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MR POWELL

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Speaking Note on Economic Issues

I attach, as requested, a revised draft Speaking Note on economic issues for the Prime Minister's use at the Summit.

2. I am sending copies of this minute and the attachment to Len Appleyard and Rachel Lomax.

R. HATFIELD

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1 May 1985

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BONN ECONOMIC SUMMIT : SPEAKING NOTE ON ECONOMIC ISSUES

At our meeting last year, I said that we must send a clear message from the Summit. We did. We said: "Our strategy is the right one. We intend to stick to it."

We are seeking real growth, real jobs, real prosperity, all within a free society. We are not interested in quack remedies and quick fixes. We must stick to our strategy not for one year or two years, but for as long as it takes to establish in our own countries and extend to others the benefits and rewards of sound non-inflationary growth.

Since our last Summit, the levels of inflation have been lower and the rates of growth have been better in our countries than many people expected.

In Britain we have now seen four years of continuous growth of real output. We expect output this year to reach three and a half per cent. And we expect our growth to continue in 1986. We believe that our success comes from following policies of fiscal and monetary discipline. We intend to maintain them. But we also need to be flexible, to adapt to changes in demand and to technological opportunities.

First and foremost is the continuing and distressingly high level of unemployment. The pain for those unemployed is all the greater when they see the paradox of rising output and rising living standards for those in work. I believe that the right way to tackle unemployment is not to boost demand by more public spending - demand is already rising steadily in our economies and the lessons of the 1970s warn us of the danger of boosting it artificially still further. The right way to bring more people into work in Britain, and indeed in the rest of Europe, is to do all we as Governments can do to let initiative and enterprise flourish. We need to identify and cut out the regulations, practices and habits which prevent markets from working, especially the labour market. Governments must leave the way free for private enterprise to

take the initiative in the creation of wealth and jobs. We have seen that in America the less regulated environment has encouraged the enterprise culture and brought new jobs with it especially among small businesses. And I know from my recent talks with the Canadian Prime Minister that he has the same ambitions for Canada. This then is the task for Europe.

The dynamic recovery of the United States economy has already made a great contribution to the improvement of the world economy as a whole. And the United States market has made the biggest single contribution towards ending the stagnation of world trade. This has in turn enabled the developing countries to begin expanding their economies and repaying their debts. It is natural that that expansion should now be moderating, and right that the United States should be taking steps to put its continued economic growth on a solid and sustainable basis. The size of the Federal Budget deficit, the pressures of the trading deficit, high interest rates and the excessive rate of the dollar, are all problems that will require careful management and political will if they are to be brought under control. The Administration's actions in this area affect us all. I know that this responsibility is recognised and accepted by the Administration. I welcome the steps which President Reagan has already taken and wish him success in his efforts. For this is the central issue where all the others meet.

Japan has an enviable record of industrial growth, of low unemployment and of expansion of exports. But we must not forget that one country's surplus is another country's deficit. Barriers of distance and language, and long habit, mean that the Japanese economy is far less open to foreign imports. Foreign banks and foreign distributors find their activities blocked by impenetrable regulations. Foreign producers of electrical appliances find that internationally accepted scientific tests are not accepted in Japan. Of course the foreign trader suffers. So does the Japanese consumer whose choice is restricted.

Prime Minister Nakasone has recognised the need to dismantle these barriers. His programme of measures to promote imports is an encouraging declaration of intent. But unless it leads rapidly to real increases in imports, the pressure for protectionist moves against Japanese exports and commercial interests will inevitably grow in Europe as in North America and risks becoming irresistible.

I have no doubt that the time has come for a new round of trade negotiations in GATT. The agenda is clear. We need to deal with the classical barriers of tariffs and quotas. We need to devise rules for trade in services which are becoming increasingly important in the world economy. We need to get a grip on the world trade in agriculture. We need to ensure that the newly industrialising countries, whose competitive edge causes us all many domestic problems, accept the responsibilities as well as the rights which are imposed by the international trading system. We need to make it easier for the debtors and particularly for the poorer developing countries to earn their living by trade rather than relying on handouts from the rich industrial countries of the world.

The move towards a new round of trade negotiations has already begun. It is now accepted that a preliminary meeting should be held in Geneva in the summer. That is the first stage. I see no reason why the new round should not be formally launched early next year. I believe that, if we give a clear lead, and if we are responsive to the needs and problems of the developing countries, we can carry the third world with us.

Of course money and trade go together: it does not however follow that there should be a mechanical link between new trade talks and discussion of a reform of the international monetary system. The old Bretton Woods fixed exchange rate system broke down mainly because too many countries allowed inflation and monetary indiscipline to blow it apart. It is desirable to get back to a more stable - not fixed, but more stable - relationship between currencies. We

can expect that only if we all follow convergent policies. At Williamsburg we asked the G10 Finance Ministers to examine the working of the international monetary system as it now is. They are to hold their final meeting in June. I hope that their report will show how the workings of the present international monetary system can be improved. That report will then be studied in the Interim Committee of the IMF. I do not believe that we need go beyond that to seek out some radical reform.

Increased trade and more open trading are the most important means by which the developing and debtor countries can improve their lot. Debts cannot be repaid if we deny the debtors the markets in which to secure the necessary export earnings. Debt restructuring agreements with the commercial banks and governments have a contribution to make. And the aid we give them is of course substantial and significant. But even more important is the adoption by the debtor countries of economic policies designed to use their resources wisely and attract resources, without fear of nationalisation or expropriation, from the outside world. I am sure that the strategy for debt on which we decided last year in London remains correct.

We should nevertheless not be blind to the political and social pressures that this inevitably places upon governments in the developing countries themselves. It is in our interest to sustain them, not only because they will otherwise be less willing and able to repay their debts, but also because of the need to promote political stability in the developing world.

Above all we have been faced in this last year with the immense suffering in Africa. To this there is no easy or early solutions. Britain and the rest of Europe, America, Canada and Japan, gave generous food aid this year to meet the immediate need. Thanks to our initiatives the UN emergency system is working much better. But it is no good thinking that the long term solution is for the United States and

Europe to grow surplus food, to sell or give away to African countries. That would be far too expensive and wasteful of resources. But even more, it would be a cynical solution. The real need is to help the African countries to grow the food to feed their own people. This means encouraging them towards sensible policies which provide incentives to farmers - as some of them, such as Malawi have demonstrated successfully - and environmental policies which prevent the land becoming a desert.

The conclusion which I reach is that we are on the right course and must have the courage to stick to it. There will be a need for some adjustments and I have said what I think these need to be, above all measures to encourage enterprise and remove restrictive practices as the best way to bring more people into work. It means patient and persistent pursuit of the policies to which we have committed ourselves at earlier Summits. We must not put at risk the gains which we have made.