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SUSPENSE ______________ Date

Remarks:

Copied to Glen [illegible], [illegible]

Executive Secretary

5/24/83

Date

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Executive Registry
83-2721

THE WHITE HOUSE
WASHINGTON

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ATTACHMENTS

CABINET AFFAIRS STAFFING MEMORANDUM

DATE: 5/23/83 NUMBER: 118700CA DUE BY: ______

SUBJECT: Cabinet Council on Economic Affairs - Tuesday, May 24, 1983 9:00 a.m. in the Roosevelt Room

	ACTION	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☑	☐
Attorney General	☐	☑
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☐	☑
Transportation	☑	☐
Energy	☐	☑
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
______	☐	☐
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	ACTION	FYI
Baker	☑	☐
Deaver	☐	☐
Clark	☑	☐
Darman *(For WH Staffing)*	☑	☐
Harper	☑	☐
Jenkins	☐	☐
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CCCT/Gunn	☐	☐
CCEA/Porter	☑	☐
CCFA/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCLP/Uhlmann	☐	☐
CCMA/Bledsoe	☐	☐
CCNRE/Boggs	☐	☐

REMARKS:

The Cabinet Council on Economic Affairs will meet on Tuesday, May 24, 1983 at 9:00 a.m. in the Roosevelt Room. The agenda is as follows:

1. Report of the National Productivity Advisory Committee/CM255 (Paper distributed on Friday, May 20)

2. Impact of Disinflation on COLAs/CM030 (Paper distributed 5/20/83)

3. Economic Summit Briefing/CM396 (Paper attached)

RETURN TO:

☐ **Craig L. Fuller**
Assistant to the President for Cabinet Affairs
456-2823

☑ **Becky Norton Dunlop**
Director, Office of Cabinet Affairs
456-2800

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THE WHITE HOUSE

WASHINGTON

May 20, 1983

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Williamsburg Economic Summit Briefing Papers

Allen Wallis has provided the attached set of briefing materials for the Williamsburg Economic Summit Conference for distribution in preparation for the Cabinet Council's discussion on Tuesday, May 24.

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MULTILATERAL SURVEILLANCE OF ECONOMIC POLICY

I. ISSUE

We should try to follow the more structured approach to multilateral surveillance initiated at Versailles. We seek to reaffirm the following objectives: achievement of sustainable non-inflationary growth of real income and employment; improvement of the process for discussion of policies designed to narrow differences in economic conditions in Summit countries; and assessment of progress toward achieving such convergence.

II. ESSENTIAL FACTS

As recovery is underway in most Summit countries, focus should be on a non-inflationary one.

Inflation is still troublesome in France and Italy. They need to follow firm, anti-inflationary policies.

While the medium-term is important, we want the shorter-term focus on the surveillance process. We want more attention on quantitative goals to measure performance and to identify exchange rate implications of disparities in performance.

III. KEY POINTS

Criticism: France wants to stabilize exchange rates by systematic intervention in foreign exchange markets.

Response: This does not work, as demonstrated by the recent experience of the European Monetary System. Attempts to rig exchange rates when policies are out-of-line lead to market instability and disagreements among countries involved. Debate should shift from quick-fix schemes to the improvement of fundamental policy approaches. This would solve exchange rate problems which now arise from differences among countries. Exchange rate instability is a symptom, not a cause, of differences in economic policies and performance.

It is not surprising that exchange markets have put downward pressure on currencies of those countries whose economic and inflation performances are weaker.

The lasting way to promote exchange market stability is to obtain convergence of Allied economic conditions and policy.

We want to toughen the multilateral surveillance process by setting quantitative targets, goals and measuring results.

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EXCHANGE RATE STUDY AND POLICY

I. ISSUE

There is consensus that more uniformly sound policies in major economies are needed for greater exchange rate stability. Many claim the dollar exchange rate is volatile, the dollar is overvalued, and that we should intervene more often in currency markets. France wants to move toward fixed exchange rates.

II. ESSENTIAL FACTS

Other countries believe the US dollar has become artificially overvalued because of our high interest rates. They want us to loosen monetary policy and cut the budget deficit in order to bring them down. While interest rates have been one factor in the dollar's strength, we attribute it more to confidence in our ability to control inflation and manage our economy soundly when conditions abroad were less satisfactory.

Some say that exchange market intervention by the US could force the dollar down. At Versailles we commissioned an intervention study to investigate this. It showed that the impact of intervention on exchange rates is limited to the short-run. Our Summit partners agree these results show that a stable, non-inflationary policy environment is the way to obtain more stable exchange markets. We should redouble our efforts at fostering such policies in all major countries by improving the multilateral surveillance process agreed to at Versailles. We agreed to greater consultation and cooperation in this area and to coordination of our intervention when we felt it would be helpful. However, we retain the basic US policy of limiting government interference in exchange markets.

III. KEY POINTS

Criticism: High interest rates overvalue the dollar. Cut the budget deficit and loosen monetary policy to lower them.

Response: Other factors add to the dollar's strength. We are trying to lower the deficit by control of non-defense items. It is counterproductive to abandon monetary discipline.

Criticism: US should intervene to bring down the dollar.

Response: Intervention is not capable of doing that.

Criticism: US should agree to return to a more fixed exchange rate system, such as setting target zones.

Response: There are arguments for both fixed and flexible systems, but the type of system is not the real issue. Stable and convergent policies are needed for exchange rate stability.

INTEREST RATES AND MONETARY POLICY

I. ISSUE

Other Summit countries will complain that high US interest rates block world recovery. At Versailles blame was placed on excessively tight US monetary policy, but with more rapid monetary growth since last fall, the complaint has shifted to high federal budget deficits, especially for the out years.

II. ESSENTIAL FACTS

Others exaggerate the interest rate impact of future US deficits. France is looking for outside scapegoats for its policy failures. Interest rates levels are more influenced by inflation rates than by the size of budget deficits. Short-term interest rates have fallen sharply in countries that have pursued successful anti-inflation policies. Since January 1981 US short-term rates have been cut in half, from 18% to 9%. UK, FRG and Japanese rates have fallen 3 to 7 percentage points in the same period. Rates in Canada, a more recent convert to firm anti-inflation policies, have declined nearly 8 points. Longer term rates have not fallen as much, implying need for continued pursuit of budgetary restraint and anti-inflation policies to increase market confidence in the durability of low inflation gains. Short-term interest rates have actually risen somewhat in France and Italy, where only limited progress in controlling inflation has been made. The US is also trying to reduce budget deficits while deficits in major foreign countries (except the UK) have been stable or rising as a share of GNP/GDP.

III. KEY POINTS

Criticism: US interest rates are too high.

Response: Rates are high but US short-term interest rates have fallen sharply, declining from 18% two years ago to 8-9% today. Long-term rates have also fallen.

Criticism: The prospect of high US budget deficits in future years keeps interest rates high and could choke recovery.

Response: The deficit is too large. We have placed high priority on reducing expenditures to reduce future deficits. We all have work to do in getting our budget deficits down.

Criticism: US rate levels prevent recovery elsewhere.

Response: Reducing inflation expectations is the key to lower interest rates. Interest rates have come down where inflation has declined sharply. The US is not to blame for inflation and inflationary policies in other countries.

ECONOMIC IMPACT OF OIL PRICE DECLINE

I. ISSUE

Since January 1 average world oil prices have fallen over 12%, from about $32.50/bbl to $28.50/bbl, and could decline further. The USG believes these price declines will bring major beneficial effects for both developed and developing nations, and thus, are to be welcomed. Such specific problems as may arise are tolerable and out-weighed by the gains. Other OECD governments appear to have arrived at similar conclusions but they differ on the issue of whether to pass through cuts in energy prices to consumers or to preempt some portion of them through import fees or energy taxes.

II. ESSENTIAL FACTS

USG study suggests that a 25% price cut to $25/bbl would:

-- slow OECD inflation by 1.5% within the first year,

-- increase OECD growth by 1% in the first year, and 1/2% in each of the two following years,

-- reduce unemployment by about 1% over three years,

-- improve the current account and budget deficits positions of OECD nations,

-- greatly improve export prospects for oil importing LDCs, increase growth and debt servicing ability. However, LDC exports could decline temporarily due to lower OPEC demand.

III. KEY POINTS

Criticism: Lower oil prices will severely impair the ability of heavily indebted oil exporters such as Mexico, Venezuela and Nigeria to manage their debt burdens.

Response: Eight of the 10 largest LDC debtors to banks are oil importers. Whatever problems arise for heavily indebted oil exporters and commercial banks are not insurmountable, and are outweighed by the benefits of cheaper oil.

Criticism: Import fees or energy taxes should be imposed to prevent erosion of conservation gains.

Response: The stimulative effect of lower oil prices are of overriding importance and cannot be obtained unless oil bill savings are passed through to business and consumers.

US ECONOMIC SITUATION

I. ISSUE

At issue is the strength and sustainability of the current US recovery and the degree to which an upturn in the major industrialized countries can be translated into economic improvement in other free market economies. The key is the mix of monetary, fiscal and trade policies that can achieve the growth and price stability goals of the Administration.

II. ESSENTIAL FACTS

The US recession ended in 4th quarter 1982. Preliminary data show 3.1% real growth for 1st quarter 1983, reflecting: (1) a strong housing recovery with 1st quarter starts at the 1.7 million rate, almost 90% above levels of a year ago; (2) a modest recovery in real consumer outlays which rose 2.3% due to income gains and a drop in the saving rate; and (3) the inventory cycle which is phasing out following a record inventory liquidation in the 4th quarter.

The recovery is based on improved economic fundamentals, including a decline in inflation reinforced by weakness in prices for oil and commodities. Rising productivity is holding down unit labor cost and aiding price stability.

The Administration forecast for 1983 shows an increase in real GNP of 4.7% and an inflation rate of 4.5% measured from the 4th quarter 1982 to 4th quarter 1983. Unemployment is expected to drop to 9.7% by year end. From 1984-88, progress in sustaining economic growth and lower inflation is expected (long-term real growth rate: 4%; inflation rate: 4.6%; unemployment at end of 1988: about 6%) through continuation of current tax policies, control of federal spending, and restrained monetary growth.

III. KEY POINTS

Criticism: Monetary policies have raised the value of the dollar, rendered the US less competitive, and discouraged world-wide economic expansion.

Response: Current policies are designed to reverse prior conditions of inflation and destabilizing economic cycles.

Criticism: Large budget deficits absorb private saving, reduce capital formation, and discourage long-term growth.

Response: Increased defense spending is imperative for national security. But we agree that credible strategy is needed to keep future deficits declining. We have proposed such strategy (see paper on budget policy) and welcome Summit support for this effort.

UNITED STATES BUDGET POLICY

I. ISSUE

Leaders of several Summit countries remain concerned that continued US budget deficits are causing abnormally high interest rates and thwarting their attempts at economic recovery.

II. ESSENTIAL FACTS

When your Administration took office it inherited a major budgetary imbalance. The social insurance system was growing rapidly and in 1981 was almost 7% of GNP, 2.5 times greater than in 1963. At the same time, means-tested entitlements had grown rapidly; between 1970 and 1981 real spending for these programs more than doubled. Increases in domestic spending were financed by both rising tax burdens and substantial reductions in defense spending, neither of which was sustainable. This inherited budgetary imbalance was accompanied by an economic imbalance. The prolonged economic adjustment of 1981-83 was essential to bring inflation under control, but it lowered the long-term path of nominal GNP and revenues and increased the Federal deficit.

III. KEY POINTS

Criticism: US has not done enough to lower its deficit.

Response: The budgetary actions of the last two years represent a good start toward lowering the inherited imbalances. The 1984 Budget proposes continued progress in reordering budget priorities and reducing projected budget deficits. The budget essentially freezes total outlays in real terms at 1983 levels. The annual growth in nominal outlays is down from 17-1/2% in 1980 to 5-1/2% in 1984. We project the deficit to drop from $190 billion in 1984 to $102 billion in 1988. As a share of GNP, it should drop from 6.5% in 1983 to 2.1% by 1988.

To assure that the deficit drops over time, the Administration has proposed a deficit insurance policy in the form of a stand-by tax equal to 1% of corporate and individual taxable income and a $5/barrel oil excise tax. These taxes would be triggered in 1986-88 only if the deficit exceeds 2.5% of GNP.

Since the budget was proposed, two important bills dealing with the problems of social security financing and unemployment have passed. Congress recently passed the 1983 Social Security Amendment, which resolves both the short and long-term financing crises in Social Security, instilling new confidence in the system. The Jobs Bill legislation enacted by Congress accelerates already planned spending. This will increase jobs in the near term without impinging on the long-term budget outlook.

The budget outlook uses prudent economic assumptions that are more conservative than many forecasters. The budget outlook will improve if the economy does better than expected.

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COMBATTING PROTECTIONISM

I. ISSUE

Faced with the worldwide problems of recession and inflation, calls for protectionism are louder than in many years.

II. ESSENTIAL FACTS

Restrictive trade policies will only serve to further distort international trade and investment flows and could threaten the post-World War II trading system as we know it. The US has taken the lead in the post-war period in creating an international trading and financial system that limits governments' ability to disrupt trade. History has taught us that the freer the flow of trade across borders, the greater world economic progress and the greater the impetus for world peace.

While the US cannot continue to tolerate unfair trading practices which adversely affect either our domestic market or our opportunity to trade and invest elsewhere, US policy has been and should continue to be one which seeks additional market access rather than protectionism.

Therefore, the US feels it must resist domestic and foreign protectionism and do whatever is necessary to preserve the open and competitive world trading and financial systems.

Either the free world continues to move forward and sustain the postwar drive toward more open markets, or we risk sliding back to the tragic mistakes of the 1930s.

III. KEY POINTS

Criticism: It is not credible to say you are against protection when the US and others are taking trade restrictive or distorting actions when it suits their domestic political needs.

Response: All of us take such actions. We need to avoid slipping into a pattern of protection as the easy way out. The only way to do so credibly is to charge our governments with developing a coherent program to reduce barriers. That is why we want the Summit to endorse the call to begin work now on a program to implement the OECD declaration calling for progressive dismantling of barriers, and to prepare for new negotiations in a few years time.

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