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10 DOWNING STREET

Sir Kenneth Couzens, KCB,  
HM Treasury,  
Parliament Street,  
London, SW1.

1 April 1982

Dear Ken,

VERSAILLES SUMMIT, 3-6 JUNE 1982  
A MACRO-ECONOMIC ASSESSMENT

I believe that the general drift of the paper is correct. And I would like to add only one really substantial statement. This is in connection with the discussion of the United States Federal deficit on page 23. We express our anxiety that the United States Government reduces the Federal deficit, and I think it would have been a good idea to argue that it should be progressively reduced over future years. But the important point is how do they do this? I would like to say that the best way to reduce the deficit of the United States would be to reduce Federal spending programmes rather than increase tax rates. This will release the economic initiatives of the private sector of the United States economy to the great benefit of the rest of the world.

I think this will be helpful to the United States Government. It also reflects the general view, with the exception of the French, that public sectors are too large and should diminish.

I have a few detailed comments. The first full paragraph of page 2, fourth line after "problems". "Often this is due to the fact that countries have not allowed energy costs to be reflected in the prices of energy." Then continue "The IMF has sharply ....."

Page 5, third line after table. After aggregates, insert "reflecting primarily an expansion of bank credit," then continue "have risen more rapidly".

Page 5, sixth line after table. Delete "reflecting the higher rate of inflation".

Page 7. I think Table 6 and the discussion is a little misleading. Japan's monetary growth is indeed likely to exceed the increase in prices, but Japan's growth of real output is likely to be positive and reasonably high. Much of their monetary growth is simply to finance an increase in real output. I think the best measure of inflationary monetary expansion is the growth of the money supply (M1) less the growth of the GDP. This will give the inflationary effect on prices.

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Page 8, second paragraph after Table, line 5. I think instead of "personal savings" this should really be "private savings". The next paragraph deals with personal savings, but does not talk about savings by the corporate sector. I should have thought this element is quite important in many countries; it used to be enormously important in Britain.

Page 12. I think the last sentence on this page is too strong. Why don't we delete the reference to the petro currency status. And just say sterling has also declined from the peaks reached in 1950.

Page 13. I am very interested in the supply side policies. I would very much like to see a draft when you have got one available.

Page 15. I am not at all sure that the first sentence is correct. Many countries that did not have expansionary policies did rapidly increase activity. For example, Taiwan, although it inflated briefly in 1974, inflation was stemmed in 1975 and remained at around 3% until 1978. Yet the growth rate in 1976-79 was as high or even higher than it had been in the years before 1974. I am nervous of this because it does imply that one can get an increase in activity by expansionary policies, and I doubt very much whether we can.

Page 16. It is a pity we cannot refer here in Table 10 to public investment. I suspect it is included in public consumption, but it seems to me worth a mention.

Page 17. I think that in the last paragraph the thrust of the argument is that there will be an increase in the dispersion of inflation rates. This is rather a serious matter and probably deserves a bit more airing.

Page 18. The "it" that leads this does not refer to inflation but might be taken to be by some translator. I should have said rather "The improving labour competitiveness and substitution of labour for capital should also help bring about a recovery.....".

I think we should make more of the threat of protection in the last sentence of page 20.

At the top of page 22 there is a suggestion of a wage push theory of inflation. Furthermore, there is also a suggestion that high real wage increases can be sustained by inflation. True the inflation has to keep on increasing, but even so I think we should redraft those sentences. Should we not emphasise here also the need for free capital movements? This will probably annoy the French, but what matter? At the end of the first full paragraph on page 22 we are saying essentially that the policies of the Summit group of countries are just about right. Is that the impression we wish to give?

Page 25, fourth line. Before "restrictions on sale" insert "subsidies and". Ditto in sixth line.

Page 25, first full paragraph. In the first sentence should we not make the point that this would enable other taxes to be reduced rather than public expenditure to be expanded?



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Page 25/26. There is a littly sally into supply side policies here, and it might be worth considering whether the main discussion of supply side efficacy shouldn't be in this position rather than earlier as in the present draft. I think supply side policies go automatically with the elimination or at least the reduction of protection.

Best wishes.

Yours

Alan

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