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Macroeconomic Assessment

This report has been prepared by a group convened by CEA Chairman Charles Schultze of the United States at the request of the Preparatory Group for the Bonn Summit. The group included representatives from the seven largest industrial countries and the E.C. Commission (a list of participants is attached). The group met in Washington on May 20-21 to assess the current macroeconomic situation and future prospects in their countries and to consider what policy measures might be considered in light of these circumstances.

The group recognized that their own economies and the world economy have not yet fully recovered from or adjusted to the shocks of the early 1970s, which gave rise to an upsurge of inflation, the emergence of unprecedented deficits in the current accounts of many countries, and the deep worldwide recession of 1974-75.

Some aspects of our economic performance have improved in recent years.

- Inflation rates in our seven countries, which ranged from 6 percent to 25 percent in 1975 have been brought down to a range from 3 percent to 13 percent.
- Cumulative real output gains averaged 9.7 percent from 1975 to 1977.
- Some countries whose external financial positions were extremely perilous have achieved significant improvements in their payments positions.

In addition, serious threats to the stability of the world economy have been averted. Despite pressures generated by unprecedented payments imbalances and depressed levels of employment and output, a liberal world trading system has been maintained essentially intact, and the momentum for further reduction of trade barriers in the Tokyo Round of trade negotiations has been sustained.

The economic problems that still face us are serious, however.

- Our economies continue to fall short of their productive potential and in many of our countries the gaps have widened in the past year. The smaller industrial countries have had even more disappointing recoveries in output and the developing countries have not yet recovered from the serious setbacks the recession dealt their development programs.

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-- The unemployed constitute a greatly expanded group compared with the record of the fifteen years prior to 1975.

-- Productive investments are currently accounting for smaller shares of total output in our countries. Hence the growth of productivity has been impaired and future employment opportunities have been reduced.

-- Although down from peak levels, continued high and widely differing inflation rates pose a continuing threat to economic stability and a constraint on more rapid recovery.

-- Government budget deficits are very large by standards.

-- Some important imbalances in current accounts persist and new ones have emerged or become more serious.

-- New and more subtle forms of protection are being introduced, threatening both the health of the international trading system and the longer term rise in living standards.

Current Economic Conditions and the Outlook for this Year and Next

In 1977 the growth of real GNP in our economies averaged 3.9 percent. Growth in the European Community was only 2.2 percent. The growth of industrial output was generally less than total GNP growth, as shares of government and other services in GNP rose. Unemployment rates were unchanged or rose in 1977 except in the United States, and, in early 1978, unemployment rates in all countries stood substantially above the average unemployment rate for the ten years prior to the 1975 recession.

Several developments, which vary in importance from country to country, have meant that the lowest unemployment rates that could be achieved without accelerating inflation are somewhat higher now than in the 1960s. These developments include rapid growth in the numbers of young people and women entering labor markets, higher levels of income maintenance programs for the unemployed, and slow rates of capital formation combined with rapid labor force growth. Nowhere, however, do these factors account for the full increase in unemployment rates. In differing degrees, scope remains in our countries for expansion of employment and output before labor market tightness would lead to accelerating inflation, although some shortages of workers with particular specialized skills exist.

Real growth in our economies may average close to 3.5 to 4 percent in 1978, but outside the United States unemployment is unlikely to be substantially reduced. Growth in other industrial countries will average less than in our countries. Some recovery in economic activity occurred in late 1977 and early this year in those economies that had been particularly depressed, but the hoped for continued acceleration to more rapid growth rates is now in doubt. Growth of the U.S. economy, despite a poor first quarter, should remain above the growth rate of potential output but average much less than in 1977 as labor constraints begin to loom closer. Thus, actual growth for calendar year 1978 might be less than expected earlier in Germany, Japan, and the United States. Moreover, in none of our countries would growth exceed objectives set earlier.

The outlook for growth in 1979 with no adjustment of policies would not appear significantly different from 1978. Profits and capacity utilization rates do not currently seem favorable to significantly stronger growth of investment, and consumer savings rates are unlikely to come down sharply. Thus many of our countries could enter a third year in which no progress is made in closing sizable output gaps.

Outside of North America significant declines in inflation occurred in 1977 and have continued into early 1978. These improvements have been associated with a slowing of nominal wage increases and a reduction of underlying inflation trends, but part of the improvement from 1976 to 1977 in several countries is attributable to contrasting exchange rate developments in the two years. It will be difficult to achieve reduction of inflation in 1978 in Italy, the United Kingdom, and France. Inflation in Germany and Japan is unlikely to hold at the very low rates of recent months, but the pace of inflation should be moderate through the rest of the year.

Although the Canadian and U.S. inflation records provide little hope that the underlying trends of prices and wages in these countries will be reduced most of the modest increase in their inflation rates is attributable to increases in food prices and the effects of exchange rate changes. These movements are unlikely to be reversed, but their contribution to inflation rates should subside in the period ahead.

For our countries to achieve reductions in inflation rates in 1979 will require favorable developments in nominal wages and productivity performance. For many countries the most likely outcome is that price rises will be as large in 1979 as in 1978. The United States and Canada, which are most likely to post some increase in inflation rates this year, may be more likely to show a small decline next year.

Current account imbalances remain both a reflection of the instability of the world economy and a source of additional instability. The external balance situation has evolved rapidly, however, and the focus of concerns has shifted. The OPEC surplus has declined substantially, and, although still large, it does not dominate the global pattern of current accounts as it did. This surplus, which exceeded $60 billion in 1974, declined to about $35 billion in 1977 and will probably be in the vicinity of $20-25 billion this year. A little more than a year ago the external deficits of the United Kingdom and Italy were of major concern. Over the past year both countries have moved into current account surplus, although the stagnation of domestic industrial activity that is partly responsible for these surpluses means that the fundamental adjustments are less than might first appear. Also, the large current account deficit of France, which was a significant constraint on economic policies there, has been reduced.

At the same time, the Japanese surplus and U.S. deficit on current account have grown phenomenally and pose serious adjustment problems. A Canadian deficit that is large relative to GNP has persisted, and the German surplus is large, although a smaller percentage of GNP than in 1974 and 1975. The deficits of some of the smaller industrial countries have shrunk, but there is still an important group of these countries for whom current account deficits are an overriding policy consideration. Another group of smaller industrial countries has had persistent and relatively large surpluses that have also contributed to instability in the international economy. While the circumstances of the non-oil LDCs as a group have improved, a number of individual countries still have serious balance of payments problems.

In 1978 the Japanese surplus and U.S. deficit and the more modest German surplus could exceed their 1977 levels, given the J-curve response of current accounts to the exchange rate changes of 1977 and early 1978. The prospects are better for some adjustment of these imbalances in 1979 as past exchange rate changes begin to have a significant effect on trade volume. No dramatic change is likely if growth rates remain on their present course, however.

Nonresidential investment in fixed capital has declined significantly as a share of GNP since 1970 in all of our countries except Canada and France, and in these latter countries investment growth slowed markedly in 1977. Weak investment performance reflects lower expectations and greater uncertainty concerning profits. Confidence is lacking that recovery can be maintained until present margins of unutilized capital are removed and profit margins are restored. Moreover, potential investors are concerned over rising costs that appear less controllable than before.

Real investment spending is expected to grow more rapidly in our economies this year than in 1977, but performance is still likely to be weaker than desirable. A stronger recovery of investment in 1979 will depend on success in establishing conditions for sustained expansion of our economies and rising business confidence.

Finally, our countries are beset by serious imbalances in important industries such as steel, shipbuilding, textiles, and energy. While economic and structural change has been very rapid throughout the postwar period, dislocations have been even more severe since the early 1970s. These dislocations are due to rapid movements in oil and commodity prices, slower productivity growth, the emergence of industrial competition from less developed countries, and, of course, chiefly the deep world recession.

Constraints on Improved Economic Performance

These constraints are of three types. First is the constraint imposed by the relationship between the rate of economic growth and inflation. Even where the limits of resource availability have not been reached, institutional factors in the setting of prices and wages set some limit to the economic growth that is consistent with the objective of controlling or reducing inflation. Pressing too close to the limits set by the availability of labor, capital, and other resources, or moving toward them too rapidly, may rekindle inflationary pressures. Second, in addition to these internal constraints, obstacles to growth may arise because of the high degree of openness of economies today. An external constraint is imposed on some countries by the need to maintain sustainable current account positions and on others by the importance of export growth to achieve a balanced expansion. Third, there are political and economic constraints on the use of policy instruments. Even where the threat of inflation is not an obstacle to higher growth, and when external constraints have been removed, some governments feel that measures taken by them to stimulate growth might themselves set off inflationary expectations and prove ineffective in increasing output. Moreover, unless they contribute to the restoration of confidence and the reduction of uncertainty, policies to promote higher growth may prove to some extent ineffective.

If internal constraints were the dominant ones in all cases there would be no scope for international cooperation to improve economic performance. Most countries today, however, have at least some scope internally to grow more rapidly while still pursuing objectives with respect to inflation. The external constraints that countries face could be relaxed somewhat by international cooperation in setting economic policies. Moreover, a concerted international approach to an increase in economic growth would reduce the amount of governmental stimulus required by an individual country to achieve any given growth objective. Thus, for most industrial countries, relaxing external constraints would make increased growth possible in 1978 and 1979. To allow continued progress beyond 1979, it will be necessary to introduce policies that relax countries' internal constraints as well.

Internal Inflation Constraint

The ultimate constraint on economic performance is the availability of resources and productivity in their use. Output cannot be pushed beyond the limits set by available labor, capital, and resources. Moreover, moving close to these limits causes wages and prices to accelerate. Outside the United States, there is sufficient slack to allow significantly faster growth over the next year and a half than contained in the outlook above. Over the longer term, a strong investment performance and measures to lower the rate of unemployment consistent with non-accelerating inflation will be needed to relax internal constraints on growth.

There does not appear to be an immediate threat of new inflation from excess demand and tight labor markets. In Japan and Germany, inflation rates have slowed substantially and are now at relatively low levels. Excess demand inflation does not threaten in these countries, although care must be taken that policies to achieve more rapid growth be designed to avoid raising inflationary expectations. In other countries, inflation rates still remain high. In some of these countries -- but not the United States -- a small increment to growth would not impede further progress against inflation. The United Kingdom and Italy, which have made substantial progress in reducing inflation over the past year, but in which rates of inflation still remain high, must continue their efforts. In France, where progress against inflation has been less, and in the United States and Canada where the rate of price increase has actually edged up, relatively greater priority must be assigned to anti-inflationary measures. With this in mind the United States announced in April a voluntary incomes policy and in May scaled back and postponed tax reductions for fiscal year 1979. The need to reduce inflation in our countries implies caution in avoiding excessively rapid growth, but it should not preclude a gradual reduction of unemployment rates.

Emphasis must be given to policies that attack the mechanisms of cost/price and wage/wage spirals. The success of such policies will hinge on achieving a moderation of income demands by all groups in our countries. The difficulties in achieving this must be clearly acknowledged. Formal wage and price controls have often not reduced the competition for higher income shares, but only transferred them from the marketplace and bargaining table to the political arena. Moreover, controls, where used, lead to rigidities in wages and prices that increasingly undermine their role in allocating resources. Hence, countries have recently relied more heavily on programs of voluntary wage and price moderation backed up by guidelines and intensive consultations. Greater stress has also been placed on efforts to reduce inflation in the government sector. The United Kingdom has achieved considerable success over the past year with a program along these lines, and the United States, among others, has recently taken steps in these directions.

External Constraints

Current Account Constraint -- While a large current account deficit is not necessarily a constraint on growth, it raises the risk of a depreciation of the currency if there are actual or perceived problems of financing the deficit. Exchange rate changes can contribute to the adjustment of imbalances and thus obviate the need to reduce growth in order to keep the current account within sustainable limits. Attempts to resist exchange rate pressures when there are large imbalances are usually ineffective. On the other hand, failing to deal with the underlying problems is costly. Depreciation tends to add to inflationary pressures and may involve a high inflationary cost for a small current account improvement, particularly where trade involves a large share of total economic activity and where wage earners are well protected against inflation by indexing schemes. In addition, imbalances can become so large and so persistent that a slowing of growth becomes an indispensable element of the adjustment process.

Although a number of countries are in much improved positions today compared with a year and a half ago, concerns about their current accounts would prevent them from strongly pursuing more expansionary policies. The United Kingdom, Italy, and possibly France have eliminated their deficits, but faster growth than projected for these countries, without correspondingly faster growth by others, could lead to a reemergence of current account problems. For Canada, which has the largest external deficit relative to GNP among the major countries, current account problems impose some constraint on growth, but internal constraints appear to be dominant and would inhibit policies to achieve more than a marginal increase in growth even if the current account were to improve. Any shortfall in growth abroad, however, would significantly tighten the external constraint in the future. Current account constraints are more serious in some of the smaller industrial countries and a number of developing countries, and could soon force some countries to take restrictive actions.

Current account deficits would bind less tightly if our countries were to increase their growth rates by moderate and varying amounts. Each country could then anticipate stronger export growth to match the increased imports resulting from additional domestic demand stimulus. In addition, leadership by our countries in a cooperative effort would make policies to achieve somewhat more rapid growth feasible for other countries. It is necessary for countries in surplus to ensure that their growth potential within their internal constraints is indeed achieved. It should not be expected, however, that countries in surplus would alone provide the demand stimulus to raise worldwide growth rates. Rather, their actions would be part of a process of relaxation of current account constraints as other countries were able to export more. Within the limits imposed by internal constraints, other countries would then be in a position to follow more expansionary policies. These policies, in turn, would serve to alleviate further the external constraints on other countries. A mutual effort to achieve faster growth in 1979 could add significantly to the average growth rate in Europe where external constraints are most important, without exceeding either external or internal constraints. Some countries would be able to raise growth more than the average while there would also be a few countries that would be unable to do more than accept the relatively small additional stimulus they received from stronger exports.

Although the U.S. deficit is very large, it is not the limiting factor on U.S. growth. Internal constraints would prevent aiming for higher growth even if the deficit were to shrink. Moreover, since foreign trade is relatively small compared to total U.S. output and since wages respond relatively slowly to higher import prices, real exchange rate movements can be an effective adjustment mechanism for the United States. Nevertheless, it must be recognized that given the central importance of the U.S. dollar in international financial markets, excessive depreciation of the dollar would be a destabilizing factor in the world economy. Thus, steps that the United States could take to reduce its deficit consistent with its internal goals would enhance global prospects for growth.

Global Energy Constraint -- Over the medium term, global economic growth may be constrained by limited potential for increased oil production. A rapid rise in oil consumption could remove the current glut of oil and lead to sharply higher prices. Fears that future growth might be limited by an oil constraint also tend to depress business investment in the short run. Thus measures taken by countries to reduce energy consumption and develop alternatives to imported oil can make possible stronger growth, both for themselves and for others. The United States must play a central role in implementing strong energy policies. A reduction of U.S. oil imports would not only help to alleviate the global energy constraint but it would also contribute to a reduction in the U.S. current account deficit without posing the risk that current account constraints on others would impinge more closely.

Constraints on Exports -- In a world of slow economic growth, countries with current account surpluses face an obstacle to more rapid growth from slow growth of export markets. Their ability to sustain expansion solely from internal demand is limited because opportunities for profitable investment are restricted and there is a risk that some sectors would reach capacity while other sectors remained depressed and unemployment remained high. Moreover, surplus countries with low internal growth face the threat of significant exchange rate appreciation that would disrupt export markets and depress growth further.

Constraints on Policies

Government Deficit Constraint -- Although the appropriateness of any particular government deficit depends crucially on other economic variables, for several reasons governments are inhibited from adopting expansionary fiscal policies when budget deficits appear large by historical standards. Institutional and political considerations discourage large deficits in all of our countries. A major concern is that stimulative fiscal policies may be difficult to withdraw once introduced, and thus a budget deficit that might be quite appropriate under current conditions would persist into the future and would ultimately lead to overheating of an economy, more rapid inflation, and crowding out of private investment spending. Thus, stimulative fiscal policies could have adverse effects on inflationary expectations. Fiscal stimulus must be designed to avoid these risks. In general, this might suggest a preference for general tax cuts over spending and transfer programs, which are politically more difficult to dismantle. Especially in countries with tax structures that generate increases in revenues more than proportionally to income growth, taxes may be cut with less risk that government deficits will not come down as recovery proceeds. In some countries, however, large leakages of tax cuts into private savings have led some to question whether they can provide an effective stimulus. Each country faces different circumstances in making the choice as to what mix of fiscal stimulus to employ.

A second source of concern with a large deficit is the possible inadequacy of countries' financial markets to the scale of financing that is implied. If financial markets are segmented and institutional rigidities exist, it may be difficult to transfer private savings to financing the public deficit. Over time, development of improved financial institutions and financing arrangements can alleviate this problem, but in the near term some see limits on the deficits their governments can incur without straining markets and jeopardizing the flow of funds for private investment.

Whatever the extent and type of fiscal stimulus a country chooses, additional growth that results will be greater if other countries are also moving to higher growth rates. A country with a large trading sector would find much of its fiscal stimulus dissipated in higher imports if it were to act alone. The hoped for improvement in the investment climate would be limited. As a part of a concerted program, however, the degree of fiscal stimulus needed in any one country would be smaller, and to the extent that the government deficit is a constraint, this constraint could be relaxed.

<u>External Constraints on Monetary Policies</u> -- Our monetary authorities have moved in recent years toward giving more attention to the medium-term growth of monetary aggregates as a means of restraining inflationary pressures. This shift in emphasis has been intended partly as a means of ensuring that monetary

policy is consistent with reducing inflation over the medium term. Within these self-imposed constraints, some countries have at times found it necessary to tighten monetary conditions further to prevent a too rapid or excessive depreciation of their currency. As a result, the mix of monetary and fiscal policies has retarded investment spending relative to other forms of spending. At the same time, countries with appreciating currencies have occasionally found their control over monetary growth rates threatened by the need to intervene in exchange markets in order to restore order.

Concerted policies to achieve growth rates among major countries consistent with a reduction in current account imbalances would permit monetary policies to be set more closely in line with domestic needs.

Political and Regulatory Hindrances to Investment -- Challenges to planned government and private sector investment either in the political process or in regulatory and legal processes, often because of environmental concerns, have held down the growth of expenditures in some cases. Uncertainties associated with regulatory processes may also have inhibited private investment even when it has not blocked it.

New approaches to these problems will be needed. First, governments should consider regulatory analysis programs, so that the economic and inflationary consequences of regulations will more explicitly be taken into account, and cost effective solutions adopted to deal with social and environmental problems. Even with improved analysis and procedures, it is likely that new social and environmental concerns will lead to some delays and higher costs. Therefore, more options for public projects and new incentives for private investment may be needed to compensate for the new risks and higher costs arising from new concerns and to maintain adequate investment. The negative impact on the growth of demand can also be overcome in the short run by stimulus to other kinds of spending, public or private.

Feasible Economic Objectives

The paths that our economies are likely to follow through 1979 if current policies are maintained would be unsatisfactory in several respects. Unemployment is unlikely to come down significantly and may continue rising in Europe. Excess capacity would remain substantial. Such an outcome would have several consequences. First, of course, would be the tragedy of unemployment -- particularly among the young whose development into productive members of the labor force is being delayed. Second would be the continued waste of material well-being, with lower investment and consumption and delays in meeting important social and economic objectives. Third, low rates of capacity utilization would continue to limit investment demand and thereby lower the trend of potential output and employment. Fourth, costs of adjustment to longer term structural changes in patterns of demand and supply would be higher than if the capital and labor that was no longer needed in one industry could be immediately employed in growing industries. Under conditions of weak overall demand there are strong pressures to adopt defensive policies that carry risks of inhibiting adjustment further, rigidifying economies and rendering them less productive and more prone to inflation. Finally, each year of slow growth and heightened uncertainty results in a further shortfall of capital accumulation and raises the spectre of future supply constraints and structural unemployment.

At the same time that the growth of output would be less than attainable with available resources, inflation would continue to be an important problem in most countries. Given the success already achieved in bringing down unemployment in the United States, and with the persistence of inflation at rates of 6 to 7 percent, inflation is the relatively more urgent problem there. Only in Japan and Germany can the short-run inflation situation be given a relatively low weight in current economic policy decisions. Of course, these countries too must avoid actions that would lead to significantly greater inflationary pressures in the future.

The outlook for the period ahead also entails current account imbalances that could continue to be a destabilizing factor in the world economy. Thus, they point toward serious risks of further disturbances in exchange markets that could prevent the achievement of even the modest growth in the outlook sketched above. Such disturbances could lead to worse than projected inflation rates in some countries and disrupt export industries in others.

The group has explored the scope for improving on the current outlook, taking note of work by the staffs of international organizations, and considered what measures would contribute to a better outcome. In doing so it has paid close attention to the constraints on economic policies and results.

Given the constraints, it does not seem possible to eliminate our economic problems quickly. We do not expect that one set of measures put in place this year will be sufficient to resolve the current problems. It has been three years since the trough of the recession and some of the origins of the current constellation of economic problems can be traced back at least ten years. Governments have taken steps to deal with the problems, often with a noticeable effect, but they have not yet been eradicated. Many economies have become so adapted to slow growth and idle resources that, inter alia, a sustained impetus to demand may be needed before the autonomous forces of expansion become strong enough to maintain growth, let alone pose the need for widespread restrictive action. Moreover, it is clear that inflation will not be unwound quickly and that the mechanisms that sustain inflation, even in the absence of excess demand, will not be dismantled easily. Simply because solutions will take time, it is essential to begin immediately and make progress as rapidly as possible.

Principles

The group agrees that the following principles should govern the development of national policies as a part of a cooperative international effort:

A. The development of a common strategy for more growth and employment must be regarded as a chief task of international economic policy. All countries should pursue policies of promoting growth as far as their constraints permit. In accordance with the different national starting points and relative economic positions, the scope for action available will, of course, differ from country to country.

B. To sustain recovery and attain full utilization of resources requires that we continue to make progress in reducing and controlling inflation. In countries where inflation is now low, we should avoid rekindling inflationary pressures. In countries where inflation remains high, the goal should be to reduce inflation in 1979 through appropriate fiscal and monetary policies and measures to deal with structural impediments to price stability.

C. Raising the share of industrial investment in GNP in our countries would be desirable. Governments should ensure that growth occurs in ways that increase business confidence and improve the prospects for profits.

D. Policies to achieve more sustained growth and better control of inflation will support the achievement of greater stability in exchange markets. In turn, exchange market stability is essential to sustained recovery. Thus, both countries in surplus and countries in deficit should work to reduce these payments imbalances and avoid extreme exchange rate fluctuations. Countries in strong external positions should also consider increased development assistance and removal of any existing obstacles to capital outflows, although such measures are not a substitute for adjustment of current account imbalances.

E. Pressures to resort to protectionism or increased government intervention must be resisted by our governments. Often these prop up or subsidize uneconomic industries, postponing inevitable structural adjustments. In the long run, such a course endangers productivity and the growth of living standards. In place of such policies, countries should introduce policies to promote structural adjustment through measures that aid the transfer of labor and capital to more productive, fast growing sectors. Protectionist measures should also be avoided with a view to assuring a growth in world markets for the products of developing countries.

F. Our countries and others must pursue vigorous policies of energy conservation and a development of new energy resources with particular emphasis on measures that will reduce oil imports.

<u>Elements of a Concerted Action Program</u>

1. The Economic Assessment Group agreed:

   -- Significant policy actions are economically necessary and feasible to improve the performance of our economies.

   -- Achieving non-inflationary full employment will be an extended process. Short-term measures alone will not be sufficient. It will require changes in our attitudes and institutions. But we must begin now if we are to achieve results in 1979 and beyond.

   -- Taken separately many of the necessary actions are likely to be politically difficult and economically risky; taken in concert they will prove politically acceptable and enhance our common economic prospects.

2. A necessary condition for sustained, non-inflationary growth is the appearance of more tranquil exchange markets and current account adjustment. The exchange market and balance of payments conditions necessary for world economic recovery will depend upon the avoidance, especially in the United States, of

conditions which threaten accelerating inflation. Another central requirement for such conditions is a definite commitment by the United States to an effective energy policy -- in particular, a specific commitment by the United States to raise domestic oil prices to world market levels, beginning in 1978 and completed no later than mid-1980.

3. Throughout most of the industrial world, unused resources are sufficient, in varying degrees, to permit an increase in economic growth without setting off new inflationary pressures. Only if efforts to increase growth are undertaken on a concerted basis, however, can undesirable balance of payments consequences be avoided and a proper role for export industries be maintained.

   a. While they should not be expected to make efforts alone, Japan and Germany must play an important role in this process. Both their balance of payments and domestic inflation give them significant room, over the next eighteen months, to achieve rates of growth significantly higher than in 1977.

   b. The principal Japanese contribution to concerted actions consists of a determination to undertake necessary actions to achieve its own growth and current account objectives for JFY 1978 and beyond. This may require (i) a relatively prompt decision on whether supplemental measures will be necessary to keep economic growth on the targeted course, and (ii) the use of other measures to reduce and eventually, under present international economic conditions, to eliminate the current account surplus.

   c. The central problems for Germany to resolve in the context of a concerted action program relate to (i) the effectiveness of alternative tax and expenditure measures for promoting self-sustaining growth, (ii) the timing of those measures, and especially (iii) the political and institutional feasibility of various policy decisions.

   d. Outside of the United States, Japan, and Germany, the Summit countries can increase their rates of economic growth in the context of a concerted action program. Some of the higher growth will occur automatically as the resulting expansion in world trade increases exports. Some non-inflationary actions could also be taken by these countries to increase growth.

e. In the spirit of concerted action, other members of the European Community and other industrialized countries could take action appropriate to the strength of their economic positions to promote faster growth. Others should avoid taking restrictive actions.

4. A commitment to a free and open trading system on the part of all countries is a central part of a concerted action program. The specifics of the necessary action are being developed elsewhere in the preparatory work for the Summit. There are three essential components of that commitment:

-- agreement to a sizeable reduction in tariffs as part of the MTN, including fair access to the markets of our countries for the products of developing nations;

-- agreement to substantial removal of non-tariff barriers to trade;

-- agreement to avoid protectionist measures.

5. Another essential element of a successful concerted action program would be an agreement to a general policy of promoting rather than impeding structural adjustment. This requires: on the one hand, promoting mobility of labor and capital, and increased scope for market forces; on ther other, avoiding measures which perpetuate unviable patterns of industry and trade.

6. Some countries have already taken actions within the spirit of what we are suggesting. Constitutional and political realities in each country must determine the appropriate timing for the announcement of further actions. We have not attempted to make specific recommendations on this matter. In general, however, we believe that wherever possible, formal announcement of measures be made in conjunction with the Summit even though preparatory consultations within each country may have already publicized the content of the measures. The impact of simultaneous and coordinated announcements could well exceed the sum of the impacts of a succession of announcements.