OTTAWA ECONOMIC SUMMIT CONFERENCE

RECORD OF PLENARY SESSION HELD AT THE CHATEAU MONTEBELLO ON MONDAY 20 JULY 1981 AT 9.30 AM

Mr Trudeau, (Canada) (Chairman) after welcoming his colleagues to his opening Session, said that he proposed to start the Conference with a discussion of the macro-economic situation, including fiscal and monetary policies and trade. He proposed that over lunch Heads of State or Government and Foreign Ministers should discuss political matters, with a view to deciding whether he should be authorised to make a political statement to the press on behalf of the Conference that evening. Mr Trudeau went on to report a meeting which he had held with Labour leaders from the seven countries some days earlier. They had asked him to put their report before the Conference. The message in the report was essentially the same as that which they had submitted to the OECD: that Governments must be concerned with the social cost of monetary policies, and with fighting unemployment. They had indicated that they were supportive of Solidarity in Poland. They looked to the Conference to take a positive attitude towards the North/South dialogue.

At this point the press photographers left the room.

Mr Trudeau then reverted to the statement of objectives enunciated by President Mitterrand at dinner the previous evening. Heads of State or Government had discussed peace over dinner last night; another objective enunciated by the President of the French Republic was that each should help the other. He (Mr Trudeau) thought that this might be the theme for the macro-economic discussion. As Heads of State or Government they should try to go beyond technicalities to the root of the problem, and to reflect on the deep causes of inflation, and how the fight against inflation - still (he took it) the highest economic priority -

could be pursued without undue social costs, particularly in unemployment. They should consider how they could minimise those social costs, whether by a different mix of policies or by remedial measures, and how to help each other, recognising that the policies of each affected the rest and that consultation should be an on-going process. He invited the Japanese Prime Minister to open the discussion, as the representative of a country whose Government had succeeded in fighting inflation without excessively high social costs.

Mr Suzuki (Japan) welcomed the opportunity to address the Conference. During his travels he had been fortunate in getting acquainted with many of his colleagues around the table. Their cultural and historical backgrounds might be different, but he had become aware of the significance and value of leaders of the main industrialised democracies getting together and dealing with their problems. He welcomed the opportunity of sharing his broad perceptions with his colleagues on this occasion. If the West was to achieve peace and stability, it was necessary to address the problems not only of the Third World but also of the Western nations in the longer term. The West needed to deal effectively with the continued Soviet military build up and Soviet incursions into the Third World. They needed to reorganise and revitalise the Western economies and revive the economic strength of the West. And they must work on North/South problems, and the stability of the Third World. They should tackle these issues from a political and economic as well as from a military point of view, and consider a wide range of measures in a comprehensive manner. It was up to the West to prove that its values, ideas and institutions were superior to all others. It was above all important to achieve a secure military balance with the East. It was for this reason that it was important to revitalise the economies of the West and to integrate the effort of the West, to its own benefit and to that of developing countries. He had often spoken of the need for a comprehensive strategy for the West. The strategy should be unified, and each nation should make its own contribution according to its own capacity and situation. There was a need for harmony: a spirit of solidarity and co-operation in the face of world problems. Harmony did not imply complete agreement of views: it was the total sum of all diversities, a blend of interdependence and diversity. From this Summit Conference there should issue a powerful message to the rest of the world on the political solidarity of the West and its determination to revitalise its economy through ingenuity and free trade.

What should be the West's response to its basic problem? Of course the successive rises in oil prices had created problems, but most of the difficulties for the West were caused by structual weaknesses in their own economies. All the industrialised countries were doing their best to adapt. All needed to do as much as possible to adapt to high technology and to remove social injustices. This should accelerate growth and the recovering of employment.

For Japan the two oil price crises had been a time of severe test. Thanks to the stringent efforts they had made for structual adjustment by the private sector as well as by the Government, they had weathered the storm. They were also helped by favourable labour-management relationships. Japan had suffered from yielding to pressure to act as one of the locomotor economies in 1978. That had left them with a heavy fiscal deficit, currently of $3 billion. Debt interest was costing them $2.5 million an hour. They were continuing to pursue a growth pattern based on an increase in domestic demand. They were convinced that the open multilateral trading system was indispensable to the growth of the world economy. From this point of view the Ottawa Summit Conference was timely and significant. It should stress the necessity of the free trading system and send this message across the world. He would be opposed to the inclusion in the communique of any expressions which implied trade restrictions. If increases in imports were damaging particular domestic industries, they should be dealt with under the rules of the GATT. He supported the initiative for a ministerial meeting of the GATT in 1982. That meeting should discuss trade affairs for the 1980s, including the question of safeguards. Difficulties could be solved by suitable macro-economic and structural adjustment policies. Japan was fully prepared to co-operate with other countries in investment in high technology contributing to structural adjustment of traditional patterns of industry.

There still seemed to exist the myth that the Japanese market was closed. It was as open as markets of other countries. Japan would co-operate with others for the expansion of imports of manufactured goods.

There were in the Far East, near Japan, a number of newly industrialised countries. It was necessary to intergrate them into the world economic system. It was important to avoid putting them into a disadvantaged position in relation to other developing countries just because they were being sucessful. The newly industrialised countries were very interested in the outcome of this Summit conference.

Interdependence between North and South was becoming stronger. It was therefore increasingly important to look at relations with developing countries with a view to promoting better international economic development and world peace and stability. Japan had doubled its official development assistance between 1978 and 1980, and was now committed to a further doubling by 1985. Assistance would be concentrated on manpower development, agriculture and food production. The industrialised countries should continue with a constructive North/South dialogue. The Asian and African countries were deeply aware of the need for assistance from the industrialised countries. If the industrialised countries did not help, the Soviet Union would get in.

Mr Suzuki supported President Reagan's statement on the prevention of nuclear proliferation and the utilization of nuclear power for peaceful purposes. He suggested that the conference should recommend developing countries to participate in the nonproliferation treaty. Japan hoped for progress in nuclear disarmament discussions. He also welcomed President Reagan's statement about the development of nuclear power and the fast reactor.

Mr Trudeau, commenting briefly on Mr Suzuki's observations, said that it was difficult to make as much progress as was desirable in structural adjustment against entrenched resistance to mobility.

President Reagan said that he would like to tell his colleagues what the United States administration were trying to do in their own country. He welcomed the observations of Mr Suzuki about free trade. The Summit countries should promote free trade and the removal of export credit subsidies. He had great fears of the development of protectionism, both ways, which could be counter-productive and destructive.

Inflation was now world wide, and the world had known the longest period of inflation ever. Previous United States administrations had gone in for intervention, using taxation and Government expenditure to try to influence the economy. When he took office, he inherited from his predecessor budgets for financial year 1981 and for financial year 1982. There was not much that the new administration had been able to do about the budget for 1981, but they had gone to work on the budget for 1982. They had gone for the greatest reduction of public expenditure ever attempted: a reduction of $40 billion in 1982, and a total reduction by 1984 of $270 billion. They were coupling that with a reduction in tax rates over three years, designed to stimulate the economy and increase productivity. It was not necessary to choose between fighting inflation and fighting unemployment: they would correct unemployment as they corrected inflation.

There had been criticism of the high level of interest rates in the United States. That was not part of the administration's economic package. They had inherited high interest rates. They hoped that, as inflation came down, interest rates would also - and shortly - come down. He felt as badly about the level of interest rates in the United States as colleagues round the table did: they were damaging to the building industry, to the real estate business, and the automobile industry and its dealers. He remained his colleagues that the Federal Reserve System was autonomous, and outside the control of the government. The administration thought that its policies were going to lead to a balanced budget by 1984, and to reduce or eliminate inflation. This should have a good effect world wide.

President Reagan hoped that in the Autumn there could be a high level meeting of COCOM to discuss the development of East West trade and its bearing on the growth of Soviet militarism.

President Reagan hoped that out of this Summit meeting there would come an atmosphere of unity, good will and determination to solve the problems of the free world. We should not be too pessimistic: these seven countries represented 80% of the gross national product of the industrialised world, and there was nothing we could not solve if we put our minds to it.

Herr Schmidt (Federal Republic of Germany) said that the co-operation which Mr Suzuki and President Reagan had talked about was the decisive reason for the fact that the world economy had withstood the upheavals of the last 8 years better than it had withstood those of the 1930s. In the 1930s they had acted in isolation, and the consequences were catastrophic: competitive devaluations, exchange controls, bilateralism, protectionism and export subsidies. The "beggar-my-neighbour" policies adopted at that time had led to a level of 6 million unemployed in Germany by February 1932. At least we had not been doing that this time. Nevertheless it was difficult to be too optimistic. The second oil price shock had hit the industrialised countries harder than had been expected, at a time when they had not recovered from the first. It had been a disaster for the non-oil developing countries. The continental countries of Western Europe had bee especially hard hit. Only some of their problems had been home made: many of them had been international.

Moreover, since Venice the United States had embarked upon radically new policies. He welcomed the emphasis of these policies on the fight against inflation. As the London Summit conference had agreed, inflation does not reduce unemployment; on the contrary it is one of its major causes. He continued to believe that, and would work to it. But the high level of US interest rates had forced interest rates up in other countries. When he and his ministerial colleagues got back to Germany they would have to tell the German public of the need to tighten their belts, because he had the impression that there was unlikely to be a change in United States policies. He did not mean to be critical, but he had the impression that nobody knew when United States interest rates would go down.

Germany's problems had been exacerbated by previous world Economic Summits. In 1978 he had given in to pressure from the United State's Government to reflate in Germany, and they had accordingly reflated. Germany was still suffering from the effects of that now. They had also bought huge quantities of United States dollars to stem the depreciation of the dollar in the late 1970s. European central banks had acquired $36 billion in 1977 in support of the US dollar. At that time Germany had been strongly criticised by the Chairman of the Banking Committee of the House of Representatives for pursuing tight monetary policies. The boot was on the other foot now. The economic scene could change extraordinarily quickly these days.

Co-operation still remained the leitmotiv of German economic policy. As he looked back he found a premium on pragmatic economic and monetary policies. Long before the discovery of monetarism, he had prevailed upon the Bundesbank to announce targets for monetary growth: not because he was a monetarist but because the Central Bank should make their plans known to other operators. The Bundesbank had announced targets for monetary growth since 1974. These were indicative, not rigid. The Government also used budgetary instruments, and the collective bargaining system was used to keep wage increases down. As a result of these policies the rate of inflation in Germany was the lowest in the world, and their rate of unemployment one of the lowest. They achieved this in the past without needing interest rates in double figures.

He was deeply persuaded that inflation was not just a monetary phenomenon. Autonomous decisions on wages and in the various layers of government played a great role in determining the level of inflation. On monetary growth, the Bundesbank had played it by ear all the time. He hoped that it would be possible to continue this way in the future. They had not sought to prevent short term changes in money supply. The German Government would continue with its middle of the road monetary policies. But he did not see how they could master their problems without some co-operation and a good deal of pragmatism. That approach had served us very well for the last 30 years, and would continue to do so. If we were to return to the "catch as catch can" policies of the 1930s, unemployment would be higher, inflation would be higher, stability would be threatened, and the domestic political fabric might not stand the strain. This would give opportunities for the communists, and for the Soviets, to benefit from wrong economic policies. Of course there was a great temptation to gain a little more time for one's own industry and workers by, for instance, the introduction of non-tariff barriers. We were all doing it, including the Germans. We were all tempted to subsidise declining industries, to intervene in exchange markets, to give export subsidies. We should pledge ourselves to resist the temptation to follow "beggar-my-neighbour" policies. The situation in continental Europe could quickly get out of hand, and the level of alienation of young people and of street protest could go far beyond that which had recently been seen in Britain.

He was not critising President Reagan but the President should realise the effect of what was happening. Unemployment in Germany stood at 5%. Real interest rates in Germany were higher than at any time since the birth of Christ. This was hitting medium and small businesses very hard. They would not, indeed could not, afford to pay interest rates of 15 or 16%; and as a result the levels of activity and investment were declining. Interest rates were being forced up, not because of the high level of inflation in Germany but because of the international network of capital markets and financial flows.

The United States had a key responsibility which none of those represented at the Conference could share. The US Administration also had a responsibility to prevent erratic movements of interest rates. The rest of them wished the US Administration success in their objectives, but asked them to put long-term world needs before short-term national interests.

He had formed the feeling that American policy on interest rates would not be changing. The Federal Government in Germany would therefore have to see to it that public borrowing was controlled, so as to give the Bundesbank freedom of manoeuvre to lower interest rates. They would be forced to cut budget expenditure; they would use part of the proceeds for restructuring with a view to increasing exports and reducing the payments deficit. He would not seek to lay the blame for this on anybody; he would simply tell the German public that that was what he had to do.

Signor Spadolini (Italy) said that the Italian government attached great importance to the Summit Conference as being an expression of Western solidarity and a reaffirmation of Western values, at a moment when the balance between East and West was very important, and when Soviet militarism was on the march. The West must strengthen themselves for the East-West dialogue and for the negotiations on Theatre Nuclear Forces, which he hoped would start soon. The countries of Europe could not afford to make any errors and give the Soviets the advantage of that.

Italy was very seriously affected by inflation; she had the highest rate of inflation in the European Community except for Greece. His government had a policy of fighting inflation, in order together with the social partners to bring Italian politics back to coherence. This was a major challenge, made more difficult by the rise in oil prices. It was not possible just to adopt monetary policies: the economies of the major industrialised countries were inter-dependent, and what was needed was a collegial approach, avoiding the "begger-my-neighbour" policies of the type which in the 1930s had led to the destruction of political freedom. It was not possible to deal separately with inflation and unemployment: if we fought inflation, we should be fighting unemployment of which advantage was being taken to undermine democracy. This could only be done successfully with a co-ordinated but differentiated strategy in which the major industrialised nations co-operated according to their needs and situations. Changes in exchange rates in the last 12 months had not been justified by changes in the underlying economic situation, but reflected purely financial movements. That was why it was necessary to have a concerted policy with the United States. If national policies were closely linked simply to the internal situation and were not internationally co-ordinated, the task of all would become very difficult. Failure to achieve this co-ordination could damage political cohesion. Early in 1981 Italy had experienced a substantial decline in inflation and a reduction in interest rates, but the rise of the Dollar rate had pushed both inflation and the level of interest rates up; the widespread indexation prevalent in Italy had contributed to this movement. The level of interest rates had substantially affected the burden of public debt financing. This would lead to slower economic growth. Indexation had made for structural imbalances, with too high a level of resources in the public sector and no productivity in industry. The Administration were proposing higher expenditure in the backward areas of Italy and on industrial enterprise. In other areas of public expenditure, and particularly administrative expenditure, they were proposing reductions. They needed to encourage greater mobilisation of resources for investment in the energy sector, where they needed to catch up with Britain, France and Germany. Support for additional investment could come only from external financing, given the inflationary pressures at home: they would be exploring the possibilities of international co-operation.

For many developing countries external private financing was not possible. We should concentrate aid on these poorer countries. The industrialised countries could not be able to do this unless they encouraged the development of a new international economic order which was credible. Italy would play her part as one of the industrialised countries. If we did not help developing countries, we should weaken the integrity of the world economic system. Participation in free trade was necessary to achieve a free world.

President Mitterrand (France) said that the main cause of the current problems of the industrialised countries was not the level of United States interest rates but the structural crisis. France, like other countries, was suffering from inflation and unemployment. Various political experiments had been undertaken by previous administrations to fight first inflation, then unemployment, and then inflation again. The result was that France had both. Increasing the level of interest rates was not the only possible way of fighting inflation, though it was one possible way. He did not propose to discuss the principles of monetarism; he was no monetarist, and in his country inflation was running at 14 per cent and unemployment at 7 per cent. It was the same crisis everywhere, and our economic system was partly responsible. Each country struggled with its own problems: we should act together in co-operation. Policies should be co-ordinated within the European Community, and among the seven Summit countries. Nevertheless we should recognise that we did not agree on all points of analysis. France was adopting another way. In France they were about to reach unemployment levels at which there were risks of enormous social upheaval; these risks exceeded the risks of high inflation. This did not mean to say that he thought it more important to fight unemployment than to fight inflation. It was necessary to do both. But unless they brought down unemployment, the social realities would make nonsence of economic realities. They would follow a policy based on the growth of consumer demand and productive investment, with maximum energy independence. The task ahead was a very difficult one. The explosion of interest rates was damaging medium and small businesses, and leading to higher unemployment. It was no good going back to a simple policy of austerity which would lead to social upheaval and greater pressure for protectionism. In political terms therefore he had sought to obtain quantities of social peace and develop discussions among the social partners. They would be discussing the length of the working week, shift working, working hours and so forth.

Of course they were encountering difficulties. They were faced with the problem of interest rates and exchange markets. He did not blame the United States; they were doing what they could. He noted what President Reagan had said about the level of interest rates being inherited from previous administrations. France would try to understand the United States, and he asked his colleagues at the Summit to try to understand the French. Nevertheless, he had to say that economic theories did not help; we had to help each other. He did not wish to accuse or criticise the United States, but the level of United States interest rates was very troublesome for France, was reducing France's economic potential and affecting her political and military responsibilities. If we were to uphold our common goals and maintain our independence, we must act together. It was not just a question of the high cost of money: everyone would hope that the United States would bring their interest rates down when they could. It was the combination of high interest rates and erratic exchange rates. President Mitterrand recalled that the Venice Summit communique had included a commitment to the avoidance of disruptive fluctuations and to stability of exchange markets; he also recalled a similar commitment made by the International Monetary Fund after the Jamaica Conference. When the International Financial Institutions had been created, it had been accepted that there was need for some flexibility within margins. Other countries could accept a high level of interest rates, for 3, 4 or 6 months, since this would help to reduce inflation and thus could improve the situation for all the countries concerned. But the conjunction between high interest rates and fluctuating exchange rates created an impossible situation, in which all that other countries could do would be to act like a boxer who crouches and raises his arms to protect himself. He had his own people, the French people, with their problems and conflicts. They were not perfect; they tended to take the easy way out. If they could not count on the support of their partners, they tended, like other people, to turn in on themselves.

Turning to trade, President Mitterrand, noted the large amounts of goods coming in from Japan. All that happened in the name of free trade. He was not against the open multilateral trading system. He noted, however, that all the countries concerned used protectionist measures of one kind or another. He suggested that it would therefore be a good idea to take stock of all our mechanisms so that we could move towards dismantling those mechanisms and towards freer trade. It was not just a question of Japanese exports: there were problems within the European Community of Italian wine, German steel and American soya oil. No doubt France was not without guilt herself.

We should set up a comprehensive list of all these problems. He was not against a Ministerial meeting of the GATT, but it would be vital for the Economic Community countries to meet in advance of such a conference, if conditions were to be created which enabled an agreement to be reached. Within the European Community this suggested that these questions might well need to be considered at a meeting of the European Council. There were problems for the developing countries with exports of raw materials; and there was no policy between the industrialised countries covering movement of manufactured goods.

He thought that the proposal for a meeting of COCOM was useful, and France would attend if such a meeting were organised. Here again it would be important to state clearly what was now being sold to the Soviet Union and other European countries. Could we do without that market? Would the products which we were asked not to sell in that market be those which we were able to sell best? Would the goods which were banned be those which would help the build-up of Soviet military strength? President Mitterrand recalled recalled that the British blockade of France during the Napoleonic wars had not worked. He asked why it should be permissible to sell grain to Eastern Europe and not goods. On these matters we needed to fight together against others, not amongst ourselves.

He was not attacking the United States, but he hoped that President Reagan and his colleagues would hear what the European countries were saying about the level of interest rates. The United States carried the main burden of the alliance and the rest of us had to be grateful; but we also hoped that the United States would hear what we said. He did not want to be faced with a social situation in France which might prevent him from fulfilling his alliance commitments. If the alliance was strong and clear, it would be able to negotiate from strength with the Soviet Union.

Reverting to the question of industries, President Mitterrand suggested that we should return to the 1971 situation. The Bretton Words system had served a liberal world for 25 years; it was not illiberal to organise the fight against inflation and the defence of the free world. We should not succeed without a clear plan for the development of the free world.

As to the developing countries, it was of course necessary to make all the appropriate humane statements; but it was in our own interests to set up an improved trade position and to create new markets. We all wished to export more high added-value products, and to expand our export markets. It was no good just continuing to exchange goods among ourselves at ever increasing prices without any increase in the real volume of trade.

Mrs Thatcher (United Kingdom) said that she had not prepared a statement, and would like to offer some comments on what her colleagues had said. She said that Mr Suzuki was fortunate in the degree of discipline, solidarity and co-operation in the Japanese economy, including good labour-management relations and the high degree of plough-back of profits. The experience of the Japanese economy was an example of the fact that in a recession it was the most efficient economy that rode it out best.

President Reagan had suggested that there should be a high level meeting of COCOM; she would like to support that proposal. It would be timely to discuss the trading policies of the West with the Soviet bloc, particularly in the field of high technology.

She agreed with Chancellor Schmidt that, even if we had all followed sound economic policies, we should by now have been in trouble on employment as a result of the second oil price shock, which had had the effect of diverting into purchases of oil resources which would otherwise have gone into investment. For many of the industralised countries, including the United Kingdom, a further problem arose as a result of competition from countries now producing the kind of goods in which the industrialised countries used to specialize. All these factors underlined the need for structural change and adaptation.

Mrs Thatcher endorsed the quotation from the communique from the London Summit to which Chancellor Schmidt had drawn attention: inflation was not a remedy for unemployment, but one of its major causes. If we were to have expansion it must be soundly based. This had not been the case in the United Kingdom, which had suffered from an explosive increase in the money supply far exceeding the expansion of output: over 10 years money supply had risen by over 300 per cent, while output had risen by only 16 per cent. This underlined the importance of fighting inflation as a means of fighting unemployment. Pouring money into the economy would just push up both inflation and unemployment. The policies which the British Government had been following had brought inflation down from 21 per cent to 11 per cent, had reduced wage settlements, and had laid the foundations for an increase in productivity. The Government was following strict budgetary policies, and though public expenditure had risen as a proportion of gross national product, the Government was intent on getting it down. The strict budgetary policies had enabled Britain to have a minimum lending rate of 12 per cent. These rates were still high, and it was to be hoped that, in order to improve the prospects for employment and expansion, United States interest rates would come down. She knew that President Reagan found the present level of interest rates in the United States as troublesome as the rest of the world did for its effect on medium and small businesses, on the real estate market, the construction industries and other industries, and she was sure that he would do everything in his power to bring about a fall in interest rates.

Recent changes in relative exchange rates were not wholly attributable to interest rate differentials. Not all exchange rate problems would be solved when interest rates came down.

In the United Kingdom the Government had taken strong measures to change the structural distribution of industry, in the steel and shipbuilding industries, for instance. Like Chancellor Schmidt they were following middle of the road monetary policies.

Mrs Thatcher agreed that one of the objectives of this Summit Conference should be to stem the tide of protectionism. We should put aside the self-protection which we all practised. She would be one of those who would wish to see non-tariff barriers coming down. It did not help to pay lip service to free trade without reducing such barriers as the "Buy American" provisions in the United States, the barriers on agricultural imports into the European Community, and export credit subsidies. The industrialised countries should try to tackle these matters, because they caused distortions in the economic pattern. No country should concentrate its exports in one small sector of industry to a particular country. It was for these reasons that certain British industries had agreements with Japanese industries. That was in her view the right way to resist worse tendencies to protectionism.

Mrs Thatcher thought that some of those that had spoken were too pessimistic. The last 2 years had been chiefly dominated by worries about possible further price rises. For the moment the world economy did not face the prospect of an early rise in oil prices, thanks to the stabilising effects of Saudi Arabia's policies. That gave us a tremendous opportunity: if we could all agree to pursue soundly based economic policies, we could have soundly based expansion. We could not expect to get back the higher growth rates of ten years ago, with corresponding increases in the rate of growth of public expenditure, and we should not encourage our peoples to expect them. But there were grounds for cautious optimism if we all followed soundly based policies, co-operated to the maximum extent possible, and emerged from this Summit Conference united in our objectives.

M Thorn (European Commission) thanked Mrs Thatcher for her analysis of the causes of the crisis which we faced. Its origins lay partly in the problem of oil price rises but also in our own failures, including our failure to put sufficient research and development into alternative sources of energy. There should be no mutual recrimination; we should see how we could help each other. We needed solidarity among ourselves, and with countries not represented at the Summit.

The recession proved worse for Europe than for the United States and Japan. In the European Community the average rate of unemployment was rising towards 9 per cent. Some saw the possibility of a reasonably early recovery, but he was less optimistic. In Europe they expected, recovery of about 2 per cent - half that of Japan: the rate would be higher in Germany and lower in some other countries. With that moderate rate of recovery, unemployment was expected to increase still further.

It was against this background that the countries of the European Community were concerned about the high level of interest rates in the United States and the erratic course of exchange rates, which were affecting prospects of recovery. They wanted the courageous attempts of the United States to fight inflation to be won, so that interest rates came down. President Reagan had said that it was not United States policy to have high interest rates; but because of the size of her economy and the importance of the dollar as a key currency, the United States had a special responsibility. If the recovery of the dollar went too far and too fast, it would be very damaging to Europe. The Japanese Prime Minister had stressed the importance of research and technological development; but that meant investment, and it was questionable whether Europe could at the present high rates of interest finance the debt burden imposed by such an investment. No one wished to criticise the United States, but it was desirable to study the reasons for the high level interest rates and erratic exchange rates. Countries in the European Community would have to take unpalatable but necessary measures, which would be the tougher given that monetary policy was already tight in Europe even before American interest rates rose to their present levels. The room for manoeuvre was limited, and, if action had to be taken to reduce payments deficits, it would be the more difficult to reduce unemployment and revive growth. It was to be hoped that the United States Administration would not be too dogmatic in their policies of non-intervention and monetarism. If the exchange rate of the dollar were to rise considerably and then to fall back sharply, there could be a disaster.

On trade, M Thorn said that co-operation among the industrialised countries was essential.

The European Community favoured an open liberal trading system. They agreed that protectionism would be suicidal. They wanted to open up and liberalise trade flows, but that became more difficult as each country tried to protect its own industries. Words and speeches would not be enough. The European Community would support the initiative for a ministerial meeting of the GATT in 1982, but that meeting should be well prepared, certainly in the European Community and perhaps also in the course of preparations for the next Summit Conference.

To the Japanese Government he would say that, if the fight against protectionism was to succeed, they would need not to go too far. If freedom of trade was to be guaranteed, it needed to be generalised: markets needed to be open not only in Europe but also in Japan. The Japanese should also be mindful of the fact that the concentration of export growth in particular products could produce a reflex of panic in importing countries.

Mr Trudeau (Canada) said that there was very little he wished to add from the Canadian point of view. Canada's position was essentially one of interdependence. Seventy per cent of her trade was with the United States. When he heard other colleagues talk of the effects of interest rates and erratic exchange rate movements, he reflected that Canada was the classical case. Since misery liked company, he was glad to welcome others to the club.

Since the Venice Summit Canada had had the opposite experience from other countries: they had had some increase in inflation, but they had managed to reduce unemployment by a job creation rate which was the highest of any in the OECD. But Canada was caught in the same trend as the rest of the industrialised countries. If he drew any inferences from this Conference, it was that Canada would have to fight inflation even harder, and even at the expense of the rate of growth. In Canada wage demands had not come under the same pressures as in some of the other countries represented round the table. They were paying the price of growing a little faster than other industrialised countries in the last year. The effect of the high level of interest rates was to increase the cost of debt finance by $\$1\frac{1}{2}$ billion compared with the original estimates for 1981. Canada shared the concern of other countries in seeing an early reduction in United States interest rates.

He had considered, following the morning's discussion, what further directions could be given to Personal Representatives. They would wish to look further at the draft language on the international economic and financial situation in the light of the discussion. It would be for consideration whether the Summit Conference could establish mechanisms for consultation between Summits. Further work would have to be done on the trade section of the communique; this could perhaps be considered by Finance Ministers over their lunch.

The meeting adjourned at noon.

The discussion was resumed in plenary session at 3.00 pm.

President Reagan (United States), commenting on the morning's discussion, said that he agreed with Chancellor Schmidt that during the 1970s the United States had created problems for the European countries. He did not wish to see that process continued. His Administration had inherited a high level of interest rates, and was at least as keen as other countries to see them come down, because the cost of debt financing made it more difficult for them to cut their budget deficit. The prosperity of the United States for the first 150 years had been built on a total absence of intervention by the government in the American economy. This aspect of American affairs had been noted by De Torqueville. America had changed course after the Great Depression. There were now 79 million Americans employed in the private sector, who were the source of the Government's revenue. No fewer than 82 million Americans were dependent upon the Government in one way or another for their livelihood, and 1 out of 5 Americans were employed by the United States Government. His Administration was aiming at reducing the government's share of the GNP. For many years it had run at 18-19 per cent. Now it had gone up 23 per cent, and it was the object of his Administration to get it back to 19 per cent. They intended to achieve this reduction in public expenditure without significantly diminishing care for the genuinely needy. Grants to the disabled, the unemployed and the poverty stricken would continue at 95 per cent of their former levels. Most of the savings in that area should come from the elimination of fraud and mismanagement. As for aid to the Third World, too much of the United States aid had gone to line pockets and not to help those whom it was meant to help. They had formed a task force to go to the aid of Jamaica. They had got together with Canada, Mexico, Venezuela and others to help in the Carribbean.

They had not yet had an opportunity to deal with interest rates; but they were already beginning to see signs of the reduction of inflation, and that could be expected to continue as measures to reduce government expenditure took effect. They would be reducing government regulation of the United States economy. Their allies should watch what the United States Administration did, not what the press thought they were doing. What they were doing would be co-ordinated with their Allies to the best of their ability. The United States and her Allies should always be talking to each other rather than about each other.