



NOTE OF A MEETING BETWEEN THE CHANCELLOR OF THE EXCHEQUER AND
MR. SECRETARY OF STATE VANCE HELD IN THE CHANCELLOR OF THE
EXCHEQUER'S ROOM AT THE TREASURY AT 9.00 A.M. ON WEDNESDAY,
23RD MAY, 1979

US Secretary of State Vance called on the Chancellor this morning, accompanied by the US Ambassador, and Mr. Morris and Mr. Ammerman from the United States Embassy. Mr. Couzens was also present.

Defence Expenditure

2. Mr. Vance said he was sensitive to the new Government's commitment to cut public expenditure. What were the implications for defence expenditure? The Chancellor recalled that in Opposition the present Government had recognised the need to except defence from the full rigors of public expenditure cuts. But there could not be a blank cheque. Expenditure on defence, aid and the EEC Community Budget together represented a very significant drain of resources across the exchanges. Mr. Vance thought the Government's high priority for defence was very important; it would be a welcome message to other members of the Alliance.

Economic Assistance

3. Mr. Vance thought economic assistance and aid extremely important. Of all the money spent on foreign affairs, defence apart, aid expenditure produced the largest return in his view. This was especially true of aid to the third world, including Africa. Provision of armaments could buy the Soviets goodwill for a year or two, but after that developing countries needed economic assistance which could be provided by the West. Getting this message across to Congress was a



continuing problem; but the US Administration was winning. The Chancellor associated himself with the need to combat Soviet influence by economic means. This was clearly important. But he tended to view with some scepticism the value of Government to Government aid: the benefits frequently fell short of the expectations of the donors. Exposure to a policy of economic liberalism, as adopted by the new Sri Lanka Government, seemed often to produce much more tangible progress than either bilateral or multilateral government aid. Mr. Vance agreed on the importance of integrating aid with trade and investment policies. These had to be compatible. There was more to be gained if countries concerted their aid policies than if each worked independently. Mr. Couzens remarked that the United Kingdom's expenditure on aid was a long way ahead of the United States and Japan as a percentage of GNP. With the possible exception of France we allocated nearly twice as much of our GNP as our main partners. The Chancellor saw this as part of our imperial heritage. And we had maintained this record despite being, in the language of the EEC, a "less prosperous country". Similarly, we spent more of our GNP on defence than did either Germany or France, and only a little less than the United States.

Preparations for the Tokyo Summit

4. Mr. Vance had been following the preparations fairly closely. He agreed that energy would be a central issue, along with macro-economic and North-South issues. This would make a sensible package. He had discussed the preparations with Sir Michael Palliser; they seemed to be going well. He referred to the paper being prepared by Mr. Schultz. The Chancellor said that preoccupation with his Budget had prevented him from drawing together the various threads on the Summit.



European Monetary System

5. Mr. Vance asked about the Government's attitude. The Chancellor said Ministers had not yet come to a final judgement. The Prime Minister had said that the UK position would be considered in the light of the intended 6-monthly review. The Government were predisposed in political terms to participate as fully as possible in European developments, but there were important technical dimensions to the EMS to be considered. Ministers would be cautious of reaching over hasty decision.

6. Mr. Vance remarked on the persistent rumours of US opposition to the EMS. He did not know where they originated from. They were certainly not true. The Chancellor suggested that the EMS could make a limited contribution towards international currency stability so long as it did not cut across policies for the dollar and other world currencies. Mr. Vance agreed.

Trade Issues

7. Mr. Vance wanted to leave the Chancellor (and the Secretary of State for Trade whom he was seeing later in the day) with assurances that the US Administration were going to stick to the letter of the agreement reached on MTNs, including maintaining the material injury clause. The United States Administration aimed to get the legislation through by the end of July. There had been some difficult moments in the last six weeks, especially over textiles. This had also proved the most difficult issue in the negotiations with the Chinese. The trade agreement with China could not be signed and sent to the Congress until it had been settled. The Chancellor said he had visited China a



year ago but did not recall textiles being a live issue at that time. Mr. Couzens associated the UK with the United States in wishing to avoid a credit war in trade with China, which the UK had also sought to avoid in relation to the USSR. Mr. Vance foresaw difficulties if the United States was driven to conceding most favoured nation treatment for China, whilst precluded - for human rights reasons - from extending this to the USSR. It would skew US foreign policy undesirably. He hoped to get round the Jackson-Vannock amendment by concentrating attention on the growing relaxations in the Soviet attitude towards human rights, rather than by insisting on formal assurances. This was an issue the US wished to take up at the Summit.

8. There followed a brief exchange about the relative importance of tariff and non-tariff barriers in restricting world economic growth. The Chancellor suggested that barriers of the latter kind were proving a greater deterrent to expansion than the former. Mr Vance seemed to agree.

Inflation

9. In answer to a question from Mr. Vance, the Chancellor said that the year on year UK inflation rate had risen to 10.1 per cent, with the 6 month annualised rather around 13 per cent. Mr. Vance said that inflation had risen last month in the United States, fuelled particularly by increases in food prices, particularly beef. But he thought the present bulge in prices would be over by the end of the summer. On the other hand, the unemployment figures were improving. He agreed with the Chancellor that public perception of inflation and the costs of Government had sharply increased, as evidenced by the interest aroused in Proposition 13. Inflation and energy were currently the main political issues in the US. Foreign affairs had much less impact.



Turkey

10. The Ambassador asked whether the issue of aid to Turkey was likely to be resolved before the Summit. Mr. Vance referred to the proposed pledging conference on 30th May. There was a question mark over whether that should take place in advance of satisfactory progress on an agreement with the IMF. There was a chicken and egg argument here. He was personally inclined to favour the argument that the existence of a contingent fund would help Prime Minister Ecevit to take the difficult political steps needed to get the IMF operation into place. He personally placed great importance on helping Turkey through her present difficulties. This was essential to the stability of the Middle East and strategically to the protection of the Southern flank of the Alliance. If Turkey went under it would be a disaster.

11. As for individual contributions, Congressional authority now existed for \$250 million on top of the similar amount already agreed for security support assistance. But \$500 represented the limit of US help. The Germans had started slowly, but had now been persuaded to increase their share from \$100 to \$200. Their original offer was not commensurate with the leadership they had assumed at Guadaloupe. Mr. Vance thought the French contribution was still too low. The Japanese had now come forward with \$70 million, perhaps more, partly in cash and partly in credits. As for the UK contribution, he had asked the Foreign Secretary if he would look again at the amount proposed by the Labour Government.

12. The Chancellor said he had already discussed the UK contribution with the United States Ambassador. He understood the political pressures which Mr. Vance had mentioned. But as Chancellor he had to bear in mind the Government's commitment to reduce public expenditure. It was difficult to be accommodating when he was pressing his colleagues to make



economies on their spending programmes. The UK contribution had also to be put in the context of the wider help we were giving to Turkey. We were allowing \$250 ECGD cover to continue, with little prospect of getting very much back. However, Ministers had certainly not yet reached a final decision on the matter. Mr. Couzens thought it was reasonable that other countries in the UK should take the lead on Turkey.

Other Contacts

13. Mr. Vance thought an early meeting between Treasury Secretary Blumenthal and the Chancellor was desirable. The Chancellor explained that arrangements were in hand for them to meet in the margins of the OECD Ministerial meeting in Paris on 14th June. Mr. Vance thought that an early visit to the UK by the Chairman of the Federal Reserve, Mr. William Miller was also a good idea. He would try to encourage that when he returned to the United States.

14. Mr. Vance thanked the Chancellor for receiving him. The meeting closed at 9.50 a.m.

Internal circulation:

Chief Secretary
Financial Secretary
Minister of State (Commons)
Minister of State (Lords)
Sir Douglas Wass
Mr. Couzens
Sir Anthony Rawlinson
Mr. Jordan Moss
Mr. Barratt
Mrs. Hedley Miller
Mr. Widdup
Mr. Michell
Mr. Scholar
Mr. Ryrrie UKTSD

AW
(A.M.W. BATTISHILL)
23rd May, 1979