

BRW/hm
DER VORSTEHER
DES
EIDG. POLITISCHEN DEPARTEMENTES

Berne, September 21, 1965.

Confidentiel

handschriftlich:

"My dear Mr. Brown", "

On the occasion of our meeting of August 30 I made, during our conversation, some comments on your economic and social plans and your intentions with respect to European integration. After having discussed my viewpoints with my colleague Dr. Schaffner, I am glad to comply with your desire to have these comments in writing.

First of all I should like to stress once more the deep interest of my country in your and your colleagues' success in solving the short- and long-term problems of the British economy.

I do not know the British economy and the political possibilities in effectuating changes in it sufficiently well to form a conclusive opinion about the impact of the corrective measures taken so far and particularly those put into effect very recently. What follows, therefore, is in the nature of impressions such as they present themselves to the foreign observer.

I do hope that the plan to introduce legislation for an incomes policy and the support of such policy by the social partners will take you a great step ahead. In particular, I regard reforms in the structure and in the policies of the British labour unions as absolutely necessary. In both respects, I admire the vigour with which you tackled these difficult problems. It might be wise, however, not to

His Excellency
The Rt. Hon. George Brown, M.P.
First Secretary of State and Secretary
for Economic Affairs
L o n d o n

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expect too much of such pioneering endeavours if no better balance is achieved at the same time between the demand of goods and labour and their supply by means of the other measures applied. It seems clear to me that your incomes policy will only become effective in balance of payments terms once their first positive results are beginning to show.

Your Government's intention to restore confidence in the ability of the United Kingdom to redress its balance of payments very rapidly is of great importance. As long as rumours are allowed to persist about a devaluation of Sterling or the introduction of quantitative restrictions, such an atmosphere may make it difficult to restore the equilibrium of a passive balance of capital; and it is the very fact of its being passive which may force you to take particularly drastic deflationary measures. There was no hesitation on the part of the Swiss Government to participate in the recent action to protect the Sterling against speculations, and I am very glad to take note of its visible effects.

It seems highly desirable that this result be safeguarded against the recurrence of weaknesses. With undiminished international competitive power, short-term balance of payments problems in themselves ought to be relatively easy to overcome, provided a sufficiently extensive dampening of domestic business activity is taken into the bargain. The extent of the deficit obviously calls for vigorous dampening actions aimed at achieving quick results.

It is too early yet to form an opinion as to whether the various measures taken by your Government will have in time a physical effect sufficient for redressing the balance of current payments. After all, the trend of the trade balance such as it has presented itself since the beginning of

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the year is encouraging. One thing is certain: the measures taken so far have not convinced economic circles sufficiently - at least not until quite recently - so that the psychological anticipation of the physical dampening effects did not come about, and this psychological component is more important than the physical to determine the pace at which the corrective measures take effect. Indeed, the lack of psychological anticipation expressed itself spectacularly in the acceleration of the price and wage boom and in a continued outflow of capital.

Abroad, doubts in the effectiveness of the British measures arose in particular through the introduction and justification of the surcharge which led to the assumption that Sterling was being overrated and which made it impossible for economic circles to get a clear picture of the net effect of the various measures taken with a view to dampen the overheated economy.

The rise in the bank's minimum reserves, the reduction of purchasing power through taxes, the announcement of an incomes policy, the restriction of imports by introducing the surcharge were at least partly offset by the lowering of the bank rate, the increase in Government expenditure, accelerated wage and price increases, and by stimulation of domestic demand on account of the surcharge.

The business world was not in a position to calculate the presumable net effect of the measures partly cancelling each other, with the result that, as already pointed out, the necessary psychological anticipation of the physical dampening effect was lacking. In my opinion it would be of advantage if the various measures already taken or still to be taken could be shaped, presented, and carried out in such a way as to convince the business world that

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the equilibrium of the balance of payments would now be rapidly restored. I have not had the opportunity to study in detail the Five Year Plan of which you spoke to me, but I am sure that any coordinated effort of this nature will be beneficial. This would also make it easier for Great Britain's friends abroad to enlighten public opinion in their countries with regard to the various actions taken in support of Sterling.

In this context the existence of the surcharge is certainly more aggravating than generally assumed in London. It gives substance to the unfounded opinion of those who continue to predict the devaluation of Sterling and supports rumours which maintain that the surcharge will be followed by import quotas.

I should like to repeat especially my warning against giving the business world cause to count upon possible quantitative import restrictions. This would not only encourage unnecessary stock-piling but also maintain flight of capital. The introduction of quantitative import restrictions after the imposition of a surcharge, which was declared a short-term measure but has meanwhile been in force for a year, would no doubt widen the circle of those who are convinced that the United Kingdom will have to devalue. There is sufficient experience to show that quantitative import restrictions, applied on a broad basis, tend to loosen contact with the world market and to impair productivity. Such a measure would also tend to reduce EFTA-solidarity and would create a very difficult atmosphere at the forthcoming Copenhagen-Conference.

In my opinion the surcharge should rather be replaced by measures encouraging the dampening of domestic business activity. I am conscious of the difficult political

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problems arising from such a course of action and of the time factor involved in trying to attain such aims, but it would be beneficial to restoring confidence in Sterling if you could make such intentions as clearly visible as possible at a psychologically opportune moment.

These reflections, I hope, also answer your question as to whether it would be expedient to replace the surcharge by quantitative import restrictions.

You were also preoccupied, in the course of our meeting, with the question as to how the forthcoming EFTA Ministerial Conference in Copenhagen should be organized in order to serve the best possible purpose.

I think we both agree that, in view of the profound structural crisis which EEC is undergoing, the moment for bridge-building has not yet come. Both the Committee of Ministers and the Commission in Brussels are entirely paralysed, a condition which will continue at least up to the end of the year, so that any appeal on the part of EFTA would remain without answer. The problem of the position EFTA should take therefore is not only one of expediency, but also of dignity. We should, therefore, rather concentrate on the questions of whether and to what extent the EFTA Member-States should take additional measures for the implementation of the Stockholm Convention and to what extent a common EFTA-conception can be reached on certain sectors which are particularly suited to initiate a possible bridge-building attempt at a later date.

There are thus questions in the foreground which concern the functioning of EFTA proper. A well functioning EFTA might even prove to those who so far only believed in EEC that the Free Trade Association can represent an acceptable

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formula for integration. In this particular context I must repeat that the surcharge constitutes a heavy liability for the functioning of EFTA.

In other words, mandate 2 of the Vienna Conference, in my opinion, should occupy us in Copenhagen much more than mandate 1. In the long run, I see good hope that the present crisis in EEC will produce new opportunities for bridge-building and perhaps even to a return to the approaches which were worked out in OEEC prior to 1958. But the moment to intervene will come only after the dust produced in the night of June 30th - July 1st and September 9th has sufficiently settled.

I have been as frank as my esteem of your person and my deep admiration for Britain have dictated me to be. Should I have exceeded the limits of friendship, then please forgive me. I am looking forward to a continuation of the discussion on October 28th.

handschriftlich:

"With best personal regards,

Yours sincerely,

F.T. Wahlen"

Kopie geht an:

- Herrn Bundesrat Dr. H. Schaffner
- Abteilung für Politische Angelegenheiten des EPD
- Herrn Minister Dr. P.R. Jolles
- Herrn Minister Dr. O. Long
- Herrn Botschafter Dr. Beat von Fischer, London
- Herrn Botschafter Dr. E. Stopper