Mr. Leigh-Pemberton 28th April, 1983

The Chancellor wishes to see you for a private chat sometime in the next month re the international scene and particularly as to how you see things in the run up to the Williamsburg Summit. Mr. John Kerr his principal Private Secretary will be telephoning.

Peter Hall will provide details — Phone 29/4

Have we any view from NatWest.

RL-P Yes — after he starts at BofE Monday 16 May.

13/5 Peter GUTMAN HAS IN HAND

Papers for Mr L-P as
background information
to the Williamsburg Summit
on 28 May.

JL

EUROPE
AGENCE INTERNATIONALE
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Société Anonyme fondée le 2 décembre 1952

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BULLETIN
QUOTIDIEN

E D I T O R I A L

Williamsburg and East-West trade

The preparation of the Summit of Seven, to be held in Williamsburg a month from now to the day, has moved into a decisive phase. After receiving Chancellor Kohl ... ten days ago and Mr Thorn a week ago, President Reagan is meeting Mr Trudeau at the White House tomorrow and will then meet the other heads of government who will be in Williamsburg in succession.

As has been said several times out loud and on paper, and as we have pointed out in our editorials on the various aspects of its peeparation, Williamsburg should be a less spectacular, less formal and, it is to be hoped, more fruitful meeting than previous ones (in particular, Versailles). It should lead not to formal decisions but to a consensus, which would surely provide the basis for "convergent" action by the governments taking part. Above all, it should enable the heads of state and government to have - alone (i.e., for most of the time, without their Foreign and Finance Ministers, and especially without their "advisors" and "experts" at their sides) - long, intimate and consequently very frank and far-reaching talks. This could show up certain differences of opinion. The reaction to this should not be surprise but rather an effort to take advantage of this opportunity to get things straight.

According to President Reagan's entourage, and more particularly, to his personal representative Mr Wallis, a new method is being used to prepare the Summit. To begin with, the heads of government informed their personal representatives of the subjects which they wanted discussed. After examining the proposals of all the heads of government together, the "sherpas" were then able to establish the priorities that could be selected, on the basis of the possibilities of serious debate and valuable results yielded by the various issues. Agreement on the priorities is already taking shape and the necessary examination is being made. We cannot say at this point whether the "new method" will work. It is especially difficult to tell whether a specific Community position has been prepared satisfactorily. In view of the nature of the meeting, there do not seem to us to be any grounds for claiming that the Council should have gone further than it did. We must not forget the character of the Summit, nor the fact that, though the Community is represented as an entity in itself, it is not there to negotiate. Indeed, there is no negotiation and it would not exactly be constructive to arrive with uncompromising positions, predetermined in their very details. What is needed is, of course, an agreement on the main lines of a strategy tailored to the fundamental needs of Europe, taking into account the objective conditions and the need to contribute to the political and economic strengthening of the Western world.

These procedures and the - to a greater or lesser extent - personal considerations which have been made public, on various topics, have created some confusion and sometimes provoked unjustified alarmist reactions.

Let us consider, for example the discussions on East-West trade, which must be distinguished from the possible discussions on trade in general. There are factors in East-West trade which can affect the security of the West. This has been recognised and was the subject of discussions, among others, at the informal NATO meeting at La Sapinière. It comprises many aspects, which are currently being examined by various organisations: - COCOM, where an attempt is being made to revise the list of high-technology products of strategic value; - the OECD, where efforts are being made to reach agreement on controlling credits; the International Energy Agency, which is discussing energy supplies, etc. This problem is sure to be raised at Williamsburg. However, only yesterday, a spokesman at the White House confirmed (what Chancellor Kohl had already said) that the implications of high-technology transfers from West to East for security would be raised but that they would not be a central topic in the Williamsburg talks. Reagan has already informed Mr Thorn of the priorities: non-inflationary growth of the world economy and strengthening the financial and trade systems. It is difficult to understand why Mr Cheysson is now pointing an accusing finger, declaring that "It would be a mistake to base the Summit on one single subject" (tightening controls over East-West trade). Are their any ulterior motives behind these threatening remarks ?

Emanuele Gazzo

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Rédacteur en chef: Ferdinando RICCARDI - Rédacteurs en chef adjoints: Leo GUDENKAUF et Marina GAZZO

THE TIMES

27 APR 1983

Economic Developments

Bailey Morris in Washington analyses crucial conferences leading to the May 28 summit

Conflict on currencies as the West marches towards Williamsburg

Finance ministers from the West's leading seven industrial nations will meet in Washington this week to begin the difficult task of unsnarling the currency problems which are putting new strains on the Western Alliance.

At the same time, the world's finance and development ministers will also converge on Washington for the World Bank's annual development committee meeting at which the social and economic costs of the developing world's debt crisis will be discussed.

[illegible]hese two meetings are the [illegible] in an unusual, not to say [illegible]ind-boggling, series of important international conferences leading up to the May 28 annual economic summit of the West's seven industrial powers: the United States, Japan, West Germany, France, Britain, Italy and Canada.

Depending on what happens in the preliminary conferences, Williamsburg could be the most important of all the regular summits so far, or a complete fiasco.

The United States originally wanted a low key conference, discussing rather than making decisions. President Reagan even thought of abandoning the usual (and often meaningless) final communique. But the other six, led surprisingly in this respect by Japan, have much greater ambitions of reforms to ensure that world recovery is not aborted.

The US attitude is understandable, since it will be in a minority of one on many of the economic issues, with only Britain and Germany taking anything near its own position. The result so far is that officials from the other six are in a state of consternation that so little [illegible]aration has so far been [illegible]. The Williamsburg agenda is now so loose that it could really concentrate on the main issues or simply dissolve into chaos.

A common set of issues will be discussed at most of these meetings and it includes: the international debt crisis and its impact on world economic growth; the gyrations in the dollar's exchange rate; East-West trade relations; and how best to coordinate the world's economic policies to achieve growth.

Of all the presummit meetings, the private conference of finance ministers this week is perhaps the most strategically important, since it will set the tone of discussion on what is expected to be a dominant issue at the Williamsburg summit – the wide imbalances among the world's main currencies.

In recent weeks there has been a growing call for a much-needed overhaul of the international monetary system.

Many European and American officials believe the current system of floating exchange rates, agreed in 1973, has been a disaster which could prevent a stable world recovery. They want a new meeting of the Western powers either to modify or restructure the system.

At the same time, European and Japanese officials are putting pressure on the Reagan Administration to alter its strict policy of non-intervention in currency markets to stabilize the erratic behaviour of the dollar.

The renewed upward surge of the dollar is straining the patience of nations such as France which have been forced to impose unpopular austerity programmes at home in the wake of currency devaluations.

This week, finance ministers will hold their first meeting on currency intervention since a study of the subject was commissioned by concerned heads of state at last year's economic summit at Versailles.

The report has since been completed by a group of experts headed by M Philippe Jurgensen, a French finance ministry official, and will be reviewed by ministers at their meeting in Washington.

His findings are reportedly so general that they can be used to bolster a variety of monetary philosophies, but those who want to force the Reagan Administration to stabilize the dollar believe the report to be useful ammunition.

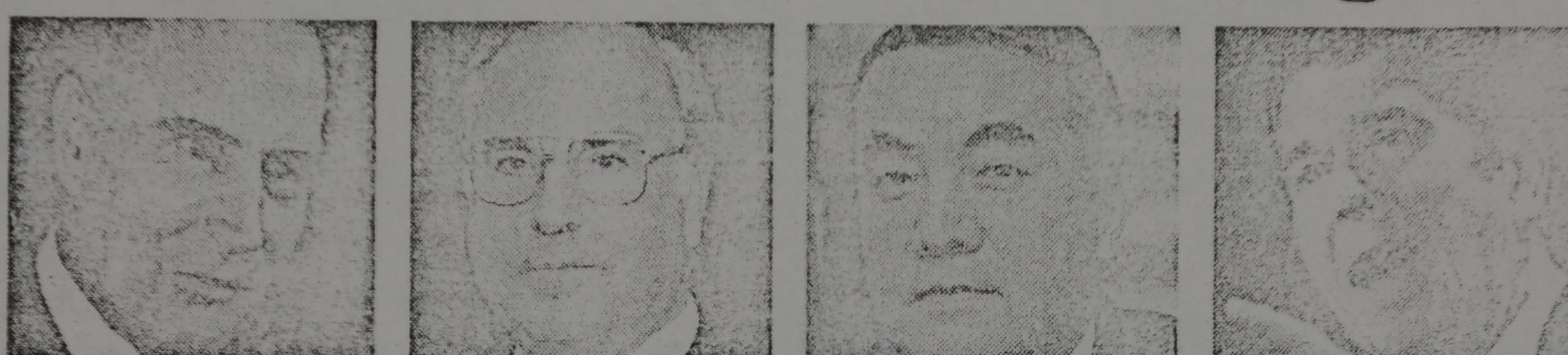
One of its conclusions is that intervention is a successful policy tool if bolstered by the right financial policies and used to even out short term currency fluctuations rather than to support unrealistic exchange rates.

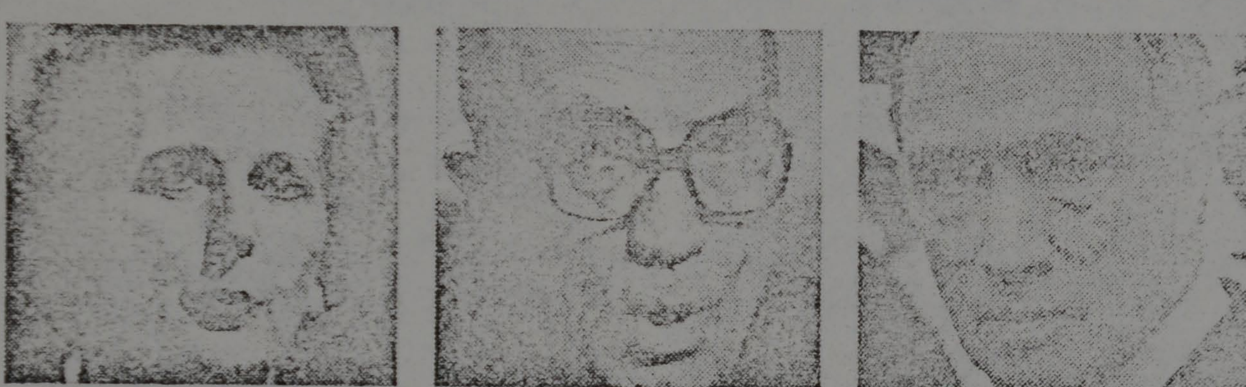
The finance ministers have agreed to an early release of the report at their meeting on Friday, rather than wait until the Williamsburg summit, so that the recommendations can be studied and discussed in advance.

Britain and West Germany are close on the currency question, since both believe in a policy of limited intervention to stabilize markets under certain conditions.

Until recently, the United States appeared to be bending a little on the currency question by indicating to Europeans that it might be willing to agree to limited intervention if that could be shown to work.

But last week, Mr Donald Regan, the United States Treasury Secretary, washed his hands of the dollar, saying he did not know whether it was too high or too low and he did not intend to use United States Treasury funds to influence it.





Seven who will lead delegations at Williamsburg. In order of muscle they are, anti-clockwise from above, President Reagan (US), Mr Nakasone (Japan), Chancellor Kohl (West Germany), President Mitterrand (France), Mrs Thatcher (Britain), Signor Fanfani (Italy, though his hold on office appears to be precarious) and Mr Trudeau (Canada).

Meanwhile, French officials, faced with the possibility of having to impose even tougher measures at home if the dollar continues to rise, have privately accused the Reagan Administration of deliberately keeping the dollar high.

This is an essential element in the general drive to send out a message from Williamsburg that the big nations are committed to maintaining world recovery. Britain, Germany and Japan will support US resistance to reflationary measures. But they will put pressure on Mr Reagan not to abort the still-fragile recovery by raising interest rates again if a US budget stalemate clashes with its monetary policy.

An equally difficult and potentially explosive set of issues will be taken up at the World Bank's development committee meeting which is expected to be dominated by the question of increased resources for the International Development Agency (IDA).

In recent years, the United States Congress, citing economic problems, has refused to appropriate the full amount of funds to meet the huge United States quota for the IDA. This has forced the agency to cut back on projects in some poor countries.

At the moment, there are indications that Congress will again refuse to approve funds already planned for the sixth replenishment of funds for the IDA and will attempt to curtail the Reagan Administration's proposals in negotiations on the seventh replenishment.

Mr A. W. "Tom" Clausen, president of the World Bank, has said repeatedly over the past year that the developing world desperately needs fresh financing to manage its economic and political problems caused by the world recession.

In the past 12 months, all the money it has received has been used to keep up with debt repayments, not to underwrite new food, transportation and related projects, he said.

Mr A. M. Haq, the Pakistani development minister, said last week he fears the mood of the developing world will turn ugly if the United States does not meet its commitment to the IDA.

It is possible that a large number of poor countries will band together in a "debtors' Opec" and take the decision to repudiate debts owed to Western banks, Mr Haq said.

The growing interdependence of the economies of the rich and poor nations is another important issue which will be taken up at the summit and at a special meeting of the West's finance and trade ministers in Paris next month.

The Paris meeting is the first of its kind and was put together by the United States at the urging of Mr Donald Regan who is concerned that the halting of private banking funds to the developing world will retard global recovery.

Mr Regan wants Western ministers to explore ways both to encourage North-South trade and to prevent protectionism.

The US angered Japan by implying that the report would be one of the main issues at Williamsburg. This now seems to have been downgraded as the EEC persuaded the US that it might provoke the sort of confrontation over trade with the Soviet block that disrupted the Versailles summit.

Even though the six want to thrash out issues they consider more vital than those at previous summits, they are as anxious as the home team that Williamsburg should project to the world the image of a common front of cooperation to increase confidence in world recovery.

DIARY OF MEETINGS

APRIL 28	**Two-day meeting of the Development Committee of the World Bank in Washington.**
APRIL 29	**Private meeting of Finance ministers to review a study on intervention on currency markets.**
MAY 8	**A meeting of Western energy ministers of the International Energy Agency, in Paris**
MAY 9-10	**Annual meeting of the member nations of the Organisation for Economic Cooperation and Development (OECD) in Paris.**
MAY 10-11	**First combined meeting of the West's finance and trade ministers in Paris**
MAY 28	**Heads of state of the big industrialized nations meet in Williamsburg.**

Bonn looks to Williamsburg with confidence

BY JONATHAN CARR IN BONN

STRANGE TO tell, the West German Government is approaching the Western economic summit conference to be held Williamsburg, Virginia, on May 28-29 with relaxed confidence.

Senior officials involved in preparation for the talks are sure the gathering is not going to produce a simple blueprint for world economic recovery—but equally they are convinced that there will not be a debacle on the lines of the summit last year at Versailles.

Despite reports to the contrary, it is felt in Bonn that differences over East-West trade will not be at the centre of the discussions, nor is a confrontation between the U.S. and its partners expected over the intervention in the currency markets.

It is thus clear what Bonn believes will not emerge from its talks wtih the other six participants — the U.S., Canada, Japan, Britain, France and Italy. But what positive role can the conference play—if any?

One reason for the relative optimism is the West German belief that conditions for an economic upturn in the West have markedly improved since the Versailles meeting —even though unemployment has continued to rise.

In most cases, prices and interest rates have fallen and several leading countries—including the U.S., West Germany and Britain—seem on the verge of a new phase of growth, with a low inflation level.

Bonn wants the Williamsburg summit to reach broad agreement on how this trend can be consolidated, and dangers to the world financial system thus headed off.

The West Germans are convinced that this end cannot be achieved by discussing a series of agenda items in isolation. It is emphasised that the key issues—including interest rates, Western economic growth, trade protectionism, developing country debt and the strains on the international banking system—are closely interrelated.

For example, it is asked what is the use of agreeing to boost aid to the Third World if the western countries continue to raise obstacles to imports from the developing states — which will then be still less able to pay back their existing debt to western banks?

The West Germans thus want a thorough discussion on the whole package of issues together — but also make clear they see interest rates (which are still too high for comfort) as the core problem.

The reasoning is that if a further fall in interest rates can be encouraged, in the first place in the U.S., the western economic upswing will take stronger hold, boosting trade, reducing protectionist pressures — and lowering the interest rate burden on Third World debt.

This topic is felt in Bonn—and at the Bundesbank in Frankfurt — to be much more important than that of more official intervention to stabilise currencies (especially the high-flying dollar).

That may seem to put the West Germans at odds with the U.S. on interest rates—and with France, where there has been some talk about "a new Bretton Woods conference," on currencies.

That implies that while Williamsburg may not be a "second Versailles" it will clearly not be a "second Bonn" either. At the 1978 summit in the West German capital, Bonn agreed to increase budget spending to try to boost economic growth as part of a "package deal" among the seven participants.

This time there is no such concrete deal available—only, or so the West Germans hope, a broader and more thorough debate than before to promote a consensus.

THE FINANCIAL TIMES 25 APR 1983

ECONOMIC DEVELOPMENTS

Outlook for Williamsburg

FEW top-level meetings have been anticipated with less excitement than the forthcoming economic summit at Williamsburg. President Reagan has been determined from the start that this should be an intimate, informal meeting of minds, aimed at understanding rather than decisions and communiqués. This approach is frustrating for the civil servants concerned, who have been able to muster little in the way of pre-negotiation, and does not seem to appeal to the orderly-minded French and Germans. It could, however, prove fruitful on the view, which we strongly support, that a greater consensus on objectives is required before any details can even be sketched.

The meeting really will be intimate: only the seven leaders and the President of the European Commission will be in the room, with interpreters out of sight in a studio, and no record-takers. The shadowy agenda for this prolonged conversation is limited only to broad headings, but does seem to have been changing in a helpful way in recent weeks.

The Americans no longer seem bent on a confrontation over East bloc trade, which will presumably be left to the normal diplomatic discourtesies. The French are resigned to the fact that the time is not ripe for their proposal to reimpose a formal exchange rate regime on the world, and some of the highly individual proposals which Mr Nakasone had threatened to introduce have reportedly been heavily diluted. There is thus a much greater chance that the talks will be devoted to topics on which there is some hope of a consensus.

Stability

There are two headings here of over-riding importance: currency stability coupled with policy convergence, and trade liberalisation. The first topic is clearly very close to the heart of our own Chancellor, Sir Geoffrey Howe, though it is not clear how far the Prime Minister shares this preoccupation. The good news is that the Americans are now much readier than before to give priority to stabler exchange rates, and may acknowledge the need to trim domestic policies to this end.

This is a great stride forward from the position last year, when the Americans grudgingly agreed to a technical study of currency intervention for smoothing purposes, and still further from the year before, when they confidently believed that the market would deliver realistic and stable rates unaided, given adequate monetary control.

The fact is that exchange rates will be neither stable nor realistic unless adjustments are made—and sometimes very painful ones—to achieve an appropriate balance of fiscal and monetary policies. The Europeans at the summit have learned this the hard way. The machinery to monitor such questions in the wider trading world was established at the last summit at Versailles, in the surveillance committee of the five countries whose currencies make up the SDR, under IMF chairmanship. Little has come of this so far, because the political commitment was lacking. One result of Williamsburg may be that this surveillance will become a serious matter and a real influence on policy.

Complacent

It would be foolish to expect any quick results, though. It is always harder to agree on the details of burden-sharing than on the principle. Furthermore, the U.S. Administration, whose fiscal deficit is generally regarded outside the U.S. as the major block on the road to stability and lower interest rates, is feeling rather complacent at the moment. It believes that it has at last started a steady recovery which will in due course reduce the deficit, increase the earnings of debtor countries, and so reduce interest rates. Those more sceptical can only wait and see.

Meanwhile, the continued U.S. commitment to free trade, despite an over-valued dollar, is admirable and welcome, and deserves support. An initiative to arrest the present drift to subsidy and protection, especially in favour of developing countries, would be the most constructive agreement which could emerge from Williamsburg, and is at least an outside possibility. That would be well worth the journey.

Currency Exchange Rates

Williamsburg: The Road Back to Bretton Woods?

A fundamental reassessment of the world's experience with floating exchange rates is under way—ironically coinciding with the 10th anniversary of the demise of the Bretton Woods system of fixed exchange rates. Out of the economic summit meeting in Versailles last summer came a study, coordinated by the U.S. Treasury, on the experience with intervention by all central banks over the last decade. It reached an essentially neutral conclusion. Since then, however, reports on the purported virtues of intervention have been coming in thick and fast—with a favorable study by the Federal Reserve now nearing completion. The political pressures for intervention are overwhelming. And agreement on the principle of a return to active, coordinated intervention by all the major central banks —with "target zones" for the world's key currencies—now appears certain to come out of this year's summit meeting in Williamsburg, Virginia, at the end of May.

The rationale for a return to more-stable currencies is straightforward: Exchange-rate fluctuations have simply become too volatile, carrying too high a social cost. This experience contrasts with the optimism prior to the shift to floating rates in the early 1970s, when economic theorists were predicting that such a move would lead to three developments:

- First, exchange rates would adjust continuously and smoothly to new information and thus provide an equilibrating force that would harmonize the world economies. This view was based on the belief that the foreign-exchange market is efficient and would thus discount all new information and forecasts. Shocks to the market would come only from wholly unforecastable events, such as central bank intervention or wars.
- Second, purely floating exchange rates would restore monetary independence to individual countries. Under a fixed-exchange-rate regime a central bank is obligated to exchange any volume of foreign currency into its own currency. The experience during the late 1960s was that because of the persistent U.S. balance-of-payments deficit, the Bundesbank was continuously being forced to exchange dollars for marks. This led to high growth in the German money supply and consequently increased German inflation—and to European accusations that the United States was "exporting" inflation.
- Third, floating exchange rates would reduce the dollar's dominance over the world monetary system. Independent financial markets would develop, providing genuinely separate financing and investment media. This prediction spurred hopes that the world would evolve toward a multiple-reserve-currency system, with the possible emergence of a "world currency" along the lines of what later became the IMF's Special Drawing Rights.

Unfortunately, none of these theoretical predictions have proved to be valid. Exchange rates have become progressively more variable. Analysis based on so-called "economic fundamentals" has failed to forecast, for example, the persistent 20% overvaluation of U.S.-traded goods above Japanese goods prices. However, models based on currency substitution *have* forecast this—in contradiction to the instantaneous discounting of efficient-markets theory. Short-run volatility has also increased enormously. It is now common to have one-percentage-point moves in major currency values overnight. And these fluctuations tend to turn into trends—witness the 20% decline in the dollar relative to the yen in the last eight weeks of 1982.

Furthermore, monetary independence is virtually non-existent because of the continued de-facto dominance of the world monetary system by the dollar. For example, if the Fed tightens monetary policy aggressively at a time when another country is easing its policy, then there will be a major shift of investment into the dollar and a shift of borrowing into the other currency. In fact, these shifts in the currency denomination of asset and liability peference are now the moving force behind changes in currency values.

Is intervention the answer?

The predominant view of economic theorists used to be that the foreign-exchange market in the major freely traded currencies is "efficient." This means that: (1) information on all forces affecting the market is available at low cost, (2) there are very few barriers to entry to the marketplace, and (3) there are no dominant participants in the market. In such a market all known information and forecasts are instantaneously reflected in the current exchange rates.

One major corollary to this statement, which can be statistically tested, is that there should never be discernible trends in currencies that can be traded upon consistently for profit—at low risk. If there were, for example, a clear uptrend in the dollar, then speculators would immediately buy the dollar, pushing it up to the point where the best guess of the next move is—sideways. In fact, however, the history of floating exchange rates disproves this. Low risk currency trends do exist—and persist.

From the perspective of efficient-markets theory, central bank intervention can be effective in changing trends only if either (a) the intervention is so heavy that it destroys market efficiency, or (b) the intervention is based on more perfect insights into future developments than the combined judgment of the market participants.

According to the theorists, the acid test of effective foreign-exchange intervention is whether it turns out to be profitable—and not just in terms of one currency. If it is profitable, then the insights of the intervening central bank were correct; thus, the intervention gave the correct signals to the market and speeded the move toward a new equilibrium. If the intervention is unprofitable, then the central bank will have merely sidetracked the market and postponed making needed adjustments in domestic policies. In the vast majority of historical studies on intervention, the latter proved to be the case: Intervention was unprofitable and largely undertaken with the forlorn hope that an adjustment in domestic policies would not be required.

Furthermore, both risk and the potential future costs of policy flexibility must also be taken into account. For example, it is clearly possible for a central bank to fix an exchange rate at any value for any period of time. But if the rate chosen is out of line with the private market's view, then such a policy carries with it extremely high risks—not only that the free markets will be severely distorted, but also that a large part of the populace will be put out of a job by the central bank's attempt to hold the rate. Even if intervention is profitable with no major immediate indirect costs, the costs of acquiring and holding foreign-exchange reserves may deeply compromise future policy flexibility. In the extreme situation—which unfortunately does occur—a near-total loss of reserves can subsequently lead to spiraling devaluation and severe disruption of the economy.

Target zones—the first step

Although most of the earlier studies on intervention suggest it is valueless or disruptive, the fact is that the implicit intent of almost all intervention actions in the past was to postpone or avoid domestic policy actions—not to solve problems in the foreign-currency markets per se. For instance, the failed intervention to support the dollar during 1976-78 was, in reality, an attempt by the United States to postpone the politically painful process of raising the U.S. gasoline price to the world price level—and in that it was, of course, successful.

The fact that the one-percentage-point overnight currency moves are disruptive to world commerce provides interventionists a prima facie case for intervention to stabilize short-run exchange-market fluctuations. The most popular proposal at present is the target-zone idea: Central banks would intervene flexibly on both sides of a pre-agreed but unannounced band that would move over time. The theory is that the visible presence of the central banks would eliminate the tendency for currency "runs" to occur. This would enable "regressive," or stabilizing, expectations to emerge and, by reducing the high uncertainty premium, encourage longer-term stabilizing speculations.

The proponents of intervention see this as a first step back toward Bretton Woods—back to fixed exchange rates with a role for gold. However, except in the aftermath of world financial crisis, a return to fixed exchange relationships maintained by intervention is simply not feasible. There are three main reasons for this:

- First, the volume of potential arbitrage would overwhelm the total reserves of all the central banks. If exchange rates are fixed for even one month, all the one-month interest rates will be forced into instant equality with incredibly large capital flows—perhaps more than $50 billion by major U.S. financial institutions alone in the first two weeks. The clearing interest rate in such a world would be primarily set—as it currently is—by the deepest market: the dollar market. This would leave real interst rates in different markets in acute disequilibria and would severely tax employment in countries with inflation rates lower than that of the United States, to the benefit of higher-inflation countries. This would be totally unacceptable to politicians who want harmonized policies, but at no cost.
- Second, real exchange rates have been at such acute disequilibria over the past five years that there has been a massive redistribution of worldwide production. As a result, there are now self-perpetuating instabilities that would overwhelm intervention. Thus if the dollar is permanently fixed at current levels, then large sectors of U.S. manufacturing industry may never recover.
- Third and finally, there is arithmetic to contend with. In principle, the balances of payments of all countries must sum to zero (in practice, they do not because of measurement errors); someone's surplus must be matched by another country's deficit. If all countries try to achieve a payments surplus, at least one country must lose. Since the dollar enjoys the role of world money, it is the primary buffer for disequilibrium in the international balance of payments.

Seen in this light, intervention between the major asset currencies is madness. But logic and experience have never been a powerful motivating force behind political decisions. Central banks exist to intervene and control free markets. They have to operate on the belief that they are privy to unique and deeper insights than the free market—and that they are not the source of instabilitiy. Otherwise they have no raison d'etre. Central banks realize that a return to fixed exchange rates is currently a technical and political impossibility. Nevertheless, the lure of the power to intervene and to "stabilize" the world economy is too great to be resisted. Hence, a move back to active, coordinated intervention by the major central banks seems to be politically inevitable.

Ronald G. Layard-Liesching

BusinessWeek April 4, 1983

WORLD TRADE

Squaring away for the next summit

Devaluations and trade issues divide the Western powers on the way to Williamsburg


Steve Murez
Mitterrand: Shuffling his Cabinet and planning new austerity measures for a sick economy.

Just a day after the deep devaluation of the French franc within the European Monetary System, socialist President François Mitterrand was forced to remake his Cabinet in a more conservative mold. The one-two punch to French pride underscores the problems that President Ronald Reagan will face in trying to restore harmony among the industrialized countries at the economic summit meeting this May in Williamsburg, Va. The Administration desperately wants to prevent the ninth annual summit of the seven major industrial countries in Williamsburg from turning into a repeat of the debacle at the Versailles summit a year ago.

But the European Community, the U.S., and Japan remain badly divided over rising protectionism and how to deal with growing instability in the currency markets. The strains within the three major Western economic powers over these issues are intensifying even though the incipient recovery in the U.S. is expected to pull the world out of its recession.

Evaporating relief. The continued strength of the dollar, caused largely by stubbornly high U.S. interest rates, helped force an 8% devaluation of the French franc against the Deutschemark. For the EC as a whole, except Britain (page 16), an overvalued dollar could also diminish the benefits from the $5-per-bbl. cut in oil prices. France, for example, stood to have $3.5 billion cut from its trade deficit because of the drop in oil prices. But the devaluation evaporates part of the gain because a stronger dollar increases the cost of its imported oil, which is priced in dollars.

The devaluation also prompted Mitterrand to introduce a series of austerity measures. He wants to increase government revenues and cut spending to balance deficits in social programs. Mitterrand signaled that he rejects calls for strongly protectionist measures to cure France's economic ills by, among other things, leaving in place Finance Minister Jacques Delors, a moderate who is liked by business, and giving him more power. Out of the government are Jean-Pierre Chevènement, the Research & Industry Minister, and Foreign Trade Minister Michel Jobert, both of whom were among those calling for more protection for French industry.

To prevent further political and economic instability within the EC, European leaders want the U.S. to intervene more in foreign-exchange markets. Their view is that the U.S. can stabilize currencies by selling dollars when the U.S. currency is too strong and buying when it is too weak. For the Europeans, who depend heavily on foreign trade, stable currencies are essential for planning investment and marketing.

'Major imbalances.' The Reagan Administration, however, remains dead opposed to intervention. According to Treasury Under Secretary Beryl W. Sprinkel, governments cannot guess correctly what the appropriate value of a currency should be, and by trying to do so they only generate more instability. "I still do not see the need for intervention except where there are major imbalances," said Sprinkel's boss, Treasury Secretary Donald T. Regan.

The Administration and European leaders are as badly divided over trade issues, particularly agricultural trade. Washington maintains that government subsidies give European farmers an unfair advantage in world markets. The Europeans, who deny the charge, may be unwilling to work for greater Atlantic alliance unity on important issues such as East-West trade and defense unless the U.S. accedes to Europe on the farm issue. The risk for President Reagan is that European intransigence over farm subsidies could torpedo his hopes that Williamsburg might be the forum in which a wide-ranging political and economic consensus is forged within the alliance.

But the U.S. is still operating at an advantage because the EC itself is badly divided over trade and currency issues. At the Brussels Common Market summit, which ended on Mar. 22, West German Chancellor Helmut Kohl promised that there will be "tough talks" with the U. S. on farm subsidies. It was one of the few major points around which European leaders could rally in a show of unity. The Brussels meeting opened under a cloud of acrimony created by marathon negotiations spread over three days to realign the eight currencies in the European Monetary System, which resulted in the 8% devaluation of the French franc against the D-mark. That agreement, however, only papered over deep differences among EC members on trade and financial matters.

Declared Delors, the French Finance Minister: "It's a good agreement. It takes account of the commercial strength of the different [EC] countries." But there was a howl of pain from German businessmen. The Bundesverband der Deutschen Industrie (German Industry Federation) complained the deal will put "extremely serious burdens on German exports." Westdeutsche Landesbank Girozentrale senior economist Ulrich Schroeder snapped that the revaluation of the mark was too big, adding: "German exporters may be able to hold up sales volumes, but only if they sacrifice profits."

The Japanese are also maneuvering to improve their position before the Williamsburg meeting. Prime Minister Yasuhiro Nakasone is pushing his economic ministers to come up by early April with some pump priming for the sluggish Japanese economy. Most likely measures are a cut of 0.5% in the official discount rate to 5% and an advance of public-works expenditures to the opening half of the fiscal year starting Apr. 1. Nakasone would also like to push through a big tax cut, à la Reaganomics, but most observers think it unlikely before the end of 1983 because of Finance Ministry concerns about Japan's $55 billion budget deficit.

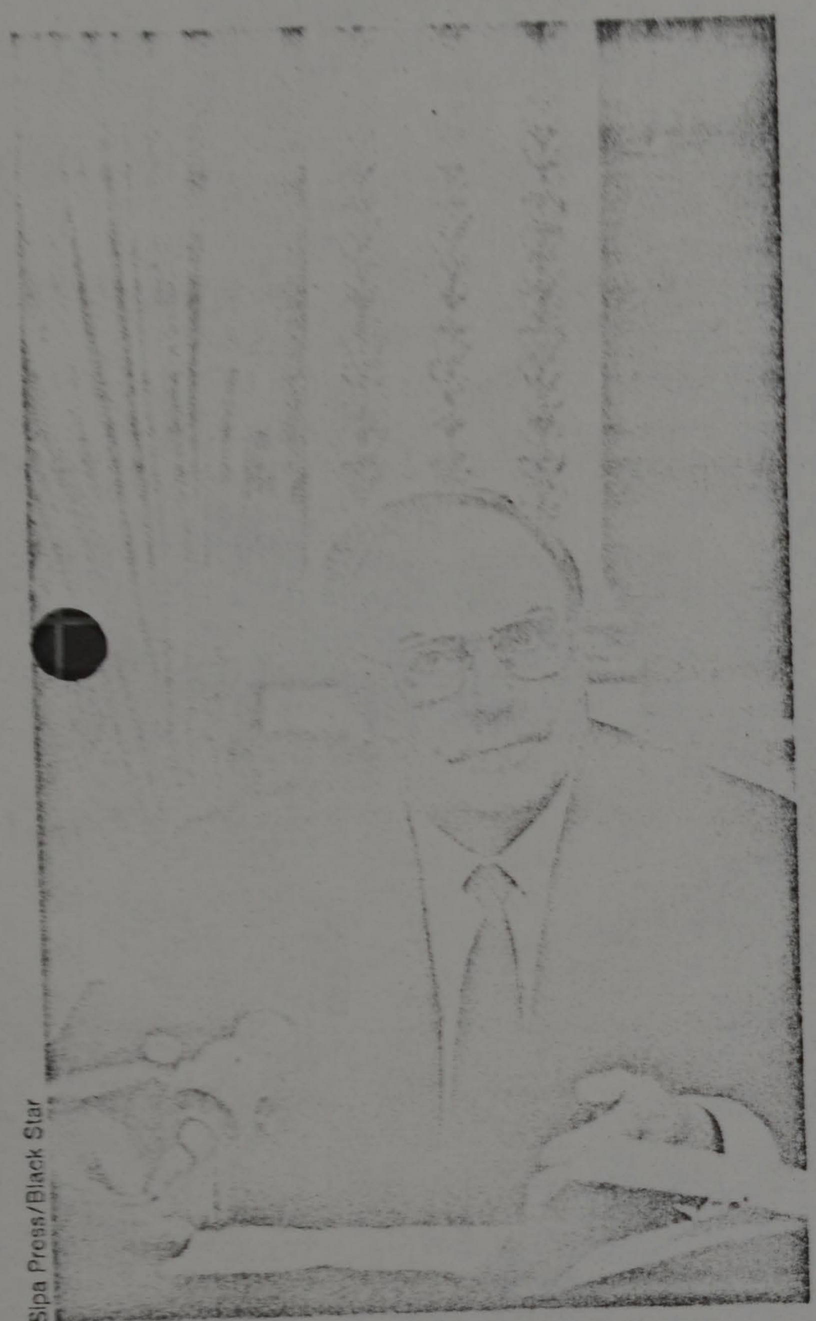
Blunting the attack. These measures, however, are considered inadequate even to Japanese economists. Hisao Kanamori, president of the Japan Economic Research Center, urges a full 1% cut in the discount rate and a supplementary budget for more public works spending.

By taking steps to stimulate the economy, the Japanese hope to blunt the attack on their trade policies they are sure to face at Williamsburg. Neither the U. S. nor the European officials have used overt pressure to push Japanese reflation, but Washington is known to want Tokyo to act as an engine to help pull the world economy into recovery. The hope, also, is that stronger Japanese growth will draw in more imports and reduce its trade surplus.

If its trade surplus does not shrink, Japan is certain to face more protectionism from Europe and the U. S. The EC has moved to protect its markets against Japanese videotape recorders, TV tubes, and machine tools, and this is spilling over into trade with the U. S. "Machine tool exports affect us as well," says a U. S. trade official. The EC's trade commissioner, Count Etienne Davignon, argues that "protection is justified" for emerging high-technology industries, and his officials have drawn up a checklist of 23 sectors suitable for this type of treatment.

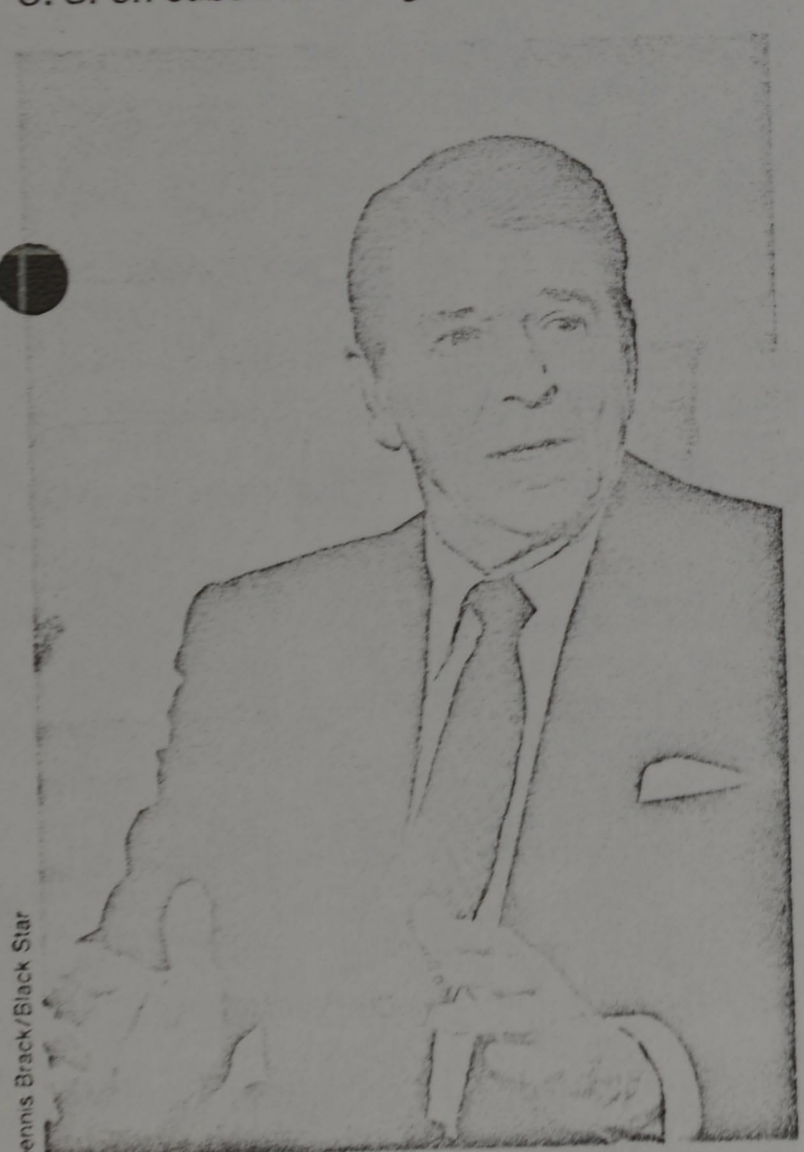
Endangered. British Prime Minister Margaret Thatcher, a proclaimed free trader, says the Williamsburg summit must tackle "the whole question of trade and trying to stem the protectionist tide." But along with other heads of government she is aware that the Continent's nascent information technology industry could quickly disappear in the absence of a Europe-wide industrial policy. The 12 top European companies in the industry collectively complained that they had managed to win only a 10% share of the world market for their goods and less than 40% of the EC markets.

The danger is that the European governments, which own and run the telecommunications networks, will close those markets to the U. S. Protectionist lobbies in Europe have such political momentum that only a strong 1983 recovery in the U. S. is likely to deter them. Thatcher argues that the Williamsburg summit must work out "how to achieve expansion in a noninflationary way" to encourage business. EC Commissioner Karl-Heinz Narjes adds: "There is a hope the U. S. will go into sustained growth and will not falter." But there is a fear that the U. S. recovery could sputter out. ■



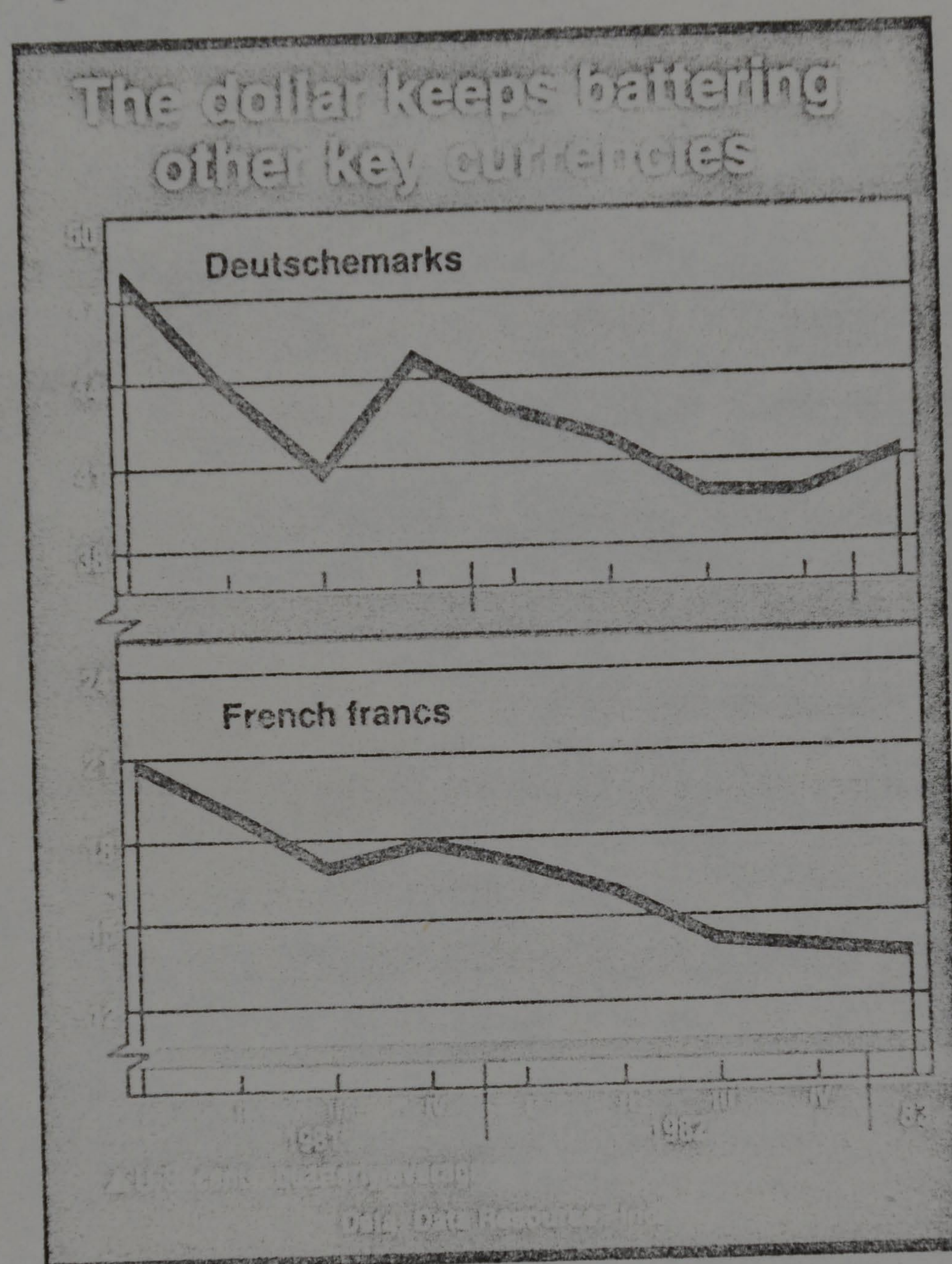
Sipa Press/Black Star

Kohl: Planning "tough talks" with the U. S. on subsidies to agriculture.



Dennis Brack/Black Star

Reagan: Trying to avoid a repetition of last year's debacle at Versailles.



Arlene Cassidy—BW

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Please address your reply to
Market Intelligence Department

Your ref

Our ref PTG/OF/INT
Direct Line 01-726 1110
Date 5 May 1983

I Smith Esq
Chairman's Office
41 Lothbury

Chairman to see then place with B of E papers re meeting with the Chancellor.

Dear Ian

Williamsburg Summit

As requested in your recent conversation with Peter Gutmann, I enclose a brief note on the issues likely to be discussed at the forthcoming summit meeting. When I saw you yesterday, I explained that we do not have at present a specific "NatWest view" on the various detailed topics that may arise at the Summit. However, as a major international bank we are an important member of what can be described as the "UK financial community". As such, we and most other banks share in a number of important aspirations which are detailed on the attached note.

Yours sincerely

David Kern

David Kern
Manager & Chief Economist

NOTE FOR CHAIRMAN'S OFFICE

5 May 1983

WILLIAMSBURG ECONOMIC SUMMIT MEETING - 28 MAY 1983

The four issues likely to dominate the Williamsburg Conference are

1) international growth and inflation
2) currency instability and possible reform of monetary system
3) international trade
4) the international debt problem

These subjects have been well-covered in the press, including the cuttings forwarded to your office recently in connection with this conference. The NEDC papers (NEDC (83) 25, 26, 27), on which comment was made in a note prepared for your office by this department on 29 April, also deal with these topics. Developments in each of these areas would ultimately have an important impact on the world economy and, therefore, on major banks such as National Westminster. It seems to us that there is no explicit "NatWest view" on detailed technical issues such as currency intervention or controversial political problems concerning the trade relations between Europe and the US. However, with many other major banks we share in a number of general aims such as

a) promoting non-inflationary world recovery
b) maintaining a liberal trading environment
c) preserving the integrity of the international financial system, and
d) restoring the creditworthiness of many LDCs through a process of gradual adjustment.

MARKET INTELLIGENCE DEPARTMENT

~~Return to RLP.~~

CANCELLED 9/a election

Mr. Leigh-Pemberton. 5th May, 1983

The Chancellor's Secretary telephoned again. They are now suggesting Drinks on Tuesday, 17th May. Timing 12 Noon or 6.30 p.m. at 11 Downing Street.

Have you a preference please?

Support group

Eh. John Bartlett - brief

233-5487. Donna Young. - Phoned 9/5 & arranged 12 noon 17/5

SECRET

9. 5.83

341/1

~~Or card to 1st Summits?~~

Mtg cancelled 10/5

THE DEPUTY GOVERNOR

Copy to Mr Loehnis

The Chancellor has asked to see Mr Leigh-Pemberton for a private talk about 'the international scene and in particular the run-up to the Williamsburg Summit'. An appointment has been made for next Tuesday 17 May, at noon.

Mr Leigh-Pemberton has asked to be briefed. May I have your advice on how to proceed, please? (There is, no doubt, a possibility that the meeting will be cancelled because of the election.)

Secretary's Division HO-1
9 May 1983

B

John Bartlett (3374)

SECRET 9.5.83

A

Cancelled b/o election, ~~[illegible]~~ LP's sec'y to leave a msg for Bartlett - A 10/5

THE DEPUTY GOVERNOR Copy to Mr Loehnis

D.L. said via Charles that Court to be told @ this stage. He will consult with CB re what to do.

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Mr Leigh-Pemberton has asked to be briefed. May I have your advice on how to proceed, please? (There is, no doubt, a possibility that the meeting will be cancelled because of the election.)

Secretary's Division HO-1
9 May 1983

John Bartlett (3374)