

~~CONFIDENTIAL~~

Ref.A084/1263

PRIME MINISTER

London Economic Summit 1984: Possible British Initiatives

As promised in my minute of 25 April (A084/1240), I attach a note on the advantages and disadvantages of raising certain subjects at the Summit at British initiative and the kind of reference that it might in each case be worth seeking in the final declaration or communique. The note has been prepared by the Cabinet Office on the basis of contributions from the Treasury and the Departments of Trade and Industry and of Transport. I suggest that the Secretaries of State for Trade and Industry and for Transport should be invited to attend the meeting at which the note is discussed.

2. On the basis of discussions to date between Personal Representatives and in the light of the Cabinet Office note, I would summarise the scope for British initiatives at the Summit as follows:

(a) Liberalisation of capital markets

The Chancellor of the Exchequer deals with the question of Japanese capital markets and of the role of private direct investment in developing countries in the international debt context in his minute of 18 April to you. In addition, I agree with the conclusion of the note (paragraphs 9 to 11) that some general Summit discussion of liberalisation, and an appropriate reference in the communique, could contribute to the improvement of the overall climate.

not  
included ←

(b) Liberalisation of trade in services

As a minimum, we should seek to incorporate in the Summit communique a reference to the importance of the services sector in international trade. The three options for a more ambitious initiative are set out in paragraph 13 of the note, none of which is without difficulty. I do not see overriding objection to option (b) (an acceleration of work in OECD). I

recognise that option (c) (commissioning work on the extent to which Summit countries themselves maintain restrictions against each other's services exports) has presentational value, but am not sure how far we wish to go in 'institutionalising' Summits by commissioning further work among Summit bureaucracies. Finally, I am not convinced that we should raise the question of shipping services; the Secretary of State for Transport, if he attends, will have views on this.

(c) The burden of expenditure on social services

A reference in the communique to common longer term public expenditure problems, as recommended in paragraph 30, seems desirable and attainable.

(d) Further deregulation of air transport

For the reasons given in the note (notably paragraph 36), this idea seems to be a non-starter.

(e) Harmonisation of international standards

A general reference in the communique to the importance of harmonising international standards, in the context of reducing structural rigidities to sustained growth, could be useful and ought to be negotiable. This is likely to be reinforced by a detailed spelling out of the danger of allowing different standards and testing procedures to fragment markets in new high technology industries in the Second Report of the Versailles Working Group on Technology, Growth and Employment. The relevant extract from the latest draft of this Report, which is unlikely to be further amended, is attached to this minute. The intention is that the Report should be published, although this remains to be agreed among the Summit countries.

But these are all very general exhortatory proposals on the desirability of harmonising standards. They may well be accepted because people do not expect anything to come of them. Nothing will happen unless the Summit

invites or instructs Ministers (or an international organisation) to do something specific. For instance, the Summit might invite Trade Ministers to meet to consider in what areas and by what means harmonisation of standards should be pursued. You will want to consider whether the prospect of progress is sufficiently bright to justify the creation of a new piece of international bureaucracy.

(f) Phasing out of export subsidies

I agree that, as recommended in paragraph 46 of the note, we should aim to secure an endorsement in the Summit communique of the new OECD initiative. However, I doubt whether this will be easy to achieve. It was clear from discussion at the last meeting of Personal Representatives that there are wide differences of approach to subsidies in general. The French in particular take the view that this is a difficult area because subsidies arise throughout the production process, whether manufacturing or agricultural, and that in consequence the whole fiscal situation needs to be taken into account to produce a fair comparison between the United States, Japan and Europe. They are therefore likely to insist that any reference to phasing out export subsidies should be linked to eliminating other forms of assistance which distort trade, as in paragraph 6.3 of the Thematic Paper.

3. I am sending copies of this minute, together with the Cabinet Office note, to the Secretary of State for Foreign and Commonwealth Affairs and the Chancellor of the Exchequer. It would be helpful to have an early decision on the attendance of the Secretaries of State for Trade and Industry and for Transport, to whom I should like also to send copies of the paper in advance of the meeting if they are to be invited to attend.

*Re*  
Approved by  
ROBERT ARMSTRONG  
and signed in his absence

26 April 1984

OBSTACLES TO THE INTRODUCTION OF NEW TECHNOLOGIES

6. In removing obstacles to the introduction of new technologies, two issues face our Governments: -

i. the maintainance of a free flow of international trade in high technology products, whilst having regard to national interests;

ii. the acceptability of new technologies generally in society and particularly in the work place.

7. The free flow of high technology products is influenced by the general climate for trade which will be discussed at the London Economic Summit. But there are also two special factors: -

i. The effect on scientific, technological and trading relationships between Summit countries of controls intended to regulate the transfer of high technology to Eastern Bloc countries. The utility of high technology components and products developed for military use in civilian environments and the lead in these products enjoyed by OECD, particularly Summit countries, has persuaded governments of the need for controls over the destination of such products. Their proper protection is not in dispute, but an unfortunate by-product of the recent application of controls has been a limitation on trade in advanced technological products between Summit countries. Of equal concern to the Working Group has been the associated trend towards inhibition of open discussion and exchange of scientific ideas between scientists in the Summit countries. These two observable, if unintended, consequences can only be to the detriment of scientific progress and technological innovation.

ii. the wish of countries to develop and maintain their own indigenous high technology capacity. There is a temptation for countries to erect tariff and non tariff barriers to trade especially whilst high technology industries are in their infancy. There are presently a number of such barriers affecting the free flow of high technology goods between Summit countries and the Working Group urges that measures be taken to reduce and eventually eliminate these barriers. In particular, the application of different standards and testing procedures fragments the market, which in turn inhibits the growth of dynamic new industries. It also provides the conditions for the establishment of private and state monopolies and standards with consequential damage to international competition. One welcome feature of the international collaboration instigated by the work of the Working Group has been the opportunity it has created to establish common standards at an early stage in the development of certain technologies, eg advanced materials, advanced robots and photovoltaic solar energy. One way forward lies in sustaining science and technology collaboration through to the point of industrial competition.

LONDON ECONOMIC SUMMIT: POSSIBLE BRITISH INITIATIVES

Note by the Cabinet Office

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ANNEX B - EXCHANGE CONTROL ARRANGEMENTS IN SUMMIT COUNTRIES

ANNEX C - SERVICES AND INTERNATIONAL TRADE

Cabinet Office

26 April 1984

BACKGROUND

1. At the Prime Minister's meeting with the Secretary of State for Foreign and Commonwealth Affairs and the Chancellor of the Exchequer on 23 March, it was decided that Ministers would meet after Easter to consider a paper on possible British initiatives at the summit. Meanwhile, the Thematic Paper under discussion between Personal Representatives should be amended to provide pegs on which such initiatives could, if necessary, be hung.

2. The Prime Minister's meeting on 23 March identified six possible areas for initiatives -

- i. liberalisation of capital markets (6.9 and 6.10)\*;
- ii. liberalisation of services (6.6);
- iii. the problem of the burden of expenditure on the social services (6.3);
- iv. the further deregulation of air transport (6.6);
- v. harmonisation of international standards (7.2);
- vi. phasing out export subsidies in the context of world trade revival (6.3).

3. Department of Transport officials argue that shipping should be included under the general heading of liberalisation of services (see paragraph 7 of Annex C). Otherwise, there have been no suggestions for additions to this list.

4. The advantages and disadvantages of raising these subjects at the Summit, and the kind of wording that it might be worth seeking in any Summit declaration or communique, are examined below seriatim.

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\* Note: references in brackets are to the latest version of the Thematic Paper - extracts at Annex A.



LIBERALISATION OF CAPITAL MARKETS

Present proposals

5. In the Summit preparations so far, thinking in this area has focused on liberalisation of capital markets in two main respects -

i. as regards developed countries, merit has been seen in pressing for further liberalisation of inward investment to Japanese financial markets, primarily in order to strengthen the yen. The creation of a Treasury Bill market and commercial paper market would, for example, increase the attraction of Japan for short term investors. The US had held bilateral talks with Japan on financial liberalisation, but, notwithstanding some indications of progress in the euro-yen market, there has been little new movement. The US has lately contrasted Japan's reluctance to liberalise further with its aspirations to being the second largest IBRD shareholder; the general atmosphere is currently rather sour, which may inhibit further progress.

ii. as regards developing countries, merit has been seen in seeking the agreement of Summit partners to the desirability of debtor nations opening up their markets to inward direct investment, as an alternative to bank finance. There is a spectrum of possibilities here, ranging from seeking equity in existing assets and using the proceeds to reduce foreign currency debt, to reducing barriers to foreign investment in new projects. Some countries, notably Mexico, have made some recent moves in this direction. But others remain relatively hostile.

These issues are being pursued separately.

Wider application?

6. There are two main angles from which a broader Summit initiative on capital market liberalisation could be approached -

i. general liberalisation of capital markets by Summit countries;

ii. as a counterpart to encouragement to LDCs to be receptive to foreign investment, removal of barriers to outward investment erected by Summit countries.

7. On (i), Canada, Germany, the United Kingdom and the United States already have virtually no exchange controls. Any pressure towards liberalisation would therefore be directed at France, Italy and Japan. A summary of exchange control arrangements in Summit countries at Annex B. The OECD's Capital Movements and Invisible Transactions Committee monitors exchange restrictions and exerts pressure on member states to liberalise, although its powers are limited. The European Commission is pressing for intra-EC liberalisation, and France and Italy have hinted that some modest steps might be possible. But they are both likely to argue that balance of payments constraints inhibit any far-reaching measures. Nevertheless, United Kingdom financial institutions are among the world's most important, and it is worth pressing for changes which would enable them to exploit their existing comparative advantages further. The increased integration of world financial markets also leads to better global allocation of funds and greater choice for investors.

8. On (ii) - which may of course be pursued at the same time as (i) - it has been argued that it may be easier to try to persuade developing countries to be more receptive to foreign investment if developed countries can be seen to be reducing barriers to the flow themselves. While Canada, Germany, the United Kingdom and the United States have no restrictions on direct investment overseas, the French, Italian and Japanese authorities impose certain conditions, although these are not generally particularly stringent (see Annex B for details). So in practice there appears to be little scope for material relaxations, although there might be some presentational value in being seen to be free from restrictions in the case of some countries, and to be moving in that direction in the case of others. All Summit countries (except Italy) offer various facilities to assist and encourage direct investment overseas, and our own approach is currently being reviewed in a Working Group chaired by the DTI. We would be against proposals to increase financial support for overseas direct investment; but this matter is in any case peripheral to the matter of capital movements liberalisation.

Conclusions and possible Summit treatment

9. The Summit communique may be expected to contain an appropriate reflection of the outcome of discussion of the two issues outlined in paragraph 5 viz the liberalisation of Japanese capital markets and the inward investment regime of developing countries. These are being pursued separately.

10. As regards any wider initiative, it is unlikely that Summit discussions would persuade the French and the Italians of the value of substantial early liberalisation of their capital markets. But only persistent pressure in every forum possible, including the Summit, will eventually bear fruit. Similarly some consideration of barriers in developed countries to outward investment, while offering little scope for material changes, could have value.

11. In short, some general Summit discussion of liberalisation, and an appropriate reference in the Communique, could contribute to the improvement of the overall climate.

LIBERALISATION OF TRADE IN SERVICES

What could the Summit do?

12. The Summit declaration could point to the importance of services in the wealth-creation process: liberalisation would work to the benefit of both producers and users of services. A background note on the contribution that services make to international trade is at Annex C.

13. As regards international action to promote liberalisation, Ministers may wish to consider whether it would be possible for the Summit to -

a. press the case for an extension of GATT disciplines to services - and for the acceptance of these disciplines by all GATT members (including the newly industrialised countries);

b. seek an acceleration of work under way in OECD designed to establish a framework for liberalisation of trade in services across the board (intra-OECD);

c. commission work on the extent to which Summit countries themselves maintain restrictions against each others' services exports - with a view to agreeing a programme for the removal of such restrictions (as among Summiteers).

14. None of these options is without difficulty.

15. In the first place, it is not certain that all Summiteers will have the same perspective as the United Kingdom (and United States). Japan's efforts to open its services market have been halting: France and Italy appear sceptical about the need for formal international liberalisation. At the practical level, the best hope for early useful progress lies in further opening of the internal EC market: the Summit cannot help directly with this.

16. On the individual options -

a. could give the impression of seeking to pre-judge the outcome of a new GATT round. Non-Summiteers - and particularly the developing countries - could be irritated if they perceived such an initiative as an attempt by the Summit countries to impose their interests on the wider GATT constituency. Negotiations in the GATT could be made more difficult;

b. likewise involves some risk of pre-empting the work of a wider body (OECD). The risk is not as great as with GATT - and a common view as among the Summit countries would have a powerful influence on the formation of OECD policy. But concentration on an OECD exercise could be interpreted by the ldc's as recognition by the developed world that liberalisation of trade in services was a matter for the "rich and strong". The United States (and United Kingdom) may not wish to let the NICs off the hook that easily;

*Handwritten:*  
Lubricate  
Shipping - maintain liberal conditions.  
(Rajan + Pittman)

c. might have some presentational value but would probably not lead very far on its own. The United Kingdom would have less to fear than most other Summiters: and we could highlight restrictive practices in other Summit countries (including, for instance, United States restrictions in the shipping field)\*. But, without an institutional umbrella like GATT or OECD, an initiative among Summiters might well not bring about the required legislative changes in "offending" countries. The United States Administration in particular finds it easier to persuade Congress to make concessions when there is a package (preferably of a binding character within GATT) under which others have made concessions to the United States.

Conclusions and possible Summit treatment

17. It will not be easy to get all Summiters to agree to "forward-looking" language on the liberalisation of trade in services. But a Summit reference of some kind to the importance of the services sector could provide some leverage over fellow Summiters in future discussions.

18. Specific proposals for international initiatives in GATT or OECD should respect the sensitivities of non-Summiters and avoid being counter-productive. The impression that the Summiters are simply trying to promote their own economic self interest should be avoided. In particular, any reference to services in the context of a new GATT round should recognise that the content of such a round will be a matter for negotiation among all GATT members - including the developing countries. It would be counter-productive to antagonise the already sceptical NICs by appearing to pre-empt GATT discussions. The recent ES discussion laid down the general approach which the United Kingdom should adopt to the references to a new GATT round in the Summit communique.

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Note: See paragraph 7 of Annex C for a fuller explanation of the shipping point

19. There might be some mileage in option c. - if only as a means of engaging the attention of all Summiteers. The exercise would probably not proceed beyond the information-gathering phase (perhaps with suggestions for remedies): and any conclusions would ultimately have to be fed into GATT or OECD. The EC Commission (plus France and Italy) might resist on the grounds that the Community should work out its own position first. But a Summit exercise might be a way of keeping up the pressure on the Community: and self-mortification by Summiteers could prove salutary in itself.

#### THE PROBLEM OF EXPENDITURE ON THE SOCIAL SERVICES

##### The problem

20. Public expenditure on social programmes (health, education, pensions and other income maintenance programmes) has grown almost twice as fast as GDP in OECD countries over the last twenty years. The main factors have been demographic changes, higher uptake of existing benefits, higher real benefits and relative price increases. But higher social expenditure has brought higher taxes and insurance contributions. This process can not continue indefinitely.

##### OECD work

21. The OECD held a Ministerial Conference on 13-14 February 1984 to consider the Longer Term Performance of OECD Governments: Challenges Facing Governments. By prior agreement there was no final communique. The material presented to that conference showed that pension costs accounted for over 40 per cent of social expenditure in the seven major OECD countries in 1981. Expenditure on health care came to 23 per cent of social spending while education took 20 per cent. Unemployment insurance represented around 5 per cent.

22. The ad hoc OECD committee that collated this information noted that, in the OECD as a whole, if there are no further attempts to expand the coverage of social programmes and if cost increases in health and education can be held to the overall rate of inflation plus one per cent, it should be possible to hold on to the gains in coverage and benefits made during the 1960s and

1970s and to improve on these approximately in step with, but no faster than, economic growth. However, even on the optimistic scenario considered by the committee, it was difficult to foresee increases in the scope or coverage of any of the main social programmes. Yet, the committee concluded, there are likely to be pressures to do just that. A number of them will be associated with the difficulties individuals find in obtaining security and support from the labour market. The ageing population and changing family and life cycle patterns will also make greater demands on the social system.

23. In the longer term (beyond 1990) the main challenge facing social welfare systems may be to accommodate the demands on the social budget of an ageing population. An increase in the proportion of old people in the population requires higher pension transfers and places heavy demands on the health system. The thrust for equality of treatment between men and women will also exert pressure on governments to improve the social security coverage of women. The rise in divorce rates, longer life expectancy and more one-parent families mean more family units having little or no income from employment. If these trends are not reversed, further demands on public welfare programmes seem inevitable.

#### The next ten years

24. The Chancellor of the Exchequer presented, in March, a Green Paper on the Next Ten Years: Public Expenditure into the 1990s. The Green Paper identified a number of pressures on public expenditure, notably demographic and technological changes. For example, the number of people in the United Kingdom over 75 is expected to increase from 3.3 million in 1981 to 3.9 million in 1991, while health care costs are nine times higher for those over 75 than for those of working age. Technological advance will yield substantial cost savings in some areas; but it can also open up new possibilities for improved levels of service and therefore new demands. Rising expectations as incomes of the working population increase will provide other pressures.

25. Over a wide range of services demands are literally limitless because they are not restrained by the price mechanism which forces those making demands to balance them against costs. In these cases the only means of controlling costs is for government to limit the supply. <sup>determine priorities</sup> Wherever it is possible and sensible to do so, the UK Government is seeking to transfer the provision of services into the market sector. In other areas, it may be possible to use charges as a more direct way of testing demand. There may, too, be a case for hypothecating revenues to individual expenditure programmes, particularly in the social field, in order to bring home the costs.

Other countries' experience

26. In the United States the social security retirement and disability funds faced a shortfall \$150-200 billion between 1983-1989. As a result, the bipartisan Greenspan Commission proposed revenue increases and planned expenditure reductions of about \$165 billion over this period. Measures adopted included a 6 month delay in cost of living adjustments for Social Security benefits, higher contributions and reduced benefits for those who retire early. According to recent press reports, the Social Security trustees have warned that Medicare funds may be exhausted by 1989 unless measures are taken to curtail rapidly rising costs.

27. There will also be serious demographic pressures on public spending programmes in Japan. It has been estimated that the proportion of over 65s will rise from around 9 per cent at present to 16 per cent by the year 2000. These pressures, on the basis of the current social security program, might lead to the share of social security transfers in national income rising from just under 13 per cent in FY1980 to 23 per cent in FY2000.

28. The German government has already taken measures to curb planned expenditure and in particular social security spending. It has recently adopted a target of holding the growth of nominal public expenditure to 3 per cent a year from now until 1988. If successful this would appear to allow little or no room for growth in the volume of public expenditure. The measures already taken include reductions in some unemployment benefits and delays in pension increases. In future the government intends that pensions should only rise as fast as wages, rather than rising faster as they have in recent years.



29. The French government has attempted to reduce the growth in public expenditure as part of the austerity programme first adopted in 1982. The government reduced planned expenditure by FF 15 billion in the package of austerity measures announced in March last year. It has also taken measures to curb social security spending, including cuts in pre-retirement benefits.

Possible Summit outcome

30. It may be feasible to refer to common longer term public expenditure problems in all or most of the Summit countries and common approaches to these problems. The OECD might be most suitable international organisation to develop specific areas of particular interest.

FURTHER DEREGULATION OF AIR TRANSPORT

Background

31. Under international law national sovereignty extends to the airspace over a country's territory. International air services can therefore only operate with the permission of the various governments on the route.

32. Almost all countries attach importance to maintaining a national airline (generally State owned) to safeguard their international communications rather than needing to depend on foreign airlines for the purpose. Many countries (including some industrialised as well as almost all third world and state trading countries) are prepared if necessary for their State airlines to be unprofitable.

33. Scheduled international air services are regulated through a series of multilateral and bilateral agreements which impose strict controls on the routes which may be served by individual airlines, the capacity which may be deployed and the tariffs which may be charged. Even these restrictions would not, however, safeguard the position of many international airlines. In practice therefore many (particularly third world and state trading) countries adopt additional protective devices such as -

(i) Capacity sharing arrangements (under which the foreign airline is allowed to deploy only the same capacity on the route as the national airline).

(ii) Pooling arrangements (under which the airlines share their income from the route between the two countries).

(iii) Exchange control restrictions operated (contrary to international agreements) so as to deprive foreign airlines of the opportunity to compete for international traffic originating in the domestic market (either by preventing nationals from buying tickets on foreign carriers or preventing foreign carriers from repatriating their earnings).

(iv) Illicit charging of uneconomically low fares in order to attract custom in overseas markets.

(v) Retaliatory action, consistent with bilateral agreements, by countries such as the United Kingdom whose airlines are deprived of their rights in other countries by action such as that in (iii) or (iv).

34. Different problems exist on the North Atlantic. The United Kingdom has deliberately set out to encourage the maximum competition consistent with the effective survival of British airlines. As a result, the North Atlantic is the most competitive market in the world, offering scheduled services from Concorde on the one hand, to People Express on the other, plus substantial charter services which are exempt from price controls. United States airlines however have an enormous advantage over their British (and other European) competitors because of their size and because of their ability to serve the entire United States market through domestic services connecting with their trans-Atlantic flights. (British and other European carriers can only serve a limited number of "gateways" beyond which passengers for other United States destinations must use domestic services provided in many cases by their United States trans-Atlantic competitors). United Kingdom and other European countries need therefore to retain their existing controls over United States operations in order to offset the enormous commercial advantages enjoyed by United States carriers.

35. The United Kingdom Government is pressing its Community partners to liberalise the restrictions on intra-Community air traffic. Even here, however, progress is very slow since the majority of our partners prefer to maintain the present controls which are convenient to their State airlines. The aim therefore is to seek in advance, wherever possible, to liberalise bilateral relations with other member states, particularly with the Dutch, in the hope that such bilateral experiments will demonstrate the advantages of liberalisation and encourage progress on an EC-wide basis.

The scope for action of the Summit

36. There seems practically no scope for worldwide deregulation of international air transport. Third world and state trading countries could not face the damage which their airlines would suffer from deregulation; and in the absence of generalised deregulation, countries need to maintain their existing regulations in order to offset the unfair competition to which they are exposed.

HARMONISATION OF INTERNATIONAL STANDARDS

Background

37. The United Kingdom recognises the importance of standards for assisting the competitiveness of United Kingdom trade and commerce, and the need to employ internationally accepted standards. The Government's proposals to enhance the status of United Kingdom standards system were published in a White Paper, "Standards, Quality and International Competitiveness" (Cmd 8621) in 1982.

State of existing discussion

38. The United Kingdom is active, through the British Standards Institution, a non-governmental body, in international standards committees. In Europe, the EC Commission is pursuing an initiative to strengthen and co-ordinate the role of European standardisation, key factors in which are the information exchange directive (83/189/EEC) adopted in 1983 and a boosting of the role of European standards organisations. A committee of senior government officials of the EC member states develops policy and implements it nationally.

39. Internationally, the pace of standardisation is determined by the need for consensus among the many national delegations to international standards committees. Governments contribute in the main by seeking to influence national standards organisations and as members of national delegations. It is important to devote national resources to those areas of high priority trade and industry, and ensure that the British Standards Institution seeks and where possible obtains the secretariats and chairmanships in important areas.

Possible Summit treatment

40. The United Kingdom might usefully invite the Summit to identify and endorse greater harmonisation of international standards as a means of reducing structural rigidities to sustained economic growth. (Note: the dangers of developing different standards and testing procedures in the field of high technology products will be dealt with in the Second Report of the Versailles Working Group on Technology, Growth and Employment).

PHASING OUT OF EXPORT SUBSIDIES

Background

41. Export subsidies, especially mixed credits, are an increasing distortion of international trade. Following the Williamsburg commitment to roll back protectionism as the recovery proceeds, there is a case for a further international initiative to phase out the use of mixed credits and other forms of associated financing.

42. The need for a new initiative is currently being discussed within OECD after it was raised at the Ministerial meeting in February. The current aim is to report to the OECD Ministerial in May and to seek a firm commitment to a new initiative then.

Why not restrict mixed credits only?

43. A prerequisite to establishing discipline in soft financing lies in the need to cover the wide variety of mechanisms employed which can have the same effect as 'mixed credits'. With United Kingdom aid predominantly in grant form, the United Kingdom's retaliation to such techniques is relatively transparent, whereas devices such as 'pre-blending, 'associated financing' - as practiced by Germany, Japan, Austria, Sweden, Switzerland, and others - can have comparable consequences either by themselves or worked alongside normal export credit.

United Kingdom's record on mixed credits

44. United Kingdom activity in concessionary finance is transparent and within existing definitions; the United Kingdom's share of all such concessionary finance, rather than that caught by present definitions, would be relatively small. Even on mixed credits caught by present definitions, the apparently high incidence in 1982 arises because a number of major commitments fell due for reporting that year. 1983 statistics should show a very different picture. It should also be noted that whilst the number of notified 'mixed credits' have increased from 37 in 1980 to 147 in 1983, United Kingdom notifications have fallen by 30 per cent.

Newly industrialised countries (NICs)

45. Export subsidies are used in a trade distorting manner by the NICs, and notably by a major debtors. This might be dealt with by tightening up the conditions on export subsidies in IMF packages, which precede debt rescheduling. The NICs' activities should not be allowed to prevent an effective agreement between OECD members to phase out associated financing.

Possible Summit treatment

46. The aim might be an endorsement of the new OECD initiative by the Summit countries. This would be particularly useful in helping to bind the French, who are heavy users of mixed credits, to the new initiative. Otherwise, they will block any attempt to agree to a Community line on a matter which is partly one of Commission competence.

### Medium Term Objectives and Policies

6. Increased confidence and economic recovery offer the opportunity to move to a period of sustained growth. But if this is to be achieved, Summit countries need to set themselves a common range of medium-term objectives, entailing a wide range of interrelated policies, and to take account of the impact of their policies on each other and on the rest of the world. Other countries and groups of countries have already expressed their concern in this respect. The objectives can be summarised as -
- 6.3 - to devote greater attention to reducing the structural obstacles to higher employment by encouraging labour mobility, more flexible labour costs and industrial adaptation, by discouraging short term sectoral support measures, reducing and, if possible, phasing out export subsidies and other forms of assistance which distort trade. As demand expands, it will be particularly important to ensure that wherever possible the unemployed are drawn into productive employment; this will also reduce the strains on public expenditure from social security provisions, which seem likely otherwise to rise to insupportable levels in many industrialised countries;
- 6.6 - to consolidate the basis for sustainable non-inflationary growth and job creation by renewed practical efforts to liberalise and expand trade, in services and high technology as well as in manufactures and commodities, and to consolidate the open trading system;
- 6.9 - to find ways of increasing the flow of private investment, through the removal by all countries of impediments to capital flows generally and by encouraging countries to create a climate of confidence for investment;

[6.10 -to adapt and improve the operation of the international financial system. This entails creating a more stable medium term financial environment by prudent and convergent policies and performance among the major countries, particularly the reserve currency countries, providing a consistent flow of funding to the international financial institutions and removing restrictions on and improving international access to capital markets in industrialised countries;]\*

#### Immediate Measures

7. In order to attain these objectives within a framework of sustained recovery and growth, Summit countries can agree on the following range of immediate measures -

7.2 - to study structural adjustment with the appropriate international organisations, notably the OECD, and to adopt further measures to reduce structural rigidities to sustained growth, in particular by harmonising international standards, by encouraging innovation and industrial adaptation to technological change and greater labour and capital mobility, thus maximising job creation and job training opportunities, and by increasing public understanding and acceptance of the need for advanced technical development;

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\* Note: depends on the outcome of the April IMF and May G10 Meetings.

EXCHANGE CONTROL ARRANGEMENTS IN SUMMIT COUNTRIES

Canada

1. No exchange controls currently exist on any capital receipts or payments by residents or non-residents. There are no controls on outward direct investment; but inward direct investment is subject to some restrictions and proposed projects are vetted by the Foreign Investment Review Agency.

France

2. Capital movements between France and all countries except Monaco and the "Operations Account countries" (which comprise various former colonies) are subject to exchange control approval. The general aim of the restrictions is to prevent excessive capital outflows. Their main characteristics are as follows -

i. there are various restrictions on portfolio operations of non-residents in French securities, and on operations by residents in foreign securities markets. The issue in France by non-residents of franc-denominated securities, and trading in them, is subject to government authorisation; and the sale in France by non-residents of foreign currency denominated securities is prohibited. Residents may purchase abroad securities denominated in foreign currencies only with foreign exchange resulting from the sale of similar securities;

ii. lending by residents to non-residents is subject to government authorisation, except for foreign currency loans made by banks and financed by foreign currency borrowing or from their own funds. Lending to non-residents in francs is generally prohibited;

iii. French security issues abroad are subject to government authorisation, as is lending from non-residents to residents generally (there is a FF50 million ceiling on such loans to any individual);



iv. residents may not make deposits with banks abroad;

v. there are extensive restrictions on inward direct investment in France. French direct investment abroad requires government authorisation, and must generally be 75 per cent financed by foreign currency borrowing;

vi. the purchase by residents of property abroad is generally prohibited.

Germany

3. No exchange controls are currently in operation. However, non-resident bond issues in Germany are monitored by the Central Capital Market Committee; and DM bonds issued abroad must be made through a consortium lead-managed by a German bank.

Italy

4. Outward investment generally is inhibited by a requirement that transfers of resident-owned capital abroad must usually be matched by a lira deposit equivalent to 50 per cent of the amount transferred in a non-interest bearing account with the bank effecting the transfer. Besides this, various other controls exist -

i. residents may generally purchase and sell securities in foreign markets; but issues of securities abroad by residents are subject to government approval;

ii. non-residents may generally purchase and sell Italian securities; but issues by non-residents on the Italian market are generally restricted to international institutions;

iii. lending abroad is subject to restrictions, except for short and medium term loans to EC residents. Authorisation is required for certain categories of inward loans;

iv. residents may not generally make deposits with banks abroad;

v. inward direct investment is generally free from restrictions, as is outward direct investment in OECD member states; but direct investment from other countries is in certain cases subject to authorisation. Outward direct investment transactions have generally been given ad hoc exemption from the lira deposit requirement;

vi. there are restrictions on the purchase of property abroad by residents.

#### Japan

5. In recent years, Japan has been gradually reducing exchange restrictions. The main kinds of international capital transactions by residents which require authorisation are -

- i. issues of securities abroad;
- ii. overseas lending;
- iii. direct investment abroad;
- iv. foreign currency deposits overseas;
- v. borrowing and lending in foreign currencies between residents.

6. Both yen and foreign currency operations by Japanese banks are fairly free from restriction.

7. For non-residents, inward direct investment is closely vetted by the authorities, and care taken not to allow substantial erosion of the position of national companies. While non-resident portfolio operations, and operations by foreign banks, are generally fairly free from restrictions in principle, the main problem is not exchange controls per se but the underdevelopment of the Japanese financial market. For example, markets in Treasury bills, bankers' acceptances and commercial paper do not exist; and the CD market is relatively underdeveloped. While steps have been taken to liberalise the euro-yen market, a withholding tax on interest payments will be a disincentive to its development. The Japanese authorities appear particularly keen to resist a diminution of the market share of domestic financial institutions.

CONFIDENTIAL

United Kingdom

8. No exchange controls.

United States

9. No exchange controls.

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SERVICES AND INTERNATIONAL TRADE

1. Services now make a major contribution to international trade. Existing service sectors are expanding, and new services are being developed. The new technologies are revolutionising communications. The economies of the advanced industrial countries are becoming proportionately more reliant on service industries: through the process of structural adjustment, certain types of manufacturing activity are passing to the newly industrialised countries. The United Kingdom has particular skills in certain service sectors and is one of the world's leading exporters of services. Statistics for services are imperfect. IMF figures (1980 basis) show the United States as the largest single exporter on a value basis (\$34.9 billion) - closely followed by the United Kingdom (\$34.2 billion), France (\$33.0 billion) and Germany (\$31.9 billion). Services now account for 56 per cent of United Kingdom GDP (but internationally-traded services represent a much smaller proportion - around 10 per cent).

2. United Kingdom sectors involved in international trade include -

Accountancy  
Advertising agencies  
Banking  
Civil aviation  
Commodity trading and other merchanting  
Computer services  
Construction and consultancy services  
Distribution services  
Educational services  
Films and television  
Insurance  
Legal services  
Medical services  
Shipping  
Stock Exchange  
Telecommunications and Postal services  
Travel and Tourism

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3. The United Kingdom has a liberal domestic regime for services and a long standing interest in promoting the removal of other countries' restrictions. The United States and some of the other advanced industrialised countries share the United Kingdom view. The United States has for some time been active in promoting formal liberalisation of trade in services through the GATT. GATT disciplines, which have contributed so much to the liberalisation of trade in goods over the last 30 years, do not currently apply to services. The developing countries are allowed derogations even from the open trading system in goods.

4. One United Kingdom objective in a new GATT round would be to integrate the newly industrialised countries into the open trading system (thus reserving preferential status for the poorer developing countries). It is time for the NICs to open their markets to British goods and services - in return for the inroads which they have made into the markets of the developed world. But the NICs will want to exact a high price in return - probably a wholesale dismantling of the protectionist measures which the developed world now maintains against their textiles etc. They are hostile to the idea of including services in any overall package. They think liberalisation would work only for the benefit of the developed countries - and they want to retain the right to protect their airlines, insurance companies etc. They see more advantages in working through UNCTAD - where the concept of prescriptive rights for developing countries (usually by way of exception from the open trading system) is well-established. Some developed countries, notably France (but also probably Italy) are likewise unenthusiastic about GATT involvement in services: these countries would probably not want to go beyond existing work in OECD (where there are already Codes for invisible transactions and capital movements).

5. Because of the opposition of developing countries, the GATT Ministerial in 1982 was unable to agree to a work programme on services. It was left that individual GATT members with an interest in services would submit national studies: the United States and Canada have already done so. The United Kingdom national study will be presented to the GATT shortly. The GATT Contracting Parties meeting in November will review the national studies: but any decision on future work will have to await the next GATT Ministerial (probably late 1985). By that time, discussion will be focussing on the shape of a new GATT round.

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6. The chances of negotiating worthwhile disciplines for services in the GATT appear to be slim although the effort must be made. The opposition of the developing countries - and the doubts of certain developed countries - will be difficult to overcome. The United Kingdom nonetheless hopes to achieve a liberalisation of the internal EC market in services, perhaps accompanied by an extension of OECD's role in relation to services generally. It could be argued that such an outcome would be less disadvantageous to the United Kingdom than to other developed countries. Perhaps as a legacy of Empire, United Kingdom service industries have achieved a widespread presence in developing country markets: they do face restrictions but they seem to have learned to circumvent these rather more successfully than their competitors. By implication, formal liberalisation could thus be proportionately more beneficial to the competition than to us.

#### Shipping

7. Department of Transport officials argue that it would be useful to obtain the endorsement and encouragement of the Summit for the important negotiations which are now in progress between the United States and European countries, on maintaining competitive access to one another's shipping trades. These discussions are an essential element in the preservation of the open world trading system, and concern a service industry which is important not only in its own right, but also as the one which carries most international trade. At present, however the negotiations are in danger of getting becalmed for lack of high-level political support, especially in the United States, and a renewed political impetus would help them forward.