

SUBJECT

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10 DOWNING STREET

THE PRIME MINISTER

1 December, 1982

PRIME MINISTER'S
PERSONAL MESSAGE
SERIAL No. T 22910/82

Dear Bob,

I have now had a chance to read carefully the copy of your speech at Suva, which you sent to me on 18 November; and to look also at your article for the journal of the Royal Commonwealth Society. Both the analysis and the proposals you made were interesting and thought-provoking.

I found myself in agreement with nearly all your analysis. I agree with you that it was a sad day when the exchange rate part of the Bretton Woods system finally collapsed under the strains of American inflation, and when the oil price increase destroyed all hope of an early return to stable exchange rates. I am sure you are right to say that growing protectionism and the international debt situation should be looked at together as threats to the international trade and payments system of the free world; and that protectionism has taken many new forms not originally recognised in the GATT. I see the force of your argument about agricultural protectionism, and the damage it inflicts on third countries. You know we have done our best for New Zealand in that area.

I agree that there has been over-lending to some of the newly industrialising countries in the 1970s - and to Eastern Europe - and that time will be needed to put the situation right. And of course you are right to say that cutting back subsidies and budget deficits in these countries can be particularly painful, though we have to remember that bank lending helped some of the newly industrialising countries to maintain or achieve very high growth rates in the 1970s in spite of the enormous oil price increases.

/ You say in your

CM

You say in your article that you have no simple solution for the problems which beset us but you do have a number of lines of attack. In the complex world in which we now live - vastly more complex in its power balance and in its financial and economic structure than the world of 1946 - that must be the right approach, always provided that one does not lose sight of certain basic lessons on which I am sure we would both agree: that the free market economic system has performed infinitely better than the bureaucratic Marxist command economy; that the free system has successfully accommodated great changes in economic strength among nations; and that inflation and monopoly have been the main forces damaging its performance and its ability to provide sustained growth and jobs.

On lines of advance, I agree that we must provide substantial new resources for the IMF. Indeed I hope we can find ways of accelerating the process of doing so and demonstrating that the international community can reach speedy and constructive agreements. There is certainly something to be said for trying to encourage countries in trouble to turn sooner rather than later to the Fund. But I think we should do them (and ourselves) a disservice if we went too far to suggest that due conditionality could be avoided.

I agree too that we must by a whole series of steps reduce the risk of banking failures and rebuild confidence. I like your point about "symmetrical surveillance" of surplus as well as deficit countries, though I am not sure how you would apply it to OPEC surplus countries. But I would myself want to be careful about really long-term lending by the IMF, with conditionality extending over equally long periods and tending in practice to become nominal. The IMF may have to do more, but I don't think it can or should take over a large part of what has been done by the international banks and by private investment.

I was interested in what you say about a new Bretton Woods conference. Geoffrey Howe told me how you developed the argument at Lancaster House and in Toronto. I look forward to seeing the results of the review of the international financial system that is now being undertaken by the Commonwealth Secretariat.

/ Of course you

Of course you are right about the need for political will and about the irrelevance of some existing machinery like the "global negotiations". But would your conference go beyond the questions of protectionism and alleviations for LDCs described in your proposals? To many people, including myself, "Bretton Woods" means the post-war currency system which ended in 1973. Currency fluctuations can cause acute trade problems and greatly affect LDCs. I would much like to see a way out of currency instability, but I don't see that happening without a durably lower level of inflation and interest rates in major countries and the avoidance of shocks like the oil price increases.

I have replied at length: forgive me. As you can see, I found your speech and article of great interest.

Yours sincerely
Raymond

The Right Honourable Robert Muldoon, CH, MP.