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29 DEC 1976

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[CULL]

TO IMMEDIATE FCO TELNO 392 OF 21 DECEMBER 1976

INFO IMMEDIATE WASHINGTON (UKTSD), UKREP BRUSSELS, BONN, TOKYO,  
AND INFO SAVING PARIS, ROME, BRUSSELS, THE HAGUE, LUXEMBOURG,  
COPENHAGEN AND DUBLIN, OTTAWA, STOCKHOLM, BERNE.

OECD WORKING PARTY NO 3: UK ECONOMY  
SUMMARY

1. WORKING PARTY NO. 3 MET AT 10.30 AM ON 21 DECEMBER. [REDACTED]  
WAS IN THE CHAIR. THE UK WAS REPRESENTED BY [REDACTED],  
[REDACTED] AND [REDACTED].

2. THE MORNING SESSION WAS DEVOTED TO AN EXAMINATION OF THE UK  
ECONOMY ON THE BASIS OF THE IMF STAFF REPORT AND THE CHANCELLOR'S  
STATEMENT OF 15 DECEMBER AND LETTER OF APPLICATION TO THE IMF. THE  
EXAMINATION WAS SEARCHING, BUT EXCEPT FOR AN UNHELPFUL INTERVENTION  
BY [REDACTED] (SECRETARIAT) - FAIR-MINDED AND SYMPATHETIC. [REDACTED]  
WITH STRONG SUPPORT FROM [REDACTED] (USA) AND [REDACTED] (GERMANY) SUMMED UP  
THE DISCUSSION BY SAYING THAT THE WP3 SHARED THE IMF STAFF'S  
ENDORSEMENT OF AND SUPPORT FOR THE GOVERNMENT'S PROGRAMME. HE WOULD  
REPORT THIS OUTCOME TO THE MEETING OF G10 DEPUTIES THE FOLLOWING  
DAY. HE ALSO AGREED TO SPEAK IN SIMILAR TERMS TO THE PRESS AND DID  
SO IMMEDIATELY AFTER THE MORNING SESSION.

#### DISCUSSION

3. FOR THE UK [REDACTED] OUTLINED THE RECENT ECONOMIC  
DEVELOPMENTS IN THE UK AND THE MAIN FEATURES IN THE SHORT-TERM  
FORECASTS WHICH HAD LED THE GOVERNMENT TO DECIDE ON THE RECENT  
MEASURES, EMPHASISING THE NEED TO BRING TO AN END THE INSTABILITY  
IN THE EXCHANGE MARKETS AND THE PRESSURES ON MONETARY AGGREGATES  
WHICH HAD DEVELOPED DURING THE AUTUMN AND TO ENSURE THAT ADEQUATE  
RESOURCES WERE AVAILABLE TO PERMIT A SUFFICIENTLY RAPID IMPROVE-  
MENT IN THE BALANCE OF PAYMENTS AND INVESTMENT. HE DREW ATTENTION

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TO THE TIGHT LIMITS SET FOR BOTH DCE AND, IMPLICITLY, FOR M3, WHICH WOULD BE SIGNIFICANTLY BELOW THE GROWTH IN NOMINAL GDP IN 1977 AND TO THE SUBSTANTIAL REDUCTION IN PUBLIC SECTOR ABSORPTION OF RESOURCES FOLLOWING FROM THE CUTS. HE NOTED THAT WHILE THE COMPOSITION OF THE CUTS (WHICH REFLECTED POLITICAL AS WELL AS ECONOMIC FACTORS) HAD BEEN THE SUBJECT OF SOME CRITICISM, THERE WAS INCREASING RECOGNITION BY ECONOMIC COMMENTATORS THAT THE MEASURES WERE TOUGHER THAN THEY HAD ORIGINALLY RECOGNISED. IT WAS NOW THE RESPONSIBILITY OF THE UK AUTHORITIES TO ENSURE THE PROGRAMME WORKED. HE WELCOMED THE AFFIRMATION OF SUPPORT GIVEN TO IT BY THE IMF STAFF, TO WHOSE WORK HE PAID TRIBUTE.

4. IN DISCUSSION, THERE WAS GENERAL ACCEPTANCE THAT THE UK'S BALANCE OF PAYMENTS POSITION WOULD SWING INTO SUBSTANTIAL SURPLUS OVER THE NEXT TWO YEARS AND THERE WAS NO DISPOSITION TO ARGUE THAT THE PACKAGE SHOULD HAVE BEEN MORE DEFLATIONARY. THERE WAS ALSO LITTLE DISPOSITION TO CRITICISE THE DCE AND PSBR TARGETS, THOUGH [REDACTED] (CANADA) AND [REDACTED] (NETHERLANDS) WONDERED WHETHER THE M3 FIGURES FOR 1978-9 MIGHT NOT BE HIGH IN RELATION TO THE EXPECTED RATE OF INFLATION. THERE WAS NO DISCUSSION OF EXCHANGE RATE POLICY, EXCEPT FOR AN UNSUCCESSFUL ATTEMPT BY [REDACTED] (SECRETARIAT) TO EXTRACT A FORECAST OF THE EXCHANGE RATE PATH. THE MAIN AREAS OF QUESTIONING CENTRED ON WHETHER INVESTMENT WAS LIKELY TO BE ADEQUATE TO TAKE UP SLACK IN THE ECONOMY, WHETHER PROFITABILITY AND THE PRESENT TAX STRUCTURE PROVIDED ADEQUATE INCENTIVES, AND WHETHER THE INCOMES POLICY WOULD HOLD, GIVEN THE EXPECTED RATE OF PRICE INCREASE IN 1977.

5. IN REPLY, [REDACTED] INDICATED THAT THE PRESENT PHASE OF THE PAY POLICY WAS STANDING UP WELL. THERE HAD BEEN A MOST HELPFUL STATEMENT FROM THE TUC ON THE NEED FOR A FURTHER PERIOD OF RESTRAINT ON INCOMES. THE PUBLICATION OF THE RETAIL PRICE FORECAST SHOULD ITSELF HELP TO ACCUSTOM PUBLIC OPINION TO THE NECESSARY FALL IN LIVING STANDARDS. AS REGARDS INCENTIVES, THE CHANCELLOR HAD CLEARLY INDICATED HIS RECOGNITION OF THE PROBLEM AND, WITHIN THE LIMITS SET BY THE PSBR TARGETS, INTENDED TO SEE WHAT IMPROVEMENTS COULD BE MADE. AS REGARDS INVESTMENT, THE RATE OF GROWTH FORECAST FOR 1977 WAS HIGH. THE PROSPECTS FOR EXPORTS AND THE GENERAL IMPROVEMENT IN CONFIDENCE WERE FAVOURABLE FACTORS AND THE SURVEYS OF INVESTMENT INTENTIONS WERE HIGHLY PROMISING. /6.

6. [REDACTED] THEN ASKED FOR GENERAL VIEWS ON THE ADEQUACY OF THE UK'S PROGRAMME. [REDACTED] (SECRETARIAT) EXPRESSED DOUBTS AS TO WHETHER IT WOULD BE SUFFICIENT, INDICATING CONTINUED SCEPTICISM ABOUT THE SUCCESS OF THE COUNTER-INFLATION POLICY AND CONCERN AT THE CONTINUING HIGH LEVEL OF PUBLIC EXPENDITURE. HE ARGUED THAT THE PROGRAMME DID NOT REPRESENT A FUNDAMENTAL CHANGE IN THE UK'S ECONOMIC PROSPECTS AND COMPLAINED AT THE LACK OF FRANKNESS IN DISCUSSION.

UM THIS DREW STRONG RETORTS FROM [REDACTED] AND [REDACTED] BOTH OF WHOM EMPHASISED THEIR FULL SUPPORT FOR THE PROGRAMME. [REDACTED] DESCRIBED IT AS OUTSTANDING. THE REDUCTIONS IN THE PSBR WERE ON A CONSIDERABLE SCALE AND THE NECESSARY FALL IN REAL INCOMES WELL ON THE WAY TO ACCOMPLISHMENT. THE PROGRAMME PROVIDED AN OPPORTUNITY FOR A DECISIVE CHANGE IN THE UK'S ECONOMIC SITUATION.

8. SUMMING UP THE DISCUSSION, [REDACTED] EMPHASISED THE CLEAR AGREEMENT THAT THE UK'S BALANCE OF PAYMENTS WOULD MOVE INTO SUBSTANTIAL SURPLUS. IN GENERAL, THE WORKING PARTY SHARED THE IMF STAFF'S APPRAISAL OF AND (CAUTIOUS) ENDORSEMENT OF THE PROGRAMME. PROVIDED THE MAJOR ELEMENTS IN THE PROGRAMME WERE FULLY CARRIED OUT, THERE WERE GOOD PROSPECTS OF SUCCESS. HE WOULD REPORT IN THIS SENSE TO THE G10 DEPUTIES.

9. A REPORT OF DISCUSSIONS ON THE SECRETARIAT'S PAPERS ON THE ADJUSTMENT PROCESS AND INTERNATIONAL LIQUIDITY WILL FOLLOW. NO SIGNIFICANT POINTS EMERGED OVER LUNCH EXCEPT THAT THE ITALIANS MIGHT BE READY FOR AN IMF DRAWING IN FEBRUARY, FOR WHICH THE GAB WOULD HAVE TO BE ACTIVATED.

FCO PLEASE PASS SAVING ADDRESSEES  
FCO PLEASE PASS ADVANCE COPIES TO:

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

(ALL OF THE TREASURY)

[ADVANCED AS REQUESTED]

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