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10 DOWNING STREET

From the Private Secretary

Sir Robert Armstrong

London Economic Summit: Thematic Paper

Thank you for your minute of 8 May. The Prime Minister has considered the slightly amended version of the Thematic Paper which you enclosed. Her only comment is to ask whether it is really necessary to hit the United States so hard. She has in mind paragraphs 4.4, 4.5, 4.7, 9 (last sentence), and 11 (second sentence). Mrs. Thatcher believes that we could be less specific in our references to the United States.

I should be grateful for your comments.

I am sending copies of this minute to Roger Bone (Foreign and Commonwealth Office), David Peretz (HM Treasury), Callum McCarthy (Department of Trade and Industry), and Dinah Nichols (Department of Transport).

A. J. COLES

9 May, 1984.

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From the Private Secretary

SIR ROBERT ARMSTRONG

LONDON ECONOMIC SUMMIT:
THEMATIC PAPER

The Prime Minister has seen the redrafted paper enclosed with Mr. Peretz's letter of 4 May to Mr. Hatfield,

Mrs. Thatcher thought that the redraft (the longer version) was excellent and you are free to proceed with this unless you wish to make further comments.

I am copying this minute to Mr. Peretz (HM Treasury) and Mr. Bone (Foreign and Commonwealth Office).

8 May 1984

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Do we really wish to
hit the U.S. so hard?

I have highlighted the amendments,
which Sir Robert has suggested, the
first three paragraphs apart. They don't
amount to much.

Ref. A084/1358

MR COLES

I should have
thought we could be
less specific.

Agree that the paper may now be
sent to Personal Representatives?

London Economic Summit: Thematic Paper

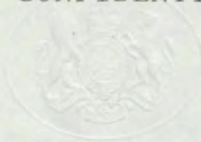
A.J.C. 8/5

The Chancellor of the Exchequer's Private Secretary sent
Mr Turnbull with his letter of 4 May two alternative further
versions of the draft Thematic Paper, prepared for the Prime
Minister's meeting on 30 April.

2. In dealing with this I hope that the Prime Minister will
bear with us on the fact that the other countries concerned have
already seen and commented on a first draft of the Thematic
Paper, which was approved by the Prime Minister and discussed
at the meeting of Personal Representatives early in April.
For this reason I hope that we can concentrate at this stage on
the longer of the two versions attached to the Chancellor of
the Exchequer's Private Secretary's letter, which broadly follows
the form and structure of the Paper as earlier circulated. The
shorter version will be very useful for the purposes of preparing
the draft Declaration.

3. In the revised version attached to this minute I have
broadly followed the Chancellor of the Exchequer's longer version.
I have, however, restored a shortened version of the three
introductory paragraphs from the earlier draft: if we curtail
the introductory material which the other countries have seen as
drastically as the Chancellor of the Exchequer's first paragraph
implies, I am afraid that we shall have a very tedious discussion
at the next meeting of Personal Representatives, in which other
countries will be suspicious of our motives and will seek to
restore references to the main themes as they see them and in
their language.

4. For the rest, I have followed the Chancellor of the
Exchequer's revised version, though I have made minor alterations
and additions in certain places to reflect points or wording to
which importance was attached in early discussion among Personal
Representatives.



5. I hope that the Prime Minister will be content that I should now circulate the revised draft to Personal Representatives. Time is getting very short before their next meeting on 20/21 May, and they will need to be given enough time to go through the draft and make comments on it.

6. I am sending a copy of this minute and of the revised draft to the Private Secretaries to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry and the Secretary of State for Transport.

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ROBERT ARMSTRONG

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8 May 1984

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LONDON ECONOMIC SUMMIT
7-9 JUNE 1984

THEMATIC PAPER

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Cabinet Office

8 May 1984

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Introduction and Background

1. 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.

2. The main concerns are now: to reinforce the basis for enduring growth, without provoking a resurgence of inflation, and to continue to spread its benefits; to make sure that the industrial economies develop flexibly and in response to market needs and technological change; to encourage flexible labour policies and to create conditions for a sustained improvement in employment, especially for the young; to strengthen and liberalise the international trading system and capital markets; to continue to manage international debt problems in ways which meet the needs of the debtor countries and protect the viability of the international financial system; to promote and encourage conditions for adequate financial flows to non-industrialised countries; and to co-operate with those countries in their efforts to place their economies on a more secure and self-reliant basis.

3. In many respects, the recovery in the industrialised nations 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 in most countries to reduce underlying fiscal deficits and control monetary growth. 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.

4. The main developments over the past year have been -

4.1 - economic growth - especially strong in North America and Japan, somewhat less so in certain European countries. This variation has helped to avoid some of the pressures seen in earlier, more rapid, recoveries;

4.2 - improvements in productivity, meaning that recovery has so far had only a 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 reductions in inflation, although it remains high in some countries;

X 4.4 - a tendency to increasing budget deficits in North America but reductions elsewhere;

X 4.5 - a 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;

4.6 - continued strength of the dollar;

X 4.7 - increases in nominal interest rates in the United States, with real rates remaining high in a number of countries;

4.8 - a reduced rate of growth of monetary aggregates, consistent with a prudent rise in nominal income;

4.9 - significant payments imbalances between Summit countries. The rising Japanese surplus has been more than offset by the United States deficit so that the group as a whole has been in deficit - in contrast to its traditional surplus;

4.10 - reductions in current account deficits elsewhere, still leaving many debtor countries with substantial debt servicing costs and increased political and social strains.

5. The future facing the poorest countries remains daunting. Official aid is constrained by budgetary pressures in donor countries. The outcome of negotiations to replenish the International Development Association (IDA) has so far disappointed many governments. The prospects for the poorest countries, especially in sub-Saharan Africa, remain bleak.

6. The flexible strategy on debt evolved during the last few years has worked well so far. World economic recovery has helped the debtor countries. An increasing number have accepted the need to adjust their economic policies, and are seeing the benefits. A key role has been played by the IMF, whose resources have been strengthened. But there is still a long way to go.

7. [Some progress has been made in implementing the commitments to resist and reverse protectionism made last year at the OECD Ministerial meeting and at Williamsburg. All Summit governments have agreed to accelerate implementation of the Tokyo Round and to ease restrictions on imports from the poorest countries.]* Nevertheless, there has been no easing of protectionist pressures, reflecting high unemployment and slow recovery in some cases, and a high exchange rate and growing trade deficit in the United States. The newly industrialised countries and others in the course of industrialisation have done little to dismantle their own trade barriers or to reduce internal constraints on competition.

8. Oil prices have remained relatively stable but the market balance is still fragile. Other commodity prices have risen modestly.

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

Prospects

9. Most forecasters expect that on present policies the recovery in the Summit countries should continue over the next year or so. Output in North America may rise more slowly after the rapid recent increases, but activity in Japan and the European economies should strengthen. 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. So long as the recovery in activity proceeds at a moderate pace, it should be possible to avoid an early resurgence of inflation. Recovery combined with present fiscal policies should help curb budget deficits in most Summit countries; they may remain high in the United States though the United States Administration is giving priority to curbing public expenditure.

10. Prospects for interest rates are uncertain. In the United States, a more moderate growth of output could help to hold the rise of interest rates in check; but an increase in the rate of inflation and 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.

11. Exchange rate prospects are also uncertain. The United States current deficit and faster inflation could tend to depress the dollar but that could be offset by the high rate of return on assets in the United States. Japan's growing surplus and strong macroeconomic performance could lead to upward pressure on the yen, but capital market rigidities could limit any appreciation. The stability of EMS countries' exchange rates, both among themselves and with the rest of the world, will depend on their success in bringing their inflation rates together at a low level.

12. Current account imbalances among Summit countries could increase. But rising exports and higher commodity prices will go some way to help many of the non-oil countries to service their debts and begin to reduce their current account deficits. The prospect of only a modest increase in energy demand should help towards achieving stable nominal oil prices.

Medium Term Objectives and Policies

13. We have the opportunity to move to a period of sustained growth. If this is to be achieved, Summit countries need to set themselves a common range of medium-term objectives, 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 are -

- 13.1 - to continue with, and where necessary strengthen, prudent monetary policies, supported by strict control of public expenditure and fiscal deficits, aiming at still lower rates of inflation. Especially firm action will be needed in countries where inflation remains relatively high;
- 13.2 - to create the conditions for lower nominal and real interest rates, by reducing inflationary expectations and putting structural budget deficits onto a sustainable basis;
- 13.3 - to reduce obstacles to higher employment by encouraging industrial adaptation and labour mobility, discouraging measures to prop up declining industries and reducing or phasing out export subsidies and other assistance which distorts trade. As demand expands, it will be 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;
- 13.4 - to promote the development of new technologies, in traditional as well as in new industries, and to encourage international co-operation and a more rapid and widespread acceptance of technological change;
- 13.5 - to promote conditions which favour productive investment and private enterprise, especially among innovative small businesses;

- 13.6 - to make renewed efforts to liberalise and expand trade, in services and high technology as well as in manufactures and commodities;
- 13.7 - to complete current trade liberalisation programmes, in cooperation with other trading partners, and to explore with them the possibility of a new negotiating round early in the second half of the decade;
- 13.8 - to maintain adequate flows of resources (including official development assistance) to the non-industrialised countries; and to encourage practical measures to conserve resources, enhance indigenous food and energy production, and create conditions where populations move towards stability;
- 13.9 - to find ways of increasing the flow of private investment, through the removal by all countries of impediments to capital flows and by encouraging a climate of confidence for investment;
- [13.10 - 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;]*

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

- 13.11 - to help debtor countries to make the necessary economic and financial changes, taking due account of political and social difficulties; for them as for the industrialised countries, success will depend on sustained world recovery and adequate but not excessive world liquidity;
- 13.12 - to pursue policies which will avoid, wherever possible, sudden and de-stabilising movements in either direction in international oil markets;
- 13.13 - to pursue research into 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 measures to minimise the effects of pollution.

Immediate Measures

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

- 14.1 - to carry forward and develop as appropriate the agreed procedures for multilateral monitoring and surveillance of national economic and financial policies, and to make further progress on prudent fiscal and monetary policies, so as to achieve lower inflation and interest rates and greater exchange rate stability;
- 14.2 - to study with the appropriate international organisations, notably the OECD, policies to improve economic efficiency, incentives and flexibility; and to reduce obstacles to growth, in particular by harmonising international standards, encouraging innovation and adaptation, facilitating the mobility of labour and capital and increasing public understanding and acceptance of the need for technical development;

- 14.3 - to invite Finance Ministers to carry forward in the appropriate organisations their consideration of the operations of the international monetary system, including exchange rates, surveillance, international liquidity and the role of the IMF;
- [14.4 - to confirm the strategy on debt and to continue to implement it flexibly, welcoming the progress made by many debtor countries and the extensive international cooperation which has supported them, and recognising that continued recovery, lower interest rates and trade liberalisation, will help further;
- 14.5 - to develop arrangements which could foster renewed economic progress by debtor countries. These might include the encouragement of private direct investment, closer co-operation between the IMF (and the IBRD; IBRD operations which can help to attract long-term capital investment; and improvements in the supervision of lending by commercial banks, notably in their overseas operations;]*
- 14.6 - to urge all trading countries to resist continuing protectionist pressures and to reduce barriers to trade, [following the decision taken at the meeting of OECD Ministers on 18 May 1984];
- 14.7 - to promote at the GATT meeting in November 1984 a successful outcome of the work programme laid down at the meeting in 1982; and to consult with other GATT Parties and with the Director General with a view to reaching a consensus for a high level meeting of GATT before the end of 1985 to consider launching a new GATT round, with clearly defined objectives and guidelines, early in the second half of the decade.

East/West Economic Relations

15. The Summit countries note, with approval, that work continues in the appropriate organisations on the economic and security implications of relations with Eastern countries.

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

Science and Technology

16. The Summit countries welcome the second report of the Working Group on Technology, Growth and Employment created by the Versailles Summit, and the progress made in the 18 areas of co-operation. They 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.

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

18. They also welcome the invitation from the United States Administration to other Summit countries to co-operate in the development of an international manned space station; to agree that other Summit countries will actively examine the possibility of taking part in the programme, directly or collectively; and the intention of the United States to report progress on space station matters to the next Summit.