

From: The Rt. Hon. Edward Heath, M.B.E., M.P.



HOUSE OF COMMONS

20 May 1981

Dear Prime Minister

The deterioration in the economic prospects of much of the Third World is being fuelled by the growing hostility of the international economic environment. This situation provides significant opportunities in these countries for political extremism, for Soviet interference, and for social instability on a large scale. It is essential to improve the prospects for growth of many developing nations whose stability is politically and strategically essential to the West.

In addition, the West has a strong interest in devising, with the developing countries, a package of measures which would serve both to bring greater order into the chaotic international oil market and to promote a more efficient recycling of the surplus funds of major oil producing nations. Such a package would also help to safeguard the precarious, and politically dangerous, position of over extremism in which the commercial banking system now finds itself.

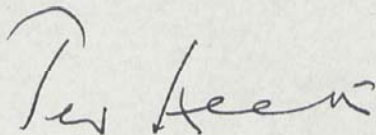
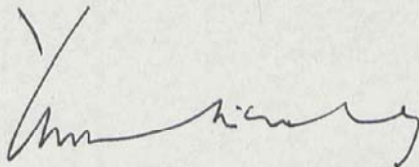
The forthcoming Summit meeting in Mexico on North-South issues provides a momentous opportunity to give impetus to policies such as these, and to the other urgent priorities for action in which both the developed and the developing countries have a strong mutual interest.

May I take the liberty of offering you some personal reflections on the tasks which lie ahead of this Summit.

If the Summit is to achieve its purpose, I suggest it will need to be successful in three fields; first, in developing a common assessment of the problems which mutually concern North and South in the economic sphere; second, in establishing a badly needed sense of priorities in the wide range of policies which could help to improve this situation; and third, in giving greater precision and direction to those priorities which are now urgent.

In the attached paper, I have set out a possible basis for such a common approach. A summary is included for your convenience.

I am writing to ask you to give your strongest personal support to these proposals at the Mexico Summit and at the Summits of the Western Seven at Ottawa and of the Commonwealth at Melbourne which will precede it.



The Rt Hon Margaret Thatcher MP
The Prime Minister

SUMMARY OF A MEMORANDUM TO THE SUMMIT ON NORTH-SOUTH
ISSUES AT CANCUN, MEXICO, BY THE RT HON EDWARD HEATH MBE MP
(full text attached)

- I. There are four aspects of the international economic situation in addition to the recession in the industrialised countries, which should receive the special attention of the Summit because no other scheduled high-level meeting could tackle them as effectively.

a) Problems of payments and debt

The current account deficit of the oil-importing developing countries is expected to reach \$80 billion this year from the already unprecedented level of \$63 billion in 1980. This raises two problems which crucially affect the interests of both North and South:

- (i) The middle-income developing countries, which are largely responsible for this payments deficit, have only been able to finance it by becoming increasingly indebted to the commercial banks of the North. Since 1975 their external debt has more than doubled -- and stood at \$280 billion by the end of 1980. There is now a growing danger of a collapse in confidence by private lenders. This could rapidly precipitate a default by a major borrower. That, in turn, could fatally weaken the commercial banking system of the North and lead to massive instability in the world's monetary arrangements.

If nothing is done to help these countries, they may have to cut back drastically on development. This could seriously unsettle them, politically and socially; and it would further restrict their imports from the North which already account for 24% of US manufactured exports and 14% of EEC manufactured exports. With low growth rates, and unemployment approaching 25 million, the North has every interest in avoiding this situation.

- (ii) The low-income developing countries, to which private banks lend much more modest sums of money, have had no alternative but to cut back substantially on their development plans. In countries like Pakistan and the Sudan, this has increased the potential for instability; and it has further limited Northern exports. In addition, it has seriously exacerbated the problem of absolute poverty. This is a major humanitarian issue; and it poses severe problems for the environment (such as increasing deforestation), for population growth (which is highest at these levels of income), for economic growth (because hungry and sick people are unproductive), and for agricultural productivity (because of all these factors). Neither North nor South can escape the consequences of such developments.

b) International oil situation

The market for oil is likely to remain finely balanced in the long term, despite temporary gluts. This will be an impediment to growth in developed and developing countries alike.

c) Food

Over the last decade, per capita food production has dropped in over 60 developing countries; and the number of malnourished people has reached record levels. This is not only a major humanitarian problem; it also affects the economic interests of the rich countries in two ways. First, it pushes up food prices on the world market, which may add to inflationary pressures; and second, it restricts economic growth in the developing countries (hungry people are unproductive), which further limits their demand for Northern goods.

d) Protectionism

Freer trade would help to increase the purchasing power of the South and reduce inflationary pressures in the North. However, protectionism in the North is increasing. This is despite the fact that the developing countries as a group have a substantial deficit with the North in trade and manufactured goods.

II. Workable initiatives in these four areas must be based on the following considerations:

- (i) The considerable limitations on the availability of finance for Third World development from the public budgets of the North, if it is not possible to change their current priorities.
- (ii) The need to ensure that the financial contributions of the major oil-producing countries to world development are as equitably balanced as possible by the contributions of the industrialised countries.
- (iii) The need to provide adequate opportunities for all to participate in some degree in the management of the world economy if the will and the resources which are required effectively to tackle the urgent problems facing it are to be mobilised.

On this basis, the following priorities for action would seem to be both urgent and practicable:

a) Problems of payments and debt

- (i) These require greater official action, by national and international institutions, to channel funds to the developing countries. To achieve this, adequate quantities of loan capital must be available to these institutions on a sustained basis. The most readily available source of funds is the major surplus countries of OPEC.
- (ii) It is therefore necessary for the industrialised countries to make it more attractive for official holders of OPEC surpluses to place in the IMF and the World Bank the additional funds which they require. Two important ways of achieving this are:
 - To give the donor countries decision-making powers

within these institutions which are more closely related to the size of their contributions. This would in no way diminish the financial responsibility of these institutions.

- To guarantee a constant, real rate of return to governments which contribute substantial quantities of additional funds. This is particularly important in the case of the World Bank. This guarantee would be available to any investor, thus avoiding any explicit favouritism towards OPEC; but, in practice, it would carry conditions which only countries with surpluses of public finance as large as those possessed by OPEC would be likely to satisfy. (See Paragraph 15 ii of full text.)

(iii) The next task is to channel a greater proportion of the funds thus acquired by the IMF and the World Bank to those developing countries which cannot afford to borrow substantially from the commercial banks, but which are not so poor that they are largely excluded even from concessional borrowing. This requires:

- more resources to be found for subsidising the interest on loans to these countries. This can be done without making large demands on the public budgets of the North;
- that the lending practices of the IMF should be further reformed in order to take proper account of the effect of deteriorating external economic conditions on the ability of developing countries to undertake economic adjustment programmes.

(iv) More OPEC capital would be attracted to the non-oil developing countries if additional means of productive investment could be identified within them. Two such means are:

- To find more satisfactory ways of 'marrying' surplus capital from OPEC, technological and managerial expertise from the developed countries, and proponents of industrial projects in the non-oil developing world.
- To increase co-financing between the IMF and World Bank and official holders of OPEC surpluses.

(v) Most of the above proposals would not deal with the present financial emergencies of many developing countries. These may require immediate relief on interest payments, or even cancellation of debt in the case of the poorest countries. The latter will, in any case, need to remain an absolute priority for direct grants in national aid policies.

b) International oil situation

Both the major producers and the major consumers have an interest and a responsibility to bring greater order and predictability into the world oil market. Three priorities:

- (i) They must seek to reach an understanding on future trends in the supply and price of oil, which includes a 'ceiling' on prices as well as a 'floor'. But this is unlikely to be achieved unless the major consumers are in a position to offer the producers concessions which are commensurate in importance with an understanding of this sort. Four possible concessions are advocated in Paragraph 21 of the full text.
- (ii) An efficient system of rules to restrain competitive bidding for freely-traded supplies of oil in times of temporary shortage is urgently needed. Otherwise the danger will persist that small interruptions in supply will precipitate massive increases in price.
- (iii) Official finance is urgently needed to prospect for sources of energy in the Third World which are not large enough for private corporations to risk the costs of initial exploration and development. Given the finely balanced nature of the world oil market, even small discoveries of oil could help to stabilise energy prices. Moreover, they could greatly improve the payments positions and growth prospects of countries which require very modest quantities of energy, but are barely able to find the foreign exchange to import them. The proposed energy affiliate of the World Bank would be in an excellent position to undertake this sort of funding.

c) Food

- (i) The overriding priority is for the South to do more to improve its own capacity for food production.
- (ii) International assistance - for example with fertilisers and additional funds for research and development - can greatly assist these indigenous efforts, and must be supported.
- (iii) Emergency food requirements will need to be met by other means. An increase in available food aid is particularly important. And an attempt to stabilise the price and supply of grain on the world market should be made through a new International Grain Agreement.

d) Protectionism

Major progress will be difficult to achieve here. But the Summit should endeavour:

- (i) to agree on the need to achieve a standstill on protectionism, particularly in the next Multi-Fibre Agreement.
- (ii) to indicate its determination to begin, where possible, to remove trade barriers against the developing countries.

III. If the Mexico Summit can be directed to these purposes, it may be able to make a powerful contribution to resolving some of the world's most vital economic problems to the benefit of North and South alike.