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cc CO
Lord Roll
AW

10 DOWNING STREET

THE PRIME MINISTER

16 May 1983

Dear Lord Lever

Thank you very much for the letter which you and Eric Roll sent to me on 4 May, and for the memorandum reporting the conclusions which were reached at your meeting under Helmut Schmidt's chairmanship.

I found the memorandum interesting and stimulating as I would expect from its distinguished authorship. You will not be surprised if I say that there are points at which our emphasis would be different but I enjoyed reading it.

I am sending a copy of this letter to Eric Roll.

Yours sincerely

Margaret Thatcher

The Rt. Hon. The Lord Lever of Manchester

The Lord Lever of Manchester, PC.
86 Eaton Square,
London.
SW1

The Lord Roll of Ipsden, KCMG, CB.
30 Gresham Street,
London.
EC2P 2EB

4th May, 1983

Dear Prime Minister,

We have just attended a private meeting chaired by Helmut Schmidt to discuss the economic issues likely to arise at the Williamsburg 'summit'. Our conclusions are set out in the enclosed memorandum which each of those of us from countries represented at the summit has agreed to send to the head of our government. The document as a whole has been agreed by all of us, although each of us would, no doubt, have preferred a different emphasis here and there.

For convenience sake we are sending copies of this letter and enclosure to Geoffrey Howe, Francis Pym and Robert Armstrong.

Yours sincerely,

Harold Lever

Eric Roll

Lever

Roll

The Rt. Hon. Mrs. Margaret Thatcher, PC, MP,
Prime Minister,
10 Downing Street,
London SW1.

R/dl

CONFIDENTIAL

April 30, 1983

The Williamsburg Economic Summit: What can it do for us?

1. The Williamsburg Economic Summit takes place at a crucial point in time. The safety of the free world is at risk in two ways: from the increase in tension and the arms race between East and West and from the danger of a protracted world economic crisis. If our governments do not create confidence by demonstrating their ability to cope with this double crisis, there might be political destabilization. The most pressing task is to ensure a sustained worldwide recovery, and not merely occasional, regionally limited, spurts of economic activity.

2. The world economy is in bad shape. In the Western industrial countries more than 32 million people are out of work. Even if these countries were to get back to an average growth rate of 3 per cent, unemployment would not be reduced in the next few years. Real interest rates continue to be extremely high. The exchange rates of key currencies are seriously misaligned. Short-sighted national egoism prevails in international trade. Banking is under strain, domestically as well as internationally. Many developing countries are in dire straits. On the positive side is the fact that inflation in the industrial countries is at its lowest level for many years and that at least a

part of the excessive oil price increase of 1979/80 is in the process of being reversed.

3. Recovery is the key to a lasting solution of many of our current problems. There are increasing signs of an economic upturn in the United States and in a few other industrial countries. It is doubtful, however, whether this spontaneous recovery will be strong enough and last long enough in the face of serious distortions in the world economy. These distortions will not disappear without a concerted effort of the major industrial countries, led by the United States. If the recovery should falter, confidence in Western leadership would be seriously eroded and the risk of political destabilization would be greatly enhanced.

4. There will be no lasting recovery in the world economy as long as real interest rates remain extremely high. Current and expected structural budget deficits are a major cause of high interest rates. Because of its relative weight, the United States must take the lead in bringing down world interest rates. Even a lower long-term real interest rate than the actual rate of 5 - 7 % would - by historical comparison - still be very high for the United States.

The Federal Reserve System last year has courageously revised its strict monetarist course. It will not be able to continue the more accommodative course without rekindling inflationary expectations unless there is a firm prospect that the full employment deficit in the U.S. budget will be decreased[1]. The deficits expected for FY 1985 and beyond are largely structural. Continuing structural deficits of the order of 4 to 5 per cent of GNP would absorb an unprecedentedly high proportion of net savings, strain the capital markets, keep real interest rates high, draw in funds from abroad and thereby tend toward overvaluation of the U.S. dollar. A reversal in U.S. fiscal policy is therefore a matter of great urgency.

5. A further decline in U.S. interest rates is highly desirable not only from the point of view of the United States but also for the sake of the world economy. It would restore the attractiveness of physical investment over financial investment. It would help other countries bring down their interest rates. It would substantially alleviate the debt servicing burden of developing countries. It would help bring about an exchange rate structure that is more in line with economic fundamentals, thereby reducing protectionist pressures. And it would make it easier for countries like Britain, Japan and West Germany, which have brought their inflation rates under control and whose current account is in good shape, to take the action which is now possible for them that would lead to expansion and which, in turn, would put the U.S. recovery on a broader basis. Countries like France and Italy should persevere in their efforts to fight inflation and to reduce fiscal and

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1) The full employment deficit/surplus is defined as the deficit/surplus that would currently result if 94 per cent of the labor force is employed.

payments imbalances. Canada will be a main beneficiary from a recovery in the U.S. which will contribute to a reduction of very high levels of unemployment and budget deficits.

Such a set of mutually supportive changes in fiscal and monetary policies is essential for balanced world recovery.

6. Equally urgent are, however, joint efforts to stabilize the international monetary system, to preserve the world trading system and to minimize the disruptions in the international financial system. There are important linkages between these areas and between them and the current and future state of the world economy.

7. There is disorder in the international monetary system. Ten years after the breakdown of the Bretton Woods system there is growing disappointment about the way the floating rate system has behaved in practice. Exchange rates have been much more volatile in these years than would have been justified on the basis of economic fundamentals. The alternate overshooting and undershooting of key currencies has had a negative impact on world investment, trade and production.

8. If the free flow of payments and hence free trade in goods and services is not to fall victim to growing bilateralism, closer economic and monetary co-operation between the key currency countries is required. Central banks and governments must make it plain where exchange rate policy is heading. They must make a renewed effort to stabilize exchange rates. Moreover, the multilateral surveillance of and influence on the five key currencies (the dollar, yen, D-mark, sterling and French franc) agreed on in Versailles, under the auspices of the IMF, has to be implemented. There is also a need for smoothing the volatility of exchange rates directly through official intervention. This, however, will not produce lasting stability of exchange rates unless there is greater convergence of policies, particularly leading toward low inflation rates. What is required, while making progress in policy convergence, is an improvement in the working of the current floating system, which lacks calculability and dependability and invites economic nationalism and private speculation.

9. The payments crisis, in which many developing middle-income countries found themselves in 1982, caused understandable but dangerous reduction in international lending. Nothing would be more undesirable at the moment than a contraction of international lending. Credit creates trade, trade secures credit. Short-term reschedulings, as practiced now, are no long-run solution if a solvency crisis is to be avoided.

The burden of reliably servicing the debt will be different in different countries. It is clear, however, that this burden can only continuously and reliably be discharged if the public authorities play a much greater role than in the past in providing the support, funds and disciplines required to maintain and provide this vital lending at the levels required. The IMF and the World Bank must be provided with the necessary funds for this mandate. This will provide a sound basis for new lending by commercial banks which will remain essential if developing countries are to resume their dynamic role in the world economy.

Credit relations between creditor and debtor countries must be transparent, well regulated and stable. The BIS, the IMF and the central banks of creditor countries will need to provide greater information and guidance to commercial banks on the financial position of developing countries. An information and early warning system among commercial banks is also essential.

10. Appropriate adjustments of this economic policies are a prerequisite for establishing the longer-term creditworthiness of sovereign borrowers. The IMF and the World Bank are the only bodies which can negotiate appropriate conditions with their borrowing members. The conditions must be realistic and stop short of endangering the political and social stability of

borrowing countries. The ultimate responsibility for maintaining this long-term debt-service capacity rests with the debtor countries themselves.

Solving the debt problem of the developing countries will take time. Meanwhile the international financial system may come under renewed strain which could cause chain reactions in the system. Adequate contingency planning is therefore essential.

11. The least developed and other low income countries have undoubtedly been hit hardest by the world recession. Their most urgent need is for an increase, in real terms, in official development assistance (ODA), bilateral as well as multilateral. In contrast to the needed increases, ODA - and hence the level of financial transfers - has been declining in real terms. We are particularly concerned about the continuing failure to solve the funding problems of the International Development Association. If the present stalemate continues there is danger that IDA commitments for the years 1981 through 1985 will fall 40 per cent below what was contemplated when the financing plan for these years was agreed upon in 1981. It is therefore important that this problem is soon satisfactorily solved.

Our foreign policy interests require that we assist in maintaining economic growth in the developing countries.

The developing countries themselves do hold some of the keys for revitalization, but the present world economic situation may undo even their best efforts. The help they need must include private direct investment and joint ventures which their governments ought to invite and assist steadily. The "private sector", however, will not be able to solve all the problems alone.

The decline in raw material prices, due to the world recession, is one of the main causes of the current economic difficulties of developing countries. These difficulties would be eased if there is recovery of the world economy as a whole. In the long run there is also need for a worldwide system to stabilize export earnings along the lines of the Stabex system which the EEC has agreed on with a number of developing countries in Africa, the Caribbean and the Pacific.

12. The recent GATT ministerial meeting did not stop the worldwide danger of protectionism. There is an increasing risk that the virtuous circle of economic growth, increasing trade and adequate credit is turning into a vicious circle of stagnation, misaligned exchange rates, debt crisis and protectionism.

A particular danger is the manifest tendency toward bilateralization of trade policy, for instance by making the trade balance between two countries the criterion of whether free trade between these two countries is useful or damaging.

Protectionism is also lethal to the international financial system. There is only one real basis for servicing a country's external debt: its exports of commodities, manufactured goods and services. Protectionism in industrial countries erodes this basis, and through the financial system the effects of increased protection would be immediately transmitted to other countries. The eventual destruction of the open, multilateral world trading system would lead to bilateralism and barter trade and block investment, growth and employment.

13. This year 1983 must bring some first successes in the fight against protectionism. Free-trade rhetoric must be backed by action. At the very least the Seven must enter into binding commitments not to introduce any further obstacles to, and distortions of, trade with each other or with third countries in the next two years. A credible move toward trade liberalization is needed as soon as possible to restore the lost momentum.

There also is a pressing need to defuse the imminent conflict between the United States and the EEC over agricultural trade. We are deeply worried about the prospect of a mutually ruinous subsidy race. It would set a very bad example for the rest of the world. Constructive solutions are needed, both in the United States and in the EEC.

14. While the drop in world oil prices obviously has some favourable aspects, it has to be remembered that the more drastically oil prices fall today, the greater the likelihood that they will rise even higher again later. Both oil-producing and oil-consuming countries have to face the fact that violent fluctuations in oil prices help nobody in the longer run. Since investment in energy takes a particularly long time to bear fruit, short-term price gyrations bring confusion rather than clarification.

We must not become complacent but on the contrary increase our efforts to save energy and to develop alternative sources of energy, and thereby reduce our long-term dependence on oil. In order to achieve this, governments need to give more of a lead in the energy sector.

Oil is a non-renewable commodity. Given current consumption levels, given the increase of the oil-consuming world population, and assuming an economic recovery in the world during the eighties, it is likely that in the long run oil prices will again rise from present, or intermediately even lower, price levels. Therefore both investors and consumers must gear themselves to long-term prospects and long-term developments.

Governments would be wise to provide incentives to consumers and industry to take the necessary steps in order to meet future situations without new dramatic crises.

Cooperation between oil-producing and oil-consuming countries as well as steps to assist energy production in non-oil developing countries are essential elements of a global energy policy.

Another important area of international energy policy co-operation is the further development of nuclear energy as a source of electric power. Today, achievement of that objective is limited by problems associated with the disposal of nuclear waste. Few if any countries, and none of those that do not produce nuclear weapons, have yet found a proper solution. Many countries have little scope for storing nuclear waste on their own territory. An international energy policy must include an international agreement on nuclear waste disposal.

15. Cooperation between North America, Japan and the EEC is essential for a healthy world economy. If cooperation does not work in this triangle, then it will certainly not work in the very much more difficult context of the world economy which includes the other OECD countries, the OPEC countries,

the COMECON countries, the threshold countries and the other non-oil developing countries. Trilateral cooperation must set an example to all.

If we have referred more often in this memorandum to the United States than to other countries, it is because of the fact that neither trilateral cooperation nor worldwide cooperation is imaginable at present without American leadership, based as it is on its world position and its responsibilities.

16. Our record of economic crisis management is in the main a good one, as evidenced most recently by our successful common effort to forestall an international banking crisis. We have failed, however, to anticipate problems early enough and to provide solutions in time. This failure will become ever more critical as our economic interdependence continues to grow. It is not too late to shift from crisis management to crisis prevention. In this light, the above ideas represent an attempt to identify the issues which will have to be tackled in Williamsburg.

This report was prepared during a meeting which took place at the Schloßhotel Tremsbüttel on April 29 - 30. 1983. The meeting was chaired by Helmut Schmidt. The Körber Foundation generously provided financial support for the meeting. Participants included:

Abdul Aziz Alquaraishi (Saudi Arabia)

Guido Carli (Italy)

Herbert Grünewald (Federal Republic of Germany)

Takashi Hosomi (Japan)

Milton W. Hudson[1)] (United States)

Manfred Lahnstein (Federal Republic of Germany)

Harold Lever (United Kingdom)

Donald S. Macdonald (Canada)

Robert Marjolin (France)

Robert S. McNamara (United States)

I.G. Patel (India)

Eric Roll (United Kingdom)

Helmut Schmidt (Federal Republic of Germany)

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1) For Alan S. Greenspan

Type letter of.

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MR COLES

As requested I attach a draft reply for the Prime Minister to send to Lord Lever and Lord Roll, to thank them for the communication which they sent her on 4 May.

2. I am sending copies of this minute to the Private Secretaries to the Chancellor of the Exchequer and the Foreign and Commonwealth Secretary.

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ROBERT ARMSTRONG

13 May 1983

DRAFT LETTER FROM THE PRIME MINISTER TO THE RT HON THE LORD LEVER OF MANCHESTER, 86 EATON SQUARE, LONDON SW1

Thank you very much for the letter which you and Eric Roll sent to me on 4 May, and for ~~sending on to me~~ the memorandum reporting the conclusions which were reached at your meeting under Helmut Schmidt's chairmanship.

I found the memorandum interesting and stimulating as I would expect from its distinguished authorship. You will not be surprised if I say that there are points at which our emphasis would be different but I enjoyed reading it.

~~It is interesting and useful to have this memorandum before the Williamsburg Summit. I dare say that you will not be surprised to hear that the general drift of it is much in line with the general drift of our own thinking, though there are certainly points at which our emphasis would be different.~~

I am sending a copy of this letter to Eric Roll.

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10 DOWNING STREET

cc MCS
AW

From the Private Secretary

SIR ROBERT ARMSTRONG

WILLIAMSBURG: MEETING ARRANGED BY HELMUT SCHMIDT

The Prime Minister has received a letter from Lord Lever and Lord Roll bringing to her attention a memorandum agreed at a meeting convened by Mr. Helmut Schmidt in Germany in April to discuss recommendations for action at the Williamsburg Summit. I understand that copies of the letter and the memorandum have been sent to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary and you yourself.

B/F

I should be grateful if you could suggest a draft reply to the letter, for signature by the Prime Minister.

I am copying this minute to John Kerr (HM Treasury) and Brian Fall (Foreign and Commonwealth Office).

A. J. COLES

5 May, 1983

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