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PRIME MINISTER

London Economic Summit 1984

Personal Representatives met from 7 to 9 April, to discuss the draft thematic paper which I sent to you on 21 March.

2. In general, Personal Representatives agreed that the paper was comprehensive, and very much on the right lines. Points of emphasis and detail apart, such general differences of approach as emerged tended to be self-cancelling. Thus some of the Europeans found the tone of the paper too optimistic, and wanted greater prominence to be given to features like the level of interest rates and the size of budget deficits in the United States. Conversely, the American delegation regarded the paper as already too critical of the United States and wanted more about the negative features of the performance of the European economies, such as the conspicuous failure to create more jobs. Predictably perhaps, the French displayed especial sensitivity to the concerns of the third world, although much of their criticism (eg that those parts of the paper dealing with developing countries were patronising and paternalistic in tone) was vague and imprecise.

3. I attach a revised version of the thematic paper which takes these and other points raised at the meeting into account. There will be an opportunity to discuss it at the meeting planned for 30 April with the Foreign and Commonwealth Secretary and the Chancellor of the Exchequer. Prior to that, I will circulate the paper on possible British initiatives at the Summit which was requested in Mr Coles's minute of 23 March to me. The latest version of the thematic paper includes suitable pegs on which to hang any or all of the possible initiatives mentioned by Mr Coles if, in the event, it is decided to pursue them. I will also advise on whether other Ministers might be invited to that meeting and, if so, who they should be.

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4. I am sending copies of this minute and of the revised draft thematic paper to the Foreign and Commonwealth Secretary and to the Chancellor of the Exchequer.

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ROBERT ARMSTRONG

CONQUEROR

25 April 1984

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LONDON ECONOMIC SUMMIT
7-9 JUNE 1984

THEMATIC PAPER

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Cabinet Office

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Introduction

1. The London Summit forms part of a continuing process of consultation among the major economies. Through successive recent Summits, governments have worked to bring down levels of inflation, nationally and internationally, to promote soundly-based growth in their own countries and to spread the benefits more widely, and to promote greater stability in international monetary and exchange conditions. Over the past two years, inflation has fallen and output has begun to recover, particularly in the United States. The work to sustain and spread this recovery continues. As we approach the mid 1980s, the London Summit provides a vantage-point from which to review and chart policies to guide the major industrialised economies successfully into the second half of the decade.

2. The main concerns in the years ahead are likely to be: to reinforce the basis for enduring growth, [transcending the customary cyclical recovery phases,] without provoking [a resurgence of] inflationary pressures] and to disseminate the benefits of that growth throughout our societies; to ^{disseminate} promote structural adjustment in our economies and to create the conditions for a sustained improvement in employment, especially for the young; to strengthen and liberalise the international trading system and capital markets; to [improve the prospects for] managing the international debt problem and fostering conditions for adequate financial flows to non-industrialised countries; and to co-operate with the wide range of those countries in their efforts to place their economies on a more secure and self-reliant basis. The Summit countries share a profound commitment to the fundamental values of political liberty and the free market system, with justice and responsibility. They are convinced that these principles alone provide a sure foundation for long term economic development.

Macroeconomic Background

3. Over the past year the recovery in the industrialised nations, discerned at Williamsburg, has strengthened [and deepened.] In many respects the recovery is more soundly-based than in [some] previous cycles, founded as it is upon real and often painful structural changes against a background of firm efforts to reduce underlying [fiscal] deficits and control monetary growth [in most countries.] But its continuation cannot be taken for granted. In the industrialised countries, failure to sustain policies to reduce inflation [and

damp down inflationary expectations) could put recovery at risk. Many other countries, including relatively advanced economies with substantial debt burdens as well as (endemically) low income countries, are still encountering severe difficulties. In considering the contribution which the Summit countries can best make to help these countries, it is essential to recognise the wide diversity of their circumstances and requirements.

4. The principal features of macroeconomic developments over the past year can be summarised as -

- 4.1 - growth has revived strongly in North America and Japan, and somewhat less strongly in certain European countries. This phased recovery has helped to avoid some of the pressures seen in earlier, more rapid, recoveries;
- 4.2 - recovery has been accompanied by productivity gains. So far, it has had only limited impact on employment. Experience on job creation has varied widely in the Summit countries with a particularly strong rise in employment in the United States;
- 4.3 - significant success has been achieved in lowering inflation rates, although they remain high in some individual countries;
- 4.4 - underlying structural budget deficits have tended to rise in North America but good progress has been made in other countries in bringing about a reduction, reflecting both measures designed to cut planned public spending and, where necessary, a readiness to increase taxes;
- 4.5 - there has been a perceptible revival in world trade, with a marked rise in the imports of some Summit countries, notably the United States, helping to spread the benefits of the recovery to other countries;
- 4.6 - exchange rates were dominated until the turn of the year by the strength of the dollar although this has recently declined;

- 4.7 - nominal interest rates have risen sharply recently in the United States and real rates remain historically high in a number of countries;
- 4.8 - the overall growth of monetary aggregates in Summit countries, despite some volatility, has slowed after the rapid rises early last year, and is now more consistent with a prudent rise in nominal income;
- 4.9 - significant payments imbalances have emerged between Summit countries. A large and rising Japanese surplus has been more than offset by the very large United States deficit so that the group as a whole has been in deficit - in contrast to its traditional surplus;
- 4.10 - most other countries have reduced their current account deficits, benefitting from a recovery in their export markets and rising commodity prices. Nevertheless many of the debtor countries among them still face the consequences of import reductions, substantial debt servicing costs, increased political and social strains and a level of net bank lending which is low compared to the position a few years ago;
- 4.11 - the future confronting endemically low-income countries remains daunting. Levels of official aid are constrained by budgetary pressures in donor countries and the outcome of IDA 7 so far has disappointed many governments. The prospects for the poorest countries, especially in sub-Saharan Africa, remain bleak;
- 4.12 - the flexible strategy on debt evolved during the last few years has worked well so far. Threats of global financial crisis have been averted. World economic recovery has played an important part. The central objective of encouraging necessary, often severe, adjustment of the economic policies of debtor countries has been achieved in a growing number of cases. This has involved a key

role for the IMF, whose resources have been strengthened, and substantial co-ordinated support measures by creditor governments and their central banks, other financial institutions and private banks. But there is still a long way to go and problems and risks remain;

4.13 -[some progress has been made in implementing the commitments on resisting and reversing protectionism made last year at the OECD Ministerial meeting and at Williamsburg. All Summit governments have agreed steps to accelerate implementation of the Tokyo Round and to ease restrictions on imports from the poorest countries;]*

4.14 - nevertheless, protectionist pressures in the industrialised countries have not abated, associated with high unemployment and slow recovery in some cases and a high exchange rate and growing trade deficit in the United States. There has been little movement among the newly industrialised countries and others in the course of industrialisation to dismantle their own trade barriers or to reduce internal constraints upon competition;

4.15 - oil prices have remained relatively stable but the market balance is still fragile, poised between the twin dangers of over-production and sharply reduced supplies due to political events. Other commodity prices have risen modestly.

Prospects

5. Most forecasters expect that on present policies the recovery in activity in the Summit countries should continue over the next year or so -

5.1 - output in North America may rise more slowly after the rapid recent increases but activity in Japan and the European economies should gradually strengthen. A phased recovery of this kind can be a helpful basis for sustained growth;

* Note: depends on the outcome of the OECD Ministerial meeting on 18 May.

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- 5.2 - unemployment seems likely to fall further in the United States but the recovery may not be rapid enough to bring more than a slight reduction elsewhere, particularly where market rigidities persist;
- 5.3 - the moderate overall pace of recovery in activity should prevent an early resurgence of inflation but prices could rise more rapidly than last year in the United States. Others may either manage to keep inflation close to present levels or achieve some further reduction;
- 5.4 - world trade seems likely to rise rather faster than the recovery in activity;
- 5.5 - current account imbalances within the Summit group seem likely to increase and the Summit countries as a whole may remain in deficit with the rest of the world;
- 5.6 - recovery combined with present fiscal policies should help curb budget deficits in most Summit countries. The United States Administration is giving priority to curbing public expenditure but the structural deficit may remain at a high level;
- 5.7 - prospects for interest rates are uncertain. In the United States, more moderate output growth could help check interest rate pressures but any resumption of inflation, particularly if allied to concern about financing the budget deficit, could work in the opposite direction. Elsewhere, further progress in curbing inflation and budget deficits may ease interest rate pressures;
- 5.8 - exchange rate prospects are also uncertain. The growing United States current deficit, particularly if coupled with faster inflation, could put further downward pressure on the dollar although a continued high rate of return on assets in the United States could be an offsetting factor. In the case of the yen,

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Japan's growing surplus and strong macroeconomic performance may lead to upward pressure but capital market rigidities could limit the extent of any yen appreciation. The stability of EMS countries' exchange rates, both among themselves and with the rest of the world, will depend importantly on their success in bringing their inflation rates together at a low level;

5.9 - rising exports, higher commodity prices and effective adjustment are likely to help many of the non-oil countries to service their debts and begin to reduce their current account deficits;

5.10 - the prospect of only a modest increase in energy demand should help towards achieving stable nominal oil prices, though resulting limits on the revenues of oil producers will reduce the scope for import growth in oil producing countries. Rising activity may also lead to further modest increases in other commodity prices;

5.11 - in the medium term, the prospects for sustained recovery depend on avoiding a resurgence of inflation, achieving lower real interest rates and a strong recovery in investment, sustaining structural adjustment efforts and maintaining the growth of world trade on which the prospects for poor countries in particular depend.

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 -

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- 6.1 - to continue with, and where necessary strengthen, prudent monetary policies, supported by strict control of public expenditure and fiscal deficits, in particular aimed at still lower rates of inflation, especially through firm action by countries where inflation rates remain relatively high;
- 6.2 - to adopt policies to create conditions for lower nominal and real interest rates. This mainly entails further progress to reduce inflationary expectations and resolute action to put structural budget deficits onto a prudent and sustainable basis;
- 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;
- 6.4 - to promote the development of new technologies, in traditional as well as in new industries, international co-operation and a more rapid and widespread acceptance of technological change, recognising its importance to long-term growth;
- 6.5 - to promote conditions conducive to productive investment and private enterprise, especially among innovative small businesses;
- 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;

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6.7 - with this aim in view and as recovery proceeds, to complete current trade liberalisation programmes, in cooperation with other trading partners, and to explore with them the need for and possibility of a new negotiating round early in the second half of the decade;

6.8 - to maintain adequate flows of resources (including official development assistance) to the non-industrialised countries, taking into account the diversity of their requirements, and in particular to stimulate the development and application of practical measures to improve the environment of those countries in a fashion that conserves non-renewable resources for the future, enhances indigenous food and energy production, and creates conditions where populations move towards stability;

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;]*

6.11 - to continue to encourage and assist the efforts of economic and financial adjustment by debtor countries, taking due account of political and social difficulties. Such adjustment is the essential condition for them to establish the basis for sound growth and of

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

confidence on which they once again attract new capital. Sustained world recovery which presupposes adequate but not excessive world liquidity will continue to be a prerequisite for success;

6.12 - to pursue policies, wherever possible, best designed to avoid sudden and de-stabilising movements in either direction in international oil markets;

6.13 - to pursue the necessary scientific research to establish the causes, effects and means of limiting pollution; in the light of such research to make greater national and international efforts to reduce pollution of air, water and ground; and to work on countermeasures to minimise the effects of pollution.

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 -

7.1 - to intensify multilateral surveillance procedures and make further progress (in all our countries) on prudent fiscal and monetary policies (with a view) to achieving ^{lower} reduced levels of inflation and interest rates and greater exchange rate stability;

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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7.3 - to note, with approval, the progress report of Finance Ministers on their consideration of the operations of the international monetary system and the work of G10 Ministers on exchange rates, surveillance, international liquidity and the role of the IMF and to invite Finance Ministers to take forward these studies in the appropriate organisations;

[7.4 - to confirm the basic strategy on debt and to ^{apply it -} continue to implement it flexibly) on a case by case basis, recognising (with satisfaction) the progress made by many debtor countries and the (extensive) international cooperation which has helped to encourage and support them;

7.5 - to note that (continued world economic recovery,) reduced interest rates and trade liberalisation, all desirable general aims, are also (particularly) important to the resolution of debt problems;

7.6 - to urge Finance Ministers, international institutions and the debtor countries themselves to seek and develop arrangements which could foster renewed economic progress by debtor countries on a sustainable basis. These might include:

7.6.1 - encouragement of private direct investment;

7.6.2 - closer co-operation and compatibility between the IMF (focussing on shorter-term financial and economic adjustment) and the IBRD (focussing on structural and longer-term development needs);

7.6.3 - scope for developing the kind of IBRD operations which can be a catalyst to attract long-term capital investment;

7.6.4 - further development of international cooperation for improving the supervision of lending by commercial banks, 'notably in their overseas operations;]*

* Note: depends on outcome of April IMF and May G10 meetings

7.7 - [to note [with approval] the decision taken at the meeting of OECD Ministers on 18 May 1984 concerning the initial phase of the OECD and Williamsburg commitments and the OECD Secretary General's initiative]*, and to urge all trading countries to resist continuing protectionist pressures and to reduce barriers to trade;

7.8 - to promote at the GATT Contracting Parties meeting in November 1984 a successful outcome of the work programme laid down at the GATT Ministerial meeting in November 1982; and to broaden consultations with Contracting Parties and with the Director General with a view to obtaining a consensus for a high level meeting of GATT before the end of 1985 to consider launching a new GATT round on the basis of clearly defined objectives and guidelines, at the appropriate moment in the second half of the decade.

East/West Economic Relations

8. To note, with approval, the ongoing work on the economic and security implications of relations with Eastern countries and to endorse the need to continue the work in progress in the appropriate organisations.

Science and Technology

9.1 To note, with approval, the second report of the Working Group on Technology, Growth and Employment created by the Versailles Summit; to endorse the progress made in the 18 areas of co-operation; and to invite the Group to pursue further work on technology and the environment, adaptation to technological change, the relationship between technology and trade and the sharing of major scientific facilities, and to report to the next Economic Summit.

* Note: depends on outcome of the OECD Ministerial meeting on 18 May.

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9.2. To thank Prime Minister Nakasone for his report on the Conference on Life Sciences and Mankind, organised by the Japan Foundation in March 1984, and to welcome the intention of the French Government to host a follow-up Conference in 1985.

9.3 To note the invitation from the United States Administration to cooperate in the development of an international space station; and to agree that other Summit countries will actively examine the possibility of taking part in the programme, directly or collectively; and to welcome the intention of the United States to report progress on space station matters to the next Summit.

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