OVERSEAS DEVELOPMENT COUNCIL
1717 Massachusetts Ave., N.W. / Washington, D.C. 20036 / (202) 234-8701

May 4, 1983

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The Honorable Margaret Thatcher
The Prime Minister of Great Britian
London, ENGLAND

Dear Madam Prime Minister:

The ninth annual economic summit of the major industrial countries meets at a time when relations among the industrial countries and among the countries of the North and South are entering a new, precarious phase. The summit, therefore, provides a major opportunity for correcting the severe trade and financial difficulties currently faced by both industrial and developing countries. It also offers the opportunity for bold leadership on these urgent issues.

Robert S. McNamara, Chairman of the Overseas Development Council, has asked me to send you the enclosed statement, approved by the Council's Board of Directors, urging that you and the other industrial-country leaders agree on a series of measures that directly address the serious condition of the global economy. These recommendations are offered in full awareness of the budgetary and political constraints that you face, and with deep concern that the global financial and trading systems will unravel if such actions are not taken.

I hope you find the statement of help in the difficult task ahead.

Respectfully yours,

John Sewell

John W. Sewell
President

cc CO
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10 DOWNING STREET

From the Private Secretary

19 May 1983

The Prime Minister has asked me to thank you for your letter of 4 May enclosing a copy of the statement by the President of the Overseas Development Council containing recommendations for the Williamsburg Summit. The Prime Minister found this an interesting and timely paper.

A. J. COLES

Mr. J.W. Sewell

overseas development council

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GLOBAL RECOVERY: THE CONTRIBUTION OF THE DEVELOPING COUNTRY

Statement of the Overseas Development Council
for the Williamsburg Summit*

*Not for Release Until May 9, 1983

Statement of the Overseas Development Council for the
Williamsburg Summit, May 28-30, 1983

The ninth annual economic summit of major industrial countries meets at a time when relations among the industrial countries and between the countries of the North and South are entering a new, precarious phase. The world economy is stagnating. Although the prospects for recovery in the United States have improved, near-term growth is not likely to be strong in Western Europe, Japan, or the developing countries. The resources of the international financial institutions are stretched to their limits as they seek to stabilize the financial system while meeting the needs of developing countries. These difficulties are compounded by a new wave of protectionist pressure and government intervention in trade that threaten to undermine the multilateral trading system. The world's financial and trading systems are in grave danger of unravelling.

Because the stakes are so great for both the industrial and developing nations, the Board of Directors of the Overseas Development Council is taking the unusual step of issuing a formal call to the West's leaders to act boldly to prevent continuing global economic stagnation. Our recommendations are addressed to the seven leaders in general and, as the Council is an American institution, particularly to the government of the United States. There is a consensus among the Council's Board regarding the analysis and recommendations, although not every member is necessarily in full agreement with every point in this statement.

In summary, our recommendations for the Williamsburg Summit are:

Industrial countries with relatively strong payments positions should agree to adopt fiscal and monetary policies that lead to sustained, non-inflationary growth (<u>Recommendation 1</u>).

To bring greater order to the international financial system and to create an environment for future economic growth, countries should strengthen the International Monetary Fund and encourage commercial banks to expand their net credit outstanding in the developing countries (Recommendations 2, 3, and 4).

The dim prospects now facing many low-income countries can improve only if there is a significant increase in concessional assistance. The industrial nations should reaffirm their commitment to the International Development Association, the soft-loan window of the World Bank. In addition, the United States, among other countries, should announce its intention to devote a higher proportion of its bilateral development assistance to the low-income countries (Recommendations 5 and 6).

Developed and developing countries have an urgent interest in revitalizing the international trading system. Industrial nations should pledge not to restrict trade further, and invite the General Agreement on Tariffs and Trade (GATT) to monitor the effects of restrictive trade agreements that adversely affect developing countries. The GATT should be strengthened by creating systems to monitor and reduce the distortions resulting from some "industrial policies," by increasing the participation of developing countries, and by identifying ways to facilitate the domestic adjustment of firms and labor to international competition (Recommendations 7, 8, and 9).

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GLOBAL RECOVERY: THE CONTRIBUTIONS OF THE DEVELOPING COUNTRIES

While developing countries will not be represented at Williamsburg, their economic performance is inextricably woven into the fabric of the international financial and trading systems. As a result of their impressive growth during the 1960s and even during the troubled 1970s, developing countries now account for over 20 per cent of total world production. Developing countries absorb over 40 per cent of all U.S. exports, providing many U.S. firms with their most dynamic markets, and they are major clients of U.S. commercial banks. But sluggish export markets, adverse terms of trade, and unexpectedly high real interest rates have darkened the economic prospects of the developing countries. A 3 per cent loss in output in the developing countries could lead to a 1 per cent loss in the output of the OECD countries, according to an estimate by the Morgan Guaranty Trust Company.

Developing countries have become the strategic link through which a deteriorating trade situation further weakens a financial system already under stress. To service their debt, developing countries must expand their exports, but they cannot do so if other countries raise restrictive trade barriers. The crises confronting the international trading and financial regimes are therefore intimately linked.

Just as the liquidity crises and import constraints in the South are creating severe problems for the economies of the North, so could renewed financial stability and economic growth in the South be an important component of a sustained recovery in the North. The developing countries are both part of the problem and part of the solution. Renewed growth in the Third World can contribute to a surge forward in the North.

The world is at a moment of choice. Individual countries can, of course, undertake independent actions which are meant to protect their own welfare, but which, in the end, are destructive for all; they can erect new trade barriers, impede capital flows, and seek security in isolationism. Alternatively, a renewed effort can be made to reaffirm the commitment to an open, growing economy, and to correct the managerial and structural flaws that have led to the current crisis.

The Williamsburg Summit will be brief. We therefore limit ourselves to those issues of finance and trade that are the most urgent for both the industrial and developing countries. We make our recommendations in full awareness of budgetary constraints and competing priorities. We are convinced that a policy that allowed the global financial and trading systems to unravel would be the worst of economies.

I. The Need for Global Expansion

The Reagan administration is correct to assert that the single greatest contribution that the United States can make to global prosperity is the renewal of growth at home. But no nation--not even the United States--can sustain growth in a stagnant global environment. It is imperative that other industrial countries with relatively strong payments positions--including Japan, West Germany, and Great Britain--join the United States in deliberately adopting a mix of monetary and fiscal policies that promote domestic growth. This should in turn allow the developing countries to add their renewed dynamism to a global expansion.

Global growth can be sustained only if real interest rates come down. Inflationary expectations responding in part to the projected deficits in the U.S. budget have kept real interest rates very high. The United States must act to reduce out-year fiscal deficits. A more prudent fiscal policy will facilitate the maintenance of a moderately expansionary monetary policy by the Federal Reserve Board. The resulting lower interest rates in the United States will permit other nations to relax their own monetary policies in the pursuit of growth.

We therefore recommend that the Summit:

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1. Agree to adopt fiscal and monetary policies that lead to sustained, non-inflationary growth.

II. Financing Renewed Growth

Growth in the industrial nations is a necessary--but not sufficient--condition for the establishment of a framework for sustained global prosperity. The maintenance of open and expanding financial and trading systems also requires the strengthening of key existing international institutions. The International Monetary Fund, the World Bank, and the General Agreement on Tariffs and Trade (GATT) have served us well in the past and can do so now.

During the 1970s, the nature of financial transactions between the industrial world and the developing countries changed radically. The ratio of private to official capital flows to the developing world rose rapidly as commercial banks undertook to recycle capital from surplus to deficit countries. In retrospect, it is now clear that the failure of official institutions to keep pace has resulted in a less stable international system. In the 1980s, a more balanced mix between official and private lending is required, both to manage the immediate liquidity crises and to finance future growth.

Assuring Liquidity for the Middle-Income Countries

An international financial breakdown is not inevitable. It can be avoided, providing that: global growth is renewed; the International Monetary Fund has sufficient resources and authority; and commerical banks continue to expand the net credit outstanding to developing countries.

The Federal Reserve Board and the central banks of other industrial nations have reacted with impressive decisiveness and creativity to the liquidity crises facing several major debtors by opening short-term lines of credit. Under the leadership of Jacques de Larosiere, the IMF has been instrumental in persuading the commerical banks that their own best interests lie not in a sudden contraction of exposure but in a continuing expansion of their lending, albeit at slower rates than in past years.

The IMF has played the leading role in managing the recent liquidity crises, but its resources could be severely stretched in the period ahead. IMF resources have shrunk drastically over the last two decades, falling from over 12 per cent of world trade in 1960 to under 4 per cent today. The IMF badly needs more resources if it is to continue to assist countries in meeting short-term liquidity crises. The IMF must also be able to provide countries with sufficient credits to support adjustment programs that are flexible enough to be economically effective as well as politically and socially sustainable.

The Interim Committee of the IMF has recommended that member quotas be expanded by 47.5 per cent, to approximately $99 billion (or 90 billion

SDRs--Special Drawing Rights). The parallel expansion of the General Arrangements to Borrow (GAB)--both with respect to resources and to their use by developing countries--will provide an essential backstop to the IMF's own efforts to facilitate orderly adjustment processes.

But this enlargement of IMF quotas and the GAB may not come soon enough or be sufficient to meet the financing needs of the many potential developing- and industrial-country borrowers over the next several years. The IMF's Articles of Agreement permit it to borrow from member governments and private capital markets, provided that the Board of Governors so authorizes. Governments should support such borrowing as required.

The large current-account imbalances still facing some countries, despite their adoption of severe austerity measures, suggest that the Fund may want to provide funding in excess of current country-specific ceilings (450 per cent of quota over three years). The Fund will need the necessary flexibility to expand its country lending levels if the liquidity crises extend into 1984.

At the same time, the commercial banks must expand their net credit outstanding in the developing countries (at rates of perhaps 3-5 per cent per year in real terms) if their economies are to grow. Yet, in 1982, net credit outstanding appears to have actually declined slightly in real terms. While this withdrawal may appear rational to individual banks, its continuation will be disastrous for the banking community as a whole, as well as for the debtor countries.

The public sectors in the industrial and developing countries must create a reliable environment that encourages the commerical banks to resume real rates of growth in lending. A renewal of global growth, a stronger IMF, and the adoption of adjustment programs by the debtor countries are all crucial steps. In addition, there is a need for the more timely provision of information on developing-country economies, especially with regard to the quantity and structure of their foreign debt. The newly created Institute for International Finance can play a role in constructing an "early warning system" to signal an impending unhealthy balance-of-payments situation. National regulatory authorities can assist in the collection and dissemination of information on international lending. They can also seek to devise criteria that inhibit imprudent expansions of exposure or destabilizing, sudden retrenchments. Reforms in the regulatory systems should not inadvertently discourage lending to creditworthy countries. But more work is necessary in order to determine how best to gather and process credit data in ways that can best reduce market uncertainty and stabilize the international financial system.

To bring greater order to the international financial system and to create and environment for future economic growth, we recommend that the Summit:

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2. Strengthen the International Monetary Fund by: a) reaffirming the importance of the prompt ratification of member quotas and the GAB; b) agreeing to support IMF borrowing from member governments and international capital markets if needed; and c) deciding to permit the IMF to expand its ceiling on loans to individual governments.

3. Encourage future incremental lending by commercial banks to developing countries by committing themselves to provide an environment of global growth and a fortified IMF; and

4. Agree, furthermore, to sustain this pattern of incremental lending a process of consultations among the IMF, World Bank, the commercial banks, and the national regulatory agencies and governments of the OECD countries--to search for better ways to a) collect and disseminate information regarding external debt, and b) more generally, to bring greater stability to international capital markets. The findings of this consultation process should be reported to the next Summit.

Financing Development in Low-Income Countries

The U.S. government has demonstrated strong leadership in responding to the financial crises in the middle-income developing countries, although more remains to be done. The United States has shown less vision and commitment, however, in responding to the needs of the low-income countries, whose external capital inflows consist primarily of official concessional assistance.

The United States traditionally has been a strong leader in the international effort to provide concessional assistance. More recently, the U.S. record has been deteriorating, both with respect to its past performance and to that of its Western allies. In the early 1970s, the United States contributed 0.30 per cent of its GNP to official assistance; by 1982, the figure had fallen to 0.20 per cent. While U.S. aid did increase slowly in real terms over the last decade, its performance was surpassed by most other Western donors. Fourteen of the seventeen OECD countries significantly increased their aid program as a percentage of GNP. As a result, the United States has fallen to next to last place; Italy, which is now last, is stepping up its contributions at a rate which is soon likely to leave the United States at the bottom.

Prospects for the low-income countries will not improve without a significant increase in concessional aid. Many of these countries, especially those in Africa, face chronically declining living standards. Yet in 1981 only 19 per cent of U.S. bilateral concessional aid was earmarked for low-income countries.

Most disheartening has been the failure of the United States to meet its pledge to the sixth replenishment of the International Development Association (IDA). This action undermines the sense of trust and continuity that multilateral economic institutions require, and undercuts the U.S. claim to international leadership. As a result of the shortfalls in U.S. contributions, it is likely that IDA-VI will have to authorize its $12 billion in resources over five years instead of the originally planned three-year period--a reduction of 35-40 per cent. Moreover, the delays in IDA-VI have created great uncertainty regarding the timing and scale of the next replenishment (IDA-VII). The United States sought a reduction in IDA activity--despite the findings of its own study which gave the multilateral development banks in general and the World Bank in particular high marks for serving a wide range of U.S. interests.

The industrial nations have an important stake in the economic development, social cohesion, and political stability of the low-income countries. The industrial countries and the United States in particular must renew their commitment to development assistance. In the United States, this will require a joint Executive/Congressional effort. We recommend that the Summit:

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5. Agree that all countries complete the sixth replenishment of IDA by the end of fiscal year 1984, and commit themselves to timely negotiations on a seventh replenishment that would permit IDA to at least maintain its lending levels in real terms as originally scheduled in IDA-VI. If the United States will not, or cannot, join in such a program, the other six countries should proceed without it.

In addition, we recommend that, in the context of the Summit,

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6. The United States, among other countries, announce that it will devote a higher proportion of its bilateral development assistance to the low-income countries.

III. Revitalizing the International Trading System

For most of the post-war period, the GATT process of non-discriminatory tariff cuts and multilateral rules facilitated the growth of international trade. But trade is no longer growing. From 1963 to 1973, the volume of world trade increased by 8.5 per cent annually. During the 1974-80 period, it increased at only half that rate. In 1981, trade volume fell by 1 per cent, and in 1982 it shrank by another 2 per cent. The fall-off in trade is an effect as well as a cause of the decline in business activity during the period, but the decline also reflects alarming new trends.

Traditional principles of non-discrimination, transparency, and multilateral reductions in tariff barriers have been increasingly supplanted by unilateral or bilateral applications of non-tariff barriers, including voluntary export restraints, orderly marketing agreements, and quota systems. The European countries are increasingly resorting to the GATT's "safeguards clause" to shield domestic industry from the trade of particular countries.

Use of non-tariff barriers is not, however, limited to OECD countries. Under severe pressure to reduce their current account deficits and control domestic inflation developing countries too, have frequently opted for multiple exchange rates, direct allocation of foreign exchange, performance requirements, and licensing of imports. Too frequently, they, like many developed countries, subsidized their exports.

A driving cause of these new protectionist measures has been the stagnation in the world economy, particularly since 1979. But renewed growth alone will not be sufficient to prevent the further deterioration of the multilateral framework. Strong centrifugal forces of disintegration emanate from at least three, often interacting, sources.

First, many OECD countries are experiencing secular increases in unemployment that are independent of short-term swings in the business cycle.

Demographic trends and rapid changes in technology create enormous problems of dislocation for domestic work forces. Labor markets permit only slow adjustment. Moreover, the new competition from international trade forces certain firms and social groups to accept lower prices and wages. While this process almost always produces net gains in national income, some businesses and labor groups inevitably are hurt. The dislocated groups will pressure governments for protection.

Second, governments have more actively engaged in promoting their domestic industries. These measures commonly take the form of "industrial policies" that involve production subsidies, subsidies to technology development, use of public enterprises, and greater government coordination of investment and industrial development, as well as selective protection. According to one recent study for the major OECD countries, subsidies as a share of national income have doubled since 1955. The GATT has mechanisms to deal with subsidies to exports, but industrial policies that affect trade more indirectly are difficult to measure. The multilateral rules governing indirect subsidies and industrial policies are vague and imprecise.

Finally, developing countries--especially the newly industrialized countries--are inadequately incorporated into the multilateral system. Even though developing countries have increased their share of world trade, only a few of them have subscribed to the key GATT codes. Many developing countries have historically felt, rightly or wrongly, that their national development objectives require even greater flexibility to use tariffs and other policies than is permitted in the special treatment of developing countries under the GATT. From the point of view of these countries, the inducements for them to submit to the discipline of multilateral rules have been insufficient; the sectors of greatest interest to them--agricultural and textile products--are not effectively covered by GATT and are highly protected in most industrialized countries. This perception may now be changing. As weaker members of the international economy, developing countries have the most to lose from the slow evolution toward a discriminatory trading system. Multilateral rules truly based on principles of non-discrimination and equal access to markets offer the best hope for stemming protectionist pressures within the industrialized countries.

Therefore, both developed and developing countries have an urgent interest in strengthening and revitalizing the international trading system. To this end, we recommend that the Summit:

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7. Pledge to undertake no new actions that restrict trade or increase subsidies, and that they call upon the other industrial and developing countries to follow suit.

8. Take note of restrictive agreements among industrial states that have an adverse impact upon the trading opportunities open to developing countries. The conferees should invite GATT to monitor and report on these agreements and their effects on developing countries.

9. Determine to strengthen the GATT by: a) creating systems to monitor and eventually reduce the distortions resulting from some "industrial policies"; b) exploring ways of bringing more developing countries into the multilateral system; and c) identifying ways to facilitate the domestic adjustment of firms and labor to international competition in ways that do not distort trade.

The Summit can mark a renewed commitment to an open, international economy and to the system's key coordinating mechanisms. We urge the leaders of the industrial states to ignite a new "Spirit of Williamsburg" on behalf of international cooperation, and to instruct their representatives to pursue the results of their deliberations. Speedy and determined action in the appropriate international institutions can help to restore confidence in the international financial and economic systems and to inaugurate a new era of prosperity.

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10 DOWNING STREET

From the Private Secretary

MR HATFIELD

Williamsburg Summit

I attach to this minute a copy of a letter which the Prime Minister has received from the President of the Overseas Development Council which in turn encloses a statement of the Council containing recommendations for the Williamsburg Summit.

I should be grateful if you could let me have a suitable draft reply for my signature on behalf of the Prime Minister.

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

A. J. COLES

10 May 1983

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10 May 1983

I am writing on behalf of the Prime Minister to thank you for your letter of 4 May.

Your letter is receiving attention and a reply will be sent to you as soon as possible.

A.J.C.

Mr J.W. Sewell.

Type letter pl.

A.J.C. 19/5

Ref.A083/1415

MR COLES

As requested, I attach a draft reply to the President of the Overseas Development Council which you might send on behalf of the Prime Minister.

Papers attached

R P HATFIELD

18 May 1983

DRAFT LETTER FROM MR COLES TO
MR J W SEWELL, OVERSEAS DEVELOPMENT COUNCIL,
1717 MASSACHUSETTS AVENUE NW,
WASHINGTON DC 20036

The Prime Minister has asked me to thank you for your letter of 4 May enclosing a copy of the statement by the President of the Overseas Development Council containing recommendations for the Williamsburg Summit. The Prime Minister found this an interesting and timely paper.