

Econ Summit Pt B.

SECRET



Sir Robert Armstrong will provide advice, if necessary, on the thematic paper after the Paris meeting. 4

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MR COLES ✓

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Williamsburg Summit

In your minute of 9 May you asked for advice on the line which I propose to take at the forthcoming Sherpa meeting on the President's thematic paper.

2. I propose to be guided by:

- flag A (a) The paper which the Chancellor of the Exchequer prepared for discussion at the NEDC earlier this month.
- flag B (b) The statement which the Chancellor of the Exchequer made about the Government's approach to the Williamsburg Summit at a press briefing before he left for the Development Committee in Washington.
- flag C (c) The attached note prepared in the Treasury identifying the main issues which will arise at the Summit.
- flag D (d) The line which the Prime Minister took with Mr Meese at their meeting on 4 May, as recorded in the note attached to your letter of 5 May.

REA

ROBERT ARMSTRONG

10 May 1983

SECRET



## INTERNATIONAL ECONOMIC ISSUES

### Introduction

The world economy has been going through a painful process of adjustment and transition affecting all countries.

2. In the 1970's most industrial countries adopted expansionary fiscal and monetary policies, while developing countries extended their borrowing, in an attempt to stimulate economic growth. The result was cycles of successively higher rates of inflation, coupled with successively higher levels of unemployment, and compounded by shock increases in oil prices.

3. A halt to this process was inevitable, and has led to a recession which has proved long and difficult. We have seen further sharp rises in unemployment, increases in public deficits, high interest rates, a reduction in the volume of world trade, and falling commodity prices. This has produced severe imbalances for non-oil-exporting developing countries, and dramatic increases in the short-term debts of some developing countries. It has contributed to increased volatility in exchange rates as industrial countries have adjusted economic and financial conditions at different times and with varying success.

4. This paper considers what has been done to improve the prospects for recovery, and what remains to be done.

### The Objective

5. The broad objective must be to strengthen the foundations of sustainable, non-inflationary growth for the world economy as a whole. Much of the responsibility lies with the conduct by individual governments, particularly in the major industrial countries, of their domestic economic and financial policies. Internationally, we need also to pay attention to two other objectives:

- to overcome the legacy of excessive debts incurred by some countries. This requires policy adjustment by debtor countries, and support from the international financial community while this proceeds;



- to restore greater stability in exchange rates, in the interest of more confident international trade and investment and of a more settled framework for many domestic financial decisions.

### What Has Been Done?

6. At the Economic Summit in Versailles a year ago important conclusions were reached about the need for adjustment. It was agreed that recovery on a durable basis depended on success in the continuing fight against inflation. The first task for the main industrial countries, therefore, was to restore their own economies, by reducing their structural public deficits, controlling monetary growth and reducing rates of inflation. It was recognised that the immediate prospect for industry, trade and unemployment would be difficult, but that this was the price to be paid for having lived for so long on inflation and debt.

7. Internationally, a series of major debt problems erupted during the second half of 1982. The international financial community responded speedily and effectively. The principle was recognised at the outset: necessary adjustment of domestic policies must be undertaken by debtor countries, with the IMF playing a supervisory role. This would be supported by creditor governments and central banks, and commercial banks would continue to play an important part. It was increasingly recognised that a major increase in IMF resources was vital and urgent, and early this year governments agreed to an expansion of the General Arrangements to Borrow and a major increase in IMF quotas. The result, subject to ratification, will be effectively to double the resources available to the IMF by the beginning of 1984, some two years earlier than previously planned.

### Progress So Far

8. There are important signs of progress in some key areas:

- a growing number of countries are successfully tackling budget deficits, and the determination to gain and keep control of structural deficits is widespread and strong - though not always easy to translate into practice;
- most countries are also paying close attention to the need to discipline monetary growth;
- inflation has fallen steeply among major countries and now averages about 5 per cent, the lowest rate for a decade;



- nominal interest rates have fallen significantly in the United States, the United Kingdom and elsewhere;

- oil prices have fallen by some 15 per cent, offering on balance hope of favourable impact on both world inflation and world output; though for some oil-producing countries this obviously creates problems, at least in the short run;
- there are growing signs of recovery of real demand and real output, particularly in those countries which have had the greatest success in bringing down rates of inflation and interest rates.

9. For the world economy as a whole there are grounds for cautious optimism. In the United States economy, GDP, industrial production and capacity utilisation all seem to have been increasing since the turn of the year; retail sales have picked up slightly; and the Administration has revised its forecast for GDP growth in 1983 from 1½ per cent to almost 3 per cent. In the United Kingdom, the rapid fall in the rate of inflation last year helped to promote a revival of demand, and there have been more recent indications of increased output coupled with some revival of business confidence. In Germany, industrial production has recovered, while construction activity and the volume of new orders have improved, creating there too a revival of business confidence. Output in Japan is expanding, although at a modest rate, and perhaps in Canada also. In France and Italy, little growth is expected this year as both concentrate on reducing their continuing high inflation rates.

10. For the leading industrial countries taken together, there is a prospect of real growth of perhaps 2 per cent between 1982 and 1983, becoming stronger as the year proceeds and into 1984. The prospect for inflation also remains favourable. Recovery on this scale would be modest and gradual. It could not be associated with any early and dramatic reduction in unemployment. But it could, and should, be durable and gather strength, with beneficial effects on unemployment, and without precipitating renewed inflation.

#### What Needs To Be Done?

11. The task now is to maintain and consolidate the foundations for sustainable growth. The industrial countries (and so the world) would not benefit from short-lived boosts to public expenditure or consumption which cannot be matched by output: that is the road to higher inflation. Nor is there any foundation for the idea that countries which have been relatively successful in reducing their rates of inflation could help others by expanding their domestic demand in a co-ordinated way: that course too would simply generate more inflation.



12. It is important to have room for sustainable growth of real demand and output. But that is best achieved by making more head-way against inflation, against high interest rates, and against high public deficits. The importance of the US economy means that their success in these directions - and particularly in relation to their Budget deficit - is of special significance for the rest of the world.

13. Meanwhile, we must look to ways of gradually easing strains on developing countries, especially those which need to tackle severe debt problems, over the years ahead.

#### A Programme For Action

14. All these matters have been or will be discussed extensively in international meetings, particularly of the IMF/IBRD Development Committee last week in Washington, of the OECD in Paris next week, and of the Summit at Williamsburg at the end of May. I hope that those meetings will confirm the objective of sustainable, non-inflationary growth, and develop proposals for action through international co-operation on the following lines:

1. Industrial economies: at Versailles it was agreed that industrial countries, particularly the five whose currencies constitute the SDR (United States, United Kingdom, France, Germany and Japan), should seek to strengthen their co-operation with the International Monetary fund through a process of mutual examination of their economic and financial development. We have made progress in outlining a common approach to the strategies each of our countries needs to adopt. A closer concertation of our economic objectives over the medium-term would be valuable, and mutually reinforcing.
2. Exchange rates: a convergence of economic policies designed to produce low rates of inflation should facilitate greater stability of exchange rates and interest rates.
3. Exchange rate intervention: as a result of a study which was commissioned at Versailles agreement may be reached on the limited but valuable role of exchange rate intervention.
4. Debt: the debt problems which still confront a number of countries will need continued vigilant monitoring.
5. IMF resources: the authority and skill of the IMF in helping with the adjustment problems of individual countries has to be reinforced by the availability of



adequate resources. Before the enlargement of IMF Quotas takes effect there could be liquidity problems which would need to be resolved, whether by official bridging operations or possible market borrowing; subsequently it will remain necessary to monitor total IMF resources, in relation to the scale of debt problems. The case for a new issue of SDR to maintain adequate world liquidity will need to be further considered.

6. Aid: programmes of official aid should be maintained, and it is particularly important now to complete the IDA VI programme (in which the UK has played a leading role and in which we look to the United States now to play its part), and to prepare for IDA VII.
7. Protectionism: we need to halt, and reverse, the tide of protectionism, and to find ways of doing so effectively and fairly.
8. East/West trade: we need to steer through potential misunderstandings and conflicts of interest to arrangements which satisfy common strategic and overall economic interests.





## THE APPROACH TO THE WILLIAMSBURG SUMMIT

[ Statement by the Chancellor of the Exchequer: 26 April ]

In just over one month, the Economic Summit meeting will take place in Williamsburg on 28-30 May. There are other important meetings between now and then: of the Development Committee in Washington this week on 28-29 April, and of the Ministerial Committee of the OECD in Paris on 9-10 May. Both in Washington and in Paris, I and my Finance Minister colleagues of the Summit countries will be taking the opportunity to talk together, and in Paris we will be joined by our Foreign and Trade Minister colleagues.

2. The central theme of all our discussions will be world economic recovery - the prospects, the dangers, the strategy we need to nurse the recovery through to sustained non-inflationary growth, whose benefits can be shared by all countries.

### Since Versailles

3. At the Economic Summit in Versailles a year ago, as the recession was deepening, important conclusions were reached about the need for adjustment to escape from the imbalances and turbulence of the 1970's. It was agreed that recovery on a durable basis would be obtainable only if the continuing fight against inflation were successful.

4. Adjustment to the second oil price shock of 1979 has inevitably been painful. The struggle to restore sanity to our economic and financial life has been at the centre of the recent recession. For industrial countries it has meant initially a further inflationary shock and major disruption to key industries, with rapidly rising unemployment. Developing countries have suffered from the oil price increase, from high inflation, from reduced export earnings and from





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high interest rates which in some cases have led to a dramatic growth of short-term debt, threatening the structure of financial markets. The hardship for many of the developing countries has, of course, been all the more severe because of the poverty from which they still suffer.

5. Since Versailles, the cumulative effects of recession have in many respects become more visibly grave, and therefore more alarming to many people. But appearances often lag behind the underlying reality, and in fact we can record some very important progress:

- inflation has fallen steeply among major countries and now averages about 5 per cent, the lowest rate for a decade;
- progress has been made in a growing number of countries in tackling budget deficits, and the determination to gain and keep control of structural budget deficits is widespread and strong;
- nominal interest rates have fallen significantly in the United States, the United Kingdom and elsewhere;
- oil prices have fallen by some 15 per cent, offering on balance hope of favourable impact on both world inflation and world output;
- growing signs of recovery are now seen, particularly in those countries which have had the greatest success in bringing down rates of inflation and interest rates





(United States, Germany, Japan and, happily, the United Kingdom), and this recovery does not result from artificial stimulus of demand.

### The Prospects for Recovery

6. Activity has clearly picked up in the United States, where the Administration has recently revised upwards its forecast for GDP growth in 1983 from 1½ per cent to almost 3 per cent. There are signs of recovery in the United Kingdom and Germany, coupled with a revival of business confidence. Output in Japan is expanding, although at a modest rate, and perhaps in Canada also. In France and Italy, little growth is expected this year as each concentrates on reducing its continuing high rate of inflation.

7. The prospect for Summit countries taken together seems to be of some 2 per cent real growth between 1982 and 1983, becoming stronger as the year proceeds and into 1984, and with prospects for inflation remaining favourable. Recovery on this scale would be modest and gradual. It could not be associated with any early and dramatic reduction in unemployment. For some time indeed it would do no more than gradually check the rise. But it could, and should, be durable and gather strength, without precipitating renewed inflation. This is the opportunity which must be grasped.

### A Co-operative Strategy

8. I believe there is a strong and shared desire of all Summit countries to see the recovery sustained and extended to each of them, without rekindling inflation pressures. We need lower inflation, which will contribute directly to higher real incomes and a better prospect for employment. We need lower interest rates, which will in turn both benefit the cash flow of companies and improve their profitability, and so help to finance higher





output, stock-building and investment. This will improve the outlook for jobs.

9. The individual and collective strategies of Summit countries must focus on making room for the recovery to develop without relaxing the disciplines on growth of monetary aggregates, and without losing control - in some cases indeed improving control - of fiscal deficits. This is the only prescription for maximising growth of demand and output in real terms, and not in money terms.

10. At Versailles it was agreed that Summit countries would seek to strengthen their co-operation with the International Monetary Fund in mutual surveillance of their economic development, and to develop this particularly among the countries whose currencies constitute the SDR (United States, United Kingdom, France, Germany and Japan). I hope that the meeting at Williamsburg will give additional authority and impetus to this development, so that our individual policies can take account of each other, and mutually reinforce each other over the years ahead. The idea of concerting our economic policies over the medium term is something which needs to be reinforced.

#### Problems and Uncertainties

11. There are some important problems and uncertainties, which we need to guard against:

- those of developing countries, among which the problems of major sovereign debtors have loomed large, will be a particular focus of attention at the meeting of the Development Committee later this week;





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- protectionism has significantly, and understandably, been growing as individual countries and industries have found themselves subject to particular pressures. This is a process which could threaten to choke off wider opportunities for recovery. The general need to halt, and indeed reverse, the tide of protectionism, and to find ways of doing so effectively and fairly, will be an important topic for consideration at the meetings in Paris, and again at Williamsburg;
- high real interest rates, reflecting pessimistic expectations of future inflation and imbalances of policies, are a major obstacle to recovery, and contribute substantially to current debt problems. Our discussions of strategy must address themselves to the need to keep interest rates down, on a basis which can be maintained without excessive monetary expansion;
- exchange rate volatility has been a substantive and increasing worry over recent years. It is clear that greater stability of exchange rates would benefit international trade and investment, as well as providing a more settled framework for development by individual countries of their own domestic policies.

All these problems will be eased by the sound recovery we are seeking. Let me say more about two of these problems in particular, which have attracted a good deal of recent attention.

#### International Debt

12. There have been some key landmarks over recent months in handling the debt situation:





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- the international community has shown itself able to undertake major rescue operations in short order, in conjunction with adjustment programmes worked out with the International Monetary Fund;
- a major new development has been the role of the Fund in establishing contact and exchange of information with commercial banks in order to encourage them to play an appropriate continuing part;
- early this year the international community agreed speedily on a substantial replenishment of resources for IMF. This was achieved in part by a major increase in credit lines available under the General Arrangements To Borrow and their availability to non-Members, and in part by a 50 per cent increase in the size of the Fund itself. Subject to ratification, these measures represent a doubling of resources available in practice to the IMF, made available some two years earlier than previously planned.

13. Further progress in easing the financial problems of debtor countries can be expected from:

- lower interest rates;
- a gradual improvement in export prospects as recovery in the industrial countries emerges;
- the effects of major adjustment programmes agreed by debtor countries themselves, with the IMF;





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- continuation of the key role played by the World Bank, and in particular by IDA, in meeting the needs of other countries.

The Fund estimates that non-oil developing countries will reduce their current deficits from \$90 billion in 1982 to \$70 billion this year. The recent reduction in oil prices should help them on balance.

14. We must expect continuing pressure on the resources and skill of the IMF in superintending the adjustment process, and the many problems which will still arise in it. There have recently been proposals, of greater or less ingenuity, involving wholesale refinancing of debt. It is right to consider such proposals on their merits. But I am distrustful of "blanket solutions", usually involving major institutional developments which would take years to implement. I am wary too of proposals which would replace market judgements and financing by Government decisions and funding. It is generally preferable to build on existing techniques. It is important that Governments, international institutions and the financial community generally should be ready and able to continue their effective co-operation.

#### Exchange Rate Stability

15. Experience has shown that exchange rate stability can only sensibly be built on parallel policies and performance by major industrial countries. Direct market intervention may sometimes help with short-term fluctuations. But stability in currency relationships over the medium term requires:-





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- reduced and convergent inflation rates;
- a healthier and more convergent general balance of fiscal and monetary policies.

16. I believe that an approach to these requirements can be reinforced by the evolution, in a medium-term framework, of the arrangements for leading industrial and currency countries to work together with the IMF in the development of their policies.

17. It is contrary to the experience of many years to believe that any system of exchange rate rules, or any practice of relying on intervention, can overcome large basic differences in the performance of different economies. We have to begin with the essentials, and create stable foundations, before we can aspire to a more stable exchange rate system.

#### Conclusions

18. There have been strident voices in recent times, understandably worried by the depth and duration of the recession, crying for "locomotive" action by some or all industrial countries to get the world's economy moving, for a new Bretton Woods to recreate order, and for <sup>the</sup> artificial creation of flows of funds to resolve debt problems and finance activity regardless of consequences.

19. A common feature of many of these demands is that they seek to resolve this year's problems - or indeed last year's - at the expense of the future. We cannot afford that attitude. It gives me confidence that there has developed over the last year or two a strong consensus among the nations' leaders that we should set our sights on a sounder and more durable future. That is the objective we shall be seeking at our meetings in the coming weeks, building on the foundations which are already being laid.

26th April 1983



ECONOMIC THEMES FOR WILLIAMSBURG SUMMITSince Versailles

At Versailles, as the recession was deepening, important conclusions were reached about the need for adjustment to escape from the imbalances and turbulence of the 1970's. It was agreed that recovery on a durable basis would be obtainable only if the continuing fight against inflation was successful.

2. Progress has in fact been made since Versailles (see below), but the cumulative effects of recession have in many respects become more visibly grave and therefore more frightening to many people.

Broad Theme of Williamsburg Summit

3. Economic recovery is the key to the range of inter-related problems which overshadow the world at present - recession, unemployment, debt problems, growing protectionism, instability of prices, interest rates and exchange rates.

4. The Summit will assess the prospects for recovery, debate the strategies necessary to support and sustain it, and examine the implications for other problems and actions which can be taken to help in dealing with them.

Recovery

5. The basis for recovery has undoubtedly strengthened:

- inflation has fallen steeply among major countries and now averages about 5 per cent, the lowest rate for a decade;
- progress has been made in a growing number of countries in tackling budget deficits;
- nominal interest rates have fallen, although real interest rates remain high in some countries;
- growing signs of recovery are seen particularly in those countries which have had the greatest success in bringing down rates of inflation and interest rates (United States, Germany, Japan and, happily, the United Kingdom), and do not result from artificial stimulus of demand.



6. Latest forecasts have been tending to take a more optimistic view than was held six months ago, although still rightly cautious. They suggest GDP growth among major industrial countries from now on averaging about  $2\frac{1}{2}$  - 3 per cent. This would be a modest pace of recovery by comparison with some past experiences, but those past experiences led always to renewed inflationary pressures which then choked off the recovery.

#### Strategy

7. A strong desire of all Summit countries to see the recovery sustained and extended to all of them, without rekindling inflationary pressures. Their individual and collective strategies must focus on making room for the recovery to develop without relaxing the disciplines on growth of monetary aggregates and maintaining, in some important cases improving, control of fiscal deficits. This is the only prescription for maximising growth of demand and output in real terms, and not in money terms.

#### Multilateral Surveillance

8. At Versailles it was agreed that Summit countries were ready to strengthen their cooperation with the IMF in surveillance of their economic development, and to develop this on a multilateral basis, taking into account particularly the currencies constituting the SDR. We shall be developing our individual and collective strategies in this framework.

#### Unemployment

9. Gradual and sustainable recovery cannot be expected to have a dramatic impact on levels of unemployment. Initially, we must look to halting the rise in unemployment. Persistent recovery, widely spread, is the only way to reduce unemployment healthily by providing durable jobs.

#### Debt Problems

10. A continuing preoccupation of Finance Ministers and Central Bank Governors, and of the IMF Interim Committee. Note that debt problems are heavily concentrated on about a score of countries, the relatively advanced developing countries, and particularly heavily concentrated on half a dozen, mainly Latin American.



11. Two key requirements:

- responsible adjustment of domestic policies by the debtor countries;
- financial help for those countries through the period of adjustment, which must take some time.

12. Three stages of action:

- leading creditor countries, together with the IMF, have shown the ability to get together quickly and mobilise rescue arrangements for several individual debtors, in conjunction with new policies developed by those debtors;
- the IMF plays a vital role: steps taken in January and February, with great urgency and successfully, effectively to double resources available to the IMF and bring forward by some two years the time at which extra resources are available;
- continuing discussions, among Finance Ministers, Central Bank Governors and in the IMF, to deal with further problems which will undoubtedly arise, and to monitor continuously the adequacy of resources available.

13. The single most important contribution which Summit countries can make now to the resolution of debt problems is to sustain a recovery which will not provoke new inflation. That will give opportunity for debtor countries to improve their export performance; it will ease (indeed has already eased) the interest-rate burdens of debt; and it will support the renewal of confidence.

#### Protectionism

14. Understandable as a response to pressure on individual industries. But fundamentally a wrong direction. Post-war growth benefitted from the widening of trade. Recovery now needs wider, not narrower, international trading opportunities.



15. The Summit should discuss possibilities of preventing further protectionism and taking opportunity as recovery develops to reduce barriers which now exist. It will also explore the complex relationships between protectionism, the rate of growth of activity, problems of debtor countries which need to export, secular changes in world industry and trade patterns and exchange rates.

#### Exchange Rates

16. Study since Versailles of experience in exchange rate intervention during the past decade of floating. Likely to be made public after meeting of Finance Ministers in Washington on 29 April. Conclusion on intervention has to be that it cannot secure stability of exchange rates while economic performance of major countries diverges. But it can serve a more modestly useful purpose in countering disorderly market conditions and short-term volatility. If used at all, intervention should support other policies, not conflict with them. More fundamental stability requires a greater degree of convergence, at low rates of inflation, in the performance of separate economies. Such convergence will be a central part of the strategy being pursued under the multilateral surveillance arrangements.

#### Developing Countries

17. Long habit of speaking of developing countries as if they were homogeneous is badly out of date. It is at least necessary to distinguish between oil-producing countries, countries at a fairly high stage of development which have attracted commercial capital and many of whom are now encountering debt problems, and the poorest developing countries.

18. One thing all have in common is that they will benefit from a gradual and sustained recovery and would be hurt, even if not immediately and in differing ways, by a resurgence of inflation. As far as special action is concerned:

- there is need to consider what more the world bank itself can do - possibilities for discussion at the Development Committee [best not specify now];
- it is important for the poorest countries to maintain the operations of the IDA;



- investment, which brings with it sound and experienced management, should be given greater respectability again, in preference to the dangerous habit of commercial financial support of a general balance of payments kind, such as developed too widely in the last few years;
- the idea of an allocation of SDR is often suggested in favour of developing countries, but this is really part of a wider question of the state and need of global liquidity, to which following the Interim Committee meeting in February the IMF will be devoting special attention a few months from now (studies are at present being prepared).

### East-West Trade

19. A political and strategic problem, rather than a strictly economic problem, and in economic terms not on a scale affecting the world economy generally. But it is important for the world economy that frictions in areas such as this should be reduced. Progress is being made in OECD and NATO discussions and elsewhere, and we hope these will be productive.

### General

20. The Summit is not a meeting for operational decisions. It is an opportunity for a searching exchange of views between countries which share current problems and are conscious of the close interaction of the decisions of each upon the others. Do not expect dramatic new announcements - there are no quick and simple solutions. What is to be expected is rather an assessment and orientation, building on work already done in individual countries, in the IMF and IBRD, and in frequent meetings in the OECD and groups of Finance Ministers and others, and indicating ways in which some of that work can most usefully develop in future.