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Prime Minister
Weekend Box

Ref. A02021

MR. ALEXANDER

I think utterly totally unnecessary

As you probably know, it has been the custom for a group of business leaders from the Summit countries and the European Community to meet in advance of each Economic Summit meeting, in order to agree upon a statement of their views which can be made available to the Heads of State or Government before the Summit meeting.

2. This "Mini-Summit" has agreed on a statement of its views in preparation for the Venice Summit. I enclose a copy of their statement herewith.

3. The Chairman of the group was Mr. Robert V. Roosa; and the British members of it were Lord Roll, Lord Shackleton and Sir David Steel.

4. I am sending copies of this minute and of the statement to the Private Secretaries to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade and the Secretary of State for Energy.

RA

ROBERT ARMSTRONG

24th April, 1980

Was that communique written in advance too? MT

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ROBERT V. ROOSA
59 WALL STREET
NEW YORK, N. Y. 10005

April 9, 1980

To The Mini-Summit Participants:

As of yesterday's deadline, comments had been received from nearly all mini-Summit participants. As you can well imagine, the various comments required a good deal of reconciliation. Specific suggestions had to be altered in light of others' comments. Furthermore, in an effort to avoid the necessity of another round of clearances from you, I have attempted to make the revisions without major, substantive changes. The final draft hopefully represents the best possible compromise.

I would be most interested in hearing from you any reactions which your Head of Government and Summit planning staff may have to the memorandum. With such an exchange, we can, perhaps, both bring the issues into yet sharper focus and enhance the usefulness of any future private sector mini-Summits.

You should be aware that the planning staffs of the seven governments are to meet in Rome on Wednesday, April 16. In case you encounter delays in directly contacting your Head of Government, you might want to hand copies, at least informally, to your country's representative on the planning group. Remember, too, that the Ministers of Finance and of Foreign Affairs usually also attend these Summit meetings. Direct handing of this report to one or both of them may be a practicable alternative in the event you have difficulty arranging an appointment with your Head of Government.

With warm regards,

Bob Roosa

Enclosure.

Issues for the Venice Summit

At an informal two-day meeting held in London on March 26-27, 1980, a group of twenty business, financial and economic leaders from the seven Summit countries and the European Community* reviewed issues relevant to the discussions to be held among the seven Heads of State and Government in Venice on June 23-24. The consensus which follows may not represent fully the views of any one participant on each of the suggestions presented, but there is unanimity on the broad thrust of the conclusions. Because there are fundamental differences in structure among the seven countries, not all of the statements apply to all countries. However, the participants hope that these views may be of assistance in the process of evolving agreement among the Governmental leaders on the most significant economic issues confronting them in 1980, at the beginning of a new decade.

In the group's judgment, the major issues are:

- The urgency of curbing inflation and arresting its present destructive effects on social stability, growth and employment;
- The annual need for recycling $100 billion or more of the payments surpluses of oil-producing countries;
- The necessity to balance energy requirements and supplies while reducing dependence on OPEC sources;
- The vital importance of maintaining and developing an open and dynamic world trading system with due regard to the increasing participation of LDCs (i.e., the "South"); and
- The longer term necessity of adapting to the changing patterns of growth and technological development in the world economy.

Summary

The overriding concern of the Venice Summit must be the escalating inflation which is spreading throughout the world. Since any lasting correction of its diverse causes will require action over a long period, it is urgent to make a convincing start now on essential longer term programs.

In order to create the economic environment within which longer term measures to eliminate inflation can effectively be initiated, shorter run policies will be required to check the inflationary momentum. In some countries a powerful and concerted effort to slow inflation must be expected to bring about a slackening of economic growth or even a recession. This risk must be accepted in

*A list of participants is attached.

order to create the basis for a later resumption of stable growth.

Longer term solutions to the inflation problem must include measures that will encourage renewal and expansion of the stock of productive capital -- which inflation is now eroding -- as well as more effective utilization of existing capacity. Among the measures to enlarge the capital base, emphasis should be placed not only on the production and conservation of energy, but also on increasing the capacity of both the less developed and the industrialized countries for extraction and processing of those basic raw materials which may otherwise become scarce within the next decade.

The tax and regulatory systems of many countries impede such capital formation. These restraints should be reduced or removed and investment actively encouraged. For some countries this may involve a shift in the balance of income distribution from consumption toward savings and investment.

The Governments of the seven countries have mainly followed defensive policies thus far in coping with the energy crisis. Yet even under the best conditions, oil and gas cannot long continue as the primary source of the energy needed to support growth over the decades ahead. The Governments should agree now on aggressive common efforts to develop alternative sources of energy; to promote massive increases in research and investment on an international scale.

The huge transfer of resources to the OPEC countries, following the second wave of staggering price increases that has occurred over recent months, is creating serious imbalances within the payments flows of the world. A recycling of some part of the OPEC balance of payments surpluses should be devoted, directly or indirectly, to financing the deficits of many of the oil importing countries. During the first round of oil price shocks, direct investment by the OPEC countries routed a part of the surpluses back into productive employment, but the capital markets of the private sector, including the Euromarkets, played an even larger role in the recycling process. We expect these markets to play an important role again. However, their capacity to do so is not indefinitely extensible. The international financial institutions will need to play an increasing role in the current recycling effort, beyond anything that the OPEC countries themselves may do directly.

For this reason, we urge the Heads of State and Government to encourage the use and expansion of the facilities of the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD), and other international lending and financing institutions. We further suggest that the financial authorities explore the development of appropriate investment instruments to attract some of the available funds of the surplus countries. The deficit countries should be encouraged to look to the IMF for advice and assistance in working out the longer term structural adjustments which they must make in order to be able to service their debts and maintain their creditworthiness.

I. Inflation

Inflation has become a disintegrating force throughout the world economy; combating it must have immediate priority. That involves the risk of economic slowdown for all countries; recession for some. But such risks must be accepted in order to lay the groundwork for sustained growth in the the longer run. Indeed, the credibility of policy depends on pursuing anti-inflation programs firmly and consistently until the grip of inflation is broken.

The causes of the present inflation are deepseated. Superimposed on those, the rise in energy prices has triggered off and accentuated a further escalation of other prices. It is, nevertheless, essential for energy prices to remain high relative to other prices, regardless of their apparent inflationary impact, in order to promote necessary adjustment among the sources and uses of energy. Achieving the necessary level of prices in some oil-importing countries may require additional direct taxation of petroleum products, such as the United States has just initiated. The proceeds of such taxes should be directed toward reducing or correcting other causes of inflation.

Inflation in most western economies has been aggravated as various forms of consumption, both government and private, have become larger at the expense of investment. It is essential to check or reverse that process, over the long run, by designing public policy to encourage investment — if necessary by means of tax cuts, other incentives, or the reduction of disincentives.

Both fiscal and monetary measures are required in the fight against inflation, the main requirement in common among all countries being that they be mutually reinforcing and used consistently. Reliance on monetary and credit restraint unavoidably tends to cause higher interest rates. To the extent that Summit countries can bring their public sector borrowing requirements under tighter control, in order to reduce pressures on their capital markets, the rise in interest rates will be moderated. At least in some Summit countries, long term interest rates have reached a point where they exert a disincentive effect on investment in productive assets and if long continued would contribute to perpetuation of an inflationary climate. Paradoxically, high rates now are a prerequisite to reduction over the coming months.

Some of the Summit countries have institutional arrangements in which wage and price guidelines can be helpful, within a framework provided by monetary and fiscal policy. But a raising of the guidelines during a period of accelerating inflation risks building a high cost floor that would impede eventual downward price adjustments. In other countries, existing institutional arrangements make Governmentally suggested guidelines inappropriate. Still other countries might usefully consider whether guidelines could assist in their effort to control inflation.

The burden of excessive government regulations, and the procedures for their application, exacerbate inflation, accentuate the energy problem, and inhibit world trade. While the spread of regulation is a long term issue, it does impinge on the immediate problems. Thorough review of the cost-benefit aspects, in this wider context, should be undertaken or stepped-up as a matter of urgency.

A considerable amount of indexation is built into western economies. Continuation of inflation at high levels is encouraging the expansion of such measures through legislation and wage contracts. That builds in resistance to any slackening in the upward movement of costs and prices even at times when other causes of inflation may be receding. In present conditions, energy prices should be excluded from the formulas used for indexation because adjustment to the new relative level of energy costs is essential; they must not be offset by indexation.

II. Recycling

The recycling of OPEC surpluses did not prove as much of a problem as had been expected in 1974 to 1978 for various reasons, including the expertise of commercial banks as intermediaries and the remarkably rapid rise in OPEC imports. This time the problem is more difficult because the amounts involved are much greater and many of the earlier circumstances have changed. The equity ratios of the commercial banks have declined with some concomitant decline in their readiness to add sizable new loans on the previous scale. Moreover, a number of the oil-importing countries have already added so much to their external borrowings as to alter their standing in terms of country or credit risk.

Nonetheless, some of the developing countries have built up their reserves over the past few years and also still have unused credit lines. For them, the commercial banks can probably handle much of the 1980 recycling requirements. But the problems magnify from 1981 onwards, particularly as the LDCs will face competition for funds from more creditworthy industrial countries.

However, even allowing for considerable direct investment by the OPEC countries, their purchase of government bonds in several of the Summit countries, and their possible transfers of liquid assets to the IMF through an expanded Witteveen facility, major problems will remain to be met through more extensive use of the facilities of all the international lending institutions. Even so, the IMF must continue to link its lending criteria to responsible policy responses in the debtor countries. One serious weakness of the first recycling round was that too little attention was devoted to the adjustment problems of the oil deficit countries. Increasing reliance on the IMF will assure increasing attention to adjustment problems in the light of IMF advice and guidance.

Prudential surveillance of commercial banks' consolidated balance sheets by their central banks will help to guard against any potential breakdowns in the recycling process. No need is perceived, however, for specific controls on the Eurocurrency markets. Those markets will continue to have a major part to play in the recycling process, and their capacity should not be impaired by misguided attempts at regulation.

As more experience is acquired in putting OPEC funds to work, and in bridging the oil-induced deficits of many importing countries, further appraisal may point to the need for even larger official facilities in 1981 and beyond. The Heads of State and Government should be prepared to support such recommendations if they should emerge by the time of the Annual Meetings of the IMF and IBRD early in October.

III. Energy

The need to develop new sources of energy, to economize on the use of available energy, and to adapt the productive processes of the world to a higher real cost of energy, will dominate much of the longer term performance of the Summit countries for the next decade and beyond. One major aim must also be to reduce the relative dependence upon OPEC oil, but that cannot be done rapidly. This fact has wide implications for defense and foreign policy -- reinforcing other reasons for a unified approach by the Summit countries to their common energy problems.

In present circumstances, it would be both divisive and self-defeating to engage in bilateral arrangements between individual Summit countries and individual OPEC countries that had the effect of impairing the adequacy of energy resources for other Summit countries. Correspondingly, no one among the Summit countries can afford, in its own or in the general interest, to reject any opportunity or method for conserving the use of energy, and particularly for reducing imports from the OPEC group. The import targets agreed upon at the Tokyo Summit should be reviewed to determine whether they can appropriately be reduced further. Consideration should also be given to the feasibility of establishing, on a mutually agreed basis, overall targets for the demand and supply of energy for each of the Summit countries -- with particular attention to alternative sources of supply and the ways in which those could be increased through the work of the IEA or the IETG.

The full recognition of the price of energy, as already noted, will not only promote conservation on the part of consumers as well as the industrial users of energy, it will also bring into the range of economic viability other sources of oil and gas as well as additional uses of coal and nuclear power. These, and the other energy sources that can be developed for use in decades beyond, including nuclear fusion, will require massive commitments of capital. It is important to clear the way for major energy or industrial companies to devote all of the earnings they can be allowed to retain to the capital requirements for greater recovery of hydrocarbons in known and new geographical areas, as well as for the development of coal, uranium or other energy materials. A first claim on the growing Government revenues deriving from the taxation of oil and gas properties, notably the recent increases in the United States, should be for the support of research and investment in promising energy fields. Beyond that, ways should be found for directing more of the surplus OPEC revenues toward such investment, perhaps through enlarged OPEC contributions to the IBRD which is initiating a new program for oil exploration and production in some of the LDCs.

The Heads of State and Government should energetically support present and prospective increases in the capital and resources of the IBRD and other international programs devoted to energy problems. There must also be greater mobilization of private resources in all the Summit countries. To that end, governments and groups of governments should promote R&D and expedite flows through the capital markets into major energy projects. The sheer magnitude of the investment needed to produce meaningful quantities of coal liquification or gasification, or even to build new pipelines for energy transmission, is so enormous that it requires new and creative methods for the pooling of capital and the joining of efforts among firms that are already large. The Heads of State and Government should promote such efforts through all means at the disposal of their Governments, including the encouragement of international consortia.

IV. World Trade

World trade has been a powerful dynamic force in recent years. Even in 1979, despite the dislocations from a renewal of the oil price escalation, overall trade rose in volume terms by 7 per cent compared with a 3 1/2 per cent rise in the real GNP of the OECD area.

The successful conclusion of the GATT Tokyo Round will help preserve this dynamism although a new threat of protectionism looms as countries consider restrictive measures to avert a rise in domestic unemployment. Some understandable though regrettable restraints also continue to arise as Summit countries attempt to ease their adjustment to imports from newly industrializing countries. As a counterweight, it is important to extend the work of the Tokyo Round. The Heads of State and Government should provide for a periodic review of the practical operation of the new GATT codes. The GATT's work on a safeguards code should be expedited to counter pressures for increased protection against specific imports.

Those Summit countries which are members of the European Economic Community should strongly reaffirm their commitment to the fundamental principle of keeping the EEC an open trading system. And all of the Summit countries should cooperate, particularly through the influence of their central banks, to promote a climate for the free flow of capital among their markets, to reduce or remove obstacles to such flows, and to moderate any disequilibrating moves in their exchange rates or interest rates which aggravate adjustment problems.

The continued growth of world trade will provide opportunities for the developing countries which depend upon oil imports to increase their exports, and thereby not only ease their recycling problem but also improve their adjustment prospects. The industrial countries need to recognize the net beneficial effects to themselves of imports from the developing countries, and of exports to them, even when specific sectors of production within the industrial countries suffer initially from import competition. The overall North-South relationship should have renewed and increasing attention by the seven Governments, particularly in the light of the issues addressed by the Brandt Commission. The disappointing outcome of the last UNIDO conference should prompt the seven countries to take the initiative in new efforts to combine concessions to the LDC's with acceptance by the "Group of 77" of obligations to encourage private investment in their countries.

V. The Longer Term

In most Summit countries the priority need now is to arrest the upward momentum of inflation, but underneath there is also a long term inflationary trend among all Summit countries that will seriously threaten social, cultural, and economic values through the next decade unless Governments begin consideration now of the validity or relevance of several possible underlying causes. These causes include:

> The increasing costs of raw materials as needs for them expand;
>
> The tendency for the combined defense and welfare costs of modern government to outrun the productive base or capacity;
>
> The downward inflexibility of many costs, including wages and forms of indexation; and
>
> A general slowing in the growth of productivity as developed economies "mature," with services becoming a larger proportion of total GNP.

To be sure, most of these may call for adaptation within individual countries rather than common action among them, but the problem of possible raw material shortages in the decades ahead is clearly one that deserves international appraisal, possibly within the OECD.

In addition, stability in economic performance among Summit countries, and in their relations with the rest of the world, may be jeopardized over the longer run by the procedures followed in adapting the international monetary system to the increasing use of several other reserve currencies, alongside the dollar and the SDR. The machinery for recognition of these problems and for cooperative resolution of them is well developed. The need is for vigilance in the relations among the financial authorities of the seven countries, and for joint support by their Governments of the introduction of a "Substitution Account" within the IMF as promptly as possible.

Moreover, structural adaptation to the growing role of manufacturing in the developing countries will create continuing strains, as will the further broadening of East-West economic relations. The Heads of State and Government should initiate further exploration of the suggestion in the Brandt Report for a "Summit" meeting among representative developed and developing countries (as in the Council of Governors of the IBRD) to consider changing relations within and among the developing countries, and between them and the leading industrialized countries. Perhaps North-South as well as East-West relations could be the subject of special arrangements for further concentrated evaluation by representatives of the Summit countries.

VI. Modalities

The group considered the role of the Summit in the process of economic policy formation, and its potential for minimizing contradictions among the Summit countries. Clearly, contacts among all seven Heads of State and Government, sitting together, can contribute to a fuller understanding of joint interests and needs. Such meetings also afford an opportunity to consider methods of improving current consultation on major issues, in the light of experience in the intervals between Summit meetings.

While recognizing the inevitable interrelations between economic issues and all other aspects of international relations, the group felt that continued concentration of agreed Summit agendas on matters of political economy provided a useful focusing of attention on those economic questions which do, from time to time, require the decision and action of Heads of State and Government in the context of related common concerns for defense and other strategic objectives.

Consideration was also given to the matter of relations with countries outside the Seven, and the risk of creating an impression of a super-directorate for dealing with world economic affai rs. Nonetheless, while mindful of the perception of other governments and international institutions, and of the need to maintain full contact with them, the Heads of State and Government should not be deterred by such concerns from dealing with global economic problems and providing leadership toward implementing internationally agreed solutions.

April 8, 1980

Note: A first draft of this report was outlined during the closing session on March 27 and when completed was sent to all participants on March 28. Comments received from them by April 8 have been included in this final version. Responsibility for resolving all differences in approach rests with the Chairman.

Participants in the
Pre-Venice Mini-Summit*
London, England
March 26/27, 1980
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Mr. Yusuke Kashiwagi
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Sir David Steel
Chairman, British Petroleum Company, Ltd.
London

Mr. Edmund Wellenstein
E.E.C.
The Hague

* Invitations were extended to at least three persons from each of the seven countries. Several who were unable to attend did send helpful comments in response to an initial outline of an agenda. However, since they did not participate in the give-and-take of actual discussion, their contributions are reflected here only to the extent that concurrence emerged during the meetings.