

DRAFT PIECE FOR PRIME MINISTER'S SPEECHTHE DEBT PROBLEM

A dark shadow is cast upon the prospects of recovery of the Western industrialised countries by the burden of debt of the Third World and Eastern Bloc countries. The strains in servicing such large debts have caused great problems for the monetary authorities and commercial banks around the world. Little more than a year ago it seemed just possible that the debt problem would turn into a major crisis of liquidity. But with speed and efficiency, the monetary authorities, together with the banks, first contained the risk of illiquidity and then set in motion the long process of adjustment.

We have given our full support to the International Monetary Fund and other institutions in their efforts to ensure that the process of debt management is orderly and that it maintains the liquidity of financial institutions. We will continue to support the IMF in the months ahead.

But we must also have a care for the long run future. We must make sure that the measures that are taken to deal with the debt problem today do not come back to haunt us many years hence. We must have it firmly in our minds that the debt problem is a transitory strain on the system. After a period of five years or so the adjustments will be over and the debt will be back to manageable levels.

But it is of the utmost importance that, in dealing with this temporary problem, we do not take permanent measures which will come back to haunt us in the future. In particular I have in mind that we should not permanently increase the world's money

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supply in order to relieve today's burden of debt. For then that money will eventually add to world inflation. Over the last four years the industrialised companies have striven hard to reduce inflation. All the more reason to be on our guard against any measure which will rekindle the latent inflationary fires. Similarly, we should steadfastly avoid rewarding countries and firms that have acted with profligacy. No-one should want to see any incentives to overborrow giving rise to a repeat performance of the present crisis.

This is a considerable danger. Governments frequently set up institutions and machinery to deal with current crises. But those institutions and provisions then usually become a permanent feature of the landscape. Then what was once a solution becomes a problem.

I have in mind the many measures that were started in the 1950s and early 1960s to deal with what was then a "dollar shortage" and the alleged "shortage of world liquidity". By the time these measures, such as the SDR issues, bore fruition in 1970, the world was suffering from a dollar glut, not a shortage, and financial markets were awash with intentional liquidity from a burgeoning Euromarket. This money fuelled the great inflation of the 1970s.

We must avoid repeating these past mistakes. The world leaders and bankers are well aware of the dangers of renewed inflation and another mountain of debt. We must all be on our guard.