



10 DOWNING STREET

From the Private Secretary

24 April 1984

The Prime Minister has now seen the Chancellor's minute of 18 April about the subjects on which British interest might focus during the Economic Summit. Mrs Thatcher agrees in general terms with the Chancellor's proposals. She has commented, however, that we must avoid criticism of President Reagan at what will be a very difficult time for him. Anything we say could be distorted and misunderstood. She would therefore prefer not to direct attention specifically towards "US Policies". The Prime Minister's only other comment on the subject headings suggested by the Chancellor was that she would prefer to avoid the phrase "Supply Side" wherever possible. Mrs Thatcher very much agreed, however, with the approach to the international debt problem suggested in the paper annexed to the Chancellor's minute.

Timothy Flesher

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H.M. Treasury.



cc
Prime Minister

Content with this selection of topics?

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PRIME MINISTER

LONDON ECONOMIC SUMMIT

At our meeting on 23 March I promised you a note on subjects on which I would like to see the Summit focus from the point of view of British interests. I think there are six:-

- (i) World Economic Recovery
- (ii) US Policies
- (iii) Supply Side Policies
- (iv) Japanese Capital Markets
- (v) Trade Policies and Protectionism
- (vi) International Debt

World Economic Recovery

2. The keynote should be one of satisfaction with progress so far and emphatic confirmation of the basic non-inflationary strategy. As a leading exponent of the strategy - in theory and practice - we can take particular satisfaction.

United States Policies

3. My major worry - which my European colleagues strongly, and Canada and Japan only slightly less strongly, share - is the risk that we face a continuing rise in United States interest rates this year and into next year and/or a resurgence of domestic inflation in the United States. I believe the United States Administration and Congress are coming to recognise

Yes - but (ii) must be expressed differently. and present careful phrase - supply side - 19/4
Very much like the paper on international

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more clearly the need for action on the fundamental imbalance of the federal fiscal deficit.

4. We shall of course not get the President, at this stage, to acknowledge mistakes or take substantial new action. Repetition of the long-standing debate among Finance Ministers in Washington last week got us nowhere, and the same would happen again at the Summit. I did, however, try on Don Regan at my private talk with him at the end of my visit the idea that, both to avoid an unresolved dispute at the Summit and to try for a message of some reassurance both to the United States and others, he might try to draft a statement which would take credit for the "down payment" measures now being adopted (insufficient but in the right direction) and express determination to carry on the good work after the Election. I shall pursue this idea with him when we meet again in May.

Supply Side Policies

5. This is an area where there is an opportunity for giving credit to the United States, while European countries including the United Kingdom are the ones which primarily need change - but change of a kind we are trying to make. I envisage focus on two areas, and I would not expect any dissent at the Summit:

- the need to reduce public expenditure as a share of GDP (the two most resilient economies in terms of pace of growth and reduction of unemployment, the United States and Japan, have something like 35 per cent of GDP absorbed by public expenditure; the figure for European economies lies in the 45-50 per cent range);
- cultivation of more flexible labour markets and industrial behaviour.



Japanese Capital Markets

6. We need to keep pressure up on Japan on the trade front; but we do not have straight-forward targets of identifiable tariff and non-tariff barriers. But I believe we should join the Americans in attacking Japanese arrangements which obstruct inflow of capital to that country, and which keep the yen artificially low. I attach a short separate note.

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Trade Policies and Protectionism

7. President Reagan is under heavy pressure from sectors of United States industry and it would be particularly helpful - he is indeed likely to agree with this - for him to recommit himself at the Summit to resisting those pressures and moving in the direction of freer trade. We hope for progress at the OECD meetings in May, but will need to carry it forward in both OECD and the GATT.

International Debt

8. Late last year and early this year, the climate was improving. But with the actual and threatened rise in US interest rates, and the possible implications of the recent Argentina rescue package, that is no longer true. I attach a separate note on what might be said and done. This includes a push on foreign private participation in local assets and industry, and a larger role for the World Bank.

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9. Of the other Summit participants, I think that Germany are probably closest to the approach I have outlined. France, Italy and Canada will continue to find the disciplined strategy irksome but will go along with it; they will also be pressing the interests of developing countries generally and may link this with unwelcome ideas of "helping" debtors. We shall



have differences with the United States on some issues and with Japan over their capital markets. But I think we would have good support on each of the headings I have given.

10. I am copying this minute to the Foreign Secretary and Sir Robert Armstrong.

N.L.

N.L.
18 April 1984

JAPANESE CAPITAL MARKETS

These markets are very tightly controlled, by administration as much as, and usually more than, by law. During recent years capital outflow for various kinds of investment has been liberalised, indeed encouraged, offsetting the trade surplus but tending to prevent the currency from strengthening and thus keeping Japan very competitive in international trade.

2. Among the most significant controls are:

- entry and operations in Japanese markets by foreign institutions are limited, in marked contrast to the UK, US and some other markets;
- public availability of investment instruments, and the terms attached to them, inhibit free inflow from abroad;
- interest rates are controlled, in many cases at unattractive levels;
- operations in Euro-yen markets are similarly circumscribed, and suffer from discriminatory withholding taxes;
- even where opportunities are formally and theoretically granted, networks of arrangements between Japanese institutions can be an obstacle to entry by foreigners.

3. There are signs of a change of sentiment in parts of the Japanese authorities, but against much opposition and in part frustrated by differences among the progressives between those preferring to open domestic markets and those preferring first to liberalise Euro-yen markets.

4. The United States Treasury has been pressing the Japanese authorities vigorously in bilateral negotiations. Reports of progress so far are confined to suggestions of very small changes, many of them likely to be ineffective because other barriers remain untouched, and the time-scale envisaged seems to be very long.

5. It is particularly frustrating for UK financial institutions that their Japanese competitors operate as freely as they do in London markets, while they have only limited access to Tokyo.

INTERNATIONAL DEBT

Since Williamsburg the number of debtor countries in manifestly dangerous positions has diminished, helped by world economic recovery, but mainly through the efforts of some, such as Mexico and Indonesia, to restore a better balance of domestic policies. In other countries, where there has been little or no effort to adjust, the prospects have inevitably been getting worse (Argentina, Philippines, Brazil, Peru, Chile, perhaps Nigeria).

2. Ideas which could usefully figure at the Summit are:

✓ (a) Insistence on strategy of adjustment: this needs to be:

- publicly restated, to convince debtors that they cannot opt for an easy way out;
- privately agreed again between the major creditor countries - to reduce the risk that the United States may be unduly prepared to shield Latin American countries, which could lead to disaster.

(b) Looking to the future: two lines of thought:

- to show the debtor countries that their battles are winnable;
- to steer towards healthier future financing compared with the excessive reliance on short-term bank lending of the past decade.

(c) Specific ideas: these might include:

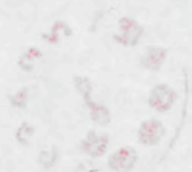
- some realisation of assets or admission of foreign private participations in local industry could give valuable easement of the total outstanding debt burden;
- a larger role for the IBRD, including both conditionality more closely linked with that of the IMF and more effectively applied and a bigger scale of net lending (on present prospects net flow from the IBRD to developing countries will diminish to zero within two or three years);
- the feared hump of maturities of debt resulting from initial rescheduling can be eased - if and only if the debtor is making good progress - by the negotiation of a

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longer and more even pattern of payments; this could be regarded as one of the "rewards for success";

- the much greater value for developing countries, on all counts, of private direct equity investment rather than the short-term bank lending on which they relied excessively for much of the last decade.

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