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PRIME MINISTER

ECONOMIC SUMMIT : *Speech's Note*

We need to commission your main speaking note for the Economic Summit from the Treasury and FCO. I suggest something on the following lines, drawing heavily on thoughts which you yourself have developed in recent weeks. The reasoning might run:

- we are entering a new phase. The command economies, and the central control of political life and the communist ideology which went with them, have cracked and crumbled. We are seeing the repercussions in the Third World: the communist or state socialist model is increasingly seen to be fatally flawed and irrelevant, and policies based on the operation of the market to offer the only sure way to prosperity and progress. We have an opportunity to make the 1990s the decade in which much the greater part of the world adopts the policies which have brought prosperity and liberty to our own countries.

- but we need to take this a step at a time. The collapse of the old system is not synonymous with the adoption of genuine democracy or economic policies which are authentically free market. Romania looks like an example of fraudulent democracy. And we certainly cannot yet say with conviction that the Soviet Union is espousing the market. There is a tendency to talk about new ways to adopt the market economy. There are not new ways, only perseverance with the old. We must not put ourselves in the position of propping up regimes which have only half-changed, so that we make it easier for them to avoid the full rigours of change. This is very relevant to the discussion which we shall have of assistance for the Soviet Union. Such help must be clearly tied to facilitating and promoting genuine market policies, not to providing an oxygen tent for the survival of much of the old system. Credits are all too likely to be dissipated in the purchase of consumer goods to purchase temporary popularity rather than to sustaining reform.

- the foremost contribution which we can make in this new phase is to maintain our own levels of prosperity and economic success. That will act as a magnet for others, as well as generating the resources to help them. We must continue the virtuous economic policies which characterised the second cycle of Economic Summits. That means bearing down on inflation and reducing public sector deficits. It also means keeping our markets open, and the successful completion of the GATT round will be vital in this respect. Indeed we should aim during this meeting for a broad political understanding to resolve the main points at issue between Europe, North America and Japan, in particular on agriculture. If we can continue to demonstrate the power of the market and of free competition in our own societies, then we will complete the task of attracting others to adopt them too. That in turn will give the best prospects for political stability.

- there is another lesson for us too. Success must not breed complacency. It is not yet proven that societies like the Soviet Union can make a peaceful transition to democracy and a market economy. Declining empires are dangerous. The forces of nationalism throughout the Soviet Union are strong. If things go badly, it is not fanciful to imagine that, in a few years time, the map of central Europe could look something like it did in the 16th or 17th century, with all the potential for conflict that can bring with it. While keeping our eyes on the goal of a world in which the basic hostility between different political, social and economic systems has been removed, we must recognise that we still have some distance and dangerous territory to traverse before we get there. We must not lull our public opinion into a sense of false security, where they come to believe that defence is no longer necessary. This is a question both of psychology and of will-power. We must sustain defence and devote sufficient resources to it, not leaving the United States to bear an unfair burden.

- if we are to make the most of the new opportunities in the 1990s, we need to give attention to six major themes:

- first, we need greater monetary stability as a way to greater exchange rate stability. I do not believe we can achieve this artificially. Currencies reflect underlying economic circumstances, and while these vary so exchange rates will fluctuate. You cannot tie them artificially without either imposing such severe strains that the system eventually cracks like Bretton Woods: or by providing massive transfers of resources between more and less prosperous regions, with all the bureaucracy which that involves. We might consider what the alternatives are and whether the notion of an objective reference standard for currencies - such as a gold or commodity standard, or an index-linked reserve asset - would not give us the combination of counter-inflationary discipline and a realistic relationship between major currencies. Of course there would be difficulties from the automatic operation of such a scheme, and the loss of the flexibility which conventional monetary policies provide. But equally you would avoid the bureaucracy, central growth and exclusivity which goes with attempts to create economic and monetary union. And is not one of the problems in the world economy at the moment that we have too much flexibility in the operation of monetary policy? Those who have done best are those like Germany which have the strongest "spine".

- second, it is not too soon to be looking beyond the GATT round to how we can continue the process of freeing up world trade in goods and services. We need to look at the possibility of further liberalisation, at least among highly industrialised countries, of financial services (including investment services, banking and insurances), aviation, public procurement and mutual recognition of standards. Our aim should be the freest possible trade over the widest possible area: and that will require further concessions from all of us. Europe would have to accept that the Uruguay Round is not the last word in reducing agricultural subsidies and protection: the US and Japan would have to accept that they still have a great deal to do before their markets, particularly in areas like defence procurement and

financial services, can be considered truly open to others. I am of course assuming that we shall complete the Uruguay Round successfully. But even after that we shall need some fresh target if we are to keep up the momentum of liberalisation. If we do not continue to move forward, there is a risk that we shall slip back into protectionism in one form or another.

- third, we must do more to ensure genuine competition within our economies. We are tackling this in the EC, but performance is still very uneven, particularly over state aids and restrictions in the financial area. To take one example, we have a situation where state-owned companies from some countries are mounting a campaign to take over private sector companies in our own country. That is not free competition because of course a state-owned company cannot itself be subject to take-over. This is one of the areas which we have really got to look at in the next phase.

- fourth, we are going to have to devote much more time as politicians and governments to environmental issues. The scientific evidence for major impending changes to world climate, with all the implications for agriculture, flooding of low-lying areas and for our whole way of life is constantly becoming clearer and more compelling. We shall be presented with some severe tests in the years ahead: and the sooner we take action - whether it is to restrict CFCs, and carbon dioxide emissions, or to create new instruments of international co-operation - the better placed we shall be to cope with the problems of the next century. It will require a vast leap of imagination and vision.

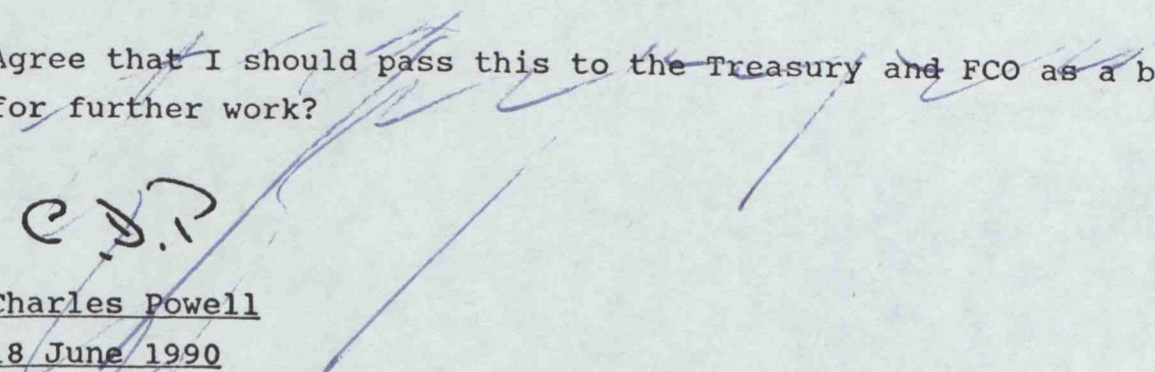
- fifth, we must avoid a relapse into blocs, particularly in the field of trade and economic and monetary matters. I see a real danger that the world will increasingly divide into self-contained and inward-looking blocs: a European bloc based on the EC and the proposed economic and monetary union: a North American bloc based on a US/Canada/Mexico Free Trade Area: and perhaps a Pacific bloc with Japan and

some of the East European countries. That would be a step backwards and a restraint on trade and economic freedom, as well as being politically stifling while excluding some of the countries which most need to be helped like those of Eastern Europe. We must avoid the creation of new economic or trade empires, and concentrate instead on keeping the wider world economy open, and on strengthening and enlarging institutions such as the GATT which promote that.

- sixth, we must keep our own institutions flexible so that they can respond to the new international situation. The worst thing would be to lock ourselves up in new centralised bureaucracies. We have to recognise the strength of feelings of nationhood and the need to accommodate diversity. At the time when the countries formerly under Communist rule are breaking away from central control and bureaucracy, they will not want to see their national identities swallowed up in some new centralised bodies. In the end such centralisation is bound to have a deadening effect and act as a constraint on the economic development which we need, if the new order we have so successfully created is to flourish.

- so it is a period of almost unprecedented change which we are entering. There is much which must be preserved as we shall be saying in our Summit Declaration: our democratic traditions, our market economies, our defence through NATO. But there are immense new opportunities to grasp, if we pursue the right policies and continue our successful co-operation in this Economic Summit framework.

Agree that I should pass this to the Treasury and FCO as a basis for further work?

  
Charles Powell

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