

SUBJECT

CONFIDENTIAL



✓ Master

no B
USA

10 DOWNING STREET

From the Private Secretary

10 May 1982

Dear Brian,

Meeting with Mr. George Shultz at Chequers on 9 May

The Prime Minister was grateful for the briefing provided under cover of Francis Richards' letter to John Coles of 7 May, for her meeting with Mr. George Shultz at Chequers at 1130 am on Sunday 9 May.

The Prime Minister's meeting with Mr. Shultz was *tete-a-tete*. After the meeting the Prime Minister told me that they had had a wide ranging discussion (which had clearly included UK/US relations over the Falklands). Mr. Shultz had said that what the President would say about the US deficit was that a balanced budget remained his objective, but that objective should not be reached through tax increases but rather through expenditure reductions. The Prime Minister had spoken of the need to press the Japanese hard on their trading responsibilities, and Mr. Shultz had not disagreed with this. Mr. Shultz had argued that discussion of the North/South problem would be inevitable, and the Prime Minister had responded by referring to the importance we attached to safeguarding the role of the specialised agencies. Finally, the Prime Minister told me that there had been some discussion of a likely French proposal for a greater stability and rigidity in the international monetary framework, but the Prime Minister's own view was that there were serious difficulties in any such proposal while economies were pursuing divergent rather than convergent policies.

The *tete-a-tete* ended at 1.00 pm and was followed by a lunch at which there was no discussion of the Versailles Economic Summit. After lunch the Chancellor of the Exchequer discussed the Summit with Mr. Shultz, in the presence of the US Ambassador and Mr. Timothy Deal from the US Embassy. Sir Douglas Wass, Mr. Michael Franklin, Professor Alan Walters and Lord Bridges were also present. I attach a record of that discussion, prepared by Lord Bridges.

I am copying this letter and attachment to Peter Jenkins (HM Treasury) and John Rhodes (Department of Trade).

Yours sincerely,

Michael Scholar

Brian Fall, Esq.,
Foreign and Commonwealth Office.

CONFIDENTIAL

B

CONFIDENTIAL

NOTE FOR THE RECORD

After the Prime Minister's lunch for Mr George Shultz at Chequers on Sunday May 9, discussion of the Versailles Economic Summit continued with the Chancellor of the Exchequer. Ambassador Lewis and Mr Timothy Deal from the US Embassy were present, as were Sir Douglas Wass, Mr Michael Franklin, Professor Alan Walters, and Lord Bridges.

2. Sir Geoffrey Howe mentioned the possibility of some discussion of monetary questions at Versailles. He believed there was quite widespread anxiety about international monetary affairs at present, and a desire to see more stable arrangements if these could be found. He asked whether Mr Shultz thought there was a role for the Summit to make a contribution in this area. Mr Shultz recalled that the discussion at the first Summit at Rambouillet in 1975 had led to the Jamaica agreement on official intervention in unstable markets. It was not the case that the United States Government was unwilling to intervene in currency markets in any circumstances, and he was aware of the current talks about the ways in which intervention might take place. He did not know what attitude President Reagan might express at the meeting, but personally he thought that some "exchange of reflections" might be possible. That did not mean that the U.S. would favour intervention in the market contrary to the true value of currencies. The subject would be one of the points on which he would report to the President.

3. Mr Shultz said that the environment for world trade was also very important. International rules on trade were being eroded: a positive and forward-looking strategy was needed. The unwillingness of Japan to open her markets was "one of the big negatives". This could not be papered over and he would mention it to the President also. There were other difficult and negative points such as the world trade in steel. The U.S. Government believed that more could be done to promote freer trade in services, to create a better understanding about the conditions needed to increase investment, and to bring developing countries into the framework of international trading rules. The President hoped that the Summit would do more than make the traditional affirmation about the value of free trade.

4. Mr Franklin agreed that these were all important matters for Versailles. It was perhaps legitimate to issue a reminder about the virtues of the free market, given the national attitudes of some of those present (France for example). But he was not sure that the Seven should make statements which could be read as pre-empting the GATT Ministerial Meeting. He agreed it was important to have a clear understanding of GATT's future role, but (referring to a possible discussion with the LDCs) suggested that quiet bilateral talks might be a better approach than a resounding declaration. As to Japan, it would be right to emphasise Japan's responsibilities; that would help the rest of us to resist protectionism and pressure for "reciprocity". It would be desirable to discuss at Versailles the way in which the Japanese conducted their macro-economic policy, since Japan needed to take a fresh and major step on import policy.

/He

CONFIDENTIAL

CONFIDENTIAL

He believed that Japan expected to come under pressure on these matters at Versailles and he saw advantage in fulfilment of the expectation. Mr Shultz agreed that we needed an impulse which would create the right atmosphere for the GATT Ministerial meeting just as a previous Summit had helped to get the Tokyo round moving. Mr Franklin recalled that the Seven had helped the developed world to get their act together, at a crucial stage in the negotiations during the Tokyo round, but he thought that the next Summit should not be too precise in describing the approach to the LDCs at this stage. Lord Bridges suggested there was a distinction between the role of the Seven at the Summit in forming coherent policies for the developed world (which was not in question) and the relationship with the developing countries. We did not want to make collaboration with the latter more difficult by what was said at Versailles. Sir Douglas Wass said it was also important to make full use of the OECD in promoting common policies among the developed countries.

5. Mr Shultz agreed that it was important to stop the movement for "reciprocity" in the US Congress. His references to the U.S. Trade Act of 1974 made clear that he was looking for undertakings at the Summit which would help to fend off protectionist pressures in Washington. He understood the difficulty about the handling of investment matters in the GATT, and (echoing the speech made two days before by Secretary Regan) thought that the World Bank might be a more suitable vehicle for that subject.

6. Mr Shultz supposed that Global Negotiations would also come up at the Summit. Sir Geoffrey Howe explained the British attitude, the importance we attached to safeguarding the role of the specialised agencies, and the doubt he felt about the concepts underlying the GNs. Lord Bridges said that, to judge by what had been said by France at the last preparatory meeting, President Mitterrand might intend to lay some considerable emphasis on this subject. The U.S. representatives at that meeting had explained the difficulties they had with the latest G77 text and seemed to be looking to their partners to suggest improvements, but the EC countries were not enthusiastic about that prospect, given the failure of attempts of the same kind during the British Presidency last year. Discussions had taken place in the Community and there would be further contact with the Americans about how we should proceed.

7. Mr Shultz asked where we stood on the talks about restricting credit to the Soviet Union. Lord Bridges referred to the meetings which had taken place with Mr Buckley. There was a general expectation that Western credits to the USSR would decline. At a recent meeting Mr Buckley had suggested a mechanism to control the amount, on a carefully worked out basis, but it seemed that a number of European countries would be reluctant to take part in a formal scheme, and did not favour making a commitment with a political flavour on this subject at Versailles. A less formal arrangement designed to reduce the proportion in each contract of western exports financed by official credit agencies was now being examined; it was also suggested that the balance should be paid by the Russians in cash. There were however likely to be difficulties with this idea,

/and

CONFIDENTIAL



CONFIDENTIAL

and he could not say whether it would be possible to work out an arrangement in time for the Summit - although there might perhaps be some reference to the matter at the meeting and in public afterwards. It was important that any arrangement made should subsequently be incorporated into the OECD consensus. Mr Franklin emphasised how important it was that any plan of this kind operated fairly between the different western exporting countries. Professor Walters pointed out that there was a danger of decisions on the supply of credit to the USSR being taken by state-owned banks (e.g. in France or Italy) on a non-commercial basis; but Mr Shultz thought that even when state-owned, such banks normally operated on commercial lines. He referred approvingly to the suggestion put forward by Frau Steeg.

8. There was a brief discussion about the financial problems of East European countries, the connection between our attitude to provision of credits for the USSR and to nations such as Romania, Yugoslavia and Hungary, and the possible domino effect of their difficulties on the international banking system. It was generally thought that no specific decisions were likely to be taken at Versailles on this subject, so far as could be foreseen. But Mr Shultz said it was legitimate to ask what the effect of recent worries about Eastern Europe and the USSR would be on decisions taken by commercial bankers in the future. He thought that many such banks had been pretty free-handed in the past, and that they would now be more cautious. He gave Argentina as another example: whatever happened in the Falklands crisis, he doubted whether Argentina would secure more loans at all easily, and feared Senor Aleman would be unlikely to survive.

9. Professor Walters pointed out that borrowing had been greatly encouraged in the 1970s by the negative interest rates then prevailing. That situation had been changed. We could now see that the present difficulties had been brought about by efforts to promote growth artificially by cheap credit. Positive interest rates would reduce credit demand, although there would have to be painful adjustments. He did not exclude one or more countries defaulting as part of that process; there were disadvantages for western creditor nations in such defaults because of their exposure to loss through official credit guarantees. Sir Douglas Wass said that we shared US anxieties about possible defaults, although he hoped that the disappearance of OPEC surplus would reduce the strains on the system. Mr Shultz concluded by saying that the discussion had highlighted the need to deal with the Soviet credit problem.

FOREIGN AND COMMONWEALTH OFFICE

10 May 1982

CONFIDENTIAL