



Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

TOKYO ECONOMIC SUMMIT

I understand we may be meeting briefly to go over the agenda for the Summit before our separate departures for Tokyo.

But I thought it might be helpful if before that I let you have a few comments in writing; and I am attaching a draft speaking note (by Sir Geoffrey Littler) for your opening statement on the world economy, following the request in Sir Robert Armstrong's minute of 23 April.

As the draft speaking note makes clear, we have a much more buoyant prospect this year than last. We can take credit for the contribution to this made by the policies of Summit countries developed and endorsed at successive Summit Meetings. There have been practical and effective developments in cooperation over exchange rates and interest rates and in handling debt problems.

We need to sustain our policies, and develop them. But we should not be looking for new directions. Points worth discussing should be largely confined to two major worries, and a number of points on which individual countries may try to grind axes and we shall want to fend them off.

The two major worries are:

- **Trade and Protectionism:** The GATT discussions are under way, but laboriously and without general conviction. Any impetus we can give is worth going for. While the Plaza agreement last September



caused some welcome abatement of protectionist pressures in the US Congress, these are likely to grow again before the year is out. I am also particularly concerned with the imminent danger of an agricultural trade war. The threat of US reprisal measures over the transitional arrangements following the accession of Spain and Portugal is potentially very serious indeed (with the UK particularly at risk), and we must do everything we can to use the occasion of the Summit to dissuade the US and get some constructive US/EEC discussion going. This is of course linked with the absurd and damaging extent of agricultural subsidies and hence over-production throughout the industrialised world. I hope you can pursue the argument against such subsidies and over-production which Geoffrey Howe and I pressed at the recent OECD Meeting. Even though we may have no specific immediate proposal at this stage the time has clearly come to focus critical attention on what is undoubtedly a major problem created by separate but similar strategies over many years in Europe, North America and Japan.

- Japanese Surplus: While other main world imbalances are probably on the way towards being corrected, the Japanese current account surplus begins to look more and more fundamental and persistent. For all the fine words, Japanese actions remain unconvincing and show little result. The trouble is that (unlike Germany) their domestic policies give no ground yet for expecting improvements. They are geared to a high level of savings providing not only cheap finance for their export-orientated industries but also a large excess which has to find its way into



overseas investment and a matching current account surplus. We should therefore take every opportunity of pressing the Japanese on such points as:

- our bilateral trading interests (whisky, etc);
- effective increase of consumer demand for imports;
- less competitive export promotion, including use of tied aid, etc;
- liberalisation of all their markets;
- greater international use of the yen;
- a structure of tax, especially on savings, more consistent with the needs of their situation;
- willingness to accept a higher exchange rate if that is what the market indicates - and one whose effect is not undermined by any form of subsidy to those firms most affected by it.

Since the Japanese are the hosts on this occasion, they may be more susceptible than usual to pressure, provided it is (a) concerted and (b) firm rather than aggressive.

The other points to watch out for are likely to be:

- unemployment, which is of course a major continuing concern, especially in Europe - but we have broad agreement (occasional backsliding by Italy and Commission) that macro-economic stimulus is not the



answer and we must simply press ahead with freer labour markets and better job-training;

- US talk of a "growth gap" between them and all others - they should be persuaded to point the finger clearly at Japan, rather than Europe;
- possible Japanese advocacy of more stable oil prices (to win friends among oil producers and divert attention from the real cause of their surpluses) - our position against this is clear;
- a remotely possible call for an international monetary conference - in fact the IMF Interim Committee now has a positive programme of work on exchange rates and we should leave that to go ahead;
- a possible French initiative on developing countries ahead of the special UN conference on Africa in May - although we have not picked up any specific warning.

Finally, on the tedious questions of G5 and G7, I hope to let you have a separate note shortly, when I learn the fate of a possibly acceptable initiative which the US have been considering.

I am copying this minute to Geoffrey Howe and Sir Robert Armstrong.

Received by...

N.L.

28 April 1986

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(approved by the Chancellor and signed in his absence)

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ECONOMIC ISSUES - DRAFT OPENING STATEMENT

We need not spend as much time this year on some of the major economic issues which have preoccupied us on previous occasions. The general prospect is more buoyant this year than last and we have made important further progress during the past year.

2. In particular:

- Inflation has continued to fall. In most of our countries it will be well below 5% this year, back to rates last seen in the early 1960s.
- Growth promises to be 3% and more for most of us and for the world as a whole, and to be more widely and evenly spread.
- Exchange rates stand in a much better relationship than for several years.
- Interest rates have come down.
- We have made patchy progress in handling the debt situation, but it is progress and there are signs of a more realistic approach to policy by some debtor countries.
- The problems of the poorest countries are formidable but we have been able to launch some initiatives to help them, and especially to help them to help themselves.

3. Our own countries, and many others throughout the world, are benefitting to an important extent from lower commodity prices, and particularly from lower oil prices. But we can take credit and satisfaction ourselves in at least two respects:

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- Our own persistence in advocating and increasingly in achieving sounder financial policies has made a major contribution.
- We have achieved especially during the past year closer cooperation in tackling exchange rate problems, in the management of interest rates, and in our response to the United States initiative last October in developing our strategy on debt.

4. We must reaffirm our basic insistence on sound financial policies. We must carry forward our individual efforts to free our labour and capital markets, to foster better training and work-experience, especially in Europe, where unemployment remains a troublesome and intractable problem.

5. But I do not think we have much to debate in these areas. Our communique should cover them - with a tone of achievement and optimism while still recognising the need to make more progress and guard against some dangers. But our discussion should focus on present difficulties and perhaps on some ideas for the future.

6. I single out two difficulties: the threat of protectionism and the problem of world trade imbalances.

7. Last autumn we faced a major threat of protectionism from the U.S. Congress. We should acknowledge the determination of President Reagan to resist it at the time, and the value of the Plaza agreement on exchange rates in easing the threat. But that threat has not gone away. The latest manifestation has come from the U.S. reaction to conditions for the accession of Spain and

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Portugal to the European Community. We must avoid getting into a trans-Atlantic trade war over that.

8. More generally, we can welcome the progress of discussions in the GATT towards a new round, but it is a painfully slow and difficult process. I hope we can give it some extra impetus. And I hope we might find time to talk together about the appalling problems we are creating - all of us: Europe, North America and Japan - by our various regimes of subsidy and protection in agriculture. They are costly to us. They are inconsistent with all that we say about economic management in other fields. And I believe they damage potential food production in many developing countries and our relations with them.

9. Finally, world trade imbalances. We can expect progress, partly from changed exchange rates, partly from domestic measures affecting the U.S. fiscal prospects and German growth prospects. I remain more worried by the Japanese surplus. I look forward to hearing more of the measures which our Japanese colleagues have in mind, and their likely timing and impact. But I have to say that the Japanese surplus looks like a very persistent problem, which will yield only to substantial and sustained changes in domestic policies and behaviour, in particular a shift from the tradition of very high savings and export-orientated industry, closer towards the freer consumer societies of other industrial countries.

10. I look forward to pursuing these and other questions in our later discussions.

