

PRIME MINISTER

VENICE ECONOMIC SUMMIT:  
DISCUSSION OF THE WORLD ECONOMY

The speaking note produced by the Treasury and approved by the Chancellor is very full but not every easy to speak. I have done an alternative version which may be slightly easier to deliver and which you will find attached.

CDD

(C. D. POWELL)

5 June 1987

SP2AFJ

VENICE ECONOMIC SUMMIT

OPENING SESSION

SPEAKING NOTE

1  
Sorry not to be able to be present for the  
whole meeting .

Sure you will understand that I cannot be  
out of the United Kingdom for long in the  
last two days of an Election campaign.

First point to make is that we can be pleased

① with the success of economic strategy

followed by the Summit countries over the  
past few years.

We have stood for prudent financial management,  
free markets and a climate of incentives  
and self-reliance.

The results have been

- success in reducing inflation
- sustained growth for at least five years
- and progress in bringing the main  
exchange rates into a much more

satisfactory pattern, which has begun to reduce the growth in imbalance.

In our case in the United Kingdom, our economic performance has been transformed.

We are entering our sixth straight year of growth, our average growth rate since 1981 has been higher than any other in Europe, and we have made great gains in productivity.

Our unemployment has been falling steadily for some months, but is still too high.

*We hope and believe it will fall*

We should, all of us, continue with our basic agreed strategy and reaffirm it in the Economic Declaration from this Summit.

But we also have to <sup>*look at*</sup> ~~recognise that~~ the

prospects for world growth over the next

year or two, ~~at present look disappointing.~~

At present it looks as if

~~The basic problem lies with the large~~

(U.S. deficit, enormous trade surplus of Germany Japan)

imbalances <sup>will</sup> ~~which~~ continue to be a drag on

the world economy.

The new pattern of exchange rates which has

emerged, with a much more realistic rate

for the yen, will help. *(but not as much as similar changes would in respect of other countries)*

~~But their effects will take time to~~

~~work through.~~ *(Indeed it looks as if the Japanese surplus this year will be very little different from last year.)*

~~And they will be fully effective only if~~  
backed up by appropriate domestic  
policies.

This is where the basic problem lies.

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The United States has made a start on the

formidable task of reducing the fiscal  
deficit.

The question is: can it achieve the

further big reductions year after year



which are needed?

Spending cuts on an adequate scale are seemingly very hard to achieve.

~~I know that President Reagan is opposed to tax increases.~~

*but as deficits & their associated interest rates can't continue to rise at this rate.*

So are we all. *There are only two possible courses of action - some cuts, some increases in taxation.*

But I would recall that we in the UK found in 1981 that we could not achieve a better fiscal balance by expenditure savings alone, so we did not flinch from some tax

increases.

That set us on the right course and we have subsequently been able to reduce tax rates again.

My own view is that only a package for dealing with the US deficit that includes some tax increase will be wholly convincing to markets.

As regards Japan, the recently announced

package of measures is clearly important.

I hope that Mr. Nakasone will be able to give us his assessment of what impact the measures are likely to make in reducing the Japanese trade surplus.

Some estimates which I have seen suggest that it will not be very much.

We also want to see action which will convince the world at large that Japanese markets are going to be genuinely open to

foreign goods and services.

There are still cases, e.g. the classification of whiskies for tax, where the only possible purpose is to keep out Scotch whisky and protect the local product, which cause a great deal of aggravation in our trade relations.

Japan needs to convince others that its actions really will lead to reduction of the external surplus.

I hope very much that Mr. Nakasone - whose personal commitment we all very much admire - will agree to give an explicit undertaking in the Summit Declaration of Japan's readiness to take decisive and sustained measures.

Helmut Kohl has done marvellously well in managing the German economy.

Germany's record of stable growth is indeed enviable.

He is quite right to refuse any action which would significantly increase inflation.

Nonetheless one has the feeling that the German economy is performing below its potential at a time when what the world economy needs from Germany is exactly the reverse.

I hope that Helmut will tell us how far he sees scope for action especially to help the supply side of the economy, which would invigorate the German economy now - for example by bringing forward the tax reforms and reductions already planned or taking action on interest rates.

That of course would be easier to do if he could be confident that action really was going to be taken to reduce the US fiscal

deficit.

Of course the countries which I have singled out are entitled to ask what the rest of us are prepared to do.

I can assure you that, if all goes well on Thursday, the United Kingdom will continue its path of non-inflationary growth, and our efforts to stimulate initiative and enterprise.



● But the main point which I want to make is that the world outside will be looking for political leadership from this Summit to maintain growth in the world economy.

If our final Declaration could contain commitments by the world's three largest economies to take the complementary steps which I have suggested - to which the rest of us would pledge our support - that would have a very significant impact.

It would also demonstrate the reality of our co-operation.

I will devote less time to other issues.

Clearly we must state our strong support for early progress in the GATT negotiations.

Nothing poses a greater danger to the continued health of the world economy than protectionism.

We must press forward with the removal of  
trade barriers.

We must also build on the progress we made at  
Tokyo on agriculture.

Present policies in all our countries are  
unsustainable.

They cost too much.

They disrupt world trade.

They suck jobs out of the rest of our

economies.

They do not even help the farmer anything like as much as is often claimed.

The principles of reform are clear enough:

collective responsibility for present

difficulties - no-one can claim exemption;

the need for concerted action; gradual

reduction in programmes of support for

agriculture; a commitment to immediate

action.

I hope the Summit Declaration will state our collective determination to make the most rapid progress possible in agricultural reform, both at home and in the GATT negotiations.

Finally on debt.

I think that we have to stick to our existing strategy.

There are no quick fixes.

Clearly some of the poorest countries, such as those in Sub-Saharan Africa, face especially difficult problems.

We have proposed a special initiative for them: conversion of aid loans to grants , rescheduling of official debts up to 20 years and a reduction of interest on debt - provided they pursue sound financial and economic policies.

I hope that the Summit can give its  
support to these proposals.

CPC



Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

5 June 1987

Charles Powell Esq  
10 Downing Street  
LONDON  
SW1

Dear Charles,

**VENICE SUMMIT - SPEAKING NOTES**

... I attach a draft of Speaking Notes for the Prime Minister on the economic subjects for the Summit, which has been prepared by officials here in close consultation with the FCO, and approved (with some amendments) by the Chancellor.

As it stands the draft is longer than the Prime Minister will need for a single statement in the meeting of Heads on Tuesday morning. But we thought it best to leave some excess of material at this stage.

One point in the draft may be worth comment - the reference in paragraph 11 to some element of tax increase as being the only move by the US which would make the prospect of significant reduction of the US fiscal deficit really credible. This is undoubtedly true in terms of the financial markets and represents the considered view of most informal opinion outside and increasingly inside the US. We know that the President remains opposed to any tax increases. But it has been striking recently that we have been told by members of the US administration that they have now recognised the need for some tax increase. Treasury Secretary Baker, in conversation with the Foreign Secretary during the Paris OECD meeting, acknowledged it. And it has been confirmed by an Economic Adviser at the White House that the view is generally held, other than by the President. An expression of this view by the Prime Minister could carry unique weight with the President - and of course the UK's own experience in 1981 is highly relevant.

I am copying this to Tony Galsworthy (FCO) and to Sir Robert Armstrong.

Yours  
Alex

A C S ALLAN  
Principal Private Secretary



DRAFT

## SPEAKING NOTES

X It is right that we should focus our talks here on problems. There are three I particularly want to discuss: world imbalances, agriculture and debt. But first a few words about our successes.

2. There is in fact much to be pleased with in the development of the world economy over recent years. Our successive Summit meetings have defined an agreed strategy:

- of disciplined monetary and fiscal policies;
- of freer markets and opportunities;
- of a climate of incentives and of self-reliance.

This strategy has been working.

3. I believe that the United Kingdom has followed the strategy more consistently and vigorously than many others. The results are plain in the transformation of our economic performance.

4. And taking all our countries together, on which progress of the whole world economy depends:

- we have all had a notable success in reducing inflation;
- we have all enjoyed sustained growth for at least five years;
- we have all seen the main exchange rates brought recently into a much more satisfactory pattern and this, backed by appropriate domestic policies, has halted and is beginning to reverse the growth of imbalances.

5. It is a vindication of our basic agreed strategy - and we must certainly not abandon that strategy now. What we must do is build on the necessary changes that have taken place - particularly in exchange rates - and press ahead with further reforms.

#### World Economic Prospects

6. For we face a prospect of world growth at a disappointing rate for the next year or so. And the imbalances which have become a drag on the world economy are still very large, and the pace of improvement in them still very slow. In part this is because the world economy takes time to adjust to major changes, such as last year's dollar depreciation. That has now created a pattern of exchange rates which will help to correct the trade imbalances, provided it is backed up by appropriate domestic action.

7. It was with this in mind that our Finance Ministers agreed in February in Paris, and confirmed in April in Washington, that they would co-operate to foster stability of exchange rates - and undertook to back this up with appropriate domestic policies. They spelled out the basic policies they wanted.

8. Where the world remains sceptical is about the ability and willingness of some Governments fully to implement promised policies.

9. We all know the three focal points: the United States, Japan and the Federal Republic of Germany.

#### The United States

10. The United States have made a beginning with the formidable task of reducing their fiscal deficit. But can they continue and achieve the big further reductions year after year which are needed? We (and all the world) can see the problems involved in securing adequate expenditure reductions to meet the need. Given these difficulties, I believe that only a package that includes some tax increase could be wholly convincing.

11. I am no enthusiast for increasing taxation. On the contrary! But there are problems of priorities. Let me remind you that the UK had very direct experience of this in 1981. We gave priority then to measures to restore a better fiscal balance. We could not reach our target by expenditure

savings alone, so we did not flinch from some tax increases, choosing forms of tax which would do minimal damage to personal and corporate incentives.

12. We have never regretted that crucial and right decision - indeed the British economy has improved continuously since, and tax rates have subsequently been reduced.

### Japan

13. Japan has undertaken to seek to sustain a more buoyant level of domestic demand, and to open its markets more freely to foreign goods and services. These changes are necessary to a more balanced world economy. They are also in the interests of the Japanese people themselves as Japan adapts to its growing importance and responsibilities in the world economy.

14. The recently announced package is plainly important - and I welcome it as far as it goes. But it would be helpful to know more clearly what impact the Japanese authorities think it is likely to make in reducing the Japanese trade surplus. Moreover, the Japanese Government need to take action that will convince the world at large that Japanese markets are going to be genuinely open to foreign goods and services.

15. We all recognise that it may take time for measures of structural reform to have full effect. That makes it the more important that measures taken now should be - and be seen to be - decisive and sustained. And if the atmosphere of trade relations is not to be soured, we need to avoid situations

which provide strong feelings, complaints and a mood of retaliation among trading partners.

16. To take one example which has had a particularly damaging impact on opinion in my own country: what possible purpose can there be in the current Japanese classifications of whiskies for tax, other than to keep out Scotch whisky and protect the local product?

17. I know that the Japanese Government faces practical and political difficulties at home. But there is a real problem of credibility here. It is in the interests of all of us that, both in substance and in presentation, Japan's policies should carry conviction abroad.

#### Germany

18. The problem here is that some of the life seems to have gone out of an economy which has otherwise managed to achieve an enviable record of stable growth. I fully understand and support the determination of the German authorities to refuse action which would threaten future price stability. But for a year or so past, and on forecasts for the next year, the German economy will be performing well below its potential, at a time when what the world economy needs from Germany is exactly the reverse.

19. Tax reforms and tax reductions are promised in Germany. But their effect will not be felt until next year. Is there not a case for some action with much earlier effect, given the

Britain \$38 bn

8-6%

5-4% use

Grain stabilisation amounts

U.S. \$27 bn

U.K. \$27 bn

Canada \$4 bn - at 350%

850,000 new jobs in 27 months

Time Reckon - historic free trade agreement with U.S.

Subsidy

\$75 bn - World Bank since the Lomé

Little adjustment in the plans over 4-5 years by J.M. - done

On Under Work by all.

Grounding Int. Trade now beyond 3% dependent further 6-7%

Short Term effects J.M. - certain adjustment

disappointing quality of recent figures, and the signs of lack of confidence within areas of German industry which have been affected by exchange rate adjustments. Economic decisions often involve balancing the risks. May there not be more risk - for Germany as well as others - in the increasing sluggishness of the German economy than there would be in some well-judged action to help invigorate the economy now, and especially action which will help the supply side of the economy, as both tax reform and additional privatisation would do.

20. The German authorities might justifiably be more readily attracted to this if convinced that the US fiscal deficit was definitely going to be reduced as needed. And this brings me to my final point on these, the world's three largest economies: complementary changes in all could be more effective for all than changes by one country in isolation - and would demonstrate the reality of our co-operation.

#### Trade and Agriculture

22. All of us here must co-operate on action on trade and on agricultural trade in particular. The obvious forum for this is the forthcoming GATT negotiations on trade. We should reiterate strongly our full political support, both for early progress in negotiations, and for the GATT system itself. That system underpins much of the prosperity we have built up over the last forty years. Even the most powerful of us depend on its continuing health.

Structure growth,

View to improve world  
economic environment.

(1) Co-operation growth strategy

Structure growth

(2) Recipient - 1. Recipient system

Structure.

(3) Fight Protectionism - Hypocritical regions

(4) Measures to help stabilize commodity  
prices.

Specific Measures - a) Subsidies to restructure debt.

Reynolds capital - up - running

Triplic structure adjustment facilities



23. At Tokyo we singled out the problems of agriculture. Since I raised the subject then, the issues have become more widely understood. It is generally agreed that present policies are unsustainable. They cost too much. They disrupt world trade. They suck jobs out of the rest of our economies. They do not even help the farmer anything like as much as is often claimed.

24. We must now move from analysis to action. I recognise all the difficulties. Farming is deeply rooted in the national life of all our countries - and that includes the United Kingdom. But action is needed for all our sakes, including the sake of the farmers themselves. That is why the European Community has already begun taking tough decisions to reform our common agricultural policy. The United Kingdom gave the process a strong push during our Presidency of the Community last year. It hasn't been easy. It won't be easy. But the effort is essential.

25. The principles of the reform we need are clear enough. They include:

- the collective responsibility of all countries for our present difficulties. None of us - whether exporters or importers - can claim exemption;
- the urgent need for concerted action - this will be more effective and lessen the domestic cost of change;
- the gradual reduction in programmes of support for agriculture; present support of production

Labour market regulations in Italy

Alan - banks

Don't take on because  
can't lay off.

Byzant language adopted at OECD  
on agriculture.

Agriculture - food price support policies

\$ 140 bn a year.

Developed  
Countries

- Learning for food exports

Support must not provide incentives  
to production.

No countries can export free  
trade unless others do too

OECD - Conditions for achieving reduction  
in imbalances

- 2) Middle non-inflationary adequate growth
- (1) Lower agreement, - st.~n. differences
  - (3) Balanced growth & int. trade

regardless of markets causes chaos in world trade and does not even help the farmers supposed to benefit;

- the need to give credit for reductions in subsidy levels which countries make in the course of the Uruguay round; we should do all we can to encourage actions in the interim, and not delay desirable domestic reforms while awaiting the outcome of international negotiations;
- the need for specific commitments to immediate action.

26. These principles were underlined by OECD Ministers in May. The OECD's technical work should be a valuable tool in the GATT negotiations. We now need to build on this. We should give our authority for the most rapid progress possible in agricultural reform, both at home, and in the GATT negotiations.

#### International Debt

27. Finally I turn to international debt problems, especially to the problems of the poorest and most heavily-indebted countries of Sub-Saharan Africa.

28. We all recognise that managing debt problems is a hard slog for all concerned. It needs patience and understanding on the part of creditors. It needs sound policies - of financial prudence and open markets - on the part of the debtors. There are still no quick fixes, and there won't be.

Imports water by 6-72 in  
real term.

Have experienced a slow-down  
in growth.

Hope ward off protectionist pressures

Debt burden not decreased.

No of debtors

Suspended interest payments on  
development aid to 3rd World countries

What each state prepared to do

RR

Structural adjustment reform

- better balance

Rigidities

- identity

Barry Miki

Tele - Deregulation

Drop in prices. Tax Reform

Culture for expenditures

Family Jam

Europe -

labor costs high

15.6% new 1985

Difficult to do down unprofitable plants

New source of growth - new business

For the major debtors who in the long run need to regain access to world capital markets on their own credit, we must stick to our strategy.

29. Equally we all recognise special problems in some of the poorest countries, especially in Sub-Saharan Africa, where the debt problems are modest on the world scale, but crippling for countries with negligible material and human resources.

30. At the IMF/IBRD meeting in April, the Chancellor of the Exchequer proposed a special initiative for these countries, including three specific measures:

- conversion of old government aid loans to grants;
- rescheduling of official debts on generous terms of up to 20 years with appropriate grace periods;
- and, most important because it is the measure which would have the biggest impact on outstanding debt, a reduction of the interest charged on rescheduled official debt.

31. Our proposals are subject to acceptance by official creditors generally, and in each case to acceptance by the debtor of sound economic and financial policies in conjunction with the IMF and/or IBRD. The role of these two institutions is clearly important: I would hope they might find ways of making a contribution in parallel with that of governments.

32. I urge that this Summit meeting should give its political support to these proposals, and call on the IMF and IBRD, and

Wilmers

Exchange rates correspond to  
reality.

Fed Reserve - Adjustments underway

Since 1985.

Slower growth.

Oil prices - takes time to adjust our  
economy.

Riskier are interest in growth.

High imbalances in foreign trade

Increasingly severe problems of developing  
countries

New commitment - implement what we  
have decided to do.

Reductions in taxes

Fiscal reduction  
2.5% GDP.

Target for real growth.

Lowering of value of dollar not

Can Trade Surplus DM 200

forever.

Surplus - current  
account has disappeared

our Finance Ministers and their colleagues in the Paris Club,  
to work out the details by the time of the September Annual  
IMF/IBRD meetings.



Make sense - World economy watershed  
Brighter side - lowering interest rates  
prices etc.

But budget imbalances.  
Serious problem.

Protectionism - seriously embedded.  
Debt - raising concern

Implement policy coordination  
Action - long term stability.

Budget deficits at root of exchange imbalances

If U.S. deficit dealt with - will have some  
effect economically

Best efforts for soft landing