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MR COLES

London Economic Summit: Thematic Paper

At this weekend's meeting Personal Representatives considered the draft Thematic Paper and, with various amendments, agreed it for submission to Heads of State or Government. Each Personal Representative will now submit it to his own Head of State or Government.

2. I submit the Prime Minister's copy herewith. There are a number of minor drafting changes, of no great significance. Significant changes include:

- an additional sub-paragraph on the provision of overseas development assistance to developing countries, with special reference to the poorest (14.7);
- a new version of the sub-paragraph on a new GATT round, reflecting the outcome of the OECD Ministerial meeting last week (14.9);
- the Prime Minister's initiative on the environment (14.10);
- an invitation to Heads of State or Government to consider what to say about the North-South dialogue (15);
- a reference to a forthcoming conference in Munich on the environment (20).

3. I am sending copies of this minute and the Thematic Paper to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer, the Secretary of State for Trade and Industry, the Secretary of State for Transport and the Secretary of State for the Environment.



ROBERT ARMSTRONG

22 May 1984

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LONDON ECONOMIC SUMMIT  
7-9 JUNE 1984

THEMATIC PAPER

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Introduction and Background

1. Through successive recent Summits, governments have worked to bring down levels of inflation, nationally and internationally, to promote soundly-based growth in their own countries and to spread the benefits more widely, and to promote greater stability in international monetary and exchange conditions. Over the past two years, inflation has fallen and output has begun to recover, particularly strongly in the United States but also in other industrialised countries.
  
2. The main concerns are now: to reinforce the basis for enduring growth, without provoking a resurgence of inflation, and to continue to spread its benefits; to make sure that the industrial economies develop flexibly and in response to market needs and technological change; to create conditions conducive to lower interest rates; to encourage flexible labour policies; by these and other means to create conditions for a sustained improvement in employment, especially for the young; to promote improvement of the functioning of the international monetary system; to strengthen and liberalise the international trading system and capital markets; to continue to manage international debt problems in ways which both meet the needs of the debtor countries and protect the viability of the international financial system; to promote and encourage conditions for adequate financial flows to non-industrialised countries; and to co-operate with those countries in their efforts to place their economies on a more secure and self-reliant basis.
  
3. In many respects, the recovery in the industrialised nations is more soundly-based than in some previous cycles, founded as it is upon real and often painful structural changes against a background of firm efforts in most countries to reduce underlying fiscal deficits and control monetary growth. But its continuation cannot be taken for granted; it requires unremitting efforts. In the industrialised countries, failure to sustain policies to reduce inflation and damp down inflationary expectations could put recovery at risk. Many other countries, including relatively advanced economies with substantial debt burdens as well as persistently low income countries, are still encountering severe difficulties.

4. The main developments over the past year have been -

- 4.1 - economic growth - strong in North America, fairly strong in Japan, somewhat less in certain European countries. This variation has helped to avoid some of the pressures seen in earlier, more rapid, recoveries;
- 4.2 - improvements in productivity, meaning that recovery has so far had only a limited impact on employment. Experience on job creation has varied widely in the Summit countries, with a particularly strong rise in employment in the United States (only partly the result of the strong recovery there);
- 4.3 - significant reductions in inflation, although it remains high in some countries;
- 4.4 - a tendency to increasing budget deficits in certain Summit countries but reductions in others;
- 4.5 - a revival in world trade, with a marked rise in the imports of some Summit countries, especially the United States, helping to spread the benefits of the recovery;
- 4.6 - high interest rates, currently rising particularly in the United States;
- 4.7 - continuing strength of the dollar and continuing volatility of certain exchange rates;
- 4.8 - a reduced rate of growth of monetary aggregates;
- 4.9 - substantial imbalances in current account between Summit countries: the United States deficit has increased considerably, the Japanese surplus has been rising, and the Summit countries as a whole have moved in to deficit with the rest of the world. Reductions in current account deficits elsewhere;
- 4.10 - many debtor countries still face substantial debt servicing costs.

5. The situation of the poorest countries, especially in sub-Saharan Africa, remains daunting. Official aid from most of the Summit countries has increased, but its rise is constrained by budgetary pressures. The outcome of negotiations to replenish the International Development Association (IDA) has so far disappointed

many governments.

6. The flexible strategy on debt evolved during the last few years has worked well so far. World economic recovery has been helping the debtor countries but its benefits will be impaired if interest rates continue to rise. An increasing number of debtor countries have accepted the need to adjust their economic policies, and are seeing the benefits. A key role has been played by the IMF, whose resources have been strengthened. But there is still a long way to go.

7. Some progress has been made in implementing the commitments to resist and reverse protectionism made last year at the OECD Ministerial meeting and at Williamsburg. All Summit governments have agreed to accelerate implementation of the Tokyo Round and to ease restrictions on imports from the poorest countries. Nevertheless, there has been no general easing of protectionist pressures and demands for new protectionist measures persist. Little has been done either in the industrialised countries or in the newly industrialised countries to dismantle trade barriers or to reduce internal constraints on competition.

8. Oil prices have remained relatively stable during the year but the market balance is fragile because of current political factors. Other commodity prices have risen modestly.

#### Prospects

9. Most forecasters expect that on present policies the recovery in the Summit countries should continue, at least for the foreseeable future. Output in North America may rise more slowly after the rapid recent increases, reflecting a return to more sustainable growth; activity in Japan and the European economies should strengthen. Unemployment seems likely to fall further in the United States, but elsewhere the recovery may in the short term bring little or no reduction, particularly where market rigidities persist or where there is short run unemployment caused by structural adjustments. In this situation, and given prudent monetary policies, it should be possible to avoid an early resurgence of

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Inflation. Recovery combined with present fiscal policies should help to limit budget deficits in most countries; in the United States the Administration, with its "down payment" measures, has taken an important step in the process of reducing the budget deficit.

10. Prospects for interest rates are uncertain but disquieting. Interest rates have recently been rising, particularly strongly in the United States. Among the factors to which this is attributed are : inflationary expectations, inappropriate monetary policies, rapidly expanding growth, availability of higher rates of return than those on fixed interest assets, and the budgetary deficit. Elsewhere, further progress in curbing inflation and budget deficits may ease interest rate pressures.

11. Exchange rate prospects are also uncertain. The influence on the United States dollar of the level of the current United States balance of payments deficit could be offset by the high rate of return on assets in the United States. Japan's growing surplus and strong macroeconomic performance could lead to upward pressure on the yen, especially in view of recent and pending liberalisation of its capital markets. The maintenance of a high degree of stability of exchange rates in the EMS, brought about by a greater degree of convergence in policies, will depend on the continuing success of the countries concerned in bringing their inflation rates together at a low level.

12. Current account imbalances among Summit countries could increase. Rising exports and higher commodity prices will go some way to help many of the non-oil developing countries to service their debts and reduce their current account deficits. The prospect that the increase in energy demand will be only modest should help towards achieving stable oil prices, leaving aside political factors.

Medium Term Objectives and Policies

13. We have the opportunity to move to a period of sustained growth. If this is to be achieved, Summit countries need to set themselves a common range of medium-term objectives, and to take account of the impact of their policies on each other and on the rest of the world. Other countries and groups of countries have already expressed their concern in this respect. The objectives are

- 13.1 - to continue to pursue, and where necessary to strengthen, appropriate monetary policies, supported by strict control of public expenditure and fiscal deficits, aiming at still lower rates of inflation. Especially firm action will be needed in countries where inflation remains relatively high;
- 13.2 - to create the conditions for lower nominal and real interest rates. It will be important to reduce inflationary expectations. Structural budget deficits need to be reduced;
- 13.3 - to ensure that, as demand expands, the unemployed are drawn into productive employment; this will also reduce the strains on public expenditure from social insurance provisions, which seem likely otherwise to rise to insupportable levels in many industrialised countries. A major objective will be to reduce obstacles to higher employment by encouraging industrial adaptation, job training and flexibility in the use of labour and in wage structures, discouraging measures to prop up declining industries, and reducing or phasing out subsidies and other assistance which distorts markets;
- 13.4 - to promote conditions for the development of new technologies, in traditional as well as in new industries, and to encourage international technical co-operation and trade in the products of high technology and a more rapid and widespread acceptance of technological change;
- 13.5 - to promote conditions which favour productive investment and private enterprise, including in innovative small businesses;

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- 13.6 - to make renewed efforts to liberalise and expand trade, in services as well as in manufactures and commodities;
- 13.7 - to maintain and wherever possible increase flows of resources, including official development assistance, to the developing countries, especially to the poorest countries; and to encourage practical measures to conserve resources and enhance indigenous food and energy production;
- 13.8 - to find ways of increasing the flow of private investment, through the progressive removal of impediments to capital flows and by encouraging a climate of confidence for investment;
- 13.9 - to adapt and improve the operation of the international financial system. This entails creating a more stable medium term financial environment by prudent and convergent policies and performance among the major countries, providing an adequate flow of funding to the international financial institutions and removing restrictions on and improving international access to capital markets in industrialised countries;
- 13.10 - to assist debtor countries in making the necessary economic and financial adjustments, taking due account of political and social difficulties; for them as for the industrialised countries, success will depend on sustained world recovery and adequate but not excessive world liquidity;
- 13.11 - to pursue policies which will avoid, wherever possible, sudden and de-stabilising movements in either direction in international oil markets;
- 13.12 - to recognise the international dimension of environmental problems and the role of environmental factors in economic development; to promote research into the causes, effects and means of limiting pollution; and, particularly in the light of such research, to make greater national and international efforts to reduce, as far as practicable, the pollution of air, water and ground.



Immediate Measures

14. In order to attain these objectives within a framework of sustained growth and promotion of employment, Summit countries can agree on the following measures -

- 14.1 - to make further progress on prudent fiscal and monetary policies, so as to achieve lower inflation and interest rates and greater exchange rate stability; and in particular to carry forward and develop as appropriate the agreed procedures for multilateral monitoring and surveillance of national economic and financial policies;
- 14.2 - to support and strengthen work in the appropriate international organisations, notably the OECD, on policies to improve economic efficiency, incentives and flexibility and to consider how understanding of the sources and patterns of economic change can be improved;
- 14.3 - to reduce obstacles to growth, in particular by encouraging productive investment, harmonising international standards, creating a climate for and stimulating innovation and adaptation, encouraging job training, facilitating the mobility of labour and capital and flexibility in wage structures, and increasing public understanding and acceptance of the need for technological development;
- 14.4 - to invite Finance Ministers to carry forward, as a matter of urgency, their current work on ways to improve the operation of the international monetary system, including exchange rates, surveillance, the creation, control and distribution of international liquidity and the role of the IMF; and by early 1985 to complete the present phase of their work and to make recommendations for next steps, including further international discussion;

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- 14.5 - to confirm the strategy on debt and to continue to implement it flexibly, welcoming the progress made by many debtor countries and the extensive international co-operation which has supported them, and recognising that continued recovery, lower interest rates and trade liberalisation will be important for further progress;
- 14.6 - to develop arrangements which could foster renewed economic progress by debtor countries and strengthen their credit standing. These include the encouragement of private direct investment and continuing flexibility in commercial bank lending; closer co-operation between the IMF and the IBRD; IBRD operations which can help to attract long-term capital investment; and improvements where necessary in the official supervision of lending by commercial banks;
- 14.7 - to provide adequate flows of official development assistance, including that channelled through the IDA, with special attention to the needs of the poorest countries, particularly those in Sub-Saharan Africa;
- 14.8 - to urge all trading countries to resist continuing protectionist pressures and to reduce barriers to trade;
- 14.9 - to accelerate the completion of current trade liberalisation programmes, in cooperation with other trading partners; to press forward with the work on trade in services in the international fora; and to explore with other GATT partners as quickly as possible the objectives for, the participation in and the timing of a new negotiating round;
- 14.10 - to invite the Working Group in Technology, Growth and Employment, to :
- consider what has been done so far and identify special areas for research on the causes, effects and means of limiting environmental pollution where existing knowledge is inadequate;
  - identify possible projects for industrial cooperation to develop cost-effective techniques to reduce environmental damage;
- and to report by 31 December 1984.

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North/South Relations

15. In the light of the foregoing, Heads of State or Government may wish to consider what position the London Summit should take in relation to proposals for pursuing the so-called North-South dialogue.

East/West Economic Relations

16. The Summit countries note, with approval, the continuing consensus on the security and other implications of economic relations with Eastern countries, and on the need to pursue the continuing work on this subject in the appropriate organisations.

Science, Technology and the Environment

17. The Summit countries welcome the report of the Working Group on Technology, Growth and Employment created by the Versailles Summit, and the progress made in the 18 areas of co-operation launched following that Summit. They invite the Group to pursue further work on technology and the environment, education and employment, adaptation to technological change, trade in technology and the products of technology, and the sharing of major scientific facilities, and to report to Personal Representatives in time for the next Economic Summit.

18. The Summit countries thank Prime Minister Nakasone for his report on the Hakone Conference on Life Sciences and Mankind, organised by the Japan Foundation in March 1984, and welcome the intention of the French Government to host a follow-up Conference in 1985.

19. They welcome the invitation from the United States Administration to other Summit countries to participate in the development of an international manned space station. They note that a space station would be an example of the kind of programme that provides a stimulus for technological development leading to

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strengthened economies and improved quality of life. They agree that other Summit countries will actively examine the possibility of accepting the invitation, having regard to their own space programmes. They welcome the intention of the United States Administration to report at the next Summit on international participation in the programme.

20. The Summit countries also welcome the invitation from the Government of the Federal Republic of Germany to other Summit countries to a multilateral conference on the environment in Munich on 24-27 June 1984.

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