pay for two years in succession. Moreover, in the second year, the policy had been supported by a majority of 18:1 compared with a majority of 2:1 for last year's policy. To achieve this, as in the case of Germany, had taken an immense amount of effort and persuasive discussion. It was clear that each country needed to adopt a mix of measures to achieve high employment and low inflation. But the conference would be wrong to go for an artificial uniformity in favour of a single answer. This would, in particular, be a mistake if it involved pressure for measures which would break the social consensus which was the basis for all the gains the UK had achieved.

President Ford said that, at Rambouillet, sound progress had been made in dealing with international monetary issues. On structural reform of the monetary system, they had resolved differences that had long appeared insoluble, and had formulated a blueprint for reform subsequently adopted by the entire IMF membership in Jamaica.

/ On more

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On more immediate issues, they had shared the same analysis of the international monetary situation, and had agreed on techniques for dealing with currency problems. They had also agreed to closer cooperation and consultation both among Treasuries and central banks. Those present recognised now that they must stabilise underlying economic and financial conditions in their national economies in order to achieve international monetary exchange stability. In his view, the international monetary issues fell under four headings:

First, they should complete the agreed monetary reform package and press ahead with the legislation required to ratify the amendment of the IMF Articles and the increase in IMF quotas.

Second, they must continue to develop the machinery of consultation agreed at Rambouillet. That machinery was effective and had enabled them to prevent recent exchange market problems from becoming even more serious.

Third, they must undertake to eliminate persistent payments imbalances, whether surpluses or deficits. This was an important precondition for achieving stable underlying economic and financial conditions.

He thought that it would be helpful to discuss the prospects, and the need for adjustment in individual countries - both those which had been recording the largest surpluses and those with the largest deficits. Action to promote and accommodate adjustment was clearly needed on both sides.

The United States, Japan and Germany had all recorded very strong current account positions in the recent past and were in a position to attract capital in the private markets. It was important that those countries and others that were in a similar position should be prepared to accept a significant reduction in current account surpluses or increase in deficits and to utilize their ability to attract capital from abroad.

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In the United States, the current account position had reversed very sharply, from large surplus to modest deficit, a turn-around of about \$15 billion. He was not concerned about that shift. It was exactly the kind of change that was need, and constituted a move toward a healthier and more stable world payments situation. He was prepared to accept an importnat part of the current account deficits which were inevitable in this period; he would resist the inevitable domestic pressures for protection and try to build public acceptance of a substantial trade and payments deficit. Other large surplus countries would need to do the same.

However, action by the countries in surplus, the United States, Japan and Germany, and a willingness to see those surpluses decline and vanish, could not alone bring a stable and sustainable international payments structure. Of perhaps greater importance was the action needed on the part of the large deficit countries - the UK and Italy in particular - to reestablish stable economic conditions.

Fourth, they needed to consider in the IMF the possibility of providing additional IMF credit, where private and official credits had been exhausted, in cases of extreme need having significant implications for the system as a whole. Such credit, beyond the normal standards of availability, should be conditional on and in each case tied to a rigorous and detailed programme of monetary and fiscal restraint that would restore domestic economic stability in a reasonably short time. This credit could not substitute for, and should not be provided without, sound domestic corrective action by the recipient to policies consistent with the fundamental tenets of the political and economic system on which cooperation among the industrial democracies were based. Such financing would complement normal IMF drawings and the proposed Financial Support Fund, and could be coupled with the activation of the General Arrangements to Borrow. Such a move would greatly strengthen the defences against possible disorderly adjustment moves which could damage the fabric of the liberal trade and payments system.

In summary, these four points provided an appropriate programme which could be agreed at this meeting:

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- to proceed to ratify promptly the Jamaica monetary reform package;
  - to continue to strengthen consultative machinery;
  - to commit themselves for the coming period to adopt policies to eliminate persistent payments imbalances, both surplus and deficit;
- and
- to consider, for cases of countries in special need, a mechanism to supplement official credit tied to a rigorous corrective programme.

The Canadian Prime Minister said that he wanted to emphasise the risk that inflation would revert to being a serious problem. For instance, in the United States, Canada's dominant neighbour, real growth was at a rate of 7% and inflation was at a rate of 7%. The Trades Union leaders had recently made settlements of the order of 8% increase. If they wanted to keep their share of the economic pie they would probably start trying to bargain for 14%. He thought that the Communique should refer to the problem of inflation. President Ford said that the latest forecast was that the inflation rate for this year would be of the order of 5½% to 6% and GNP would grow at a rate of between 6 and 7%. He had been most encouraged by the decline in the rate of inflation and the increase in employment opportunities. They had added 3.7 million jobs in the last year and the labour force now included 87.7 million people. However there were still unemployed sectors such as youth and the disadvantaged. He had been encouraged to note in the New York Times that morning that there had been a 15 to 20% increase in college job opportunities for college graduates. He agreed with Mr. Healey that a decline in the rate of inflation and an increase in employment were linked. That had been the experience of the United States over the last 12 months.

/ Signor Colombo



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Signor Colombo said that there were different points of view about the impact of inflation on employment and none of them there would want to be dogmatic about the relationship between unemployment and inflation. But none of them would like to rely on inflation to cure the problem of increasing employment or reducing unemployment. Recent experience had taught everyone a lot. All the same, because of the continuing evidence of symptoms of inflation, there was a risk that those countries with a high level of recovery might put the brakes on and that this would lead to an increase of unemployment in those countries which had not yet achieved the same rate of recovery. Referring to earlier remarks by Chancellor Schmidt, he asked how it was possible to generate confidence that the economic crisis was over and that the industrialised countries were on the way to a continuing and sustained recovery. He thought that the <sup>\*</sup>Communique should include a reference to the idea of fighting inflation.

They should confirm their confidence in the outlook and say that the reason for their confidence was that the recession was over and the sickness had been cured. They should then go on to say that there would be no further restrictive policies by the surplus countries. He referred to the emergence of new imbalances in international payments. Recent events showed that further thought was necessary especially on the question of the extent to which the exchange rate mechanism ought to be used. Italy, for both temporary and for substantive reasons, had allowed the exchange rate to follow the basic trend of their balance of payments but at a certain point irrational factors had taken hold and their exchange rate had got out of control. He recognised that those countries with substantial balance of payments deficits could not finance them without adequate domestic policies, but it was not possible to leave the responsibility for such policies to others. Each participant had a duty to perform and Italy was committed to doing its part.

Mr. MacDonald referred to President Ford's remarks about the payments imbalances. He thought that it was difficult to apply general principles to specific difficulties. As far as the discussion on trade was concerned, he had been reassured by their collective approach to protectionism. He wondered how their

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discussion would fit in with the forthcoming Multilateral Trade Negotiations. He asked whether the other participants saw much chance of early progress. As for establishing an additional IMF credit for those countries in extreme need, which included some developing countries, he thought that this might raise difficulties and he would like to know how the idea would fit in with the agreements at the IMF meeting in January for increased tranches and for the Trust Fund. President Ford said that he was very strongly in favour of concluding the MTNs in the course of 1977 and he would push to the maximum to achieve a result within that time scale. He thought that this was achievable. Mr. Simon said that his thought had been that any additional credit would be dependent on stringent conditionality, but ultimately it would be supplementary to other IMF balances.

Chancellor Schmidt stressed the absolute necessity of conditionality. It was in the interests of all who wanted to draw funds. It gave them an additional authority with which they could put through their own domestic policies, both in relation to their Parliament and public opinion.

So far as the references to trade in the communique, which had been drafted by officials, were concerned, they were satisfactory from the German point of view. He welcomed the renewal of the trade pledge and he thought that the participant countries should try to give an additional impulse to the Multilateral Trade Negotiations. He would like to express his satisfaction with the consensus reached since the meeting at Rambouillet about rates of interest and duration of credits in the export credit field.

This led him to raise the question of trade with the Soviet Union. He asked President Ford whether he would report on foreseeable Soviet imports of wheat and other foodstuffs from the United States. He thought the necessity for such imports gave an opportunity to the West to focus the attention of the Soviet leaders on the fact that the Soviet Union was no longer an autarchic

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economic entity. He was not advocating a strategy of tit-for-tat but he thought note should be taken that the aggregate Soviet and Communist indebtedness by the end of 1976 would be of the order of \$40 billion. Some of this was Arab money channelled via the Western markets, some state-financed and some private banking money. But it represented an enormous real flow of resources from the West to the Soviet Union and its affiliates. How long would it be possible to maintain that there were political dividends from this? He thought that this net inflow of capital goods and real resources from the industrialised West was one of the main reasons for the interest of the Soviet leadership in detente. But taking account of the magnitude of the sums involved this was an opportunity for the West to exert substantial influence.

President Ford said that imports from the Soviet Union in the agricultural field were based on their five year agreement which permitted, from 1976 onwards, 6 million metric tonnes of grain to be exported with a ceiling of 8 million metric tonnes; there was flexibility to permit additional purchases depending on circumstances in the United States. In 1975 the Soviet Union had imported 16 - 17 million metric tonnes. So far they had contracted to buy 3 million metric tonnes out of the 1976 crop. He had no specific information whether their purchases would go up as far as 8 million tonnes or beyond it. The Soviet Union had not had a successful winter wheat crop though the planting of its spring crop had gone better than in 1975. The situation was dependent on the weather and if the crop reached a normal level there would be less demand for wheat. If there were an exceptional crop they might come out of 1976 in a good position. But they were committed to buying 7 million tonnes for 1977 by the negotiations a year ago.

Dr. Kissinger said that there was a basic problem, if the only way to get a political benefit was to interrupt the open market system. If the West was serious about wanting to derive political benefits, there was no other way except by interrupting their market relations with the Soviet Union and exacting political terms from the supply of goods. Otherwise they were just talking about empty theories. But no decision had yet been taken to use grain sales in this way.

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/ The President



The President had paid a heavy political price for interrupting market conditions for four months last year, but the Soviet/US agreement gave the administration the right to insist on intergovernmental negotiations if the purchases went above 8 million tonnes. He did not think sufficient attention had yet been paid to this aspect of the problem.

Chancellor Schmidt said that he was not asking for quid pro quos. Even if a positive decision were to be taken to interfere with the free market mechanism this would not make a decisive impact on the Soviet Union. His understanding was that about half Soviet indebtedness was covered by State guarantees. But we should not forget that there was an instrument in our hands. His information indicated that the Soviet Union and Eastern European countries were facing considerable difficulty over food. There were reports of the slaughter of pigs and cattle and now there was a meat shortage. This gave rise to considerable domestic risks. The recent change of front by the Poles showed the enormous political problems which could be created and while it might be true that the Poles were more temperamental than the Russians, the Soviet leadership was facing similar difficulties. If the West helped the Soviet bloc by financing their trade they were in effect giving them political assistance in stabilising their systems. He was not entirely against this because one could not be sure what might otherwise come next. But if those at the Summit meeting were to talk about world trade, it was necessary to understand that the role of the Soviet Union was increasing very rapidly and the prospect was that their share would increase further. How far was it possible for there to be a transfer of real resources from East to West at the same time as from North to South? He had been questioned by the Soviet leadership whether Germany and the West were not trying to do too much for the developing countries, to the neglect of the needs of Eastern Europe and the Soviet Union. This was a sensitive area for them and it might be possible to make an equation between a transfer of economic resources and Soviet supplies of arms. They had been

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cynical in the past in explaining that the reason why they had not needed to give development aid was because they gave their aid as weapons. But it was right to bring together the different strands of the relationship with the Soviet Union - trade, finance, and credits, and the political aspects. He knew that it was not intended to talk about Southern Africa during this session, but in that context he must explain that he was not sure how far public opinion in Germany would permit him to try to help the former colonies when first they kicked us up the backside at the UN and Nairobi, and, second, they permitted the Soviet Union to gain influence by the supply of weapons and advisers. This range of problems needed to be appraised in a political light.

President Ford asked whether the level of Soviet indebtedness was such that they might ask for a rescheduling of their debts. Chancellor Schmidt said that he would not be surprised if that were to happen.

The Prime Minister said that he had expected this topic to be discussed the next morning. But his personal judgment was that so far as commercial repayments were concerned, the performance of the Soviet Union and the East Europeans was second to none. He was sure that they would not default on their debts; they had no need to do so. He had been borne out in these views by City opinion which he had consulted. He thought that the United Kingdom and the United States had been commercially motivated in offering credit to the Soviet Union, perhaps rather more than the Germans who had been influenced by the Ost-politik factor. He thought that if the need arose, ~~concerned~~ commercial bankers would be prepared to roll over Soviet debts.

President Giscard said that they had already discussed the possibility of aid to Italy. They were all aware that Italy's economic and monetary problems were of concern to the international community. He did not want to make a definitive judgment about the techniques by which help should be given, but there had been

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suggestions in relation to IMF quota limits that Italy might require aid over and above these limits. For his part, even if he were to agree to aid on that scale, he did not think that this should be through the IMF, but rather through the industrialised countries working together. It was essential to avoid setting a precedent for the use of IMF resources in this way. Italy's needs were not the same as those of the developing countries. President Giscard referred to the reference to trade in the draft communique and pointed out that the members of the Community there present could commit themselves on trade matters within the Community's competence only to the extent that that had been agreed in the European Community. He referred to the need to avoid measures of protection. At the time of Rambouillet, they had feared that the United Kingdom would be forced to resort to protectionist measures and they had been very pleased at the UK's performance in the intervening period. The United States authorities had taken certain measures which had had an adverse effect on Europe. It was desirable that they should all act with equal restraint.

After a brief discussion about the practical arrangements for clearing the communique, Mr. Miki said that he understood the present draft was 15 pages long. He thought that it was desirable to reduce its length very substantially, if necessary by not spelling out specific items. President Ford said that he would consider this decision.

The meeting concluded at 7.00 p.m.

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