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Prime Minister

A.F.C. 23/3

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MR COLES

29/30 MARCH EUROPEAN COUNCIL: SPEAKING NOTE ON ECONOMIC AND SOCIAL SITUATION

1. Paragraph 9 of the Steering Brief for the March European Council (EHG(B)(82) 2) suggests that the Prime Minister might wish to make use of the discussion of the economic and social situation within the Community to stress a number of points of importance to the United Kingdom, and indicates that a speaking note will be submitted later.

2. I now attach the speaking note, which has been agreed by officials in the Treasury, the Foreign and Commonwealth Office, and the Departments of Trade, Industry and Energy. If necessary it could no doubt be discussed at the Prime Minister's briefing meeting tomorrow morning.

*DM*

D M ELLIOTT  
23 March 1982

Cabinet Office

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① Comité d'exp

- Co-ordinated policy -  
Coordinated action

- income social security

1982 -





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*p.a.*  
*W27/3.*

EUROPEAN COUNCIL 29-30 MARCH 1982

THE ECONOMIC AND SOCIAL SITUATION

SPEAKING NOTE FOR THE PRIME MINISTER

*Oil prices.  
rise &  
then  
fall*

1. Whenever we meet we face fresh problems. At present the world is adjusting, not to a violent rise in oil prices, but to a collapse in the oil market. Like any violent change this brings problems. The loss of income to the OPEC countries may in some cases endanger their political stability and the markets that they provide for Community exports. The fall in oil prices reduces the immediate incentive to search for measures to conserve energy and reduce dependence on oil; but as the Energy Council agreed on 16 March this must not lead to a relaxation of our efforts.

2. From the point of view of the Community and of the industrial world as a whole, the advantages of these events far outweigh the disadvantages. The adjustment in the terms of trade will offset the shift of income away from oil consuming countries in the industrial and developing worlds that occurred during the 1970s. The external financing problems of a number of countries should be greatly eased as the OPEC surplus disappears more rapidly. On balance the development should be good and not bad for output and employment.

3. Yet unemployment and inflation remain our problems. We should welcome the growing realism in pay bargaining in some parts of Europe and more strikingly in the United States. Our efforts to bring home to our peoples the need for a fundamental restructuring of our economies are beginning to have some effect. But the modest general recovery of activity which ought to get under way soon could quickly be brought to a halt by imprudent action. Inflation rates for the last year declined by less than had been predicted and the absolute level of inflation is, as a result, still far too high in the Community. The alarming rise in unemployment shews how far we are from achieving a climate of confidence for business.

*Un. inflation  
Realism in  
pay bargaining*



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*Indicates  
Most known  
threat to  
recovery*

4. The most serious threat would be a new upward surge of interest rates caused by the size of the U.S. federal deficit in the Budget which Congress has been asked to pass into law. The strong public reaction both in Congress and elsewhere to President Reagan's proposals may well enable their deficit to be reduced. A number of us have already made our views known in Washington and we should all continue to do so, firmly but quietly and in a way that will not cause resentment. The starting point must be a reaffirmation of our support for U.S. policies to counter inflation. But we must make it clear that fiscal policy needs to support the Fed's monetary policy - we have no interest in a one-sided relaxation of monetary policy. We can point to the threat of an unsatisfactory balance of policy both to U.S. inflation and, through interest rates, to the growth of the European economies. We could also mention the risk of damage to trans-Atlantic relations as a whole.

*Show home  
in order*

5. The only effective way to prevent high U.S. interest rates damaging our own economies is to set our own house in order. Attempts to isolate Europe from the American economy through artificial means would not work. Such devices are no substitute for fiscal and monetary discipline. Exchange controls would impede the free flow of money and goods which has been the foundation of the prosperity of the industrial democracies for thirty years. Such financial barriers would add to the obstacles which are being created in the world of commerce.

6. We need to press on with our efforts to develop a firm common front on economic relations with Japan. This requires an appropriate mix of trade and macro-economic policies.

*Japan*

7. Japan's low import propensity for manufactured products is a deep rooted part of present economic frictions. The Community should take its stand on the ground that Japan, having benefitted enormously from the open world trading system, should now make a major effort to increase its imports from the rest of the world. This means not just removing specific barriers but government action to achieve a fundamental shift in attitudes in favour of importing. We should bring home to the Japanese

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that the free trade system embodied in the GATT can not work effectively if a major member state such as Japan is in fundamental dis-equilibrium and fails to take corrective action.

8. Japan's recovery from the second oil shock has been more successful than that of other industrial countries. Its GDP growth in the past two years has averaged 4 per cent compared to 1 per cent elsewhere. Japanese inflation is 3 per cent, which is less than half the average in other major economies. But this recovery has been biased heavily towards increased exports, resulting in a sharp improvement in Japan's current external payments.

9. Underlying the difficulties which Japan's exports cause us is the fact that the high level of Japanese savings is not matched by private domestic investment or public borrowing. The Government's stringent fiscal policy which is expected to reduce the budget deficit to 2 per cent of GDP this year should be seen in this light. At the same time, the Japanese are pursuing a policy of accommodating monetary growth and low interest rates which is preventing the yen appreciating fully to reflect Japan's underlying competitive strength. It is no part of our thinking that we should urge net expansionary measures on the Japanese at a time when we are concerned to consolidate the gains that we have made in the world as a whole in reducing inflation. But we should ask them to cut back less in the fiscal field where they are effectively increasing taxation and to rein back their relaxed monetary stance so that the yen can rise. This would help to restore a better balance in the international economy as a whole.

*Micro-electronics*  
10. We also need to take action ourselves if the challenge from Japan is to be met. A major change is taking place in the industrial base of the western world. Developments in micro-electronics, computers and telecommunications are leading to the growth of the "information society". If we fail to keep pace with these developments our economies will suffer increasingly.

11. There is much that can be done, and must be done, at a national level. But the Community too has a role to play. It can help to create the



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right economic environment for the growth of information technology. It can provide a market for companies of a size that will permit the level of production they need if they are to compete on an international scale. And it can provide a basis for collaboration between companies which will be less effective on their own. Both in Japan and the U.S. firms are co-operating in the research effort needed for the next generation of products. It is therefore encouraging that the Commission are considering with leading Community manufacturers the scope for collaboration in long lead-time research.

12. Information technology is too fundamental a development for the Community to ignore. This is why the United Kingdom worked so hard to bring the micro-electronics Regulation to a conclusion and why we are pressing for the adoption of the telecommunications Recommendations. This is essential if the European communications industry is to have the benefit of a home market on a continental scale.

13. But other industries too need to be able to take advantage of the common market. The Council agreed last year that a concerted effort must be made to strengthen and develop the internal market for goods and services which lies at the very heart of the Community. Considerable progress has been made in eliminating non-tariff barriers to trade in manufactures, even though a good deal of work remains to be done. But we have made disappointingly little headway with the liberalisation of services such as insurance and air transport. Yet the freedom of a company established in one member state to offer a service to a customer elsewhere in the Community is a fundamental principle of the Treaty. Within the Community, more than half the workforce is now employed in services, nearly twice as many as work in manufacturing industry. It is the service industries whose continued expansion could provide the employment opportunities for the workers shed by the declining industries of the first industrial revolution. Freedom of services is thus not only a Treaty right but an economic necessity. We want to make the free flow of services a reality in the Community. We look for the same commitment from our partners.

Eliminating  
non-tariff  
barriers



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14. To sum up, if the Community is to face the challenges of the difficult current world economic situation it must be strong and united. Internally we must adopt sound policies to deal with the problems of inflation and unemployment. Externally we must agree, in the run up to the Versailles Economic Summit, on an approach towards the policies of the United States and Japan which will ensure that they take full account of the repercussions which their actions have on our economies.

*[Handwritten mark]*

conqueror



① Investment - Cut consumption.

More into  
Syrus,  
Spindles  
Machinery  
Schnells

Wages - to high

Can't take or more without  
becoming uncompetitive.

<sup>Exports</sup> Different pattern of trade - High tech  
- different regimes.

Transfer opportunities for Europe

Innovation does not call for  
extensive investment.

Technological  
change.

How pattern is larger than  
than it will solve  
in the market.

different pattern  
of trade

Swires

① Oil

Steel,  
Copper,  
Car. Shone

② Investment = Competition  
wage increases

③ ~~Private business~~

④ - ~~known to remain more workers~~

⑤ Transfer opp. for high

Financing of budget deficits  
surpluses.

⑥ Swires = ⑦ Overseas  
Japan  
U.S. Int. Res.  
Co. Holdings

⑧ New technology -