

PO-CH/NL/0195 Part C

Alex  
Lawson

PART C

**SECRET**

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PO -CH /NL/0195



PART C

CHANCELLOR'S PAPERS ON  
THE MEETING OF THE GROUP  
OF SEVEN (G7) COUNTRIES,  
19-21 JUNE 1988, TORONTO

NL/0195

PO -CH

PART C

Begin: 14/6/88

Ends: 17/6/88 (CONTINUED)

DD: 25 years

7/9/95

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CONFIDENTIAL  
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TO DFSKBY 150800Z FCO  
TELNO 437  
OF 141915Z JUNE 88  
INFO IMMEDIATE BONN, ROME

YOUR TELNO 281: TORONTO ECONOMIC SUMMIT: PRIME MINISTER'S BILATERAL WITH DE MITA AND KOHL.

1. THE ITALIAN AMBASSADOR HAS CONFIRMED THAT DE MITA HAS AGREED TO A BILATERAL WITH THE PRIME MINISTER AT 0900 HOURS ON SUNDAY 19 JUNE AT THE KING EDWARD HOTEL.

2. WE HAVE ALSO CONFIRMED WITH THE GERMAN EMBASSY THAT THE BILATERAL WITH KOHL WILL TAKE PLACE AT 1200 HOURS ON SUNDAY 19 JUNE AT THE KING EDWARD HOTEL.

URWICK

YYYY

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ADDITIONAL 37

ECONOMIC SUMMIT

*NNNN*

PW

From: P. EDMONDS  
DATE: 14 JUNE 1988

MR HUDSON 13/2

cc Mr Evans  
Mr PGF Davis  
Ms Syme of  
Miss Preston

### AGRICULTURE AND THE SUMMIT

The Chancellor asked for employment shares for the EC, and non-technical language to replace "standstill and rollback", for his press release on agriculture.

2. The <sup>percentage</sup> of civilian employment that was in agriculture, fishing, forestry and hunting in the 12 countries now in the EC fell from 16% in 1966 to 8% in 1986. These figures were constructed using the OECD's 'Labour Force Statistics' and so are consistent with those for Japan and the US, which came from the same source.

3. Mr Davis has kindly provided me with a revised third aim which explains the Punta del Este commitments without using the words "standstill and rollback." I attach a copy of his minute.

4. I hope this is helpful.

P. Edmonds

P.S. Mr Evans asked me to point out that the words "to standstill and rollback, ie" could be inserted after "del Este" if desired. Mr Davis's rewrite would then become an explanation

P.E.

FROM: P G F DAVIS  
DATE: 14 JUNE 1988

MR EDMONDS

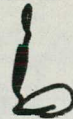
cc Miss Preston

**AGRICULTURE AND THE SUMMIT**

The draft press release on agriculture could avoid "standstill and rollback" by saying in the third tiret in paragraph 12:-

- **third**, to make operational the commitments agreed at Punta del Este to remove or phase out, within an agreed time, measures inconsistent with GATT which restrict or distort trade, and not to take any new ones;

This phraseology would be consistent with the Punta del Este Declaration.



P G F DAVIS



FROM: A C S ALLAN  
DATE: 14 JUNE 1988

CHANCELLOR

SUMMIT: PM'S BRIEFING MEETING

The main papers the Prime Minister will have are:

- i. the Steering Brief
  - ii. Nigel's Speaking Notes for the Opening Session; and
  - iii. the Political Declaration
2. Nigel's steer is that she should first consider the overall message from the Summit. There is a danger of it all being pretty boring, and we need a coherent message. Nigel suggests something on the lines: done a lot by pursuing sound macro-and micro-policies; now apply them to reach points not reached before: trade, agriculture, debt etc.
3. Nigel plans that this would lead to a substantive discussion of those three issues.
4. A couple of other issues might come up: exchange rate stability, where the thematic paper deliberately reiterates the language of the recent G7 communiqués; and indicators, where the US will want to make much of the commodity indicator.
5. Stuff on debt of the poorest is in a separate folder.

A C S ALLAN

pre-summit

Gredff SBCL  
Gieve, Jattnell  
ACSA HBush.  
APH  
HPE + 2  
Neil G. G. ✓

FROM: M HANNAFORD  
DATE: 14 JUNE 1988

MR GIEVE

cc Principal Private Secretary  
Sir G Littler  
Mr Bush  
Mr Bottrill

PRE-SUMMIT BRIEFING

The following journalists have accepted invitations to the pre-Summit Press Briefing to be given by the Chancellor at 3.00 pm, Wednesday, 15 June in the State Room at No 11.

- Robin Anlow - IRN
- Dan Atkinson - Press Association
- Mr Baum - Christian Science Monitor
- Marjorie Deans - Economist (Financial Report)
- Miss K De-Young - Washington Post
- John Fairburn - COI
- Warren Getler - Herald Tribune
- Rick Gibbons - Canadian Press
- Jonathan Gregson - Sunday Telegraph
- Robert Head - Daily Mirror
- John Hitchcock - Dow Jones
- Chris Huhne - Guardian
- Graham Ingham - BBC External
- Trevor Kavanagh - Sun
- William Keegan - Observer
- Mark Leheney - Knight Ridder
- Steve Levinson - Independent
- Steve Lohr - New York Times
- Rodney Lord - The Times
- Peter Norman - Wall Street Journal
- Brian O'Connor - Daily Mail
- Heather Peyton - BBC Financial World Tonight
- Janet Porter - New York Journal of Commerce
- Alan Ruddock - Today
- Anne Segall - Daily Telegraph
- Chris Smallwood - Sunday Times
- Philip Stephens - Financial Times
- Sten Stovall - Reuters
- Pam Woodall - Economist

M HANNAFORD

CH/EXCHEQUER	
REC.	14 JUN 1988
ACTION	Sir G. Littler
COPIES TO	Sir P. Middleton
	Sir T. Burns Mr H. P. Evans Mr P. Mountfield
From the Private Secretary	



*Prof*

10 DOWNING STREET  
LONDON SW1A 2AA

14 June 1988

TORONTO ECONOMIC SUMMIT

I enclose a copy of a letter to the Prime Minister from Mr. William Wallace of the Royal Institute of International Affairs which in turn encloses proposals for the Toronto Economic Summit from the Tokyo Club Foundation for Global Studies. I am not sure that any reply is needed beyond the acknowledgement which I have already sent him.

I am copying this letter and enclosure to Alex Allan (HM Treasury), Stephen Ratcliffe (Department of Trade and Industry) and to Nigel Wicks here.

Charles Powell

A. C. Galsworthy, Esq., C.M.G.,  
Foreign and Commonwealth Office.



# The Royal Institute of International Affairs

Chatham House 10 St James's Square London SW1Y 4LE  
Telephone 01 930 2233 Fax 01 839 3593

*Patron Her Majesty the Queen*  
*Chairman Christopher Tugendhat*  
*Director Admiral Sir James Eberle GCB*

Ref:WW/CH

13th June 1988

Charles Powell,  
Private Secretary to the Prime Minister,  
10, Downing Street,  
LONDON SW1A 2AA

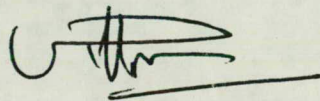
Dear Charles,

I attach, at the request of Christopher Tugendhat, a copy of the Tokyo Club proposals as presented to Mr Takeshita this morning. It is being released to the press in Tokyo today, and we are releasing it to the Financial Times at their request in London this evening.

You may know a little about the "Tokyo Club", which was an initiative of the Nomura Research Institute two years ago to set up a "G-5 of the Think-Tanks" alongside the intergovernmental G-5. The economists of the five institutes meet twice a year to compare perspectives and review their research work; at the June meeting they placed this in the context of the forthcoming G-7 Summit, and brief the Japanese Prime Minister on their recommendations. At their winter meeting they participated in a major conference in Tokyo (which appears in full on Japanese television, a briefer version of this year's conference was broadcast on Channel 4).

We are also sending copies to the Private Offices of Nigel Lawson and Sir Geoffrey Howe, at Christopher's request.

Yours ever,



William Wallace

Enc.

# The Royal Institute of International Affairs

Chatham House 10 St James's Square London SW1Y 4LE

Telephone 01 930 2233 Fax 01 839 3593

*Patron Her Majesty the Queen*

*Chairman Christopher Tugendhat*

*Director Admiral Sir James Eberle GCB*

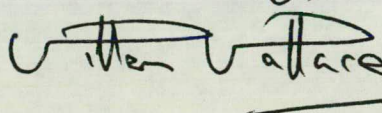
Ref:WW/CH

13th June 1988

The Rt Hon. Mrs M.H. Thatcher, MP FRS,  
Prime Minister,  
10, Downing Street,  
LONDON SW1A 2AA

Dear Prime Minister,

I attach on behalf of our Chairman, Christopher Tugendhat, the "Proposals for the Toronto Summit" from the Tokyo Club Foundation for Global Studies, which Christopher Tugendhat and his colleagues from institutes in the United States, Federal Germany, France and Japan presented to Mr Takeshita this morning in Tokyo. We hope that these may be of interest to you and your advisers in the preparations for the Summit.

Yours sincerely,  


William Wallace  
Deputy Director

Enc.

**PROPOSALS FOR THE TORONTO SUMMIT**

June 13, 1988

Tokyo Club Foundation for Global Studies

Brookings Institution (U.S.A.)

IFO-Institut für Wirtschaftsforschung (F.R.G.)

Institut Français des Relations Internationales (France)

The Royal Institute of International Affairs (U.K.)

Nomura Research Institute and Nomura Computer Systems (Japan)

**Proposals****Overview**

- I. Macroeconomic Imbalances
  - 1. United States
  - 2. Japan
  - 3. Europe
  - 4. Newly Industrialized Countries (NICs)
  
- II. International Systemic Problems
  - 1. The World Trading System
  - 2. The International Monetary System
  - 3. Debt and Aid Problems

The world economy has absorbed the shock of the decline in stock markets in October 1987 far better than was anticipated immediately after the declines occurred. The risks of recession during the year 1988 now appear to be small, while the risks of renewed inflation have somewhat increased.

The problems to which the turbulence in financial markets called attention remain unresolved. For example, although the huge current account imbalances among the major developed countries have begun to decline, the pace of reduction is still too slow. More progress is necessary to assure healthy, noninflationary growth in the world economy.

The role of the United States in promoting the needed adjustments is central. Japan and West Germany, with their large surpluses and economic power, bear the next heaviest responsibility for reducing the imbalances.

In addition to macroeconomic imbalances, the world economy is plagued by other systemic problems. These include the lack of progress in the current round of GATT negotiations, the fragility of the international monetary system, and the continuing seriousness of the debt problems of developing countries.

## I. Macroeconomic Imbalances

The imbalances in current accounts are still enormous, casting dark shadows over the stable growth of the world economy. During the past 12 months, since the Venice Summit in May 1987, the need for international cooperation to curb the current account imbalances has been stressed a number of times. Apart from measures in Japan to stimulate domestic demand, little has been done to modify economic policies. The current approach to the problem seems to be to wait for the next U.S. president to take some drastic action to cut the U.S. fiscal deficit, in the meantime trying to buy time through rhetorical support for improved international cooperation.

### 1. The United States

The urgent task for the United States is to reduce the still swollen deficit of the federal government. Past agreements between the President and the Congress to deal with the budget deficit have been timid and inadequate. Regrettably, effective action is likely to be postponed until after the November 1988 elections. As their highest economic priority, early in 1989 the new President and the new Congress should act decisively to adopt a multi-year program for reducing the structural budget deficit. A credible budget compromise must include both expenditure cuts and tax increases.

The failure of the United States to adopt adequate changes in fiscal policy is rekindling inflation. In the absence of such changes, increases in the rate of capacity utilization, reductions in the unemployment rate, and the 1987-88 depreciation in the

exchange value of the dollar are threatening to put upward pressure on wages.

Based on the current economic conditions, the recent actions of the Federal Reserve to tighten credit slightly seem appropriate. More tightening in the future may be necessary if domestic demand threatens to grow too rapidly. However, this monetary tightening will be costly to domestic investment in the United States and to successful servicing of the debts of the developing countries. It would be much better, for the United States and for other countries, to resist inflation pressures through U.S. fiscal rather than monetary restraint.

## 2. Japan

Important progress has been made in shifting the sources of expansion in the Japanese economy to domestic demand away from exports, while maintaining a high rate of growth. However, this progress is primarily due to the income effects of higher growth and the price effects of yen appreciation. Market opening measures that entail real pain have only been taken slowly. To sustain progress in reducing its external surplus, Japan must be more decisive in pursuing structural policies that open its markets further and alter regulations that inhibit adjustment. The Japanese government must be more courageous in adopting such measures even if they are painful and politically difficult. In particular, further deregulation and market opening in the fields of agriculture, distribution, telecommunications, construction, and transportation should result in improved efficiency in those industries and lead to a better life for the Japanese people.

While opening its markets, Japan must be careful to follow macroeconomic policies that sustain the noninflationary expansion of the domestic economy.

### 3. Europe

The macroeconomic situation in European countries exhibits significant diversity. The extent of the external imbalance varies widely among individual economies, with current account surpluses excessively concentrated in Germany and to a lesser extent Switzerland, the Netherlands, and Belgium. Some countries, notably the United Kingdom, Italy and Spain, have achieved relatively high growth, while others like France and Germany seem trapped in a slow growth future. Accordingly, macroeconomic constraints differ widely. Everywhere, however, unemployment remains a paramount concern.

Within the current EMS-exchange rate environment, appropriate stimulus to growth coming from Europe requires Germany to take the lead. In effect, France is constrained by the need to capitalize on the progress toward disinflation and structural adjustment; Britain and Italy are confronted with a delicate weighing of their internal and external objectives for growth, inflation, and the exchange rate. Germany, with its high unemployment and huge current account surplus, has the margin of maneuver to provide the needed stimulus with a clearly expansionary fiscal policy. That could be achieved by moving forward the tax reduction scheduled for 1990 and foregoing the consumption tax increase proposed for 1989. If it fails to do so, a significant realignment of EMS currencies and appreciation of the Deutsche Mark will be

necessary, although it may carry some destabilizing effects, notably on inflation in devaluating countries.

In the longer term, however, Europe can deal with its unemployment problem and reach a sustainable, higher rate of growth, only if supply conditions improve. Liberalization and deregulation have been helpful in reducing impediments to growth in some countries, but more is required, especially in Germany. In this respect, completion of the internal market provides a welcome opportunity and a worthwhile challenge.

#### 4. Newly Industrialized Countries (NICs) of Asia

The Asian NICs, Korea, Taiwan, Hong Kong and Singapore, have achieved high rates of economic growth, and they have become important players in the world economy, providing an example to developing countries in other parts of the world. At the same time, they have developed substantial trade surpluses. It is desirable that Asian NICs contribute over time to the reduction of world trade imbalances. Since their individual circumstances vary, they should develop their own policies to achieve that goal, while continuing their progress in modernization and industrialization.

## II. International Systemic Problems

### 1. The World Trading System

The Punta del Este agreement to launch a new round of trade negotiations was an important and positive step. Including the large area of services for the first time in multilateral trade



discussions and covering both direct and indirect support to agriculture set an ambitious agenda for the talks. Now, however, the talks appear to be stalled in several key areas. This lack of progress encourages protectionist sentiment in the United States, causes the European Community to focus more on its internal reform effort and less on its multilateral context, and encourages efforts to reduce bilateral trade imbalances through circumvention of GATT rules.

The most important area of GATT stalemate is agriculture. The U.S. insistence on full liberalization as the negotiating goal has met firm rejection from the EC. Meanwhile, the Japanese proposal has little common ground with either of the others. The U.S. and the EC negotiators should begin to seriously explore the room for a compromise agreement on the negotiating framework (such as a target of 50% reduction in subsidies over 5 years) so that real progress can be demonstrated at the December mid-term review. The Japanese government should be willing to liberalize agricultural imports and reduce subsidies in concert with the other countries.

Economic integration of a huge area like the 12 members of the EC and the U.S.-Canada free-trade block will enhance their economies by expanding the size of some markets. However, these arrangements should provide free access and opportunities to third parties, which reinforces the need for continuing market opening in other parts of the world.

## 2. The International Monetary System

The demand of private investors for U.S. dollar assets declined sharply in 1987. The American current-account deficit was

financed, indirectly, by heavy support of the dollar in exchange markets by central banks. This exchange-market intervention was extraordinary and cannot be indefinitely sustained. Since the beginning of 1988, the foreign exchange markets have remained relatively tranquil. But exchange and other financial markets remain vulnerable to adverse changes in expectations about economic policies.

In this situation, the governments of the major countries seem likely to continue supporting the "invisible reference zone" approach, which they have de facto been pursuing since early 1987. This approach, however, is at best fragile. Stabilization of exchange rates around the levels current in June 1988 cannot be viable without changes in domestic macroeconomic and structural policies that foster adjustment of existing payments imbalances.

For the longer run, governments should continue to explore ways to improve the international monetary system. These improvements might include cooperative guidelines and institutional arrangements for the management of exchange rates and the coordination of macroeconomic policies.

### 3. Debt and Aid Problems

There still is a debt crisis. The current debt rescheduling process is becoming less effective, while smaller banks increasingly seek to get disentangled from this process. In addition, the Baker plan has succeeded in mobilizing only very limited new resources from the commercial banks to support LDC adjustment. We are "muddling on" rather than "muddling through."

A number of new initiatives has been proposed. These include forgiveness of debt for some of the lowest income countries. In other cases, a partial reduction of principal and long term restructuring can be effective. The implementation of these options will need the active encouragement of governments. In any event, several countries are on the brink of serious social/political disruption. The situation is so serious that it behooves the summit leaders to give a higher priority to the resolution of this problem.

Besides considerations of debt forgiveness for the poorest countries, the quantity, structure and quality of foreign aid must be reviewed. The industrialized countries should increase their foreign aid, which is currently far below the benchmark of 0.7% of GNP postulated by the OECD. The quality of official development aid would improve if the grant element were raised and the loan element untied. Japan, in particular, could provide more official development aid by substantially increasing its contribution to the capital of the major international institutions, including the IMF and the World Bank. If the United States is unwilling to contribute as large a share of new capital contributions as in the past, it should agree to reduce its voting share in the institutions as a means of allowing others to raise their contributions.

These measures on the part of the industrialized countries must be matched by a willingness on the part of the developing countries to undertake structural reforms, and to open their economies to alternative financial instruments including equity and direct investment.

CH/EXCHEQUER	
REC.	15 JUN 1988
ACTION	Sir G. Little
COPIES TO	Sir P. Middleton
	Sir T. Burns
	Mr H.P. Evans
	Mr P. Mountfield
From the Private Secretary	



10 DOWNING STREET  
LONDON SW1A 2AA

14 June 1988

*Dear Sir,*

TORONTO ECONOMIC SUMMIT

Following Alex Allan's letter to me of today, I attach a further version of the Prime Minister's note for the opening session which takes account of the points that Alex made.

I am copying this letter to Alex Allan (HM Treasury) and Trevor Woolley (Cabinet Office).

*Nigel Wicks*

(N. L. WICKS)

Lyn Parker, Esq.,  
Foreign and Commonwealth Office.

DRAFT SPEAKING NOTE FOR THE PRIME MINISTER TO USE AT THE  
OPENING SESSION OF THE ECONOMIC SUMMIT

1. Any initial courtesies which are necessary  
e.g. welcoming Mr. De Mita and Mr. Takeshita  
congratulating President Mitterrand  
saying farewell to President Reagan  
thanking Mr. Mulroney for the Summit  
arrangements, etc.
  
2. The annual Economic Summits are a time for sharing, quite informally, experience on the economic situation and a time for resolution on the common economic action which we should follow in the years ahead. The Summit forum alone can see every dimension of the global issues before us. Summits have provided, in the past, opportunities for leaders to take charge of issues from the bureaucrats and give them a political push which can only come from the very top. This Summit should be no exception.

[Paragraphs 3-10 can be omitted in the interests of brevity.]

- [3. This is the last of this series of Summits which President Mitterrand initiated in Versailles in 1982. President Mitterrand, President Reagan and the President of the European Commission (who was present as the French

Minister of Finance) will remember the problems which faced us at that Summit.

(i) World recession in the period 1980-82: output growth averaged under 1 per cent over these three years, and output actually fell in 1982.

(ii) Inflation in the industrialised countries averaged about 10 per cent in 1981 and 1982.

(iii) Investment in industrial countries had fallen by  $2\frac{1}{2}$  per cent a year over the period 1980-82.

4. The problems of the world economy are not all solved. Far from it. But there has been an enormous improvement in the world economic situation in the last six or seven years. In particular:

(i) growth has averaged a good 3 per cent a year since 1982;

(ii) inflation has come down to and stayed at around 3 per cent;

(iii) Investment has risen continuously since 1982 in the industrial countries at an average of  $4\frac{1}{2}$  per cent a year.

(iv) in many countries, unemployment is falling.

But there remain serious problems: the fiscal deficit in the United States, and trade imbalances there and in Japan and Germany; the protectionist threat; high unemployment, especially in Europe; the massive scale of agricultural protection and support; and the serious position in many developing countries, especially in Africa.

5. That improvement has not come about by accident. The seventies were a decade of financial irresponsibility, economic mis-management and economic opportunity foregone. But in the Eighties, the Summit countries have lead the way in implementing a change in the approach to economic policy of historic proportions. Successive Summit declarations bear witness to that change. And many other countries are now following our lead. International cooperation fell apart in the Seventies and has been gradually rebuilt during the current series of summits. Priority has been given to inflation and to prudent fiscal and monetary policies. But the real innovation has been the emphasis on "structural reform", tax reform, abolishing controls, introducing competition, privatisation and the need for freer world trade especially in agriculture, following our discussion at the Tokyo Summit 1986.
6. The recent record of economic history shows the rightness of these policies. The world economy could not have

withstood so well the shock of last Autumn's fall in stock prices unless our policies had built sound foundations.

7. I suggest that our task at this Summit is to consider how to carry these policies through the rest of the Eighties and into the Nineties, so that we can carry on the progress already made. That will require,
- first, continuing action to reduce trade and budgetary imbalances;
  - second, progress with our national structural reform programmes;
  - third, a successful conclusion to the Uruguay Round; and as part of that,
  - fourth, continuing action to - and here I use the words in the Economic Declaration issued in Venice in 1987 - "... allow market signals to influence ... agricultural production ...",
  - fifth, supporting the developing countries in their efforts of economic reform; and I want to say something on the various debt initiatives in a moment.

#### The Imbalances

8. First on the imbalances. There has certainly been some progress. THE US budget deficit is now on the way down, and the trade imbalances are at last beginning to decline. But there is still a long way to go, and it



will help confidence if we acknowledge the need for further and sustained action to get the imbalances under control. I shall want to say more about that in our session tomorrow.

#### Structural Reform

9. It is vital that the surplus countries too play a full part in resolving the imbalances problem. But it is through structural reforms to open their markets and invigorate their economic performance - not through fiscal stimulus - that they must make their contribution.
10. Education and training is a particular element of structural reform that I want to stress. We face a decade of technological change, fewer young people coming into the workforce, and the need for training and retraining, not just for the young people but right through the working life, so that people can be re-equipped with new skills. I look forward to discussing this important issue at our informal session tomorrow.]

#### Trade and agriculture

11. Agriculture and trade are, in my view, priority topics this Summit. Certainly, Summits are not negotiating bodies. We cannot get into the details which are under discussion in Geneva. But we must give an impetus to

those discussions and map out some common directions so as to keep up the momentum.

### Trade

12. To take trade first: too often in the last few years there have been threats of trade wars. Protectionism has inched forward. And protectionism reduces growth in our countries, puts up inflation in the short term, increases unemployment in the long term and damages the developing countries. The GATT Round provides an opportunity to turn back protectionism to the benefit of both our own economies and to the developing countries. We must seize that opportunity and maintain and extend the open world trading system by multilateral reduction of trade barriers.
  
13. I believe that the Mid Term Meeting (MTM), to be held in Montreal in December, offers a valuable opportunity to demonstrate that real progress can be made in all areas of the Uruguay Round. This progress should cover the areas to which we gave special emphasis at our previous meeting at the Tokyo summit, namely trade in services, intellectual property rights and foreign direct investment. A significant step towards the Round's successful conclusion would be the establishment at an early date of an agreed negotiating framework. I believe, too, that we should use to the fullest extent possible at the mid term meeting the provision in the

Punta Del Este Declaration which permits the implementation of agreements reached at an early stage in the negotiations. We must not hold up action on any issue until agreement is reached on all issues. For example, tropical products are a high priority for the developing countries for whom there is unlikely to be much else on the table at Montreal. If we can by then agree on other issues too, so much the better. Above all the strengthening of GATT itself must be a high priority. We should work for the earliest possible agreement on ways of reinforcing the GATT process: through greater involvement of political Ministers; through intensification of the surveillance of trade policies; and through greater effectiveness of dispute settlement procedures so that disagreements can be resolved speedily, conclusively and fairly.

14. I suggest that these are the objectives which Summit countries should set themselves in making their contributions to the preparation for the Montreal meeting.

#### Agriculture

15. The Venice and Tokyo Summits made reform of agriculture policy a priority for our Governments. Present agricultural policies distort national economies by putting unfair burdens on the consumer.

16. In February the European Community took some important first steps to reform agricultural policy. We now have:

- a legally binding ceiling which will cut the growth of agricultural spending to less than 2 per cent a year in real terms, from around 10 per cent in recent years,
- and automatic stabilisers for each individual commodity which will cut support levels if production exceeds pre-set levels, and thus discourage surplus production.

If production continues on current trends, the stabilisers will save some \$4 billion in the three years 1988/90. In cereals alone, if production continues to rise, support levels will fall by 15 per cent over the next four years. For oilseeds, where we already have a stabiliser in place, the new measures should save a further \$1 billion by 1990.

17. That agreement was a real achievement for the Community and for the world.

No-one should belittle what the Community has achieved. But far more needs to be done by all of us to achieve our agreed [i.e. in the OECD Communique] long term objective of reducing agricultural support and protection, while maintaining, at the same time, a dynamic and viable

agricultural sector.

18. This Summit should make clear that the Montreal Mid-Term Review should give a good shove to the negotiating process. So far there has been a dialogue of the deaf between our officials. I believe it is for us here to re-inject the sense of political urgency which we so successfully invoked at our Summits in Tokyo and Venice. The aims are clear:-

- first, as our long term objective, to work for liberalisation of world agricultural markets, through major reductions in overall support and protection;
- second, to determine a framework for the GATT negotiations, that focuses specifically on an overall measure of support [such as the producer subsidy equivalent];
- third, to make operational the standstill commitments that were agreed at Punta Del Este;
- fourth, a multilateral commitment to specific early action that not only prevents the situation getting worse, but also makes real headway towards our long term objectives.

We should not try to negotiate the details now. But we

should commit ourselves, here and now, to make concrete progress towards agreement on these matters at the Mid-Term Meeting in Montreal in December.

19. Finally, a word on the debt of the poorest countries. I have been greatly encouraged in recent weeks by the willingness of the United States and France, in particular, to join in the search for solutions which will reduce the debt burden faced by these countries. In Venice last year, we recognised that their problems were "uniquely difficult" and needed "special treatment". And we agreed that consideration should be given to interest rate reductions for those countries which were following sensible adjustment policies. Let me again urge as many as possible to accept interest rate reductions, as the UK has been advocating for some time. For those unable to do this, then some other visible and additional move is vital: extending the rescheduling period to 25 or 30 years is one possibility. The important point is that all countries must take action that will bring a significant reduction in the interest burden over and above what has already been done. It is vital we now reach a conclusion on this issue.
  
20. There are many other issues we need to consider at the Summit - the Newly Industrialising Economies is an obvious example. But I will reserve my comments on this subject until later.

21. Mr. Chairman, this Summit gives us an opportunity to reinforce the close international cooperation of recent years and so to shape economic history for the rest of the century. Let us seize it.

*Pryg*



Minister of Finance

Ministre des Finances

14 June 1988

Mr. Nigel Lawson  
Chancellor of the Exchequer  
H.M. Treasury  
Parliament Street  
London, SW1P 3AG  
UNITED KINGDOM

CH/EXCHEQUER	
REC.	15 JUN 1988 ✓ 15/6
ACTION	SIR G LITTLE
COPIES TO	SIR P MIDDLETON
	SIR T BURNS
	MR EVANS
	MR MOUNTFIELD

My dear *Nigel* Colleague:

I am writing to outline the agenda I propose for our sessions at the Toronto Summit. I have enclosed a table showing the times of our meetings and the proposed subjects.

As you can see from the table, we will have the opportunity to meet by ourselves a total of six times during the three-day Summit. Following our third meeting together, which will be quite brief, I will deliver an oral Finance Ministers' Report to Leaders. This will take place at the beginning of the Monday morning plenary session. My presentation will give us an opportunity to register with Leaders our discussions in areas of mutual concern, and to suggest communique language on issues of importance to us.

Following my presentation, we will have two further meetings together during a luncheon and dinner on Monday. In addition, we have a block of time free on Monday afternoon when we could meet if the need arises.

With this background in mind, I propose that we devote our first session (Sunday, June 19, 1500 - 1700) to a discussion of the debt of low- and middle-income developing countries. We might also take some time in this session to review our relations with the newly industrializing economies.

With regard to the debt of the poorest countries, agreement on a menu of options approach, including concessions, for rescheduling the debt of these countries at the Paris Club is likely to be a major achievement of this Summit, and I think it is important that we reach a consensus on this issue at the earliest possible opportunity. In view of the strongly supportive statements that have emerged from

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a number of countries in recent days, I am confident that a consensus is possible.

With regard to the debt of the middle-income countries, I would like us to have a full discussion of the possibilities for a more active role for the IFIs in facilitating innovative financing techniques.

At our first dinner (Sunday, June 19, 1900 - 2100), I would like to begin with a discussion of structural reform. I believe we are in agreement on the merits of structural reform, and I suggest we seek agreement on communiqué language that would endorse the inclusion of structural policies in the process of international policy coordination.

You in the United Kingdom began the process of structural reform before the rest of us, giving you a unique perspective on this important policy area. I would be pleased if you would agree to begin our discussion. It is certainly not necessary to prepare anything formal, but if you could speak for four or five minutes at the start I think it would help get the discussion underway.

I would also like to discuss over dinner Agriculture and the Multilateral Trade Negotiations. I think it would be productive for us to undertake a low-key exploration of ways to reduce the polarization that is evident on agriculture, and to seek ways to make progress towards a meaningful Mid-Term Review in Montreal.

Before we finish dinner, I suggest we briefly review the possible elements of our report to Leaders at Monday's plenary session. Following dinner, I will draft my speaking notes to reflect our discussion, and circulate the notes to you on Monday morning. We will have a short session (Monday, June 20, 1000 - 1015) to discuss the notes, following which I will make an oral presentation to the Leaders.

I propose that we discuss macroeconomic issues during our luncheon (Monday, June 20, 1230 - 1400). I think we are in general agreement on the current situation and the outlook for the remainder of this year. I therefore suggest that we focus on the risks to the outlook and on the longer-term issues. Without looking for specific policy commitments, we might want to discuss what additional policy measures will be necessary to sustain adjustment beyond this year.

Our final session together will be over dinner (Monday, June 20, 2000 - 2130). I propose that we spend this time looking ahead to the future of the multilateral trading system, and in particular to discussing the challenges and opportunities presented by regional trading agreements such

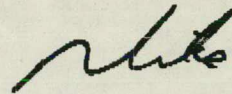
What does this mean?

as the the European Single Internal Market and the  
Canada/United States Free Trade Agreement.

At some point during our meetings I think it would  
be useful to discuss those aspects of the drug problem that  
relate to our responsibilities as Finance Ministers, such as  
money laundering. I suggest, however, that we work this  
discussion in when we can, rather than try to schedule it in  
advance.

I look forward to working with you in Toronto.

Yours sincerely,



Michael H. Wilson

**FINANCE MINISTERS MEETINGS  
TORONTO SUMMIT  
JUNE 19 - 21, 1988**

**AGENDA**

<b><u>SESSION</u></b>	<b><u>SUBJECT</u></b>
Sunday, June 19 1500 - 1700	Debt of the poorest countries Debt of the middle-income countries Relations with the newly industrializing countries
Sunday, June 19 1900 - 2100 (Dinner)	Structural reform Trade and agriculture
Monday, June 20 1000 - 1015	Finance Ministers' Report to Leaders
Monday, June 20 1230 - 1400 (Lunch)	Macroeconomic policies and adjustment
Monday, June 20 1600 - 1700	Open
Monday, June 20 2000 - 2130 (Dinner)	European Single Internal Market Canada-U.S. Free Trade Agreement

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WHITE HOUSE PRESS BRIEFING ON ECONOMIC ISSUES AT TORONTO SUMMIT  
SUMMARY

1. WALLIS AND MULFORD BRIEFED US PRESS ON LIKELY TOPICS AT TORONTO. POLICY CO-ORDINATION, TRADE ISSUES AND INTERNATIONAL DEBT SAID TO BE MAIN ECONOMIC TOPICS. LESS CERTAINTY ABOUT NON-ECONOMIC ISSUES BUT WALLIS EXPECTED DISCUSSIONS TO COVER EAST-WEST RELATIONS, MOSCOW SUMMIT, PHILIPPINES, TERRORISM, DRUGS AND ENVIRONMENT.

DETAIL

2. AT A WHITE HOUSE PRESS BRIEFING, MULFORD (TREASURY), AND WALLIS (STATE) DISCUSSED THE TOPICS THAT THEY THOUGHT WOULD BE DISCUSSED AT THE SUMMIT. THE BRIEFING WAS SUPPOSED TO CONCENTRATE ON ECONOMIC ISSUES BUT WALLIS WAS ASKED A FEW QUESTIONS ON OTHER ISSUES.

POLICY CO-ORDINATION AND THE COMMODITY PRICE INDEX

3. MULFORD SAID THE US WOULD REAFFIRM ITS COMMITMENT TO CLOSE COOPERATION TO HELP CO-ORDINATION AND QUOTE TO FOSTER EXCHANGE RATE STABILITY UNQUOTE. HE HOPED THE SUMMIT WOULD STRENGTHEN CO-ORDINATION EFFORTS BY, FIRST, OBTAINING AGREEMENT AND IMPLEMENTING A NEW COMMODITY PRICE INDICATOR AND, SECOND, BY AGREEING QUOTE TO COOPERATE MORE CLOSELY AND MORE EFFECTIVELY TO PURSUE STRUCTURAL POLICY CHANGES IN THE VARIOUS ECONOMIES WHICH WE HOPE CAN BE INTEGRATED IN SOME WAY MORE CLOSELY INTO THE CO-ORDINATION PROCESS UNQUOTE. MULFORD DESCRIBED THE COMMODITY PRICE INDEX AS A QUOTE USEFUL ADDITIONAL TOOL THAT WILL HELP EVALUATE WHAT IS GOING ON ACROSS THE BOARD IN THE WORLD ECONOMY UNQUOTE. HE REFUSED TO BE DRAWN ON THE PRECISE WEIGHT TO BE GIVEN TO GOLD, BUT SAID HIS GUESS WAS THAT IT WOULD BE INCLUDED ALTHOUGH THE WEIGHTINGS FOR THE INDEX WOULD PROBABLY REMAIN CONFIDENTIAL.

4. MULFORD WAS ASKED WHETHER THERE WOULD BE PROGRESS ON MONITORING ZONES OR OTHER INDICATORS AS MENTIONED BY SECRETARY BAKER IN HIS RECENT PARIS SPEECH. HE REPLIED THAT THIS SUBJECT REQUIRED MORE STUDY AND WOULD PROBABLY NOT BE DISCUSSED UNTIL THE NEXT G7 MINISTERIAL MEETING.

DEBT

5. MULFORD THOUGHT THAT FOR LARGE, MIDDLE INCOME DEBTORS THERE WOULD BE QUOTE A STRONG REAFFIRMATION OF THE PRESENT STRATEGY

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UNQUOTE. FOR POORER COUNTRIES THERE COULD BE CHANGES OF QUOTE  
CONSIDERABLE SIGNIFICANCE UNQUOTE. HE SAID PARIS CLUB  
RESCHEDULINGS THAT INVOLVED QUOTE A DEGREE OF RELIEF BY EXTENDING  
MATURITIES OR BY REDUCING COSTS UNQUOTE WERE ALREADY AGREED.  
THE OUTSTANDING QUESTION WAS QUOTE WHETHER THERE CAN BE  
FURTHER RELIEF PROVIDED TO THESE COUNTRIES THROUGH THE PARIS  
CLUB PRIMARILY BY FINDING A WAY TO ALLOW CONCESSIONARY RATES TO  
BE GRANTED IN THOSE CASES WHERE IT IS JUSTIFIED UNQUOTE. MULFORD  
SAID THE DISCUSSION, FROM THE US STAND-POINT, WOULD BE ALONG THE  
LINES OF SECRETARY BAKER'S RECENT SPEECH IN AFRICA. THE FIRST  
IMPORTANT POINT WAS THAT THERE SHOULD BE DIFFERENTIATION BETWEEN  
CREDITORS THAT WOULD QUOTE ALLOW THOSE WHO WISH TO GIVE  
CONCESSIONAL RATES TO GO AHEAD AND GIVE THEM. AND THAT WOULD  
NOT, IN OUR CASE, NECESSARILY INCLUDE US BUT IT WOULD ALLOW  
RELIEF TO BE GRANTED BY THE GROUP TO SOME EXTENT UNQUOTE.  
THE SECOND REQUIREMENT WAS THAT ANY SCHEME BE IMPLEMENTED ON A  
FLEXIBLE QUOTE CASE BY CASE UNQUOTE APPROACH.

OTHER ECONOMIC AND NON-ECONOMIC ISSUES

6. WALLIS SAID THAT THE BIG ECONOMIC PROBLEMS THAT WOULD BE  
THE FOCUS OF THE SUMMIT WERE QUOTE TRADE AND LIBERALIZATION OF  
TRADE WITH A SPECIAL EMPHASIS ON AGRICULTURE UNQUOTE. ON NON-  
ECONOMIC TOPICS HE MENTIONED EAST-WEST RELATIONS, THE MOSCOW SUMMIT,  
DRUGS (AND POSSIBLY MONEY LAUNDERING), TERRORISM AND THE  
ENVIRONMENT. HE WOULD NOT GET DRAWN ON DETAILS. IN RESPONSE  
TO A QUESTION ABOUT THE PRESIDENT'S RECENT REMARKS ABOUT A PLAN  
TO HELP THE PHILIPPINES AND AFGHANISTAN, WALLIS SAID THAT THERE  
MIGHT BE TALK QUOTE ABOUT WHAT THEY CAN DO CO-OPERATIVELY THAT  
WILL IMPROVE THE SITUATION IN THE PHILIPPINES UNQUOTE.

COMMENT

7. THE BRIEFING CONTAINED FEW SURPRISES. MULFORD'S COMMENTS  
SUGGEST THAT HE EXPECTS PROGRESS IN OBTAINING AGREEMENT ON A  
COMMODITY PRICE INDICATOR, INCLUDING GOLD, AND SOME KIND OF  
DEAL FOR SUB-SAHARAN AFRICAN DEBT.

8. FCO PLEASE ADVANCE TO RICHARDSON AND SIR G LITTLER, LANKESTER  
AND EVANS (TREASURY) AND WARE (BANK).

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ADDITIONAL 37

ECONOMIC SUMMIT

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FROM: J M G TAYLOR

DATE: 15 June 1988

MR H P EVANS

cc Sir Geoffrey Littler  
Mr Lankester**ECONOMIC SUMMIT: THE JAPANESE ECONOMY**

The Chancellor has seen Tokyo Telno 589 (attached).

2. He has noted in particular the passage in paragraph 10 which reads: "But it is still appropriate, as seen from here, for Japan's partners privately to express concern about the risk to market stability from the likely level of surplus, and urge speedier action to liberalise financial and agricultural markets and to increase imports by further tariff reductions, deregulation of controlled prices, major purchases of capital goods and by introducing greater competition into the distribution system". He agrees with this, which he has commented is highly relevant to Toronto (and after). He wonders, however, whether it is the Japanese public sector which is meant to be urged to make major purchases of capital goods, or whether this goes wider.

A handwritten signature in dark ink, appearing to be "JMG".

J M G TAYLOR

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ECONOMIC SUMMIT: THE JAPANESE ECONOMY

SUMMARY

1. STRONG GNP GROWTH LED BY DOMESTIC DEMAND LIKELY TO CONTINUE. IMPORTS STILL INCREASING RAPIDLY BUT REVIVAL OF EXPORTS THREATENS GOVERNMENT'S TARGET FOR REDUCTION IN TRADE SURPLUS. GOVERNMENT FORMULATING MEDIUM TERM OBJECTIVES FOR DOMESTIC DEMAND - LED GROWTH AND STRUCTURAL REFORMS. DESPITE PROGRESS MADE JAPAN'S PARTNERS SHOULD CONTINUE TO PRESS FOR MORE URGENT ACTION TO INCREASE IMPORTS.

DETAIL

THE DOMESTIC SECTOR

2. STRONG GROWTH CONTINUES, LED BY DOMESTIC DEMAND, AND SPREAD WIDELY ACROSS INDUSTRIES AND REGIONS. EPA QUARTERLY REPORT DUE OUT SHORTLY IS EXPECTED TO SHOW GNP GROWTH AT AN ANNUAL RATE OF 10 PERCENT OR OVER IN JANUARY-MARCH, WHICH MAY LIFT THE FINAL OUTTURN FOR FY 1987 TO BETWEEN 4.7 PERCENT AND 5 PERCENT. FURTHERMORE THIS LEVEL OF GROWTH IS EXPECTED TO CONTINUE AT LEAST THROUGH THE FIRST TWO QUARTERS OF FY 1988. ALTHOUGH HOUSING INVESTMENT, WHICH LED TO LAST YEAR'S EXPANSION, HAS PEAKED IN THE MAJOR CITIES, INDUSTRIAL CAPITAL INVESTMENT, IS EXPANDING RAPIDLY IN ANTICIPATION OF CONTINUED STRONG DEMAND, AND PERSONAL CONSUMPTION IS LIKELY TO REMAIN STRONG NOT LEAST BECAUSE OF THE LIKELYHOOD OF INCOME TAX CUTS IN THIS AND THE NEXT FINANCIAL YEAR. INDUSTRIAL PRODUCTION IN MARCH WAS UP 11 PERCENT OVER THE PREVIOUS YEAR. SINCE EMPLOYMENT INCREASED BY ONLY 2 PERCENT AND WAGES BY LESS THAN 4 PERCENT THIS GAVE MANUFACTURERS ADDED MARGINS WITHOUT RAISING PRICES. THE CPI REMAINS EXTREMELY STABLE, ASSISTED BY THE IMPACT ON DOMESTIC PRICES OF INCREASED IMPORTS, ESPECIALLY FROM THE NICS. THE BANK OF JAPAN REMAINS WARY OF INFLATIONARY



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DANGERS BECAUSE OF THE HIGH RATE OF GROWTH AND IS ANXIOUS ABOUT A POSSIBLE SLOW DOWN IN INDUSTRIAL PRODUCTION LATER IN THE YEAR, BUT THE GOVERNMENT SEES NO NEED AT PRESENT FOR ANY CHANGE IN MONETARY POLICY OR ADDITIONAL FISCAL MEASURES IN THE AUTUMN SUPPLEMENTARY BUDGET.

THE EXTERNAL SECTOR

3. IN VOLUME TERMS EXPORTS WHICH DECLINED BY 2 PERCENT IN CALENDAR 1987 HAVE STOPPED FALLING. AND SIGNIFICANTLY HAVE RISEN BY ABOUT 3 TO 4 PERCENT YEAR ON YEAR IN EACH OF THE LAST THREE MONTHS IMPORT VOLUMES WERE UP BY 20 PERCENT YEAR ON YEAR IN APRIL. ON A DOLLAR BASIS EXPORTS HAVE STARTED TO RISE MORE RAPIDLY SINCE THE END OF CALENDAR 1987 AND ARE 15 PERCENT ABOVE THE PREVIOUS YEAR'S LEVEL. THIS RISE IN EXPORT VALUES IS EXPLAINED BY A STRONG RISE IN THE EXPORT OF HIGH-VALUE ITEMS SUCH AS COMPUTERS, SEMI CONDUCTORS ETC, AND BY MANUFACTURERS TAKING THE OPPORTUNITIES TO RAISE EXPORT PRICES WHILE DOMESTIC CONDITIONS ARE STRONG. IMPORTS, THOUGH UP BY 38 PERCENT APPEAR NOW TO BE RISING MORE SLOWLY. THE SEASONALLY ADJUSTED TRADE SURPLUS (CUSTOMS CLEARANCE BASIS) IN Q4 OF FY 1987 WAS DOLLARS 20.8 BILLION, 2.5 BILLION HIGHER THAN IN THE PREVIOUS QUARTER.

4. THE TRADE WITH THE EC HAS BEEN STRONG IN BOTH DIRECTIONS. EC EXPORTS (EXCLUDING GOLD) ROSE BY 49 PERCENT TO DOLLAR 7.3 BILLION IN JANUARY-APRIL 1988, AND IMPORTS FROM JAPAN BY 25 PERCENT TO DOLLARS 15.4 BILLION (CUSTOMS CLEARANCE BASIS).

5. DIRECT OVERSEAS INVESTMENT BY JAPANESE FIRMS IS REFLECTED IN BOTH SIDES OF THE ACCOUNT. THE REVIVAL OF PLANT MACHINERY EXPORTS AND OF SHIPMENTS OF PARTS IS AT LEAST PARTLY DUE TO THE CONSTRUCTION OF OVERSEAS FACTORIES: WHILE REVERSE IMPORTS OF SEMI-FINISHED AND NOW FINISHED GOODS FROM JAPANESE COMPANIES ABROAD CONTRIBUTES TO THE RISE OF IMPORTS, ESPECIALLY FROM SOUTH EAST ASIA.

6. THE CURRENT ACCOUNT BALANCE OF DOLLAR 84.5 BILLION (ON AN IMF BASIS) IN FY 1987 WAS DOLLAR 2 BILLION ABOVE THE GOVERNMENT'S ESTIMATE, AND WHILE THE GOVERNMENT MAINTAINS THAT ITS TARGET OF A DOLLAR 10 BILLION REDUCTION IN THE CURRENT ACCOUNT SURPLUS IN FY 1988 IS STILL ACHIEVABLE, MANY OBSERVERS EXPECT A MODEST FALL IN THE REGION OF DOLLARS 3-5 BILLION. FOR THIS REASON THE AUTHORITIES ARE PUTTING MORE EMPHASIS ON THE REDUCTION OF THE RATIO OF THE CURRENT ACCOUNT SURPLUS TO GNP FROM ITS LEVEL OF 4.5 PERCENT IN FY 86, TO 3.3 PERCENT IN FY 1987,

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AND ITS TARGET OF 2.6 PERCENT IN 1988.

GOVERNMENT POLICY

7. THE GOVERNMENT FORMALLY ADOPTED ON 27 MAY A NEW

5 - YEAR ECONOMIC PLAN WITH THE THREEFOLD OBJECTIVES OF:

A) CORRECTING EXTERNAL IMBALANCES AND CONTRIBUTING TO THE  
WORLD ECONOMY

B) INCREASING THE LIVING STANDARDS AND SENSE OF AFFLUENCE OF  
JAPANESE PEOPLE

C) FACILITATING FURTHER INDUSTRIAL RESTRUCTURING AND BALANCED  
REGIONAL GROWTH.

THE PLAN POSTULATES REAL DOMESTIC GROWTH OF 4.25 PERCENT AND NET  
EXTERNAL DEMAND (EXPORTS MINUS IMPORTS) OF MINUS 0.5 PERCENT  
OF GNP IN EACH OF THE NEXT FIVE YEARS. THE CURRENT ACCOUNT SURPLUS  
IS EXPECTED TO FALL TO AN INTERNATIONALLY TOLERABLE LEVEL  
WHICH IS NOT PUBLICLY AVOWED BUT PRIVATELY DEFINED AS  
AROUND 1.5 PERCENT OF GNP (DOLLAR 50-60 BILLION) IN 1992. IN  
ADDITION THE GOVERNMENT/LDP COMMITTEE FOR THE PROMOTION OF  
STRUCTURAL REFORM IS ABOUT TO PRODUCE AN OUTLINE CARRYING  
FORWARD THE IDEAS IN THE 1986 MAEKAWA REPORT, AND CENTERING UPON  
REFORMS OF AGRICULTURE, THE DISTRIBUTION SYSTEM AND REDUCTION  
OF WORKING HOURS. BY FURTHER ENCOURAGING IMPORTS AND THE  
REDUCTION OF DOMESTIC PRICES THE GOVERNMENT AIMS TO INCREASE  
DISPOSABLE INCOMES AND GROWTH BASED ON PERSONAL  
CONSUMPTION. AT THE SAME TIME IT INTENDS TO INCREASE ITS OFFICIAL  
AID EXPENDITURE AND ENCOURAGE CONTINUED OVERSEAS DIRECT  
INVESTMENT INCLUDING IN THE LDCS. TAKESHITA IS LIKELY TO  
OUTLINE THESE IDEAS AT THE TORONTO SUMMIT. AT THIS STAGE  
THEY ARE GENERAL OBJECTIVES RATHER THAN CONCRETE PLANS.

COMMENT

8. THE FLEXIBILITY AND RESPONSIVENESS OF THE ECONOMY - PRIMARILY  
THE INDUSTRIAL SECTOR - HAS ENABLED JAPAN TO TURN YEN APPRECIATION  
TO ITS ADVANTAGE. THE ADJUSTMENTS MADE DURING THE INITIAL DOWNTURN  
IN 1986 CREATED THE CONDITIONS FOR CURRENT STRONG DOMESTIC GROWTH  
WITHOUT OVERALL LOSS OF EXTERNAL COMPETITIVENESS. THE GOVERNMENT  
POINTS TO THE RAPID GROWTH OF MANUFACTURED IMPORTS AS EVIDENCE THAT  
ITS POLICIES TO REDUCE THE BALANCE OF PAYMENTS SURPLUS HAVE HAD  
EFFECT. IT IS NOW TENTATIVELY TURNING ITS ATTENTION TO TWO AREAS OF  
MUCH GREATER RIGIDITY - AGRICULTURE AND THE DISTRIBUTION SYSTEM,  
WHOSE INEFFICIENCY AND HIGH PRICES ARE A FOCUS OF DOMESTIC AS WELL AS  
FOREIGN CRITICISM. THE IMPACT OF THIS ON THE TRADE SURPLUS MAY  
HOWEVER BE SMALL, OR AT LEAST SLOW IN COMING.

9. SOME ARGUE THAT THE BENEFITS FOR THE BALANCE OF PAYMENTS OF THE CURRENT HIGH LEVELS OF JAPANESE MANUFACTURING INVESTMENT IN THE U S AND EUROPE WILL BE FELT VERY STRONGLY IN TWO OR THREE YEARS' TIME. IN THE MEANTIME HOWEVER AS SHOWN BY THE RECENT RISE IN EXPORTS AND HIGH PROFITS OF THE MAJOR EXPORTING COMPANIES IT IS CLEAR BOTH THAT THE TRADE SURPLUS IS UNLIKELY TO BE SUBSTANTIALLY REDUCED, AND THAT THE MAJOR COMPANIES ARE MORE THAN COMFORTABLE AT CURRENT EXCHANGE RATES. THERE IS NO GUARANTEE THAT IF DOMESTIC GROWTH SLOWED DOWN EXPORT VOLUMES WOULD NOT RISE SHARPLY ONCE MORE. ALTHOUGH THE GOVERNMENT LINE REMAINS THAT THE CURRENT EXCHANGE RATE OF YEN 125 TO THE DOLLAR IS APPROPRIATE, THE PRIVATE SECTOR AT LEAST RECOGNISES THAT THE EXTERNAL IMBALANCE COULD, DEPENDING ON U S TRADE PERFORMANCE, CAUSE RENEWED INSTABILITY IN THE MARKETS, AND ARE ALREADY PREPARED FOR THE NECESSITY OF A FURTHER RISE IN THE YEN.

10. AGAINST THIS BACKGROUND, THE ASSUMPTIONS APPARENTLY ACCEPTED AT THE OECD MINISTERIAL AND ELSEWHERE ABOUT THE RESULTS OF STRUCTURAL CHANGES IN JAPAN'S ECONOMY SEEM OVER-COMPLACENT. WE DO NOT WISH TO BE GRUDGING IN OUR RECOGNITION OF WHAT HAS BEEN DONE SO FAR, AND PUBLICLY IT WILL BE NECESSARY TO EMPHASISE THE PROGRESS BEING MADE. BUT IT IS STILL APPROPRIATE, AS SEEN FROM HERE, FOR JAPAN'S PARTNERS PRIVATELY TO EXPRESS CONCERN ABOUT THE RISK TO MARKET STABILITY FROM THE LIKELY LEVEL OF SURPLUS, AND URGE SPEEDIER ACTION TO LIBERALISE FINANCIAL AND AGRICULTURAL MARKETS AND TO INCREASE IMPORTS BY FURTHER TARIFF REDUCTIONS DEREGULATION OF CONTROLLED PRICES, MAJOR PURCHASES OF CAPITAL GOODS AND BY INTRODUCING GREATER COMPETITION INTO THE DISTRIBUTION SYSTEM. ALTHOUGH SHORT TERM FISCAL STIMULUS IS CLEARLY NOT REQUIRED, THE GOVERNMENT SHOULD ALSO BE ENCOURAGED TO RESPOND SWIFTLY IF NECESSARY LATER IN THIS OR THE NEXT FINANCIAL YEAR TO SUPPORT DOMESTIC DEMAND.

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ADDITIONAL 43

JAPAN POLITICAL AND ECONOMIC

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CHANCELLOR - PRESS BRIEFING PRE-TORONTO

Transcript from No 11 Downing Street, 15 June 1988

CHANCELLOR: This is John Gieve, my new Press Secretary and, of course, I think everyone here knows Sir Geoffrey Littler. I'll start by making a very brief introduction and then go straight to questions. I don't expect this to be one of the more eventful economic summits. That is, of course, because the world economy is in such good shape. There's no crisis which needs attention. And I think that needs to be said because, in the aftermath of Black Monday, which was after all only 8 months ago, I think many people expected that this year's economic summit would be conducted in very different conditions from the conditions in which we find ourselves. So it follows that I would expect the summit to reaffirm both our existing economic policies and our existing arrangements for international co-operation. I hope we shall see, certainly we will be arguing this, an increased emphasis on structural problems and in particular on the opening up of markets. And in this context and in others too agriculture will loom particularly large. You will recall that it was at the Tokyo summit, at the insistence of the United Kingdom, that a section on agriculture was for the first time included in the summit communique. And we've been pressing the need ever since. Agriculture is now, both in the European Community and more widely, included again for the first time in the GATT round and although this is an intensely difficult issue it will be difficult to get any substantive agreement. I don't want to pretend otherwise. It is in our view urgent that there should be further progress on agriculture in the GATT round before very long, in particular at the mid term review in Montreal later this year. Finally, as I think all of you know, we shall be seeking agreement to a scheme to help the very poorest of the heavily indebted countries as I originally proposed over a year ago now. We will not be able to go down to the finest of fine detail. Those will

have to be left to the Paris Club to follow on quite swiftly. But I think there is a good chance that we can get a real agreement on this in Toronto.

**WILLIAM KEEGAN:** Since you proposed your solution to the sub-Saharan African debt crisis one or two other countries have made their own contributions. For example, Canada has suggested a menu of options. Will your initiative provide the <sup>secondly, since the debtors have been</sup> main course <sup>and will</sup> <sup>deal</sup> <sup>with</sup> you be trying to do something along the lines of the UN Commission chaired by Sir Douglas Wass, which suggested that for a relatively small sum you could alleviate starvation and do something to improve growth and development.

**CHANCELLOR:** I think the initiative that I put forward - and I welcome the fact that other countries have subsequently come along in various different forms, some of them very close to what I was putting forward - will be of very great benefit to the peoples of the very poorest countries in sub-Saharan Africa in particular, many of whom are, as you say, close to starvation. I think it is difficult - we will be discussing this at Toronto - to say precisely in what form the agreement will emerge. I'm much more hopeful than I have been at any time up to now, during which time I've been pressing very very hard for something along these lines. Indeed it was as a result of our pressure that for the first time the summit communique in Venice last year did accept that these countries were a specific problem and they weren't just a part, a rather minor part, a forgotten part if you like, of the overall debt issue. I think that for the first time we are close to an agreement, but it's not yet in the bag. But I think we are close to it. My proposal, as you know, had three elements to it. There was an element of complete debt write-off, that is the old aid loans in our case where we have written off very nearly a billion pounds over the years, £300 million of that in sub-Saharan Africa. There's the element of longer rescheduling of official export credit debt and grace periods. And, of course, the concessional interest rate for rescheduled debt. Now if you look at the result of the Mitterrand proposal, which is the most recent, that has other options including an element of write-off. Although they haven't written off to any significant extent their old aid loans

- and I don't think they have any intention of doing so - they are proposing a certain write off for the rescheduled export credit debt, Paris Club debt. And they are also offering among the suggested options ~~and~~ a longer rescheduling over various periods. So it is very similar, and although they don't talk in terms of interest rate reduction in practice, since these countries are not (there may be one or two minor exceptions I'm not aware of) repaying any principal at all anyway only interest if anything the only thing that is effective for them, that means anything to them, is an interest rate reduction. Whether that flows from writing off the debt or whether that flows from explicitly reducing the interest rate they can't pay. So there's a great similarity there. The Italians very early on, as you know, agreed with our proposals and the Canadians have also agreed with our proposal. They did so first of all at the Commonwealth Finance Ministers' Conference in Barbados last year and then it was reaffirmed at the Commonwealth Prime Ministers Conference in Vancouver. So there's quite a lot of support for that. As for the Germans, I'm not quite clear where they stand but they are clearly moving on this issue. The Americans have indicated, for the first time, in Jim Baker's speech in Africa that, for their part, they're prepared to move on rescheduling for much longer periods. However, they will need to go further than they have gone so far if the agreement is to get off the ground. Their contribution in my judgement doesn't measure up to what others are prepared to do. As for the Japanese, they are being traditionally inscrutable but I'm sure that they will come up with something.

**PHILIP STEPHENS:** You're very bullish about the world economy. Do you see it as in good shape or do you see any potential problems - for example the OECD warnings on the danger of inflation, capacity problems etc? Can you be sure world markets won't impose their own solutions?

**CHANCELLOR:** I think that if anybody thinks there can ever be a world without problems and difficulties they're living in a fantasy. That is not how things are. But the problems we have today are very much less acute than the problems we've had at many times in the past in the world and very much less acute, as I

indicated earlier, than people were predicting in the aftermath of Black Monday. So far as the markets are concerned, the markets are not causing problems at the present time and the international co-operation we have in the G7 context is very much alive and well. As for inflation, I indicated in my own speech at the Ministerial meeting of the OECD in Paris in May that I think those who are worried about world recession are looking in the wrong direction. In so far as there is any potential danger in the world economy today it is the danger that inflation might take off. But I said that not because I was predicting it but because I think it is important to have that in mind so we do keep anti inflationary policies firmly in place and, as I say, not have our guns trained in the wrong direction. Provided that that is so, and I believe that it is, then I don't see any great inflationary danger. But it is important to ensure that that focus of policy remains.

**PHILIP STEPHENS:** Do you think Jim Baker's idea of a commodity price index will help to ensure we are looking in the right direction?

**CHANCELLOR:** Well, in so far as a commodity price index is about prices, which it obviously is, then I think it could be helpful in keeping peoples' focus, keeping peoples' attention, on the need to resist inflation and to be vigilant in the struggle against it. But I think that it's not a magic solution. It is, as I say, something which when we agree to, it will be a sign that our eyes are on the ball. But the policies that we have to pursue will be the policies we are pursuing at the present time.

**PETER NORMAN:** You put great stress on structural policies - how far is this by default because we are in a pre-election period in the United States and therefore there can't be a fiscal response to the continuing imbalance between the deficit in the US and surpluses elsewhere. Both the BIS and OECD have stressed the need for fiscal action.

**CHANCELLOR:** You know my views which are, certainly, the views of most people that the American budget deficit does need to come



down further - bearing in mind that nobody is expecting any further action on that front this side of the Presidential election. But the need is there and it is important that the new Administration takes action. But that does not mean that in any sense that <sup>the</sup> structural side is just *faute de mieux*. It is of the first importance. The success of the British economy in recent years has been in large measure due to supply side improvements that have been made, that's why the economy is performing better. And, if we go on to look at the world economy it is through removing structural rigidities and not through some great locomotive type theory as was tried with disastrous results in the 1970s - the old demand management that is not the solution. And I think there is one area where that is particularly important, clearly, where countries have erected barriers of one kind and another against trade, we want to see those particular trade barriers removed.

RODNEY LORD: You mentioned trade and agriculture, are there any other areas of structural changes you would like to see?

CHANCELLOR: I don't think we will go into an enormous amount of detail. Largely because while it's legitimate to go into detail on matters concerned with trade, and agriculture is an aspect of trade, because it is in the GATT round and there is worse - the absurdity of every country subsidising its agriculture to a growing extent and the need to stop this happening. But when it comes to matters that are very much internal then I think it is a matter for each country to take steps to remove or reduce the rigidities which there happen to be in its own economy. And they will tend to vary from economy to economy. There can be cases where the rigidities - the internal rigidities - have an impact on trade and that is something - I don't know whether we will discuss it - that's certainly important. If you take the question of Japan. The nature of the retail and distribution trade in Japan is one that leads to many fewer goods being imported than the Japanese people would, I think, like to buy. And if, following the lines of the Maekawa report and what Nakasone said when he was Prime Minister, they are serious about seeking more imports into Japan they're going to have to <sup>address</sup> ~~retreat~~ their retail and

distribution trade. And there's also the case of public procurement, whether you're prepared to go overseas for your public procurement. There are a number of specific matters but basically, as I say, it will be countries doing their own thing to remove structural rigidities and trying to get movement, greater impetus, through GATT on trade in general and agriculture in particular. On agriculture, what we would like to see, if I can go on to that - we may not be able to get it but it's something we ought to have - is first a freeze and then reduction in subsidies on all sides as showed by the PSEs that measure subsidy equivalents, which is this OECD yardstick. I think it's important that everybody <sup>agree</sup> ~~read~~ that because it's the only objective yardstick we have. This yardstick attempts to measure, and I think it is possible, all the various different kinds of subsidy - it may take different forms in different countries - which Governments give to their farmers expressed as a percentage of total farming. And these have been steadily rising. There are some figures here which show that in the United States the PSE in 1980 was 15 per cent, in 1986 - the latest year for which we have it - it was up to 35 per cent. In the Community it was 36 per cent in 1980, 49 per cent in 1986. And in Japan 54 per cent in 1980 and 75 per cent in 1986. So the Japanese you can see are the heaviest subsidisers, the Community second, the United States least although it's interesting that in the United States the subsidy has been increasing rather faster than the Community has been increasing its. This is partly because of the very considerable pressure that we've been putting within the CAP to restrain the growth of the subsidisation of agriculture. And so, if we can get a focus on that then I think that this - and it measures the total subsidy in the short and medium term - would be more constructive than simply having a long term target while marching in the opposite direction.

**CHRIS HUHNE:** Let's be clear what these figures are about: they're the proportion of the revenue to the producer met by some form of public subsidy and or intervention.

**CHANCELLOR:** That's correct.

WARREN GETLER: On the question of inflationary signals in the world economy - do you feel you should try to include some sort of comment about that danger in the final economic communique and given the sensitivities in the United States before the US elections whether there is a sensitivity on having to raise interest rates to combat that trend?

CHANCELLOR: I think that it's possible that we may make some reference in the final communique but it won't be specifically directed to the United States.

GETLER: Where else do you see the inflationary threats in particular among the G7 nations?

CHANCELLOR: Well the inflationary danger is always present. It is there, as I say, in the world as a whole and we have to be vigilant and make sure our policies are designed to keep downward pressure on it. And if you look at the G7 for the moment we are, I think, at present in the middle in the sense that three countries, the United States, Canada and Italy have higher rates of inflation than we have and three countries, France, Germany and Japan have lower rates of inflation.

KEEGAN: Do you agree with the BIS that the US payments deficit is easily financable by the private sector and do you think at the current level of interest rates?

CHANCELLOR: A lot depends on the confidence that the markets have that the deficit is going to come down. Certainly the latest American trade figures - and it's not just one month's figures but there has been a clear trend - have led to an increase in confidence.

STEVE LEVINSON: Do you see the summit taking forward in any way the relationship between the G7 and the Asian NIC's countries and in what way would you address the problem?

CHANCELLOR: I'm sure we shall discuss that issue. We can't talk about them a great deal because the NICs, or the newly

industrialised economies won't be present, so we can't carry things forward very much when they're not there.

**HUHNE:** What is your debt initiative going to mean in actual concrete terms for sub Saharan African countries, how much more are they going to be able to import or raise their own standards as a result if the summit countries actually adopted your proposals? Looking at the agricultural side, is what you said consistent with the Common EEC position on agriculture or are we ploughing a uniquely British furrow?

**CHANCELLOR:** On the second point there are of course discussions going on within the Community all the time on the CAP and we have been in the lead in trying - and with some success, quite a bit has been achieved although there's more that needs to be done - to get the cost of the CAP contained, price rises more under control and above all the subsidisation reduced. And there may be, and it does seem there'll be discussions within the Community in which different members have taken different views. There may be different nuances, as I say, by different Community countries represented at Toronto. But I think it is well known that we have to reach agreement for our part within the CAP. But that's something we have done and I think that we can carry the process further. So far as the sub-Saharan initiative is concerned, one of the conditions, an important condition, is that countries to be eligible for assistance in this way have to be carrying out proper economic policies - adjustment policies. How many of those countries do that will affect the take-up and the cost of the thing. But if they all do, if all those eligible countries do make themselves fully eligible in the way I just indicated, and if all the Paris Club countries come into the scheme, then it has been estimated that the amount of relief they would be given will build up to something like half a billion dollars a year which is a lot for those countries. But that is over a period of time and it will build up to that level as it increases as more and more reschedulings take place.

**QUESTION:** That's a flow.

CHANCELLOR: Yes that's right.

HUHNE: Am I correct in thinking that what you have just said today in terms of setting a target for a reduction of PSEs is a new British proposal?

CHANCELLOR: That's right.

HUHNE: And this presumably has not been agreed by our EEC partners?

CHANCELLOR: No, I think it won't be news to them because we were talking, Geoffrey Howe and I, were talking very much in those terms at the Ministerial meeting of OECD in Paris in May.

HUHNE: What was the response you got to this idea then?

CHANCELLOR: Well we didn't get acceptance of it then. There was a kind of compromise which is in the communique which mentions the general view to reducing subsidies and mentions PSEs. But our proposal wasn't accepted at that time. As I said a few moments ago agriculture is going to be an intensely difficult subject on which to get any agreement at Toronto.

ANNE SEGALL: What kind of time scale do you envisage for a reduction of agricultural subsidies, have you set a target? Do you see it ever being reduced to zero or is it just a phased reduction from present levels?

CHANCELLOR: I mentioned the fact that at the moment subsidies are increasing. What we have secured in the Community is that they are increasing less rapidly. So what we want to do is to stop that totally, stop those increasing and then gradually having them reducing over a period of years and it'll take a very long time. But we have no particular 1992 or 2000 type of deadlock or target in mind.

SEGALL: Is it actually possible within the structure of the Common Agricultural Policy to secure reductions, after all it's in a demand led system?

CHANCELLOR: Oh no, the actions we have taken already have slowed down the rate at which these are increasing and further action that we have taken to stabilise increases in the most recent agreement will ensure that that process continues.

O'CONNOR: Do you think interest rates are high enough to contain inflation?

CHANCELLOR: ~~No~~ I published a forecast on inflation at the time of the Budget, of 4 per cent by the end of this year and I have no reason to depart from that forecast.

PETER NORMAN: How logical is it to confine your debt initiative to the poorest countries in sub Saharan Africa, I'm sure there must be some deserving cause elsewhere in the world? Are you worried that this is going to raise expectations among less deserving poor, the Brazilians, Mexicans, and the Argentinians as well?

CHANCELLOR: On the first point the countries concerned need to satisfy two criteria quite apart from the question of carrying out sensible economic policies. They have to be very poor and also very heavily indebted. Most of those countries are in sub Saharan Africa. There are some very poor countries outside sub Saharan Africa but they tend not to be very heavily indebted. But if there are countries, and there may be one or two that are outside sub Saharan Africa, if it is felt generally that probably these should be included as well then that's certainly something I would be prepared to consider. However, the overwhelming problem is in sub Saharan Africa. As for the other part of your question about the effect on the Latin American middle income debtors and so on and so forth, that was one of the main objections that was raised by many countries when I first put the initiative forward in April 1987. And I'm glad to say that that resistance is now crumbling. That's the breakthrough that people now do accept that

it is right to address the problems of these countries separately, and that there is no read across to other countries who are very much less poor and whose debt too tends not to be to Governments or Government agencies but to commercial banks.

**STEN STOVALL:** Given that this is not a full G7 meeting do you think there will be agreement on the new commodity based indices on inflation?

**CHANCELLOR:** I don't know, we shall certainly discuss them, I'm quite sure we shall discuss them among the Finance Ministers. We shall certainly discuss them but whether they will be formally adopted and in what form I don't honestly know. It may well be it is something which is more for a subsequent G7. But I'm quite sure there will be some reference to this in the communique.

**PAUL MELLY:** Are you concerned that the developed world isn't doing enough to design a framework that will enable the LDC's to continue to grow beyond the immediate situation?

**CHANCELLOR:** Well I think that there are three things that we need to do to help them on that front. One is to be growing ourselves at a reasonable rate and the outlook now looks very much more encouraging than many people expected, and the secret of success for growth lies largely in improving the supply side of economies, that is the importance of the structural side. The second thing is the opening up of our markets to which I've already referred. It's very important that our markets are open to these countries for exports. The third thing is the freedom of capital movements so there is no restriction, no exchange control restriction, on investment in these countries which can help the countries develop. I was particularly glad to hear that we were able to reach the agreement we did at the ECOFIN meeting in Luxemburg on Monday for capital liberalisation for the Community as a whole. I think that will help these countries as well and be good news for Europe.

That's it. Thank you very much.

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OUR TELNO 1504 (NOT TO ALL): BRIEFING ON TORONTO SUMMIT GIVEN BY SECRETARIES SHULTZ AND BAKER

SUMMARY

1. BAKER PREDICTS THAT DECISIONS WILL BE TAKEN ON DEBTS OF SUBSAHARAN AFRICAN COUNTRIES, IMPLEMENTATION OF A COMMODITY PRICE INDICATOR AND STRUCTURAL ADJUSTMENT PROBLEMS. IMPROVED COOPERATION ON DRUG MONEY LAUNDERING EXPECTED. SHULTZ LOOKING FOR SUBSTANTIAL CONTRIBUTION FROM JAPAN TO PACKAGE FOR PHILIPPINES AND AFGHANISTAN.

DETAIL

2. BAKER PREDICTED THAT THE ECONOMIC TOPICS AT THE SUMMIT WOULD BE QUOTE AGRICULTURE, TRADE, THIRD WORLD DEBT, AND THE PROCESS OF INTERNATIONAL ECONOMIC POLICY CO-ORDINATION UNQUOTE. HE EXPECTED DECISIONS TO BE REACHED ON THE PROBLEM OF THE DEBTS OF SUBSAHARAN AFRICAN COUNTRIES. BAKER REAFFIRMED HIS OVERALL DEBT STRATEGY BUT DISTINGUISHED BETWEEN THE DEBT OF MIDDLE INCOME COUNTRIES, WHICH IS OWED TO BANKS, AND THE AFRICAN COUNTRIES' DEBT, WHICH IS MAINLY OFFICIAL. IT WAS ON THE LATTER THAT HE EXPECTED PROGRESS BUT DID NOT GO INTO DETAILS.

3. BAKER NOTED THAT THE LATEST US TRADE FIGURES WERE ENCOURAGING. THE DECREASE IN IMPORTS SUGGESTED THAT DOMESTIC DEMAND GROWTH WAS SLOWING DOWN WHICH HE FELT WOULD PLEASE OTHER G7 MEMBERS. IN RESPONSE TO A QUESTION ABOUT THE DOLLAR, HE REPLIED QUOTE IT'S MY VIEW THAT ALL OF THE G7 COUNTRIES ARE VERY PLEASED WITH THE STABILITY IN EXCHANGE RATES WE HAVE SEEN SINCE DECEMBER 22, 1987 UNQUOTE.

4. BAKER WAS INEVITABLY ASKED IF HE WOULD BE LEAVING SOON TO MANAGE THE CAMPAIGN OF VICE PRESIDENT BUSH. HE TOLD REPORTERS QUOTE YOU GOT YOUR BAKER RESIGNATION YESTERDAY UNQUOTE AND ADDED THAT QUOTE FOR NOW MY JOB IS AT THE TREASURY DEPARTMENT AND THAT'S WHERE I EXPECT TO STAY UNQUOTE.

5. SHULTZ PREDICTED THAT THERE WOULD BE DISCUSSION OF THE DRUG PROBLEM AND BAKER ADDED THAT QUOTE HOPEFULLY WE COULD FIND A WAY TO IMPROVE OUR COOPERATION ON MONEY LAUNDERING UNQUOTE. ON SOUTH AFRICA, SHULTZ STRESSED THE NEED TO MAINTAIN CONTACTS AND



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EXPRESSED HIS OPPOSITION TO BILLS THAT WOULD END ALL TRADE WITH, AND INVESTMENT IN SOUTH AFRICA. HE DIDN'T SEE ANY NEED FOR FURTHER SANCTIONS.

6. IN CENTRAL AMERICA SHULTZ HOPED THE SUMMIT PARTNERS WOULD EXPRESS SUPPORT FOR THE DEMOCRACIES AND SUPPORT FOR THEIR ABILITY TO DEVELOP THEIR ECONOMIES. HE FELT THAT IT WAS NOW QUITE OBVIOUS THAT QUOTE THE NICARAGUAN COMMUNIST GOVERNMENT HAS NOT BEEN NEGOTIATING IN GOOD FAITH UNQUOTE. THE THRUST TOWARDS DEMOCRACY NEEDED AN EXTRA SHOVE AND SHULTZ HOPED THAT QUOTE PERHAPS SOME OF THE CENTRAL AMERICAN COUNTRIES CAN HELP US WITH THAT UNQUOTE.

7. SHULTZ WAS ASKED ABOUT PROGRESS ON A PACKAGE FOR THE PHILIPPINES AND AFGHANISTAN. HE SAID THAT HE HAD BEEN TALKING TO OTHER COUNTRIES AND TO CONGRESS ABOUT QUOTE A MULTILATERAL PACKAGE OF ASSISTANCE TO THE PHILIPPINES. AND THE COUNTRIES AT THE SUMMIT MEETING ARE AMONG THOSE THAT WE'VE TALKED TO, SO WE'LL BE EXAMINING THAT FURTHER. SIMILARLY WHEN IT COMES TO THE AFGHAN REFUGEES, OF COURSE WE'RE SUPPORTING THE UN EFFORT THERE, AND THEY'RE AROUND NOW BEGINNING TO LOOK FOR FINANCIAL RESOURCES ... UNQUOTE. HE ADDED THAT QUOTE EVERYBODY SORT OF FIGURES THE JAPANESE CONTRIBUTION WILL BE HEAVY IN ANY ONE OF THESE PLEDGINGS UNQUOTE. HE THOUGHT THE JAPANESE WOULD BE PREPARED TO MAKE A SUBSTANTIAL CONTRIBUTION QUOTE AS LONG AS THE PROGRAMME IS SENSIBLE UNQUOTE.

COMMENT

8. NO SURPRISES BUT BAKER WENT OUT OF HIS WAY TO EMPHASISE WHAT HE DESCRIBED AS THE SLOWDOWN IN US DOMESTIC DEMAND. THE APRIL TRADE FIGURES AND THE 0.1 PERCENT RISE IN RETAIL SALES IN MAY SUPPORT HIS CASE, BUT IT IS A LITTLE PREMATURE TO ACCEPT THAT DOMESTIC DEMAND GROWTH HAS SLOWED DOWN AND IS NOW GROWING AT A SUSTAINABLE LEVEL.

9. FCO PLEASE ADVANCE TO RICHARDSON AND SIR G. LITTLER, LANKESTER AND EVANS (TREASURY) AND WARE (BANK).

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LUXEMBOURG FOR UKREP

MY TELNO 610: TORONTO SUMMIT: FRENCH DEBT INITIATIVE.

1. FOLLOWING IS LIST OF AFRICAN COUNTRIES WHICH THE AFRICAN DIVISION OF THE QUAI D'ORSAY BELIEVE, FOLLOWING PRELIMINARY CALCULATIONS, WOULD BE COVERED BY THE FRENCH DEBT INITIATIVE: BURUNDI, GAMBIA, GUINEA-BISSAU, MAURITANIA, MALI, NIGER, CENTRAL AFRICAN REPUBLIC, SOA TOME, TANZANIA, GHANA, MADAGASCAR, MOZAMBIQUE, SENEGAL.

*Mostly French ex-colonies: quelle surprise.*

2. THE QUAI BELIEVE THAT THE FOLLOWING FIVE COUNTRIES WOULD BE ELIGIBLE IF THEY AGREED TO SATISFACTORY IMF PROGRAMMES: BENIN, BURKINA FASO, COMORES, DJIBOUTI, CHAD.

3. THE FOLLOWING SIX COUNTRIES MEET, ACCORDING TO THE QUAI, THE INDEBTEDNESS AND IMF CRITERIA, BUT ARE ABOVE THE DOLLARS 500 PER CAPUT CEILING: CAMEROON, CONGO, COTE D'IVOIRE, GABON, MAURITIUS, RWANDA.

4. PLEASE ADVANCE BRAITHWAITE, KERR, RICHARDSON (FCO), LAVELLE (CAB OFFICE), LITTLER, MOUNTFIELD (TSY).

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TORONTO SUMMIT: FRENCH VIEWS ON DEBT AND AGRICULTURE.

SUMMARY

1. FURTHER DETAILS ON MITTERRAND'S DEBT INITIATIVE, FOLLOWING THE PRIME MINISTER'S MEETING LAST WEEK. RESTATEMENT OF FRENCH VIEWS ON AGRICULTURE IN THE GATT ROUND: SOME CONCERN AT POSSIBLE AMERICAN HARD LINE AT TORONTO.

DETAIL

2. MADAM GUIGOU (COUNSEILLER TECHNIQUE, ELYSEE), TOOK ADVANTAGE OF TODAY'S CALL BY LAVELLE (CABINET OFFICE) AND KERR TO REPLY TO SOME OF THE POINTS ON MITTERRAND'S DEBT INITIATIVE RAISED BY THE PRIME MINISTER ON 10 JUNE, AND TO RESTATE FRENCH VIEWS ON AGRICULTURE AND THE GATT.

3. ON THE DEBT INITIATIVE MADAME GUIGOU SAID THAT ELIGIBILITY WOULD BE AS FOR THE WORLD BANK SPECIAL ASSISTANCE PROGRAMME, IE

I) GDP PER CAPUT BELOW DOLLARS 500

II) A DEBT SERVICE RATIO OF AT LEAST 30 PER CENT

III) AGREEMENT TO AN IMF ADJUSTMENT PROGRAMME

SHE CONFIRMED THAT THERE WOULD BE NO FRENCH OBJECTION TO INCLUDING THIS LAST POINT IN THE TORONTO COMMUNIQUE.

4. THE CRITERIA POINTED TO A CLIENTELE OF AROUND 20 COUNTRIES, THOUGH THIS MIGHT NEED TO BE EXPANDED OVER TIME IF, EG, A COUNTRY'S DEBT SERVICE RATIO WERE TO MOVE ABOVE 30 PER CENT. (FURTHER TELEGRAM SETS OUT A LIST OF AFRICAN COUNTRIES WHICH THE QUAI D'ORSAY HAVE TOLD US SEPARATELY THEY BELIEVE WOULD BE COVERED BY THE INITIATIVE).

5. MADAME GUIGOU DESCRIBED THE THREE OPTIONS AVAILABLE FOR CREDITOR COUNTRIES ON THE LINES SET OUT IN MITTERRAND'S LETTER. SHE SAID THE

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THIRD OPTION IMPLIED THE CANCELLATION OF ONE-THIRD OF QUOTE PUBLIC DEBT AND OFFICIALLY GUARANTEED COMMERCIAL DEBT UNQUOTE. THE COST TO FRANCE WOULD BE AROUND F 800 MILLION A YEAR OVER THE NEXT 10 YEARS. THE MECHANISM WOULD BE FOR THE TREASURY TO REIMBURSE COFACE, THE FRENCH EXPORT CREDIT AGENCY, WHO WOULD IN TURN REIMBURSE THE BANKS.

6. MADAME GUIGOU SAID THAT THE FRENCH BELIEVED THAT IT WOULD BE TECHNICALLY POSSIBLE TO ENSURE EQUAL BURDEN-SHARING, TO WHICH THE PRIME MINISTER HAD SAID SHE ATTACHED IMPORTANCE. TRICHET (DIRECTEUR DU TRESOR) WOULD BE IN TOUCH WITH LITTLER ABOUT THE DETAILS.

7. WITHOUT BEING WHOLLY PRECISE, MADAME GUIGOU IMPLIED THAT FRANCE WOULD AIM FOR AGREEMENT AT TORONTO ON A SCHEME CENTERED ON FRENCH AND BRITISH IDEAS, WHICH WOULD THEN NEED TO BE AGREED MORE WIDELY IN THE PARIS CLUB. SHE SAID THAT, AS MENTIONED IN THE MITTERRAND LETTER, FRANCE INTENDED IN ANY CASE TO GO AHEAD WITH THE DEBT WRITE-OFF OPTION.

8. ON AGRICULTURE, MADAME GUIGOU TOOK THE STANDARD FRENCH LINE: THEY WANTED PROGRESS IN THE GATT ROUND AND TO KEEP TO THE AGREED TIMETABLE. BUT THERE MUST BE NO FAST TRACK FOR AGRICULTURE. THE COMMUNITY NEEDED TIME TO ABSORB THE REFORMS AGREED AT THE BRUSSELS EUROPEAN COUNCIL. THE FRENCH HOPED DISSENSION AT TORONTO COULD BE AVOIDED, BUT HAD REAL FEARS THAT ELECTORAL PRESSURES WOULD CAUSE THE AMERICANS TO TAKE AN UNHELPFULLY TOUGH LINE, FOR EXAMPLE BY UNRAVELLING THE OECD COMMUNIQUE LANGUAGE. SOME RECENT AMERICAN ACTIONS, INCLUDING THE REDUCTION IN THE SCOPE OF THE SET ASIDE PROGRAMME, WERE WORRYING. THE AMERICANS MUST REALISE THAT THE COMMUNITY HAD TAKEN TOUGH DECISIONS ON AGRICULTURAL REFORM: THE AMERICANS MUST PLAY THE GAME TOO.

9. KERR AND LAVELLE SAID WE WHOLLY AGREED ON THE IMPORTANCE OF CONSTRUCTIVE DISCUSSION AT TORONTO AND ON PROGRESS AT MONTREAL, AND ON THE NEED FOR THE AMERICANS TO ACCEPT THAT THE COMMUNITY HAD MADE REAL PROGRESS ON REFORM. WE DID NOT THINK THAT THE AMERICANS ZERO/2000 AIM WAS REALISTIC. BUT THE COMMUNITY COULD NOT REST ON ITS LAURELS. IT SHOULD WORK FOR A MEDIUM TERM PACKAGE BASED ON PSES AND INCLUDING A FREEZE IN SUPPORT AT CURRENT LEVELS. AS FOR GLOBALITY, WE COULD NOT (NOT) ACCEPT THAT THE CONVOY SHOULD MOVE AT THE PACE OF THE SLOWEST SHIP. PROGRESS WAS POSSIBLE IN SOME AREAS, SUCH AS TROPICAL PRODUCTS. MADAME GUIGOU AGREED: TROPICAL PRODUCTS WERE THE EXCEPTION THAT PROVED THE RULE.

10. PLEASE ADVANCE BRAITHWAITE, KERR, RICHARDSON, LAVELLE (CABINET

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OFFICE), LITTLER, MOUNTFIELD (TREASURY), ROBERTS (DTI), HADLEY  
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TORONTO AND HANOVER SUMMITS: FURTHER GERMAN VIEWS.

SUMMARY.

1. GERMANS WANT TWO HARMONIOUS FORWARD-LOOKING SUMMITS BUT DO NOT EXPECT (OR DESIRE) CONCRETE DECISIONS. AT TORONTO, THE PRIORITY WILL BE TO RENEW THE AMERICAN COMMITMENT TO THE OPEN TRADING SYSTEM AND COOPERATION IN INTERNATIONAL MACRO-ECONOMIC MANAGEMENT. AT HANOVER, THINKING ABOUT POST 1992 SHOULD BEGIN, ESPECIALLY AS IT CONCERNS THE RICHER MEMBER STATES OF THE COMMUNITY.

2. MINISTER (ECONOMIC) CALLED ON TIETMEYER (FINANCE MINISTRY). IN REPLY TO A QUESTION ABOUT GERMAN ASSESSMENT OF PROSPECTS AND THE FEDERAL GOVERNMENT'S PRIORITIES FOR TORONTO AND HANOVER, TIETMEYER SAID THAT THE SAME AIM WAS GOOD FOR BOTH: THAT THEY SHOULD BE HARMONIOUS, NOTE PROGRESS UP TO DATE AND, IN GENERAL TERMS, MARK THE ROUTE FORWARD.

TORONTO

3. TIETMEYER SAID THAT TORONTO WAS BOUND TO BE SOMETHING OF A PARTY FOR REAGAN. THE ECONOMIC ACHIEVEMENTS OF THE REAGAN YEARS (REDUCTION IN INFLATION, LIBERALISATION ETC) SHOULD BE HIGHLIGHTED. BUT IN THE DYING DAYS OF HIS ADMINISTRATION, IT WOULD BE USELESS, AND POSSIBLY CONTERPRODUCTIVE, TO TRY TO TIE THE AMERICANS DOWN TO SPECIFYING WHAT FURTHER STEPS THEY PROPOSED TO TAKE TO REDUCE THE TWO DEFICITS. MORE USEFUL WOULD BE TO GET THE AMERICANS TO COMMIT THEMSELVES IN GENERAL TERMS TO CONTINUING TO SUPPORT AN OPEN TRADING SYSTEM AND PLAY AN ACTIVE PART IN COOPERATIVE INTERNATIONAL MACRO-ECONOMIC MANAGEMENT. THE MAIN POINT WAS TO SEND THE RIGHT SIGNALS TO THE REST OF THE WORLD. TIETMEYER ACCEPTED, ALBEIT SOMEWHAT RELUCTANTLY, THAT A NECESSARY ELEMENT WOULD BE SENDING THE RIGHT SIGNALS ON AGRICULTURE, BUT ARGUED THAT SINCE AGREEMENT WAS NOT POSISBLE NOW, DISCUSSION SHOULD NOT BE OVERDONE. HE ADDED NOTHING NEW ON DEBT, THOUGH FROM THE WAY HE FOCUSSED ON THE NEED TO HELP THE POOREST COUNTRIES, IT SEEMED FAIRLY CLEAR THAT THE GERMANS DO NOT INTEND TO CHANGE THEIR POSITION ON COMMERCIAL DEBT, AT LEAST YET.

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10 DOWNING STREET  
LONDON SW1A 2AA

*From the Private Secretary*

15 June 1988

EXCHEQUER	
DATE	16 JUN 1988 ✓ 16/6
TO	SIR G LITTUER
COPIES TO	SIR P MIDDLETON
	SIR T BURNS
	MR H PEVANS
	MR MOUNTFIELD

I enclose a copy of a letter that I have received from the Canadian High Commissioner covering a statement by the Trade Union Advisory Committee to the OECD Ministerial Council and the Toronto Summit. I do not think that any action is required.

I am copying this letter and enclosure to Alex Allan in the Treasury and to Nigel Wicks here.

(C. D. POWELL)

A. C. Galsworthy, Esq., C.M.G.,  
Foreign and Commonwealth Office.

040  
Canadian High Commission



cc/PC  
Haut Commissariat du Canada

Macdonald House  
1 Grosvenor Square  
LONDON W1X 0AB

June 15, 1988

Dear Prime Minister

I have pleasure in enclosing a copy of a letter from the Rt Hon Brian Mulroney, Prime Minister of Canada, regarding the attached document by the Trade Union Advisory Committee of the OECD.

Yours very truly

A handwritten signature in black ink, appearing to read 'R Roy McMurtry'.

R Roy McMurtry  
High Commissioner

The Rt Hon Margaret Thatcher, MP  
Prime Minister  
10 Downing Street  
LONDON SW1



PRIME MINISTER · PREMIER MINISTRE

OTTAWA K1A 0A2

June 9, 1988

Dear Margaret,

As Summit host, I met on May 31 with a delegation of labour leaders representing international trade union organizations to receive their views on economic issues facing our countries.

I am forwarding to you a copy of the document prepared by the Trade Union Advisory Committee of the OECD which served as the delegation's formal presentation. I promised I would convey these views to my Summit colleagues.

With warmest regards,

Yours sincerely,

*James Mulroney*

The Right Honourable Margaret Thatcher  
Prime Minister of the United Kingdom  
10 Downing Street  
London, England

Ref

TRADE UNION STATEMENT TO THE  
OECD MINISTERIAL COUNCIL AND TORONTO SUMMIT  
May-June, 1988

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Adopted by the 80th TUAC Plenary Session  
Paris, 29 April, 1988

Introduction

1. In the past year OECD countries have moved further away from attaining what should be the fundamental objectives of economic policy : the return to full employment; the eradication of poverty; and the improvement in the quality of life both at the work place and in general. Registered unemployment in OECD countries has remained at 31 million and is forecast to rise to above 32 million in 1989. Those people with jobs are under more pressure and feel less secure. The gaps between affluent groups and regions and the poorest have begun to widen after many years of slow convergence. The trend towards a society where 2/3rds of the population have remunerative work but 1/3rd are unemployed or are trapped as "working poor" in low income and low quality jobs has dire economic as well as social and political consequences. The poverty and indebtedness of developing countries has increased.

2. These developments are the direct result of government policies, or else the result of the failure of governments to develop an adequate policy response to the changes the world economy is undergoing. In those countries where growth and employment has fared better in the past year this has been the result of changes in government economic policies.

3. A delinking has taken place between financial and productive sectors of OECD economies. The stock market crash showed the frailty and volatility of international financial markets and the irresponsibility of government policies of deregulation of these markets. The fact that equity markets could collapse on such a scale and yet apparently have limited immediate impact on the real economy raises the question of what economic role the financial markets really play. Deregulated financial markets do not represent a desirable model for the rest of the economy to follow.

4. The internationalisation of economies has continued apace, but government policies have remained disturbingly uncoordinated despite the series of communiqués issued over the last three years. European economies have most to gain from coordination, but some of the major governments have indicated their intention to introduce even more restrictive fiscal policies at the very time that they should be compensating for a slow-down in growth and further rises in unemployment. The world trade imbalances have not been substantially reduced. Workers fear that their position is being undermined by international pressures. Against this background OECD prescriptions for structural adjustment have for many workers become synonymous with further job losses and adjustment to deteriorating economic and social conditions.

5. The development of real economic cooperation is a precondition for moving OECD economies back onto a path which would bring down unemployment. Coordinated measures would substantially increase the benefits of actions taken by individual countries; but the absence of coordinated measures is no excuse for inaction. Coordination should not be a matter of making concessions to other countries, but acting because it is in the participating countries' own interest. Over the past three years the repeated statements of intent by Ministerial Council, G 7 and Summit meetings have spoken much of coordination but have not resulted in the necessary changes in the direction of economic policy.

6. Many OECD countries' governments and some employers are either unwilling to engage in genuine dialogue and negotiation with trade unions or else are using the process of social dialogue to shift from them the responsibility for taking action. Managing the structural and technological changes taking place in OECD countries in an economically desirable and socially acceptable way necessitates a genuine initiative to inform, consult and negotiate with trade unions.

#### Programme of Action

7. Government initiatives can be taken both at a national level and internationally. The policies which are urgently required to bring down unemployment include:

- the use of both general economic policy, interest rate reductions and selective investment policies to raise productive, job creating investment and to stimulate regional development in the hardest hit parts of the OECD area. This should be coupled with OECD-wide investment and restructuring programmes for major industrial sectors;
- a major programme of infrastructure investment to respond to needs which exist in areas such as: energy; transport; housing; inner cities; the environment; and telecommunications. This would in addition improve the structure of OECD economies and raise the quality of life;

- the reform of the international monetary system to stabilise currency movements, reduce persistent trade and payments surpluses, hinder speculation, and regulate international financial markets;
- the guarantee of an employment or training place for all young people based on opportunity not compulsion; targeted active employment policies for older workers and the long term unemployed; further reductions in working time and overtime;
- action to remove growing poverty and polarisation in industrialised countries by: - raising minimum incomes; providing increased rights and protections for unprotected groups; strengthening social security systems; and tax policy. This would also raise purchasing power;
- the provisions for partial debt write-offs by private sector banks must be translated into reduced repayments for the debtor countries. The IMF and World Bank must reorientate their development policies towards meeting the needs of the poorest. Industrialised countries must increase their aid flows and concessionary export credit and financing arrangements should be expanded;
- the trend to bilateralism and regionalism of trade policy needs to be countered. The multilateral trading system should be underpinned by a Social Clause in GATT and the harmonisation of working standards between countries of comparable levels of development and strength. Good practice obligations on multinational enterprises have to be enforced.

### Investment Policies

8. Profits have risen spectacularly since 1980, but the share of fixed investment in GDP has fallen from 19.1% to 16.1% in the United States, from 22.7% to 19.3% in Germany, from 21.9% to 18.8% in France, from 31.6% to 27.7% in Japan, and from 23.5% to 19.6% in Canada. OECD estimates have shown that the growth in the total productivity of production factors has slowed. Governments have failed to assume their responsibility for the process of investment and re-investment. Deregulation and generalised tax cuts, and cuts in corporate taxation, have not induced profits to be invested productively. As a result, almost every use of capital has become more profitable than productive investment and increased profits have fuelled speculative activities. Much deregulation only serves to degrade working conditions in a downward competitive spiral, not to raise investment. Companies are using profits from production for investment in purely financial assets. The focus of their attention has shifted to short-term returns. This damaging trend is being aggravated by the flurry of predatory

take-overs and threat of take-over which diverts management from its proper role in corporate development and undermines the structure of the economy. Much of the fixed investment that has taken place has been devoted to reducing employment, rather than to widening the capital base and to using the stock-pile of technological opportunities to expand production of goods and services to increase employment opportunities.

9. In order to increase productive and job creating investment governments should use general economic policy to expand output, reduce levels of unused capacity, lower interest rates and stabilise exchange rates. In addition, selective investment policies including public investment are needed to channel profits into productive uses. Specific measures, including taxation, should be introduced to control and discourage speculative activity in order to make it less profitable than real investment. Government legislation and regulations on institutional investors should be revised. Systems of investment and depreciation allowances should be applied with greater selectivity. Good-practice environmental norms and health and safety standards should be incorporated into investment projects and policies should be targeted to ensure rational use of energy (where 30% savings in energy use could be made).

10. Sectoral trends of production, investment and employment should be monitored by the OECD and programmes for restructuring and productivity improvements in those industries which face severe crises should be developed so as to allow subsidies to be reorientated towards long-term employment creation. A distinction must be drawn between sectors facing long-term problems of excess capacity and those where capacity needs to be modernised and expanded.

11. Job-creating investment in the hardest-hit regions and areas of OECD countries needs to be raised. Cooperation and coordination between public authorities and the private sector is needed. In several OECD countries cooperation agreements between central, local and regional government and the private sector have shown a practical way how public and private sector cooperation can be improved. In Japan such arrangements are an important element in regional restructuring.

#### Infrastructure Investment

12. Governments must fulfill their responsibilities in matters of investment if they expect companies to invest. They have a particular responsibility for infrastructure investment. This is because the time-scale involved over which infrastructure investment must be judged is often very long. Rates of return are therefore low in the short and medium term and may be misleading. Public investment and infrastructure investment have dropped by a third in some of the major OECD countries over the last fifteen years. For example, in the



early 1970s the main European countries devoted 4.0% of GDP to public investment, this fell to 3.5% in the late 1970's and since 1981 the European average is 2.8%, with 1.9% in the U.K. and 2.6% in Germany both below the average. In Canada, public investment as a share of GDP has fallen from 4% in the early 1970's to an average of only 2.6% since 1981 and by 1987 had dropped even further to 2.4 per cent. This decline runs counter to all efforts to improve the structure of OECD economies and involves considerable costs to the economy and society. The 1987 public works programme in Japan has shown the positive effects which can be achieved and now needs to be complemented by action to raise domestic consumer demand and purchasing power.

13. Infrastructure investment is an essential way of meeting economic, environmental and social objectives. Substantial increases in infrastructure investment are needed in the following areas:

- transport, including major regional links in OECD countries, the integration of road, rail and water transport networks, by-passes for towns and villages to avoid urban congestion;
- energy, including increased investment in new and renewable energy sources, and more rational use of energy through other infrastructure programmes e.g. insulation in buildings;
- the basic telecommunications infrastructure, including investment in the provision of integrated systems networks which would assist expansion of new activities;
- housing, which needs to be linked to land reform in some areas, and which could ease mobility and must be linked to inner city redevelopment programmes;
- the environment, both to encourage the private sector and individuals to reduce pollution and waste through regulations and incentives, and to invest in better sewage, waste disposal and water supply systems.

14. Many of these areas involve joint public and private sector activity, but all require government initiatives in order to stimulate activity. There exists a range of options concerning financing: using fiscal room for manoeuvre that governments have and coordinating action internationally to increase this; in some areas the adoption of user fees for assets created; the provision of guaranteed returns; the creation of earmarked funds with low interest and guaranteed subsidised loans for desirable projects. The goal should be to produce the maximum activity using government finance and policy. The tremendous costs and consequences of delaying vital infrastructure investments must not be overlooked.

15. The domestic job-creation multiplier is substantially higher for public investment than for comparable fiscal measures, producing jobs in the construction industry, the supplying industries, the activities using the assets and more general induced employment gains in the economy as a whole. When coordinated internationally the job-creation gains are that much greater and in turn bring in more tax revenues.

16. The OECD should carry out a study of the needs, financing, supply and effects of a comprehensive programme of infrastructure investment.

#### The international monetary system and financial markets

17. It is both alarming and bizarre that in their recommendations and on the reform of microeconomic policies the OECD appears to be suggesting that the functioning of financial markets should be some set of model to be followed by the real economy. The deregulation and internationalisation of financial markets and the integration of currency markets has produced an untenable situation. For some years progressive delinking has been taking place between the financial and real economies of OECD countries. 95% of international financial transactions are unrelated to trade in goods and services or to productive investment flows. Multinational corporations and banks have become major players in this speculative system. The stock market crash, in which the capital worth of companies dropped by 20% in one week in October 1987, underlines the chaotic functioning of capital markets, their volatility and frailty. It has also shown that the markets no longer believe that governments are facing up to the policy implications of unbalanced growth which has been developing over the last five years. Yet it is governments who have given the markets a pivotal role by considering their behaviour as the criteria by which economic strategies must be judged. The fact that equity markets could collapse on such a scale and yet apparently have limited immediate impact on the real economy raises the question of what economic role financial markets really play.

18. An international system for the regulation and control of financial markets must be developed. The deregulation of financial markets is irresponsible. It disregards the basic fact that the whole economy has to come to the rescue when a major set of financial institutions, let alone the financial system as a whole, is running the risk of bankruptcy. Regulations must ensure a proper functioning of financial markets; namely, to supply the productive economy with capital. The evaluation of the long-term capital wealth of companies must reflect their real investment performance and should not be subject to large, economically unjustified upward or downward movements. A range of measures needs to be examined such as: disclosure requirements on financial holdings and transactions, the reform of rules applied to institutional investors; taxation to restrain speculative gains; the

elimination of tax havens; cooperation between countries to prevent capital flight; and the internationalisation of rules covering competition policy and restrictive business practices.

19. Action by government to reform the international monetary system must go beyond issuing communiques and sporadic intervention in exchange markets. Two measures are particularly urgent:

- the development of a more stable international exchange rate regime, reinforced by the pursuit of compatible economic policies by the major countries. This would in turn facilitate coordination;
- the establishment of an international mechanism whereby countries with persistent surpluses would have the obligation to increase resources to development assistance and adjust their economic policies.

#### Active Employment Policies

20. The employment situation in the OECD area is alarming. In many OECD countries net new employment creation has mostly reflected a growth of precarious, inadequately protected jobs. As was to be expected, low wages, reduced social provision, the reduction of restrictions on firing, and the plethora of temporary and insecure employment contracts have not reduced unemployment. The number of people who are unemployed is still growing, long-term and youth unemployment remains a critical problem, and insufficiently paid or protected part-time work is expanding, especially for women. This situation is having a corrosive effect on the whole of the labourforce. More of the same policies will not solve these problems, let alone assist the development of employment relationships which encourage the skills necessary for productivity growth and economic efficiency.

21. Workers exposed to constant pressures and threats are not an efficient labour force. A climate of confidence in expanded job opportunities at a decent wage and with good working conditions has to be created. The ability to handle technological and structural change in a desirable way requires a framework of programmes and opportunities which provide people with the necessary security and enable them to adjust to new situations. Government measures must: develop information, consultation and negotiation rights for workers' representatives on changes; expand social protection for the hardest-hit sectors of the labourforce; fully integrate part-time workers into mainstream labour legislation and working conditions; invest in education; provide training and re-training opportunities to all; and facilitate the transition of young people from school to active working life.

22. In the OECD area 16% of young people are unemployed, and many of these have never worked in their lives. A comprehensive approach to youth unemployment must integrate education, training and active employment policies. This must cover young adults, as well as teenagers, to form a continuum of policies. Governments have to play a catalytic role with employers and trade unions so that young people are guaranteed an acceptable alternative to unemployment: further education, high quality training, a job, or some acceptable combination of these. Governments have the tool of public sector employment at their disposal. Because the young unemployed are not a homogenous group these measures, although integrated and forming a comprehensive guarantee, must be carefully targeted and applied through a network of individual counselling services. A significant investment is required so that vocational education and training leads to good jobs, instead of being a substitute for employment. Business will have to make greater efforts to provide comprehensive training and re-training if it expects properly qualified and competent employees in the future.

23. The problem of unemployment amongst older workers and people who are unemployed for long periods of time is growing. Long-term unemployment now amounts to between one third and one half of all unemployed in many OECD countries and constitutes a situation of being terminally unemployed, especially for people with many years of work experience. The age-limit for hiring workers has in practice become lower, yet this is not necessarily due to inadequate or inappropriate skills - even though skills do deteriorate during long periods of unemployment. There is discrimination by employers against the long-term unemployed, compounded by the exhaustion of unemployment benefit entitlement and the damaging psychological effects of joblessness. A much more sophisticated policy response is required by governments to solve the problem of long-term unemployment. The public sector should give a high priority to hiring the long-term unemployed for positions which become available. A combination of public and community employment programmes will have to be provided and firms should be encouraged to employ them through subsidy and other schemes. Re-training is appropriate in a number of cases. Government policies can be decisive in removing the discrimination facing the long-term unemployed.

24. Further reductions in working time, including overtime, are essential. Systematic overtime working should be eliminated at the same time that inadequate basic wages, which make overtime working an important source of income for some, are raised. In Japan, reductions in working time to 1800 hours per year and beyond must be accelerated so as to spread the benefits arising from technological change and to improve employment. In Europe, some reductions of working time have been achieved, saving many jobs which otherwise would have been lost during the last few years, and creating new jobs. Changes in working time arrangements must be negotiated so that they are accompanied by suitable safeguards to protect and improve

working conditions and by visible success in creating more employment. Governments should encourage and not hinder negotiations to achieve reduced working time and maximise the positive employment effects.

### Removing Poverty

25. Governments have presided over an unparalleled increase in poverty and deprivation in many OECD countries. Policies have deliberately favoured those on higher incomes. The growth in hardship has been significantly, although not entirely linked to the growth of unemployment, particularly long-term and recurrent unemployment. In many OECD countries unemployment benefit schemes are of inadequate duration, only compensate workers for a relatively small part of former earnings and cover a limited number of those seeking work.

26. Governments have to remove the underlying causes of poverty. Social policy cannot be based on the pretence that 31 million people registered as unemployed are responding to inadequate "incentives" and that people choose poverty. Action is needed to provide a guaranteed minimum income and improve, not undermine, social security systems. This would ensure the distribution of the benefits of economic growth throughout society and be a major stimulus to growth by raising the purchasing power of those with the greatest needs. In the first place, this could be achieved by strengthening the areas of protection of people on low incomes: improved minimum wage provisions; social benefit systems; pensions; unemployment benefits; improved and extended health care; extended protection for groups of workers not covered by social security, e.g. part-time workers and workers with precarious employment status. Governments should examine the relation between taxation and social security entitlements so as to remove hardship created by the system. The financing of such improvements requires the development of the tax base of OECD countries, and the raising of the level of social security benefits in order to eliminate poverty and deprivation. This is in contrast to some of the "tax reforms" underway in OECD countries which have reduced taxes for well-off groups, leaving the poor worse-off.

### Debt and development

27. The loss of stock market values following the October 19 crash was greater than the total indebtedness of developing countries, yet the stock losses have been absorbed with little complaint, while proposals for debt write-offs or interest relief are dismissed. It has become accepted wisdom to talk of the need to increase the flow of resources, both public and private, to developing countries, yet in 1986, total resource flows from the OECD to developing countries dropped by 15%. A large number of OECD countries fall way below the UN target for

development aid equivalent to 0.7% of GNP. Reversing this situation is not an altruistic goal but would be in the OECD countries' own interest in order to develop growth and markets.

28. Different groups of developing countries have different priorities and must be handled with different approaches: the Newly Industrialized Countries, the major oil exporters, the middle income indebted countries and the poorest countries. Overall, however, a range of measures are necessary: faster growth in the OECD area; the translation of partial debt write-offs by the banks into lower debt servicing payments by the indebted countries on a case by case basis; debts of the poorest countries should be completely written-off; reduction in interest rates; major increases in official development assistance by all OECD countries, but particularly those with large surpluses; the expansion of concessionary export credits and guarantees; and the establishment of remunerative and stable commodity prices.

29. The International Monetary Fund (IMF) and World Bank are operating as if debt repayment takes priority over development. Real wages and working conditions have been in decline for many years without any fundamental improvement in the debt crisis. Debt servicing payments must be set at realistic levels so as not to jeopardise economic and social progress. These international organisations have a role to play in using partial debt write-offs by banks in such a way as to reduce the payments due from indebted countries. A Special Facility needs to be developed to this end. In many countries, soundly based development requires international competitiveness but this cannot be achieved through suppression of consumption and shifting resources towards purely export orientated industries. The IMF and World Bank should evaluate the social impact of their respective short and long-term strategies, as recommended by the ILO High-Level Meeting on Employment and Structural Adjustment in November 1987, and should re-define them in consultation and discussion with trade unions so as to ensure that working people have a say in their formulation. This is necessary to ensure both efficiency and fairness.

### The Multilateral Trading and Investment System

30. The GATT Treaty stated that GATT was founded with a view to "raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand". Yet the multilateral trading and investment system is under increasing pressure as it was never intended to cope with unemployment and trade imbalances of current magnitudes. Exchange rate changes and in particular a massive decline in the dollar cannot remove imbalances on this scale. Coordinated economic policy changes are necessary. In addition, one factor behind the pressure could be eased if it were fully recognized in practical terms that the goal of international trade as recognised by GATT must be to increase living standards, not to

reduce them. Governments should ensure that international competitive pressures do not undermine social progress.

31. Within the OECD area trade tensions arise amongst countries of comparable economic development and strength when the benefits of increased productivity are not translated into improvements in living standards. OECD countries should seek to harmonise upwards wages, working time standards, pensions, social security benefits, working conditions, health and safety, and general social provision and living standards.

32. OECD countries must improve access to exports from developing countries and remove discrepancies which exist among themselves in this respect. However, no government should be allowed to violate internationally agreed worker and trade union rights and minimum labour standards in order to capture export markets and to attract foreign investment. The benefits of greater participation in international trade must contribute to the social and economic progress of developing countries' populations. OECD governments should ensure that international support is built up for the inclusion of a Social Clause embodying this in the GATT.

33. The failure to recognize the importance of the social aspects of international trade and to develop practical multilateral responses contributes to the spread of unilateral and bilateral actions and to the tendency to form trading blocs. These trends limit the possibility for smaller or weaker countries to participate fully in world trade. The OECD has a role to play in creating the conditions for a better functioning multilateral system and avoiding the break-up of the world economy into aggressive trade blocs.

34. Opportunities for increased direct foreign investment must go together with more serious application of internationally recognised obligations on multinational enterprises to conduct their affairs in a manner which contributes to the economic and social development of both home and host countries. This is not the case at present. Decisions on company restructuring are being taken with little opportunity for employees to affect the outcome through negotiation and with no right of access to decision-makers for trade unions from different entities. The increasingly international repercussions of investment and takeover decisions, and their competitive impact require a greater commitment from governments to enforce the OECD Guidelines on Multinational Enterprises.

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YOUR TELNO 728: UN FINANCES AND THE TORONTO ECONOMIC SUMMIT:

1. WE HAVE ALREADY CONSIDERED AN INFORMAL TREASURY SUGGESTION THAT UN FINANCES AND THE SCOPE OF CONTRIBUTIONS BE DISCUSSED AT TORONTO AND DECIDED AGAINST FOR THE VERY GOOD REASONS SET OUT IN PARAGRAPH 2 OF TUR. A FURTHER CONSIDERATION WAS THAT GIVEN OUR CLOSE BILATERAL DIALOGUE WITH THE US ON THIS, AND THE INEVITABLE CRITICISM OF THE US IN ANY DISCUSSION, THERE WOULD BE A MAJOR RISK OF ANTAGONISING THE AMERICANS TO NO PURPOSE IF THE TOPIC WERE RAISED.

HOWE

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*Pay*

Treasury Chambers, Parliament Street, SW1P 3AG  
01-270 3000

William Wallace  
Deputy Director  
Royal Institute of International Affairs  
Chatham House  
10 St James Square  
LONDON SW1Y 4LE

16 June 1988

*Dear Mr Wallace,*

Thank you for your letter of 13 June enclosing a copy of the Tokyo Club proposals. I am sure the Chancellor will be interested to read it.

*Yours sincerely*  
*Alex Allan*

**A C S ALLAN**  
Principal Private Secretary

FROM: S W MATTHEWS  
DATE: 16 June 1988

**CHANCELLOR**

*Please minute  
hand.*

cc: Sir G Littler  
Mr Lankester  
Mr Evans  
Mr Savage

*[Handwritten initials and notes]*

**ECONOMIC SUMMIT: THE JAPANESE ECONOMY**

You wondered what "major purchases of capital goods" our Embassy in Tokyo had in mind in drafting paragraph 10 of their telegram 589.

2. Civil aircraft are the obvious candidate, as they are expensive and almost entirely imported. Purchases would be by both public and private sectors.

3. With regard to public procurement more generally, with the exception of defence where the US is already the dominant supplier, the usual inbred Japanese suspicion of foreign goods continues to apply. Last year's package of Emergency Economic Measures included promoting government procurement of foreign manufactured goods (eg the odd super-computer) and the US has been putting pressure on Japan to open up the tendering for major construction projects. The overall impact of such measures on Japanese imports is, though, likely to be of the order of tens of million dollars and thus relatively small beer.

4. As far as we are aware, there have been no changes in the Government's line that, in a market economy, it cannot direct the private sector to increase its imports of manufactures.

*P. Asbott*

pp S W MATTHEWS

CH/EXCHEQUER	
REC.	17 JUN 1988
ACTION	SIR G. Little
COPIES TO	SIR P. Middleton
	Sir T Burns
	MR T Lancaster
	MR H P. Evans
	MR P. Mountfield

17/6



*Przy*

10 DOWNING STREET  
LONDON SW1A 2AA

From the Private Secretary

16 June 1988

I enclose a copy of a letter to the Prime Minister from Helmut Schmidt reporting the conclusion of the session of the InterAction Council held in Moscow from 17-19 May and commending them as relevant to the Economic Summit.

I should be grateful for a draft reply.

I am copying this letter and enclosure to Alex Allan (HM Treasury) and to Nigel Wicks here.

(C. D. POWELL)

A. C. Galsworthy, Esq., C.M.G.,  
Foreign and Commonwealth Office.

656

10 JUN 1988.

Büro Helmut Schmidt  
— Bundeskanzler a.D. —

5300 BONN 1, 8. Juni 1988  
Bundeshaus  
☎ 16 78 80

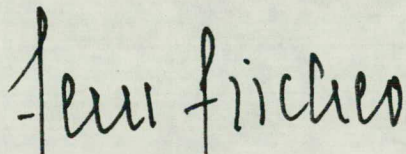
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Herrn Christopher Mallaby  
Friedrich-Ebert-Allee 77

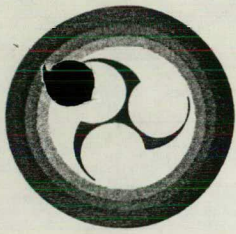
5300 Bonn 1

Dear Mr. Ambassador,

on behalf of former chancellor Mr. Helmut Schmidt  
in his capacity as chairman of the InterAction  
Council I would like to ask your kind service to  
transmit the enclosed letter to H.E. Mrs. Margret  
Thatcher.

Grateful for your help and with the expression  
of high esteem

  
(Jens Fischer)



**INTERACTION**  
**COUNCIL**  
OFFICE OF THE CHAIRMAN

BUNDESHAUS • 53 BONN 1 • FEDERAL REPUBLIC OF GERMANY • TELEPHONE: (0228) 167580 • TELEX: 886808

Helmut Schmidt, Chairman

June 8, 1988

\*Helmut Schmidt, *Chairman*  
Federal Republic of Germany

\*Takeo Fukuda, *Honorary Chairman*  
Japan

Ahmadou Ahidjo  
United Republic of Cameroon

Giulio Andreotti  
Italy

Kirti Nidhi Bista  
Nepal

James Callaghan  
United Kingdom

Jacques Chaban-Delmas  
France

Kriangsak Chomanan  
Thailand

Mathias Mainza Chona  
Zambia

Jeno Fock  
Hungary

Malcolm Fraser  
Australia

Arturo Frondizi  
Argentina

Kurt Furgler  
Switzerland

Selim Hoss  
Lebanon

\*Manea Mănescu  
Romania

Michael Manley  
Jamaica

\*Hedi Nouria  
Tunisia

Olusegun Obasanjo  
Nigeria

Ahmed Osman  
Morocco

\*Misael Pastrana Borrero  
Colombia

Carlos Andrés Pérez  
Venezuela

Maria de Lourdes Pintasilgo  
Portugal

Mitja Ribicic  
Yugoslavia

\*Léopold Sédar Senghor  
Senegal

Adolfo Suárez  
Spain

Pierre Elliott Trudeau  
Canada

Ola Ullsten  
Sweden

Andries van Agt  
Netherlands

Bradford Morse  
United States of America

Excellency,

From 17 to 19 May 1988, the InterAction Council held in Moscow its annual session which was devoted to the overall theme "Preparing for the twenty-first century". At the conclusion of its deliberations, the Council adopted a final statement. In my capacity as Council Chairman, I am pleased to transmit to you, attached, this statement and a list of participants for your information and perusal.

As the Council considered in some detail the prospects for the world economy in the 1990's, I wish to commend for your attention sections I and II of our statement which may be of particular relevance both for the forthcoming summit of industrialized countries in Toronto and for the Hannover summit of the leaders of the European community. Section III of the statement addresses the strategic panorama of the world in the 1990's.



*INTERACTION*  
*COUNCIL*

- 2 -

All members of the InterAction Council would very much welcome, if our suggestions and proposals could be taken up and given due consideration at the Toronto and Hannover summits.

With high esteem and best personal wishes,

Yours sincerely

Helmut Schmidt

H.E. Mrs. Margret Thatcher  
Prime Minister of the United Kingdom  
of Great Britain and Northern Island  
10, Downing Street

London, United Kingdom



1. At the invitation of the authorities of the Union of Soviet Socialist Republics, the InterAction Council met in Moscow from 17 to 19 May 1988. The session was devoted to the overall theme:

PREPARING FOR THE TWENTY-FIRST CENTURY

2. At the beginning of this century, world population ranged somewhere between 1.5 and 2 billion. In 1999, just eleven years from now, world population will have reached the astronomical number of 6 billion, requiring food, health, shelter, energy, education and employment. It is time to consider the necessary steps to be taken during the 1990's to bring about a more equitable and stable world than the one we have today.

3. We enter into the 1990's facing a plague which may prove to be the worst of modern times. AIDS not only threatens human lives but also could rend the fabric of international relations which has developed gradually through centuries. In other areas of health care, progress has been achieved under international auspices. We commend in particular intensified support for the programme of Universal Child Immunization and we call on all governments to continue and enlarge the efforts to reach all children of the world.

4. The pursuit of happiness, economic growth, physical health of mankind as well as the survival of a nature to which we are physically and socially adjusted hinges on the solution of complex ecological problems, among which the energy supply and global deforestation - which will lead to disastrous climatic changes - rank high.

5. These problems have acquired a strategic quality. They transcend national boundaries. They cannot be solved by nation states individually and in isolation from each other. From now on, all peoples are living in interdependence. Therefore, the 1990's must be a decade of multilateral approaches and international solutions if we are to prepare ourselves for the twenty-first century.

I. THREATS TO THE ENVIRONMENT

6. Based on the findings of a High-level Expert Group on Global Deforestation Trends, convened by the InterAction Council in January 1988 in Lisbon, we are convinced that indiscriminate deforestation and its effects on climate and environment will present one of the major problems of the twenty-first century. Already today, it is an established scientific fact that the mutually reinforcing trends of burning of ever higher amounts of hydrocarbons and global deforestation have induced climatic changes described as the so-called "greenhouse effect". Governments should be prepared to apply risk evaluation to all energy sources, for example for fossil fuel-based and nuclear-based energy, and to recognize that a call for an increase in fossil fuel-based energy is undesirable.

7. The InterAction Council calls upon the Secretary-General of the United Nations to place this question on the agenda of the next session of the General Assembly with a view to assessing the present degree of operational security of nuclear power plants and to evaluating the state of nuclear waste disposal. Furthermore, we strongly endorse all regional endeavours to reach more understanding of, and solutions to, environmental problems.

## II. THE WORLD ECONOMY OF THE 1990'S

8. The decade of the 1980's will end in dramatic imbalances among the industrialized countries as well as between creditor and debtor countries. Indeed, since the creation of the InterAction Council in 1983, the United States has transformed itself from the biggest creditor to the biggest net debtor country of the world. During the same period, the debt aggregate of the developing countries has doubled to US\$ 1.2 trillion. The debt burden, therefore, has become unbearable for most debtor countries in the Third World.

9. We are convinced that further postponement of a radical solution to Third World debt - which has been proposed by this Council since 1984 under the principle of burden-sharing - will disrupt global financial relations, increase tensions, misery and instability of societies and governments in developing countries and prove detrimental to other parties involved. Concrete co-operation on the restructuring of the economies of the low-income countries may lay the foundation for future improvement.

10. On the other hand, to leave the United States debt problem unsolved increases the risk of new inflation and economic breakdown. We, therefore, emphasize the urgency of adjustment policies on trade and finance. We are convinced that growth is the pre-condition for these adjustment processes.

11. The InterAction Council is deeply worried by the magnitude of the adjustments needed to balance international trade. Increasing shares of global trade are distorted by protectionist measures. Balance of payments policies and strategies to cope with the debt problem are vital to facilitate the necessary adjustment processes. We, therefore, urge a thorough survey of the ongoing Uruguay Round of GATT by the end of this year to enhance steps towards dismantling protectionism.

12. The United States, the European Community and Japan have engaged in costly and devastating agricultural protectionist policies. There is widespread concern that the free internal market of Europe envisaged for 1992 might well trigger new protectionist acts. The new economic entity has a great potential of contributing positively to the world economy, but in order for that potential to be realized the pursuit of liberal trade policies is no less than essential.

13. To prevent the emergence of new imbalances in the next decade, the InterAction Council is convinced of the need to establish norms for balance of payments policies. These norms should provide for regulations that would avoid excessive deficits



and surpluses. They should also imply a commitment of the rich countries to transfer part of the savings to developing countries. In particular, Japan, being the biggest creditor country, should seek to increase dramatically her contribution to official development aid. To bring about this set of norms, we call for an international dialogue to which the International Monetary Fund should contribute constructively.

14. A new international monetary arrangement should be empowered to exercise a more effective disciplinary function and should apply equally to all participants of the international currency market.

15. The InterAction Council is concerned by the tendency to solve monetary and trade problems through bilateral arrangements and by the weakening of the indispensable multilateral framework. Do political leaders understand that meaningful solutions require multilateral approaches?

16. We strongly believe that the development of reserve currencies in addition to the United States Dollar would greatly facilitate the improvement of international equilibria. We are convinced that, in the long run, there should be more than just one currency to bear the brunt of global economic growth. Are policy-makers in Japan prepared to meet this challenge? Are the leaders of the European Community aware of the need to develop a European monetary unit (ECU) that will be capable of also becoming a world reserve currency?

17. The past two decades have been characterized not only by serious economic imbalances in current accounts but also by a series of tremendous economic shocks, e.g. the two oil price explosions of the 1970's and the obvious vulnerability of the global money and stock markets. The industrialized countries as well as the developing countries have not been able to absorb these shocks in a satisfactory manner.

18. Leaders of the Third World must be conscious that disciplined economic and financial management is a prerequisite for increased assistance and credit confidence. Therefore, they must assume a share of responsibility for a successful and open economic policy, preventing the misuse of resources and unnecessary military expenditures.

19. The 1990's will foreseeably be characterized by continuous rapid changes: in the fields of technology, of market competition, of energy. Are political leaders decided to take the necessary actions in order to bring about more flexibility in their national economies and abolish market rigidities? Are they prepared to search for a new balance of social and economic needs, a new balance between the principles of equity and efficiency?

20. The 1990's will be increasingly characterized by the growth of interdependence among nations. This calls for better co-ordination of macro-economic policies of major economies and joint international action to create a secure economic environment. We are aware that this process will face the resistance of many vested interests. We nevertheless call for courageous leadership in the interest of the long-term benefits to all mankind.

### III. THE STRATEGIC PANORAMA OF THE WORLD IN THE 1990'S

21. We share the cautious optimism stemming from the resumption of summit talks between the United States and the USSR. The agreement on intermediate nuclear forces, which the InterAction Council has advocated since 1983, eliminates for the first time an entire class of weapons. We welcome it as a first constructive step towards a reduction of nuclear weapons.

22. The leaders of both powers must now build on this foundation, de-ideologize international relations and respond to the economic imperatives confronting both economies. During the next decade imagination, leadership and political will are required to achieve security at lower levels of armaments.

23. The United States and the USSR bear a special responsibility to apply fully and observe strictly the Treaty on the Non-Proliferation of Nuclear Weapons (NPT). Yet, the growing number of countries possessing a nuclear capability increases the prospect of a regional nuclear conflict. Can discussions begin on how to reduce this dreadful threat?

24. The ABM Treaty between the United States and the USSR is a centerpiece in preventing a destabilizing additional arms race in outer space. We again urge both parties to stand by the ABM Treaty. They must urgently settle on an agreed interpretation and application of it and on "offensive" and "defensive" postures, thereby strengthening the Treaty.

25. The very existence of nuclear weapons has imposed caution on the nuclear powers and their allies. Developments in the area of strategic defence and the emergence of new military doctrines require greater clarity. Talks on military doctrines may help bring about a better mutual understanding of strategic intentions and thus reduce the likelihood of conflict. We call on the countries concerned to expand on their initial discussions.

26. The prospect of a cut by 50 per cent in strategic weapons by the United States and the USSR should trigger preliminary work for a succession of strategic arms reductions. What is then the role of European strategic forces? What further cuts may induce China, the United Kingdom and France to join in a multilateral conference among all nuclear powers to reduce existing nuclear forces? May we reach a point at which the nuclear weapons on each side could become symbolic deterrents?

27. Efforts to reduce conventional forces in Europe may require the application of asymmetries, both in terms of redeployment and destruction of hardware and reduction of troops, so as to reach parities on lower levels than hitherto.

28. At least sixteen countries currently possess chemical weapons. Will these countries, on a priority basis, accede to a comprehensive ban on chemical weapons and abandon modernization?

29. The policies of perestroika and glasnost pursued by the Soviet Union may lead to a new balance in the country's economic, political and military commitments. Do these policies imply a new strategy approach to co-operation with the West in tackling the challenges of the 1990's? Will they entail a lesser emphasis on ideological differences? What is meant by the notion of a "common home" (M.S. Gorbachev) in Europe and also in the Pacific?

30. The Pacific Basin, including China and Japan, is forecast to account for as much as 50 per cent of world GNP by the end of the century. The sheer economic power of Japan is bound to have political and strategic consequences.

31. We do not think it wise to put pressure on Japan to increase its military spending. Japan, in absolute terms, is already one of the largest defence spenders with unknown implications for the strategic balance which is of interest to all global powers.

32. The competitive supply of weapons to all regions causes increasing instability in a number of regions. Can a fresh effort be made to reach agreement on the supply of arms to developing countries which drains resources sorely required for development purposes?

33. The future of East-West relations should not rest entirely on arms control. A dialogue should build on policy stability less affected by changes in leadership. The agreement on Afghanistan is a first, welcome step and has positive repercussions beyond the immediate relations between the two global powers. Is the United States prepared to refrain from delivering further weapons to forces opposed to the Government of Afghanistan?

34. We enjoin the leaders of the United States and the USSR to co-operate in bringing about, inducing, mediating or even imposing peaceful solutions to regional conflicts to the Iran-Iraq war, the Middle East, Southern Africa, the Horn of Africa, Central America and South-East Asia.

- We ask for an early withdrawal of foreign troops from Kampuchea.

- Will leaders of countries with influence over the parties to the conflict in the Sudan be prepared to join hands and stop the military confrontation?

- Are the leaders of the industrialized nations now ready to impose economic sanctions against the Republic of South Africa as a signal of world disapproval of the system of apartheid and to demonstrate that these countries support the struggle for human rights? The InterAction Council believes that the international community must begin to address itself to the prospects of a non-racial, post-apartheid South Africa.

- For how long will the industrialized countries allow economic and military destabilization of neighboring countries by South Africa with impunity? Are the Western countries prepared to step up significantly their humanitarian, economic and non-lethal

aid in order to strengthen the resilience of the countries subject to destabilization? To that effect, will the industrialized nations be ready to join immediately in the financing of a massive multilateral assistance programme?

35. Ten years ago, the United Nations Security Council adopted Resolution 435 providing for a process leading to the independence of Namibia. What measures are the Western countries prepared to take, together with other members of the Security Council, to ensure the early and full implementation of this resolution?

36. The InterAction Council condemns any act of terrorism. We regret the disparity which has arisen between countries as to the best way to address the scourge of terrorism which involves the holding of innocent hostages. Cannot discussions be launched among Governments to arrive at a new consensus, in the light of experience, on how to deal with, and restrain, terrorism?

37. Since a new atmosphere prevails in international relations, especially between the United States and the USSR, the time is propitious to re-examine the role of the United Nations in the coming decade and to turn it, with the participation of all Member States, into a more successful organization than it has been.

Are the leaders of all countries, especially of the permanent members of the Security Council, prepared to undertake efforts to achieve a fresh start in using the United Nations in solving problems and conflicts?

#### PARTICIPANTS

##### Members of the InterAction Council

Helmut Schmidt (Federal Republic of Germany) - Chairman  
Takeo Fukuda (Japan) - Honorary Chairman  
Andries van Agt (Netherlands)  
Kirti Nidhi Bista (Nepal)  
Lord Callaghan of Cardiff (United Kingdom)  
Mathias Mainza Chona (Zambia)  
Jenoe Fock (Hungary)  
Malcolm Fraser (Australia)  
Arturo Frondizi (Argentina)  
Kurt Furgler (Switzerland)  
Manea Manescu (Romania)  
Olusegun Obasanjo (Nigeria)  
Misael Pastrana Borrero (Colombia)  
Maria de Lourdes Pintasilgo (Portugal)  
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Shin Hyon-Hwak (Republic of Korea)  
Pierre Elliott Trudeau (Canada)  
Manuel Ulloa (Peru)  
Ola Ullsten (Sweden)  
Bradford Morse (United States) - Honorary Member

Members of the InterAction Policy Board

Huang Hua (China)  
Emile van Lennep (Netherlands)  
Isamu Miyazaki (Japan)  
Viktor F. Popov (USSR)  
Mario Schimberni (Italy)  
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Kenneth W. Dam (United States)  
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Vladimir F. Petrovsky (USSR)  
William P. Rogers (United States)  
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Diego Arria (Venezuela)



2 MARSHAM STREET  
LONDON SW1P 3EB  
01-212 3434

My ref:

Your ref:

CH/EXCHEQUER 17/6	
REC.	16 JUN 1988
ACTION	SIR G. Littler
COPIES TO	SIR P. Middleton
	SIR T. Burns
	MR. H.P. Evans
	MR P. Mounfield

Charles Powell Esq  
Private Secretary to  
The Prime Minister  
10 Downing Street  
LONDON  
SW1A 2AA

16 June 1988

Dear Charles,

Thank you for the copy of your letter of 7 June to Lyn Parker about the Italian Prime Minister's proposal to discuss environmental problems at the Toronto Economic Summit.

We agree with Rob Peirce's reply of 9 June that there is no need for a formal reply and that we should discourage discussion of specific environmental issues at the Summit. Officials here will continue to keep in close touch with FCO on preparations for the Summit and for the Prime Minister's bilateral with Mr de Mita.

Copies of this letter go to Bob Peirce at the FCO and Alex Allan at HM Treasury.

Yours sincerely,

Deborah Lamb.

DEBORAH LAMB  
Private Secretary



CH/EXCHEQUER	
REC.	16 JUN 1988
ACTION	SIR G LITTLE
COPIES TO	SIR P. Middleton
	SIR T. Burns
	MR H.P. Evans
	MR Mountfield
	MR S. Robinson

16/6

*Handwritten initials*

Foreign and Commonwealth Office

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London SW1A 2AH

16 June 1988

*Dear Charles,*

Prime Minister's Bilateral with Signor De Mita:  
Toronto, 19 June

The Prime Minister will meet Signor De Mita at 0900 on Sunday 19 June. This is an opportunity for the two leaders to establish contact but also to do some business before the Economic Summit gets under way and before Hanover. We recommend also that the Prime Minister raise a couple of bilateral points - possible Italian arms sales to Argentina, and possible sale of Sea Harrier to Italy.

Italy Internal

A full personality note on Signor De Mita is attached. He was appointed Prime Minister in May. He had been Secretary of the Christian Democrat Party since 1982. His Ministerial experience is limited and he has little knowledge of foreign affairs. But he is a shrewd operator with considerable political clout. The enclosed telegrams from Rome give a fuller account of the current political background.

The Italian economy is expanding at around 3%, but faces problems. Inflation has crept up from 4.2% in March to 5.2%. Unemployment, at 12½%, remains the highest in the G7. The trade balance has deteriorated sharply. A sheet of basic statistics is attached.

Toronto Economic Summit

Although we have no specific points to raise with the Italians, Signor De Mita may want to go over the economic 'agenda' for the Summit. The Italians share our interest in a continued reduction of current account imbalances because of the importance to them of the German economy. On debt relief they support Paris Club interest rate cuts.

The Prime Minister could remind Signor De Mita of our shared interest in the success of the GATT Round. At the Mid Term Meeting concrete progress should be made in specific areas (eg dispute settlement, tropical products, effective

/working

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working of the GATT); in others agreement should be reached on principles for the negotiations (particularly agriculture - but also on "new issues", ie investment, services, intellectual property). The EC should make a positive contribution in all these areas.

Signor De Mita may refer to his 30 May letter proposing a debate at Toronto on environmental issues. The Canadian Thematic Paper covers some of the same topics and we should explain that we prefer the Canadian language; we see no need for substantive discussion of the environment. Italian ideas on "city technologies", in particular, are undeveloped, though they may be related to the more general theme of urban renewal.

#### European Community (before Hanover)

Completion of the Single Market is a high priority for the new Italian Government and features prominently in Signor de Mita's programme. We recommend that the Prime Minister stress the importance we attach to maintaining a real impetus on the Single Market in the run-up to 1992. Britain and Italy should work with the Germans to get Hanover to endorse clear priorities through to the end of 1989 as suggested in Chancellor Kohl's letter. UK priorities are:

- financial services (further progress beyond the likely agreements on capital movements and non-life insurance) eg banking, securities and life insurance;
- mutual recognition of testing and certification procedures and further agreement covering product standards;
- further opening up of public purchasing in member states including measures to enable compliance;
- further transport liberalisation (including shipping cabotage; further opening up of air transport services and road transport cabotage);
- opening up of market in telecommunications.

On the external effects of the Single Market, the Prime Minister could say that it is important to reassure trading partners there will be no "Fortress Europe".

The Italians have adopted a pragmatic approach to monetary cooperation, acknowledging that a European central bank can be only a long term goal, whilst supporting work to investigate what practical steps can be taken towards it. Like the French, they are concerned at what they see as the

/deflationary

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deflationary bias in the ERM, and favour sterling membership to help counterbalance the weight of the DM. The Italians do not have strong views as to whether further study should be carried forward by wise men or central bankers, and would probably agree to either option, or a combination of both, if it seemed likely to command majority support. Signor De Mita is unlikely to wish to discuss these matters in detail.

The Prime Minister could to draw on the following points:

- there are a number of ideas in the monetary area on which early progress could be made, including a greater use of the ecu and wider cross-holdings of Community currencies in foreign exchange reserves;

- any remit from Hanover should seek to give further impetus to work on these points, ie practical work by practitioners such as the Committee of Central Bank Governors.

- [if asked] Government policy is that sterling will join the ERM when the time is right. Not sensible to try and set a timetable.

Ideas for a "social area" to match the Single Market are on the agenda for Hanover and are supported by the Commission and the French. But there is a good chance that discussion can be steered away from specific proposals.

If Signor De Mita raises the subject, the Prime Minister might make the following points:

- Europe's biggest social problem is unemployment. Single market will provide new opportunities for growth and job creation. Need to build on lead given by 1986 Employment Resolution and to implement its provisions for greater labour market flexibility, training and retraining of the long-term unemployed.

- Rights and duties of employees should be decided according to national traditions and laws. We must not create new burdens on business that destroy the benefits of the single market.

- Should not forget what we agreed in text of Single European Act, ie:

- that social priorities should avoid imposing burdens on small and medium business;

/- that

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- that the Commission was to promote dialogue between management and labour, not propose measures artificially imposed by the Council.

#### Arms to Argentina

We recommend that the Prime Minister mention the importance to us of the Italian Government's continuing to embargo major new arms sales to Argentina. The Italians have recently repeated to us their worry that others (specifically the US, FRG and French) will secure valuable arms contracts with Argentina to the detriment of Italian firms. We have told them that the assurances we have from other governments remain good.

#### Italian Defence Policy

The Italian Cabinet has approved NATO's request that Italy should receive the US F-16 wing being removed from Spain (the NATO Infrastructure Budget will bear the cost). Parliamentary approval is being sought in a debate on 16 June. The Prime Minister might welcome this development as important in the context of Alliance burden-sharing.

We have a number of equipment collaboration projects with the Italians, including EFA and the EH 101. It would be useful if the Prime Minister could remind Signor De Mita of our continued interest in selling them Sea Harrier for the aircraft carrier "Garibaldi". The legislation to allow the Navy to acquire a fixed-wing capability has been bogged down in the Italian Parliament for some time.

#### State Visit

If Signor De Mita raises reinstatement of the State Visit, we recommend that the Prime Minister say that:

- we remain keen to reinstate the Visit at an early opportunity;
- our formal planning for State Visits is however done on a long term basis, and we already have a number of Visits in the pipeline;
- at this stage we can give no firm indication on the timing of reinstatement, but we shall of course let the Italians know as soon as we can offer a date.

/Other

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Other Issues

If Signor De Mita raised East/West issues, the Prime Minister could urge the need for Western unity and firmness of purpose. The Italians are on the whole reasonably robust but sometimes inclined to argue that the importance of the opportunity represented by Mr Gorbachev is such that we should be ready to "help" him.

If Signor De Mita raises the Gulf, the Prime Minister might urge him to keep the Italian contingent of 6 ships in place. She could also stress the importance of keeping up diplomatic momentum at the UN towards a settlement on the basis of SCR 598.

I am copying this letter to Alex Allan (Treasury), Brian Hawtin (MOD) and Trevor Woolley (Cabinet Office).

Yours ever,  
*L Parker*

(L Parker)  
Private Secretary

C D Powell Esq  
10 Downing Street

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DE MITA, ONOREVOLE LUIGI CIRIACO

President of the Council of Ministers (Christian Democrat/DC).

Born the son of a tailor near Avellino in 1928. Deputy for Avellino since 1963.

Graduated in Law from the Catholic University of Milan.

Under-Secretary in the Ministry of the Interior during the third Rumor government, April-August 1970. Minister of Industry, July 1973-November 1974. Minister for Foreign Trade, November 1974-August 1976 when he was appointed Minister for the South, which he remained in Andreotti's Fourth Government (March 1978-January 1979).

De Mita came to the top in 1969 when, working together with Forlani, he succeeded in temporarily wresting control of the party Secretariat from the older generation. De Mita himself became a Vice Secretary of the DC at this time. As one of the leaders of the leftish "Base" faction, he openly attacked the second (centre-right) Andreotti Government (1972-73), while retaining his post in the Secretariat until early 1973. He remained very active in party politics, generally opposing and in the end helping to unseat Fanfani as Party Secretary. His position improved after 1976, when Andreotti began to pursue his policy of collaboration with the PCI. In March 1979, he again became Vice Secretary of the DC and, although he lost the position after the party congress in early 1980 decided on an anti-PCI line, he was reappointed Vice Secretary in December 1980. During the DC Congress in May 1982, he was directly elected Secretary to the Party, in succession to Piccoli: this was a new procedure for the DC. Member of the Chamber Foreign Affairs Commission. President of the Council of Ministers May 1988 in succession to Giovanni Goria.

Independent and ambitious, De Mita did something to restore DC self-confidence in 1982, not least by taking a firm line with Craxi during the V Fanfani Government. He has surrounded himself at DC Headquarters with cronies. There has been no sign of any move back to his earlier policy of greater openness to the PCI. Indeed he has denounced the line taken by the PCI under Natta in very strong and forthright terms. He paid well-publicised visits to the United States in January 1983, December 1984 and January 1986. He remains popular in his home area and speaks a fairly thick dialect (a gift to political cartoonists). As Party Secretary, he kept to his political circles and avoided meeting Ambassadors. An advocate of more rigorous economic policies before the elections in June 1983; he was blamed by many in the party for the DC's poor performance at the polls, but successfully survived the party Congress held in February 1984. Despite his efforts, he is not very popular with the DC in North Italy. He made strenuous efforts to clean up the image of the scandal-ridden regional section of the DC in Sicily. He visited several Latin American states in January 1986 and attaches importance to links with DC parties in that continent.

Alleged to have been a somewhat reluctant candidate for the Presidency of the Council, but seems, despite his inexperience, to be making a good showing. His first three high-level interlocutors, (Takeshita, Kohl, Mitterrand) are said to have been favourably impressed. Remains DC Party Secretary until a successor is chosen. This may not be for another few months.

Married with three daughters and one son.

ITALY: BASIC STATISTICS

		Italy	UK
Population	1986	57.2	56.8
Labour Force	1985	23.5	27.6
Unemployed (% OECD standardised rate)	1987 (P)	12.0	10.0
	Q1 1988 (P)	12.4	9.0
GDP (\$bn)	1986	599.9	547.8
GDP per head:			
at market exchange rates (\$)	1986	10,490	9,650
at purchasing power parity (UK=100)	1986	99.2	100
Annual Growth Rate of real GDP (%)	1986	2.8	3.2
	1987 (P)	3.1	4.4
Annual Growth Rate of Industrial Production (%)	1986	2.1	1.9
	1987 (P)	2.2	3.6
Inflation (%)	1987	4.7	4.2
	Feb 1988	5.2	3.3
Changes in Relative Labour Unit Costs (% change)	1986	2.2	-6.7
	9 mths 1987	2.5	-2.2
Balance of Payments on Current Account (\$ bn)	1986	0.4	0.1
	6 mths 1987	-1.4	0.7
Trade Balance (\$bn)	1986	-2.5	-12.4
	1987	-8.6	-15.8
Volume Growth (%):			
Exports	1986	1.8	4.0
	1987	2.0	5.8
Imports	1986	4.6	7.0
	1987	9.4	7.4
<hr/>			
Bilateral Trade	1985	1986	1987
UK Exports to Italy (fm)	3,466	3,472	4,146
UK Imports from Italy (fm)	4,293	4,658	5,217
Trade Balance	-827	-1,186	-1,017

Economic Advisers  
10/06/1988

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MDHIAN 3494

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LUXEMBOURG FOR UKREP

PRIME MINISTER'S MEETING WITH DE MITA 19 JUNE

1. BY THE TIME DE MITA MEETS THE PRIME MINISTER, HE WILL HAVE HAD TWO MONTHS IN OFFICE. DURING THAT PERIOD HE WILL HAVE MET ALL HIS SUMMIT SEVEN COLLEAGUES (KOHL TWICE, HAVING GONE TO GERMANY LAST WEEK-END AT KOHL'S INVITATION TO WATCH THE ITALY-GERMANY FOOTBALL MATCH). HE WILL JUST HAVE HAD A SUCCESSFUL VISIT TO WASHINGTON INCLUDING A TWO HOUR MEETING WITH PRESIDENT REAGAN AND WILL HAVE GOT A GOOD RECEPTION FROM THE US MEDIA. FOR AMERICANS HE IS A NOVELTY, AN ITALIAN AND MOREOVER THE MAN WHO HAS GIVEN A WARM WELCOME TO THE F16S. HE IS THEREFORE LIKELY TO BE IN REASONABLY BUOYANT MOOD WHEN HE GETS TO TORONTO.
2. AGAINST THAT, THE POLITICAL BACKGROUND AT HOME IS STILL DIFFICULT (SEE MIFT). MOREOVER, HE STILL SEEMS, BY ALL ACCOUNTS AND NOT SURPRISINGLY, TO BE SOMEWHAT UNCONFIDENT IN DEALING WITH INTERNATIONAL ISSUES OR WHEN FACED WITH PEOPLE HE DOES NOT KNOW. ON THE FEW OCCASIONS I HAVE SEEN HIM IN PUBLIC HE HAS SEEMED MUCH MORE COMFORTABLE WITH ITALIAN POLITICIANS THAN WITH ANYONE ELSE. HE DOES HIS HOMEWORK, LEARNS HIS LINES AND CAN BE EXPECTED TO SPEAK CLEARLY ON THE SUBJECT ON WHICH HE HAS BEEN BRIEFED. BUT HIS KNOWLEDGE CANNOT BE DEEP AND AT THIS FIRST MEETING, HE SEEMS LIKELY TO LEAVE THE RUNNING TO THE PRIME MINISTER.
3. THERE WILL NOT BE TIME TO DO MUCH MORE THAN EXCHANGE COURTESIES. BUT I HOPE, APART FROM ANY DISCUSSION OF SUMMIT OR HANOVER-RELATED ISSUES, THE PRIME MINISTER MAY FIND A MOMENT TO FLAG TWO BILATERAL ISSUES:
  - (I) ARMAMENTS COLLABORATION. THIS WOULD BE A GOOD OPPORTUNITY TO UNDERLINE TO DE MITA THE IMPORTANCE THE UK ATTACHES TO GETTING IT RIGHT ON ARMAMENTS COOPERATION, ESPECIALLY HELICOPTERS AND EFA, AND MENTIONING OUR INTEREST IN THE SALE OF SEA HARRIERS TO THE ITALIAN

NAVY.

(II) ARMS FOR ARGENTINA. IT WOULD BE A USEFUL INSURANCE POLICY IF THE PRIME MINISTER WOULD UNDERLINE OUR CONTINUED CONCERN ABOUT SALES OF SOPHISTICATED WEAPONS, ESPECIALLY TORPEDOES TO ARGENTINA: THE IMPORTANCE WE PLACE ON ANDREOTTI'S ASSURANCE OF 15 JANUARY THAT ITALY WILL NOT SUPPLY SUCH WEAPONS SO LONG AS OTHER POTENTIAL SUPPLIERS FOLLOW THE SAME POLICY: AND OUR CONFIDENCE IN SIMILAR ASSURANCES GIVEN US BY OTHER POSSIBLE SUPPLIERS.

4. IF DISCUSSION TURNS TO EAST/WEST RELATIONS OR EUROPEAN DEFENCE, THE PRIME MINISTER WILL WISH TO BE AWARE THAT ON BOTH SUBJECTS, DE MITA HAS EXPRESSED SLIGHTLY ODD VIEWS. ON EAST/WEST RELATIONS, HE HAS SPOKEN VAGUELY OF THE IDEA OF AN "ECONOMIC ASSISTANCE PLAN FOR EASTERN EUROPE" - QUOTE A KIND OF MARSHALL PLAN FOR COMMUNIST EUROPE UNQUOTE AS HE CALLED IT IN HIS ADDRESS TO THE NATIONAL PRESS CLUB IN WASHINGTON YESTERDAY. I DOUBT IF THIS NEED BE TAKEN AT FACE VALUE. HE APPEARS TO SEE THE PROCESS OF PERESTROIKA IN THE SOVIET UNION AND RELATED DEVELOPMENTS IN EASTERN EUROPE AS OFFERING NEW POSSIBILITIES FOR ITALIAN BUSINESS AS THE COUNTRIES CONCERNED MOVE TOWARDS MARKET ECONOMICS. THIS SEEMS DESIGNED TO APPEAL TO ITALIAN BUSINESSMEN LOOKING FOR NEW MARKETS. BUT IT SCARELY ADDS UP TO A MARSHALL PLAN.

5. ON EUROPEAN DEFENCE, DE MITA HAS SPOKEN OF A QUOTE EUROPEAN MILITARY POLE UNQUOTE WHICH HE SEES NOT ONLY AS A MILITARY OPTION (UNSPECIFIED) BUT AS A WAY OF PROMOTING A COMMON EUROPEAN EXTERNAL POLICY. THIS LINE APPEARS TO BE THE REVERSE OF ANDREOTTI'S MORE ACCEPTABLE VIEW THAT GREATER EUROPEAN COOPERATION IN DEFENCE CAN ONLY GO HAND-IN-HAND WITH GREATER POLITICAL INTEGRATION AND MUST BE DISCUSSED WITH THE GREATEST CAUTION. ACCORDING TO ITALIAN OFFICIALS, DE MITA IS TAKING THIS LINE TO MOVE HIS POSITION CLOSER TO CRAXI'S VIEWS ON EUROPEAN DEFENCE. IT WOULD BE USEFUL IF THE PRIME MINISTER WERE ABLE TO UNDERLINE THE IMPORTANCE OF AVOIDING CONCEPTS WHICH RISK GIVING THE IMPRESSION OF DIVISIONS WITHIN THE ALLIANCE, EVEN WHEN THE INTENTION IS THE LAUDABLE ONE OF BUILDING UP THE EUROPEAN CONTRIBUTION TO DEFENCE AS ITALY IS DOING BY TAKING THE F16S.

THOMAS

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PRIME MINISTER'S MEETING WITH DE MITA:  
POLITICAL BACKGROUND IN ITALY

SUMMARY:

1. DE MITA IS STILL FINDING HIS FEET. ONE OF HIS THREE MAJOR POLICIES IS ALREADY UNDER THREAT FROM STRIKES IN THE PUBLIC SECTOR WHICH HAVE NOT BEEN DEALT WITH FIRMLY ENOUGH. THE JURY IS STILL OUT ON WHETHER HE CAN RE-ESTABLISH FIRM GOVERNMENT IN ITALY.

DETAIL:

2. DE MITA'S GOVERNMENT HAS SO FAR MADE LITTLE IMPRESSION ON ANY OF THE PRIORITY AREAS IN ITS PROGRAMME: PREPARING FOR 1992, REDUCING THE PUBLIC DEFICIT, AND CARRYING OUT INSTITUTIONAL REFORM. THE ONLY MAJOR DECISION HAS BEEN TO TAKE THE 401ST-WING F16S FROM TORREJON. THE ITALIAN PARLIAMENT DUE TO EXAMIN THIS DECISION POST-HOC IN A DEBATE THIS WEEK OR NEXT. THE GOVERNMENT NEEDS PARLIAMENTARY APPROVAL FOR POLITICAL NOT CONSTITUTIONAL REASONS. IT IS LIKELY TO SECURE IT. IT WOULD BE A MAJOR SET-BACK FOR DE MITA IF IT DID NOT.

3. ON 1992, THERE IS INCREASING AWARENESS AMONG ITALIAN BUSINESSMEN AND POLITICIANS OF THE IMPORTANCE OF THE ADJUSTMENTS ITALY WILL NEED TO MAKE TO BENEFIT FROM THE SINGLE EUROPEAN MARKET. THE SUBJECT NOW COMES UP IN ALL MAJOR SPEECHES BY DE MITA AND OTHER MINISTERS INVOLVED, INCLUDING ANDREOTTI. BUT A FULLY-FLEDGED GOVERNMENT INFORMATIVN CAMPAIGN IS NOT YET UNDERWAY. ITALY'S WEAK POINTS IN PREPARING FOR 1992 ARE PUBLIC ADMINISTRATION AND FINANCIAL SERVICES. A COMBINATION OF COMPLEX REGULATIONS, BUREAUCRATIC INEFFICIENCY AND POLITICAL PATRONAGE HAS SO FAR SERVED TO PROTECT THE DOMESTIC MARKET FROM OUTSIDERS. IN THE CHANGED CIRCUMSTANCES OF THE SINGLE MARKET, POLITICIANS, BUSINESSMEN AND ECONOMISTS SEEM CONVINCED THAT THEY COULD SERIOUSLY HANDICAP ITALY'S ABILITY TO COMPETE ON ALL-FOURS. BUT THE TASK OF TRANSFORMING THE BUREAUCRACY AND THE MAJOR CREDIT INSTITUTIONS (MANY OF WHICH ARE STATE

CONTROLLED) IS HERCULEAN.

4. REDUCING THE BUDGET DEFICIT IS AN IMPORTANT PART OF ITALY'S PREPARATION FOR 1992. THE REAL ECONOMY STILL SEEMS TO BE DOING WELL. THE RATE OF GROWTH IN 1987 WAS JUST OVER 3 PERCENT. INDUSTRIAL PRODUCTION IN THE FIRST QUARTER OF 1988 WAS UP 6 PERCENT WITH INDUSTRIAL INVESTMENT STILL STRONG, AND INFLATION HELD BELOW 5 PERCENT. BUT THE BALANCE OF PAYMENTS IS BADLY IN THE RED (EXPORTS ROSE BY 3.4 PERCENT IN THE FIRST QUARTER BUT IMPORTS BY 9.4 PERCENT). THE PUBLIC SECTOR DEFICIT LAST YEAR WAS 11.5 PERCENT OF GDP. A DECREE LAW HAS BEEN ISSUED TO RAISE REVENUE AND REDUCE EXPENDITURE BY ENOUGH TO CUT THIS YEAR'S PROJECTED DEFICIT BY APPROXIMATELY 7000 BILLION LIRE (OR JUST OVER 5 PERCENT). DE MITA ISSUED A FIRM-SOUNDING RULING WHEN HE TOOK OFFICE THAT NO MEASURES OR LEGISLATION SHOULD BE INTRODUCED WITHOUT PROPER FINANCIAL COVERAGE. BUT HE HAS ALREADY BEEN PUSHED OFF THIS BY THE PAY OFFER WHICH THE GOVERNMENT MADE TO TEACHERS LAST WEEK WHICH INVOLVES A RISE OF AT LEAST 20 PERCENT OVER THREE YEARS. THIS IS NOT A HAPPY AUGURY, HOWEVER MUCH HIS GOVERNMENT TRIES TO TREAT THIS AS A SPECIAL CASE.

5. PROGRESS ON INSTITUTIONAL REFORM STILL SEEMS A LONG WAY OFF. ALL THE PARTIES AGREE THAT INEFFICIENT PARLIAMENTARY PROCEDURES NEED TO BE CHANGED. COMMITTEES OF BOTH HOUSES OF PARLIAMENT HAVE BEGUN TO EXAMINE PROPOSALS FOR REFORM PUT FORWARD BY THE VARIOUS PARTIES. SO FAR, THE GOVERNMENT ITSELF HAS GIVEN NO CLEAR LEAD TO THE DEBATE, DESPITE DE MITA'S INNOVATION OF APPOINTING A MINISTER WITH SPECIFIC RESPONSIBILITY FOR OVERSEEING INSTITUTIONAL REFORM. THE SUBJECT IS HIGHLY CONTROVERSIAL. FUNDAMENTAL CHANGE IS UNLIKELY WITHOUT CHANGING THE PRESENT SYSTEM OF PROPORTIONAL REPRESENTATION. THIS IS NOT IN THE GOVERNMENT'S PROGRAMME.

6. THE DE MITA GOVERNMENT IS THUS STILL RUNNING IN. IT IS STRONGER THAN ITS PREDECESSOR. THERE IS GREATER WILLINGNESS AMONG THE COALITION PARTIES TO WORK TOGETHER UNDER DE MITA. THAT INCLUDES, AT LEAST FOR THE PRESENT, CRAXI AND THE SOCIALIST PARTY. BUT DE MITA'S STYLE AS PRIME MINISTER CREATES LITTLE IMPRESSION IN PUBLIC OF STRONG LEADERSHIP. DE MITA ASKED, WHEN HIS GOVERNMENT WAS SWORN IN, FOR A MANDATE UNTIL 1992. HIS COALITION PARTNERS GAVE NO SUCH COMMITMENT. NOR HAS HE YET DISPLAYED THE AUTHORITY AND DEFTNESS WHICH WOULD BE NECESSARY FOR HIS GOVERNMENT TO SURVIVE SO LONG. ANDREOTTI HAS TOLD ME PRIVATELY THAT HE REGARDS DE MITA AS SECURE AT LEAST UNTIL THE EUROPEAN ELECTIONS NEXT JUNE. IF THE STRENGTHENING OF CRAXI'S POSITION IN THE RECENT LOCAL ELECTIONS IS CONFIRMED AT THOSE EUROPEAN ELECTIONS, DE MITA'S TENURE MAY BE

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	MR MOUNTFIELD

Foreign and Commonwealth Office

CONFIDENTIAL London SW1A 2AH

16 June 1988

Dear Charles,

Toronto Summit: Prime Minister's Bilateral  
with Chancellor Kohl

The Prime Minister will have a half-hour bilateral discussion with Chancellor Kohl at 1200 on 19 June. In the limited time available, the Foreign Secretary recommends that the Prime Minister concentrate on the more important short-term issues and leave other matters for the meeting at Chequers on 9 July. This letter therefore covers one or two points connected with the Toronto Summit agenda, EC issues before Hanover, the question of Tornado sales to Jordan, on which the final German decision is to be taken on 29 June, and Berlin air services, which Chancellor Kohl might raise.

Internal Background

The CDU Conference this week has been marked by murmurs of unhappiness at Chancellor Kohl's leadership; the Schleswig Holstein election on 8 May was a particular low point, and divisions within the Government coalition are chronic. Nevertheless, there is no sign of any inclination in the FDP to switch coalition partners. The only Land election due before the Federal elections in 1990 will be in Berlin, where the CDU seem bound to retain power. At present Chancellor Kohl looks set to continue in office for some years to come.

Anglo-German Relations

Our relations with the Germans are based on enormous common interests and habits of close consultation and frank discussion. They have however been going through a slightly difficult patch recently, stemming partly from disagreements of substance (eg SNF) but also from differences of perception. We consider that such fundamental factors as our contribution to German defence are too readily overlooked by the Germans. They seem to feel that we have not been devoting enough time and attention to their particular interests and preoccupations. There are moves on both sides to put this right. It would however be helpful if the Prime Minister could at some stage say to Chancellor Kohl:-

/that

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- that we shall need to keep in particularly close contact at all levels over the coming period. With the forthcoming change of US Administration and the continuing uncertainties in the Soviet Union and Eastern Europe, Britain and Germany will have a crucial role within the Alliance.

- that she is conscious of the need to get across to public opinion in both countries the excellence and importance of our relationship.

- that she is looking forward to seeing him at Chequers on 9 July for a longer discussion of all these things.

We recommend also that the Prime Minister take this opportunity to thank the Chancellor for the work of the German police during the European Nations football competition and for their close cooperation with the British agencies involved, and to express regret at the appalling behaviour of some English fans.

#### Tornado sales to Jordan

The Prime Minister wrote to Chancellor Kohl on 18 May to press for a German decision on credit support for their work-share of the Tornado package for Jordan. Now that MOD have agreed on price and other arrangements with the Jordanians, this is the principal obstacle to concluding the deal (the only other problem being that the Italians have not yet firmly committed themselves to underwriting the credit for their workshare). The German decision will not be made until the Federal Security Council meets on 29 June. Prospects are bleak: the FRG may yet object, on grounds of policy and Jordanian credit worthiness, to the sale going ahead. We recommend that the Prime Minister press the Chancellor very firmly on the political case. The Germans claim many difficulties, including fear of the Jewish lobby; but the Israelis have so far made no opposition at all to the proposed sale. The Chancellor's mind should be focussed on the likely implications of any negative decision: renewed Jordanian interest in MiG 29 leading to closer Jordan/Soviet Union relations. This would be a disaster for overall Western interests in the Middle East (and most unwelcome to the Israelis). The Americans recognise this danger, and are supplementing our own pressure on the Germans at a high level.

#### Toronto Economic Summit

Chancellor Kohl will be feeling vulnerable to criticism about sluggish German growth. At the Venice Summit, the Japanese were under fire; in Toronto the Germans will be more

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exposed. FRG has done less well than Japan in switching to domestically generated growth, and in reducing her current account surplus relative to GDP.

We recommend that the Prime Minister press Chancellor Kohl on debt relief for the poorest: Germany is reported to be considering further write-off of aid debts, but is likely to join the US in agreeing Paris Club rescheduling over 25 years rather than offering genuine concessions through interest cuts or write-off of commercial debt. The Prime Minister might urge Chancellor Kohl to reconsider. She might point out that among European Summit countries Germany would be isolated in taking such a restrictive approach.

On the GATT negotiations, we recommend that the Prime Minister express appreciation at the progress that has been made under the German Presidency. The Toronto Summit provides a vital opportunity to give political impetus to the negotiations, particularly in the run-up to the Mid Term Meeting (MTM) in Montreal. By December, it should be possible to make progress on a range of issues including tropical products, dispute settlement and the functioning of the GATT system itself; it should also be possible to agree on a framework to guide future negotiations on other major issues (particularly agriculture, but also "new issues" such as services and investment).

Agriculture remains a vital element. We recommend that the Prime Minister underline that the EC and US must get into serious negotiations before the MTM. This will require flexibility and a constructive approach by both sides. The US must move away from insisting on removal of all support by the year 2000, and be prepared to acknowledge the significance of the Brussels reforms. The Community will have to show willingness to do more - in the short and long term.

On the political agenda, we want to persuade the Germans that the communique should include firm and specific language on terrorism.

/ I enclose a telegram from Bonn reporting German views on Summit issues.

#### EC issues

The meeting will provide a useful opportunity to influence Chancellor Kohl's handling of discussion at the Hanover European Council of single market issues and monetary cooperation. On the Single Market, the Prime Minister could congratulate Chancellor Kohl on agreement reached on capital liberalisation - one of the UK and Germany's major objectives.

/We

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We also hope that the Transport Council (due to meet on 20 June) will be able to agree on road haulage liberalisation on the basis of a revised Commission text, which we support and is acceptable to the Germans. Few of the other measures in Chancellor Kohl's single market package present any substantive problems for the UK.

The Prime Minister might stress the importance we attach to setting some priorities on the single market through to 1989 (Greek, Spanish and French Presidencies). UK priorities are:

- financial services (further progress beyond capital liberalisation and non-life insurance) eg banking, securities and life insurance;
- mutual recognition of testing and certification procedures and further agreement covering product standards;
- further opening up of public purchasing in member states including measures to ensure compliance;
- further transport liberalisation (including shipping cabotage; further opening up of air transport services and road transport cabotage);
- opening up of market in telecommunications.

German priorities are very similar to ours. Others (eg France, Greece and Spain) may want to include a reference to social issues. The Prime Minister might say that we should not allow the notion to gain ground that the single market is good for employers but not employees. We need to explain the benefits to employees, which are those of extra job creation. The Commission's report suggests an extra 1.75 million jobs will be created over the medium term by the Single Market. We favour steps to tackle unemployment through training and retraining, or increased labour market flexibility. We should resist the imposition of more burdens on business. The Single European Act contains new provisions which encourage greater dialogue between management and unions but which provide that directives in the social area should avoid administrative, financial and legal constraints in ways which would hold back the creation and development of small and medium-sized undertakings.

The Presidency have not yet made up their minds firmly on the form of any group to which further work on European monetary cooperation might be referred at Hanover, or on the mandate they should be given. Chancellor Kohl said at a press conference on 9 June:

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"In Hanover we want to make preparations for the further development of cooperation on monetary policy on the path to economic and monetary union. It is not a question of taking a decision on the establishment of a European Central Bank. Such a bank, firmly rooted in a European central bank system, can only lie at the end of this road".

The German Finance Minister (Herr Stoltenberg) told Mr Lawson on 13 June that he was keen to avoid a committee of 'wise men'.

We understand that the latest draft mandate drawn up in Bonn is consistent with this, calling for the group to concentrate on concrete steps to improve coordination of financial and monetary policy and on strengthening the EMS, and referring to a European central bank within the framework of a system of national central banks.

We recommend that the Prime Minister draw on the following points:

- have followed closely discussion on European economic and monetary union taking place since January; a lot of useful work going on eg in Monetary Committee. Close consultations between Chancellor and Stoltenberg;

- two questions need to be resolved: the form of expert group to which further work should be referred at Hanover, and the mandate they receive;

- our strong preference is for a group of practitioners: eg Committee of Central Bank Governors, guided by ECOFIN. Wrong to remit work to those not directly involved and with no responsibility for these issues - could be recipe for delay and muddle;

- pleased to note Chancellor's comments at press conference on 9 June that further work should concentrate on practical measures in monetary area;

- any remit from Hanover should give further impetus to practical measures, eg greater use of the ecu and wider cross-holdings of Community currencies in foreign exchange reserves. Should be a practical remit to practitioners such as Committee of Central Bank Governors and should report back to ECOFIN or via ECOFIN to European Council.

/If

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Berlin Air Services

If Kohl expresses concern about the failure of the three Allies to reach agreement on Berlin air services (about which I am writing separately), the Prime Minister might reassure him that we are working hard and urgently to reach an agreed solution, based on tripartite consensus, which will promote greater choice and competition while maintaining stability and the presence of airlines from all three Allies. Like the Germans, we believe that unilateral American action would be politically damaging.

I am copying this letter to Alex Allan (Treasury), Brian Hawkin (MOD) and Trevor Woolley (Cabinet Office).

Yours ever,  
*L Parker*

(L Parker)  
Private Secretary

C D Powell Esq  
10 Downing Street

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MY TELNO 518 : GERMAN VIEWS ON TORONTO SUMMIT

SUMMIT

1. NO SURPRISES EXPECTED AT TORONTO. ON DEBT, ONLY GENERAL GUIDELINES EXPECTED: A POSSIBILITY OF GERMAN MOVEMENT ON COMMERCIAL DEBT. NO WILLINGNESS TO SEE THE COMMUNITY GO FURTHER AT PRESENT ON AGRICULTURE AND VIEW TAKEN THAT ATTACKS ON WHAT WAS ACHIEVED ON CAP REFORM IN BRUSSELS SHOULD BE FIRMLY RESISTED. PARTNERS WELCOME TO LEAD ON POLITICAL SUBJECTS

DETAIL

2. SINCE MY TUR I HAVE BEEN ABLE TO DISCUSS GERMAN VIEWS ON DEBT, AGRICULTURE AND THE POLITICAL SUBJECTS SUGGESTED FOR THE TORONTO SUMMIT.

DEBT

3. THIS HAVING BEEN DISCUSSED BETWEEN KOHL AND MITTERRAND AT EVIAN, I ASKED TELTSCHIK (CHANCELLERY) HOW THE GERMAN APPROACH TO TORONTO WAS AFFECTED. HE SAID THAT THE GERMANS EXPECTED THAT ONLY GENERAL GUIDELINES WOULD BE AGREED, WITH DECISIONS ON SPECIFIC MEASURES BEING LEFT TO NATIONAL GOVERNMENTS. THE FEDERAL GOVERNMENT HAD ALREADY WRITTEN OFF AID LOANS TO 24 LLDCS THROUGH RETROSPECTIVE TERMS ADJUSTMENT. AND THE FEDERAL CABINET HAD DECIDED ON 8 JULY TO WAIVE REPAYMENT OF OFFICIAL DEBT FOR A FURTHER FIVE SUB-SAHARAN AFRICAN COUNTRIES. BUT THERE HAD BEEN NO CHANGE SO FAR IN THE FEDERAL GOVERNMENT'S POSITION ON RESCHEDULING OF COMMERCIAL DEBT. JELONEK (AUSWAERTIGES AMT) COMMENTED TO ME THAT THE MITTERRAND INITIATIVE, BEING CONFINED TO THE DEBTS OF THE POOREST COUNTRIES, WAS HARDLY CONCERNED WITH COMMERCIAL DEBT: BUT HE CONFIRMED THAT STOLTENBERG AND KLEIN (FINANCE AND ECONOMIC COOPERATION MINISTERS) HAD HAD A REMIT FROM THE CABINET ON 8 JUNE TO LOOK AGAIN AT GERMAN POLICY ON DEBT RELIEF. IT WAS POSSIBLE THAT THE GERMANS WOULD BE WILLING AT TORONTO TO AGREE TO RECONSIDER THE QUESTION OF

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CONCESSIONS ON COMMERCIAL DEBT. ECONOMICS MINISTRY CONTACTS THINK DECISIONS BEFORE TORONTO ARE UNLIKELY.

AGRICULTURE

4. KITTEL (STATE SECRETARY, AGRICULTURE MINISTRY) IN CONVERSATIONS WITH ME HELD FAST TO THE LINE THAT THE COMMUNITY HAD DONE A GREAT DEAL SINCE 1984 TO PUT ITS HOUSE IN ORDER AND SHOULD INSIST ON RECOGNITION FOR THIS. HE SAID KOHL WAS NOT KEEN TO SEE AGRICULTURE HIGH ON THE AGENDA AT TORONTO BUT IF THE CANADIANS OR OTHERS INSISTED COMMUNITY LEADERS HAD A GOOD STORY TO TELL. PRESSURE SHOULD BE PUT ON THE AMERICANS TO EXPLAIN WHY, HAVING BROUGHT PROGRESS TO A HALT WITH THEIR INSISTENCE ON A LONG-TERM ZERO SOLUTION, THEY WERE REDUCING SET ASIDE AND THREATENING FURTHER UNHELPFUL MEASURES. KITTEL SAW NO LIKELIHOOD OF A CHANGE OF APPROACH BY THE OUTGOING U S ADMINISTRATION. ON SHORT-TERM MEASURES HE WAS CLEAR THAT THE COMMUNITY COULD NOT GO FURTHER THAN THE BRUSSELS PACKAGE, THE IMPLICATIONS OF WHICH HAD NOT YET EVEN SUNK IN WITH THE FARMERS. JELONEK SAID WHILE HE PERSONALLY WOULD WELCOME FURTHER SHORT-TERM STEPS BY THE COMMUNITY ON AGRICULTURE, HE COULD NOT SEE THE FEDERAL GOVERNMENT AGREEING TO THEM.

POLITICAL SUBJECTS

5. I SPOKE TO SUDHOFF (STATE SECRETARY, AUSWAERTIGES AMT) ABOUT THESE. HE SAID THAT THE FRG WAS HAPPY WITH THE DRAFT POLITICAL DECLARATION AS IT STOOD AND DID NOT WANT TO RAISE ANY PARTICULAR SUBJECT. THEY DID NOT WANT TO DISCUSS SOUTH AFRICA BUT WOULD NOT OPPOSE DISCUSSION IF THE HOSTS INSISTED. SEE MY TELNO 564 FOR SUDHOFF'S COMMENTS ON TERRORISM. HE THOUGHT THAT EAST-WEST WOULD DOMINATE FOREIGN MINISTERS' DISCUSSIONS.

COMMENT

6. THE GERMANS ARE NOT EXPECTING SURPRISES AT TORONTO, AND BELIEVE THE COMMUNITY SHOULD STAND FIRM AGAINST ATTACKS ON WHAT WAS ACHIEVED ON CAP REFORM AT THE BRUSSELS COUNCIL.

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ECONOMIC SUMMIT

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From the Principal Private Secretary

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REC.	17 JUN 1988
ACTION	Sir G. Little
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	Sir T. Burns
	Mr H. P. Evans
	Mr P. Mountfield

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16 June 1988

*[Handwritten signature]*

*Dear Tony,*

TORONTO ECONOMIC SUMMIT

I wrote to you on 13 June to tell you that my Canadian Sherpa colleague had proposed that the discussion at the Summit on Newly Industrialising Economies should be moved from the afternoon plenary on Monday 20 June to the morning session.

Dr Ostry has now sent me the attached letter in which she reports that there was no consensus for this move and that the discussion on the Newly Industrialising Economies will remain, as originally envisaged, allotted to the afternoon session on Monday 20 June.

You may like to know, as background, that the change of time for this item was supported by the United States, Canada and ourselves and, weakly, by the French. It was opposed by the Commission, Germany and the Japanese (with no view recorded from the Italians). This line-up is easily explained when the motive for the change is recalled - leaving a full afternoon session to discuss Trade and Agriculture.

I am sending a copy of this letter to Alex Allan (HM Treasury).

*His only*

*Nigel Wicks*

N. L. WICKS

Canadian High Commission



Haut Commissariat du Canada

16 June 1988

Dear Colleague

I have now received the views of all of our colleagues on the place of NIES in the order of discussions. Opinions differed significantly, but, as there was no consensus to move the issue to the morning session, I have concluded it should be left to the afternoon plenary on 20 June where it will be the first item for discussion, as originally agreed among ourselves at the Millcroft Inn on 5 June.

Yours sincerely

SYLVIA OSTRY

Mr Nigel Wicks, CBE  
Principal Private Secretary  
to the Prime Minister  
Prime Minister's Office  
10 Downing Street  
LONDON  
SW1A 2AA

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10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

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17/6

16 June 1988

*part*

*Dear Tony,*

TORONTO ECONOMIC SUMMIT

As you know, the Toronto Summit includes an informal session, planned for 1830-2000 on Monday 20 June, on "long-term issues". One subject for that discussion is "Education and Training", on which President Mitterrand will lead.

I have just received the letter attached from the Canadian Sherpa, which reports that President Reagan wishes to introduce the informal session with a topic of his own which will centre on his extrapolation on what the world will look like if the economic policies of the last seven years are carried forward in the coming years. Further information about the President's intentions is given in Dr Ostry's letter.

I doubt whether the Prime Minister will need extensive briefing for this aspect of the informal discussion. But I think that it might help her if she could have a couple of pages of talking points around the theme which the President has in mind. Please could I have this material by 1730 tomorrow, Friday 17 June.

I am sending a copy of this letter to Alex Allan (HM Treasury).

*L. W.*  
*Wick Wicks*

N. L. WICKS

A. C. Galsworthy, Esq., C.M.G.  
Foreign and Commonwealth Office

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15 June 1988

To the Personal Representatives  
of Summit Leaders

Dear Colleague

I have now heard from our colleague Allen Wallis on the outline of President Reagan's intervention in leading off the informal session for leaders on long-term issues at Hart House, June 20 from 1830-2000 hrs. The President's presentation will first trace the changes which have taken place over the past seven years (essentially since the Montebello Summit) in terms of economic conditions and economic policies.

The President will then extrapolate what the world would look like if these policies are carried forward in the coming years. This section of the presentation will feature two main themes: 1) technology (a broad perspective: there is more to technology than the economic dimensions, e.g. East-West relations and security); and 2) the globalization of markets, around the theme that the future belongs to the flexible (as enunciated in the enclosed speech delivered by President Reagan on June 13 on the Toronto Summit). This theme will be developed with specific examples illustrating how flexible markets improve adaptation and will point to the need for improving and extending cooperation in economic and political areas (e.g. GATT and the issue of responsibility sharing).

Yours sincerely

SYLVIA OSTRY

What about foreign  
exchange markets?  
Sounds as if it  
could be a bit troublesome  
Worth a word with  
Baker?

THE WHITE HOUSE  
Office of the Press Secretary

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For Immediate Release

June 13, 1988

REMARKS BY THE PRESIDENT  
AT ANNUAL MEETING OF  
THE ATLANTIC COUNCIL

The Loy Henderson Auditorium  
The State Department  
Washington, D.C.

2:06 P.M. EDT

THE PRESIDENT: (Applause.) Thank you very much. And thank you, General Goodpaster, Secretary Shultz, John Gray, General Seignious, Gene Bradley, James Shinn, and ladies and gentlemen. Just a week and a half ago, I had the honor to address the British people, the Atlantic Community, and the world from the ancient and historic podium of Guildhall in London. After my report on the Moscow summit, Mrs. Thatcher graciously said that she believed that "There is now more hope between East and West than ever before in the lifetime of most of those" there. And she spoke of the new confidence and optimism in the West, and she recalled the words of Sir Winston Churchill when he wrote, "where we are able to stand together and work together for righteous causes, we shall always be thankful and the world will always be free."

Well, this message of unity and optimism and hope and strength is the message that I bring to you today. You've been talking here today about "rebuilding the consensus on East-West relations." And I would admit that, at times, in recent years a free world consensus in this area seemed particularly elusive, rather like the story that Franklin Roosevelt liked to tell about the Marine who was ordered home from Guadalcanal. The Marine was very unhappy because he hadn't shot a single enemy soldier, so his sergeant just told him, "Just go up on that hill over there and shout, 'To the devil with Tojo.'" Well, the Marine did as he was told, and sure enough, out of the jungle ran a Japanese soldier shouting, 'To the devil with Roosevelt.' "And, of course," said the Marine afterward, "how could I shoot a fellow Republican?" (Laughter.)

But our consensus is built not only on what we're against, but on what we're for. And we are against totalitarianism. We're for freedom and democracy -- for them without hesitation or apology, and virtually, I would venture, without division. This is the first great truth to keep in mind. There may be divisions within our countries as to methods, but there are none as to fundamental goals.

In the last decade-and-a-half, we in the democracies have, in true democratic fashion, tested the various propositions about the methods for best approaching East-West affairs. Now that we have an INF Treaty, the first agreement ever to eliminate an entire class of U.S. and Soviet nuclear missiles and with the most stringent verification procedures in arms control history; now that the Soviets have begun withdrawing from Afghanistan; now that we've begun to see internal changes within the Soviet Union -- can there be any doubt that we were right about a forward strategy for freedom, right about the importance of candor regarding the differences between our systems, and right to say that the road to peace is not through weakness, division, or preemptive concession, but through unity, confidence, and strength?

MORE

In just a few days I will attend another summit -- the economic summit in Toronto, as the General has told you. And this is an excellent forum before which to talk about our hopes for that summit. I know that the Atlantic Council is examining how to best integrate economics and security. The International Management and Development Institute is meeting to discuss economic challenges facing us.

Over the years, the economic summits have been a cornerstone of cooperation among the major democratic economies. They're part of the superstructure of Western strength and East-West affairs. And here again our democracies have, as democracies do, tested among ourselves various propositions about economic growth and vitality since the first of the summits that I attended in 1981.

Everywhere in the democratic world we're seeing the emergence of a new consensus that growth and opportunity must go hand in hand. Consider taxes. In the past three years, Britain, Canada, Japan, and France, among others, have all let their top tax rates tumble. Why? Well, here's what Nigel Lawson, Britain's Chancellor of the Exchequer, said not long ago, in his words: "The reason for the worldwide trend toward lower top rates of tax is clear. Excessive rates of income tax destroy enterprise, encourage avoidance, and drive talent to more hospitable shores overseas. Far from raising additional revenue, over time they actually raise less. And he concluded, "By contrast, a reduction in the top rates of income tax can, over time, result in a higher, not lower, yield to the Exchequer." Well, it seems I've heard somebody else say that before, somewhere.

But this new consensus doesn't stop with taxation. Country after country has begun to sell off state-owned industries. Restrictive regulations have begun to fall. Paying for the excesses of government spending with high inflation has all but stopped. And, at least in the United States, deficit spending by government is falling.

The idea that connects all this is the market. The industrial world -- the entire world -- is turning away from state control of economies, and returning to the marketplace. From India to Argentina, from Africa to China, and even in the Soviet Union, the shackles of state economic domination are beginning to loosen. And you know something's happening when there's talk of lower taxes in the Soviet Union.

Now I don't need to tell you that the United States has led the way, or that the remarkable performance of our economy since our expansion began has been the driving force behind this new consensus. I don't need to recite all we've done -- the longest peacetime expansion on record; more than twice as many jobs created as the other six summit countries combined -- and they have 50 percent more employment-age population than we do. The family income is up sharply after riding a falling roller coaster through the previous decade; a larger percentage of the workforce employed than ever before; exports the highest in our history. I don't need to tell you all this, but you might guess that I'm a little proud of it. And I have to watch myself when I talk about it. I don't want people to get the impression that I think of politics the way Will Rogers thought of the movies. He said, "The only business where you can sit out front and applaud yourself." (Laughter.)

This new consensus has not only brought the economies of America, Britain, Canada, and so many other countries roaring back. It has also opened the way for a coordination of economic policy among the summit countries that would have been unthinkable just a few years ago. Whether it's through what's known as the G-7, or in managing the debt crisis in so many Third World countries, or responding to the tremors in the world financial markets last October, we work together.

MORE

Today we use a common set of books to tell how our policies are doing, and we're working in common for balance in trade and capital flows and government budgets and for surefootedness in the world's financial markets. Starting with the United States, the summit countries have had nearly six years of uninterrupted growth. I'd like to make it 60 and more.

But it can't happen if we try to live as if we're the only economy on earth. The summit nations are working together as never before because our economies are tied together as never before. To give an example of this, someone pointed out to me recently, while the New York Stock Exchange does \$8 billion of business on a good day, the foreign exchange markets do over 25 times as much business every day.

In this global marketplace, industries around the world rise and fall together. The decline in the worldwide demand for steel was felt in the Rhine Basin of Europe in just the same way it was felt in our Lehigh Valley. Thousands of jobs disappeared in both places, and not just to foreign competition. Here in America, high-tech mini-mills melted down the business of many old, integrated producers.

But there's one difference in the way we in America dealt with the decline. We lost the same kind of jobs other countries lost, but -- unlike those European nations that lag behind in cutting taxes, regulations, and government ownership -- we created new jobs in place of the old ones. Allentown in Lehigh Valley was once a horse of heavy industry. Then the steelmill and the truck factory shut down. Many people wrote off Allentown -- too soon. In place of a few big, old companies, dozens of new companies started up. Small companies that were already open grew. Entrepreneurs created what David Birch, MIT's authority on job creation, calls "a hidden economy." He adds that all across America, "the small companies, not the big ones that get so much attention, are building a new economy that is providing jobs and making the country competitive again." And that's why today, Allentown has an unemployment rate of only 5.4 percent.

Throughout what used to be called the rust belt, the story is the same. One midwesterner recently told the New York Times, as he said, "I go through the newspapers from county-seat-size towns, and I'm finding dozens of announcements of new plants and plans for new plants and expansion projects."

And new or expanding entrepreneurial companies and bigger, older, but now streamlined manufacturers are leading an export boom that some say has stretched our production capacity to the limit. Not long ago, for example, Business Week reported that America's steelmakers had become among the world's most productive and announced in its headline, "Cancel the Funeral, Steel is on the Mend."

Yes, America is leading the world -- both as consumer and producer -- into the global marketplace of the next century. For all of us, what's happening in Japan or Germany, Britain, France, Italy, or Canada is as momentous as what's happening in California, Florida, New York, or Illinois.

There's a lesson in all this -- in the story of Allentown and one of the so-called Rust Belt, as well as in the globalization of trade and finance -- and the lesson is that the future belongs to the flexible. It belongs to those who look at the problem and see an opportunity; to those who look at the unknown and see an adventure; to those who look at the untried and see a challenge; to those who have shed the weight of structural rigidities and protective subsidies and face the future with energy and excitement.

In no field do we all have more weeding to do than agriculture, where subsidies cost the consumers and taxpayers of

MORE

Europe, North America, and Japan \$200 billion a year. Agriculture is planted on the agenda of the Uruguay round of trade talks -- as are the issues of establishing rules for trade in intellectual property, investment, services, and the lowering of tariff and non-tariff trade barriers. Those talks were scheduled to go for four years. They are now nearing the halfway point. It's time to narrow down and lay out specific goals, a road map, and a timetable to the finish line. In Toronto we -- the heads of the major industrial states -- can push our ministers to have that job completed by the end of the year. No excuses. You know, sometimes when I hear people say why we can't do this or that in the trade talks, it reminds me of how Chico Marx, one of the Marx Brothers, used to try to walk off the Hollywood sets in the middle of the afternoon. As he explained, "But it's after quitting time in New York." (Laughter.)

Well, it's time that we in the summit nations forget about quitting time and join in a great "venture to progress" -- a joint venture that opens the international marketplace and that also strengthens the weak links in the international economy.

Let us join together to help restore the economies of two countries: One -- the Philippines -- an heroic democracy ravaged by Communist-led insurrection; the other, Afghanistan, a victim of brutal aggression.

Let's join together to bring the newly industrialized countries into the full and mature place in the world trading system that they have earned.



Let's join together in helping the countries of sub-Saharan Africa work out their debt problems. We'll take up their problems, as we have those of other debtor nations; on a case-by-case basis, working to help develop economic policies that promote growth and opportunity. The United States has already indicated its willingness to consider new ways of rescheduling the debt of the poorest countries, ways that can produce substantial new relief.

And let us join together to attack the lifeblood of one trade that should never be part of international trade, the international narcotics trade. At this summit, we should join in a common offensive against money laundering and the flow of drug profits through the world's financial institutions.

Pushing forward the trade negotiations, a joint venture for progress, strengthening the system of policy coordination -- this is the agenda of the Toronto summit. We'll be building on a decade of progress, on the new economic consensus in our countries. We'll be looking to continue the building of the global marketplace.

I know there are some who want to turn back, who want to return to the more insular and isolationist days of old. I vetoed the trade bill last week because I don't believe we can or should turn back.

Critics of our policies complain that, on one hand, America is, as they say, "exporting jobs," which is to say our companies invest overseas; and on the other hand, that America is selling itself to foreigners, which is to say that foreign companies are investing here. Put it together and what they're really saying is "turn back." The isolationism of their foreign policy walks hand-in-hand with the isolationism of their economic policy, and both will lead us to disaster.

We're in a new age of invention and exploration, a time when the vast capacity of the human imagination is opening new universes for exploration. "To see the universe in a grain of sand" is no longer a poetic metaphor but the daily reality of the silicon chip. F. Scott Fitzgerald wrote that when the early explorers just looked on this land, they must have held their breath. They had, for the last time in history, come face-to-face with something

MORE

commensurate to man's infinite capacity for wonder. Yet it was not for the last time. We, too, stand on the shores of something as vast -- of an economic and technological future immense with promise.

If we seize it, if we don't turn away from it, that future will transform the democratic world and, I am confident after my visit to Moscow, the countries of the Soviet bloc, as well. I believe that the House of Democracy's current consensus for strength and growth will usher in a new age of which we can only dream. But if we have the courage and the resolve, I believe that age will give us a world of peace and freedom, of opportunity and hope for generations to come. And I believe that even more after the summit that we've just been to and what I saw on the faces of the rank and file, the people of the Soviet Union.

And I can't resist now, I'm -- I brought back a story that was being told there -- I didn't bring it back, one of our Secret Service agents did and told it to me. The story has it -- this is what they tell among themselves -- that General Secretary Gorbachev and I were in the limousine with the head of our Secret Service unit, Ray, and he had a security man with him. And we were sight-seeing. And they pulled up before a magnificent big fall, a waterfall, and we got out to look at it.

And Gorbachev said to Ray, "Go ahead, jump over." And Ray said, "I've got a wife and three kids." And Gorbachev turned to his man and said to jump over -- and he did. And Ray, with great humanity, went down around the waterfall, scrambling over the rocks to the bottom, and found the man wringing out his clothes. And he said, "When he told you to jump, why did you jump?" The man says, "I've got a wife and three kids." (Laughter.)

Thank you all very much. (Applause.)

END

2:25 P.M. EDT



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June 16, 1988

(Background for the Toronto Economic Summit)

BAKER PREDICTS RESULTS FROM TORONTO SUMMIT

(Article on Baker, Shultz Briefing at White House)

Washington -- Pundits who predict few results from the June 19-21 Toronto Economic Summit because of the upcoming U.S. presidential elections will be wrong, U.S. Secretary of the Treasury James Baker says.

"I think there is going to be real action on economic issues," Baker told reporters at a White House briefing June 15. He said he expects the leaders to implement a new "commodity price indicator," to reach some agreement on ways of handling the official debt of the poorest countries in Sub-Saharan Africa, to make some progress with respect to addressing structural adjustment problems as part of the economic policy coordination process, and to have "a full-fledged discussion of issues on agricultural trade."

Baker and Secretary of State George Shultz, also attending the briefing, are the two key U.S. officials accompanying President Reagan to the Economic Summit, attended also by the leaders of Canada, West Germany, Japan, France, the United Kingdom, Italy, and the European Community.

The commodity price index indicator, proposed last October by the treasury secretary, would be one of a group of indicators that the seven summit countries would use to examine the policies of individual countries and determine whether additional action is needed by these countries to put their economies on track with mutually agreed goals.

The United States expects the index, which would include a gold component, to be a good -- though not a sole -- indicator of inflationary pressures.

Baker said he also expects the summit countries to give further endorsement to the idea that "reliance on free markets and reliance on open societies is the best way to foster economic growth and sound economic development."

"This is the message that President Reagan took to the first economic summit in 1981 -- a message at the time that was greeted with certain skepticism and perhaps even with some derision," Baker said. "And now it is not so greeted. Everybody is pretty much in sync (in step) and on board with that concept."

The treasury secretary said the latest trade figures, released June 14, might suggest that consumption is slowing in the United States. They showed a continued drop in the U.S. trade deficit, particularly in imports.

"We've been very pleased that exports have gone up 25 percent," he said. "What we haven't seen as much as we would have liked up until yesterday is a decline in imports. Now we are seeing a decrease in imports, which I think presages a slowing of consumption in the United States and perhaps a contraction in domestic demand, and it is that domestic demand component that has been most bothersome to our allies."

Other summit countries have expressed concern that unless U.S. domestic demand slowed, inflationary pressures would intensify in the United States and spill over into other countries.

Baker said that to avoid such pressures, it is important that domestic demand not expand at a faster rate than growth in gross national product (GNP), and it is not doing so. He pointed out that while domestic demand grew at a 2.1 percent annual rate in the first quarter, GNP climbed 3.9 percent.

The treasury secretary refused to comment on the dollar other than to say that "it is my view that all of the Group of Seven (economic summit) countries are very pleased with the stability of exchange rates that we've seen since December 22, 1987." That was the date the seven finance ministers issued another statement reaffirming their intention to continue economic coordination efforts and pledging to continue cooperation aimed at achieving greater stability in exchange rates.

On the issue of the debt problems of the middle-income debtors, Baker said he expects the existing strategy -- economic reforms by the debtors supported by additional commercial bank and multilateral development bank funding -- to be supported by the other summit countries as "the only viable strategy" to deal with the developing nation debt owed to private creditors.

Asked to elaborate on Reagan's recent comments about a new multinational economic package for the Philippines and Afghanistan, Secretary Shultz said the administration has been talking to other countries and to Congress about such a package.

"When it comes to the Afghan refugees, we're supporting the United Nations effort there and they are now beginning to look for financial resources and we want to see that process of resettlement, reconstruction go on as smoothly as possible," Shultz said. He said that since Japan has expressed an inclination to step up its aid contributions, in both the Philippine and Afghanistan cases "it is appropriate to look to them for a substantial contribution."

He also pointed out, when asked, that Japan has been increasing its share of the cost for maintaining a U.S. military presence in Japan.

Shultz said one of the non-economic discussion at the Toronto Summit will focus on international drug trafficking. He said that the United States hopes to enlist the support of the other summit countries "in a broad and comprehensive effort" to combat this problem.

Baker added that the finance ministers are likely to address one aspect of that problem, "money laundering" -- techniques used to disguise the source and ownership of profits from drug operations as they flow through the international banking system -- "and hopefully we can find a way to improve our cooperation" in that area.

In a separate interview on Worldnet, the USIA world television service, earlier the same day, Shultz said that the major

industrialized countries must agree on a plan to decrease agricultural subsidies and eventually eliminate them.

"We want to see the situation sorted out so that the farming is done when it can be done most efficiently and let the market rule," he said.

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10 DOWNING STREET

CC: SIR G. LITTLE  
SIR T. BURNS  
MR HP EVANS  
MR P MOUNTFIELD  
MR BOTTRILL  
MR TYRIE

MR HUDSON

From the Principal Private Secretary

16 June 1988

(Translation to follow)

Dear Mr Allan

I should be grateful for urgent advice on, as well as a translation of, the letter attached from the President of the European Commission to President Mitterrand. Please could I have this by close of play today if at all possible.

I am copying this letter to Tony Galsworthy (Foreign and Commonwealth Office) and Myles Wickstead (ODA).

Yours sincerely

*N. L. Wicks*

PP N. L. WICKS

Alex Allan, Esq.,  
H M Treasury

COMMISSION  
DES  
COMMUNAUTÉS EUROPÉENNES

200 RUE DE LA LOI  
1049 BRUXELLES  
TEL. (02) 838 11 11

*L. President*

3787

Strasbourg, le 15 juin 1988

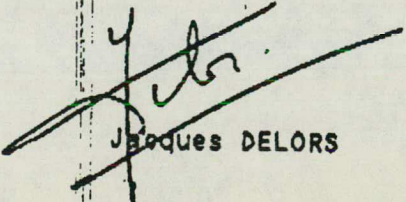
Monsieur Le Président,

Permettez-moi de vous remercier tout particulièrement pour la lettre que vous avez bien voulu me faire parvenir, ainsi qu'aux autres participants du tout prochain Sommet de Toronto. Comme vous le savez, la Commission partage tout à fait votre appréciation sur les problèmes des pays endettés les plus pauvres. Au-delà des acquis du Sommet de Venise et des progrès intervenus depuis, d'autres efforts sont en effet nécessaires pour sortir des impasses qui subsistent et pour améliorer les possibilités de croissance des pays concernés.

Les options que vous proposez constituent, à mon sens, une contribution essentielle pour aller plus loin à l'occasion des travaux de Toronto. C'est en tout cas le voeu que je formule et je serais heureux si une position commune pouvait être exprimée au nom de l'Europe des Douze, ou à tout le moins des quatre pays européens présents au Canada. J'ai d'ailleurs suggéré au Chancelier de la République fédérale d'Allemagne, qui exerce actuellement la Présidence du Conseil, de prendre l'initiative de contacts à cet effet avec la France, la Grande-Bretagne, l'Italie et la Commission.

En tout état de cause, et à la lumière des discussions qui auront lieu sur ce point, j'envisage de proposer qu'une discussion soit organisée au sein de la Communauté, afin de faire en sorte qu'une approche cohérente et constructive de ses Etats membres soit définie dans les délais les meilleurs. Comme vous le savez sans doute, la préoccupation de l'endettement sera présente dans la préparation des nouveaux accords de Lomé. Il pourrait en résulter une action exemplaire, aidant les pays sous-développés à réussir à la fois l'assainissement conjoncturel et l'ajustement structurel dégageant des potentialités nouvelles pour leur croissance.

Je me réjouis, Monsieur Le Président, de pouvoir discuter avec vous de cette question et je vous prie de croire à l'assurance de ma plus haute et plus respectueuse considération.

  
Jacques DELORS

Monsieur François MITTERRAND  
Président de la République Française

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From the Principal Private Secretary

CH/EXCHEQUER	
REC.	17 JUN 1988
ACTION	SIR G. LITTLE
COPIES TO	SIR P. MIDDLETON
	SIR T. BURNS
	MR. H. P. EVANS
	MR P. MOUNTFIELD

16 June 1988

*File  
M. tell private office  
wmy letter attached*

*Dear Tony,*

TORONTO ECONOMIC SUMMIT

As you know, the Toronto Summit includes an informal session, planned for 1830-2000 on Monday 20 June, on "long-term issues". One subject for that discussion is "Education and Training", on which President Mitterrand will lead.

I have just received the letter attached from the Canadian Sherpa, which reports that President Reagan wishes to introduce the informal session with a topic of his own which will centre on his extrapolation on what the world will look like if the economic policies of the last seven years are carried forward in the coming years. Further information about the President's intentions is given in Dr Ostry's letter.

I doubt whether the Prime Minister will need extensive briefing for this aspect of the informal discussion. But I think that it might help her if she could have a couple of pages of talking points around the theme which the President has in mind. Please could I have this material by 1730 tomorrow, Friday 17 June.

I am sending a copy of this letter to Alex Allan (HM Treasury).

*L. W.*  
*Nigel Wicks*

N. L. WICKS

A. C. Galsworthy, Esq., C.M.G.  
Foreign and Commonwealth Office

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Canadian High Commission



Haut Commissariat du Canada

16 June 1988

Dear Colleague

I have now received the views of all of our colleagues on the place of NIES in the order of discussions. Opinions differed significantly, but, as there was no consensus to move the issue to the morning session, I have concluded it should be left to the afternoon plenary on 20 June where it will be the first item for discussion, as originally agreed among ourselves at the Millcroft Inn on 5 June.

Yours sincerely

SYLVIA OSTRY

Mr Nigel Wicks, CBE  
Principal Private Secretary  
to the Prime Minister  
Prime Minister's Office  
10 Downing Street  
LONDON  
SW1A 2AA

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FOR MAED

TORONTO SUMMIT: BRUNDTLAND REPORT

1. WE HAVE RECEIVED A LETTER ADDRESSED TO THE PRIME MINISTER (TEXT FAXED TO BEETHAM) FROM THE CONVENER OF THE JAKOBSTETTEL CONFERENCE. JAKOBSTETTEL IS A SMALL TOWN IN S.W. ONTARIO AND THE PARTICIPANTS IN THIS CONFERENCE, HELD IN EARLY MAY, WERE SOME FIFTY ACADEMICS CONCERNED ABOUT THREATS TO THE ENVIRONMENT.

2. ESSENTIALLY, THIS GROUP WISH THE PRIME MINISTER (AND THE OTHER SUMMIT PARTICIPANTS, TO WHOM SIMILAR LETTERS HAVE BEEN SENT) TO ENDORSE THE RECOMMENDATIONS OF THE BRUNDTLAND REPORT. WE RECOMMEND THAT WE BE INSTRUCTED SIMPLY TO ACKNOWLEDGE THE LETTER, SAYING THAT THE CONCERNS EXPRESSED IN IT HAVE BEEN DRAWN TO THE PRIME MINISTER'S ATTENTION. YOU MAY ALSO WISH TO WARN NEWS DEPT AND NO 10 PRESS UNIT OF THE POSSIBILITY THAT ENVIRONMENTAL CONCERNS MAY BE RAISED AT THE PRIME MINISTER'S PRESS CONFERENCE.

URWICK

YYYY

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INFO PRIORITY WASHINGTON, TOKYO, BONN, ROME, PARIS, UKREP BRUSSELS  
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MY TELNO 345: TORONTO ECONOMIC SUMMIT: CANADIAN VIEWS

#### SUMMARY

1. THE CANADIANS STILL HOPE THE SUMMIT WILL SEND OUT A CLEAR SIGNAL OF DETERMINATION TO PROMOTE AGRICULTURAL REFORM. IN A SERIES OF PUBLIC MEETINGS, MR MULRONEY HAS SAID UNEQUIVOCALLY THAT AGRICULTURE IS HIS TOP PRIORITY AT THE SUMMIT: BUT, AS ON MOST OTHER SUBJECTS, THE CANADIANS WILL PROBABLY BE CONTENT IF SOME SORT OF COMPROMISE AGREEMENT EMERGES FROM THE DIFFERING VIEWPOINTS. THEY HOPE THE SUMMIT WILL RECOGNISE US/CANADA FREE TRADE AGREEMENT AS PROMOTING TRADE LIBERALISATION.

#### DETAIL

2. WE HAVE SPOKEN AGAIN TO OFFICIALS IN EXTERNAL AFFAIRS, FINANCE CANADA AND THE PRIME MINISTER'S OFFICE INVOLVED IN PREPARATIONS FOR THE TORONTO SUMMIT. THE CANADIAN POSITION REMAINS LARGELY AS IN MY TUR, BUT WITH SOME GLOSSES AS OUTLINED BELOW.

#### ECONOMIC COORDINATION

3. THE CANADIANS CAN LIVE WITH ANY COMPROMISE WHICH CAN BE REACHED BETWEEN THE US AND THE OTHERS ON EXCHANGE RATES. ON THE MICRO-ECONOMIC SIDE THEY WOULD LIKE TO SHORTEN THE ANNEX, BUT WOULD WANT TO RETAIN ENDORSEMENT OF THE POLICIES OF PRIVATISATION, DEREGULATION AND TRADE LIBERALISATION.

#### AGRICULTURE

4. CANADIAN OFFICIALS FEEL THE FACT THAT THE ISSUE HAS BEEN LEFT WIDE OPEN IN THE SUMMIT PREPARATIONS COULD CONCEIVABLY LEAD TO A USEFUL DEBATE BY THE LEADERS. THEY SEE KOHL AS ESSENTIAL TO THIS PROCESS. ALTHOUGH THEY ARE RECEIVING MIXED SIGNALS FROM GERMANY, THEY HAVE HEARD THAT KOHL IS IN FAVOUR OF STARTING THE PROCESS OF DISMEMBERING SUBSIDIES AS SOON AS POSSIBLE AND THAT HE HAS RESIGNED HIMSELF TO LOSING THE FARMERS' VOTE IN ANY CASE. MULRONEY WOULD LIKE THE SUMMIT TO SEND A CLEAR SIGNAL THAT THE LEADERS ARE AS DETERMINED AS EVER TO PROMOTE AGRICULTURAL REFORM. PUBLICLY IN A SERIES OF SPEECHES TO FARM LEADERS, BUSINESSMEN

*This is dreadful  
Ow High Commissioner  
to Ottawa have been  
informed & badly*

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AND UNION LEADERS. MULRONEY CONTINUES TO SAY THAT THIS WILL BE HIS MAIN PRIORITY AT THE SUMMIT AND THAT HIS OBJECTIVE IS TO SET THE SCENE FOR SUBSTANTIVE RESULTS AT THE MTM IN MONTREAL IN DECEMBER AND START THE PROCESS OF PROGRESSIVE REDUCTION OR ELIMINATION OF TRADE-DISTORTING SUBSIDIES. HOWEVER, THE CANADIANS DO NOT KNOW WHETHER REAGAN OR MITTERRAND WILL PROVE WILLING TO ABANDON EXTREME POSITIONS.

#### MULTILATERAL TRADE

5. THE CANADIANS ARE SATISFIED WITH THE LANGUAGE ON TRADE AGREED AT THE LAST SHERPAS' MEETING. THEY HOPE THAT THIS WILL BE ENOUGH TO ENABLE NEGOTIATIONS TO START IN EARNEST THIS SUMMER TO FACILITATE A SUCCESSFUL MTM IN DECEMBER. THEY WILL WANT THE SUMMIT TO RECOGNISE THAT THE CANADA/US TRADE AGREEMENT IS A LIBERALISING ONE AND WILL HELP TO PROMOTE THE MULTILATERAL NEGOTIATIONS.

#### DEBT

6. THE CANADIANS WANT AS MUCH PROGRESS ON DEBT FOR THE POOREST COUNTRIES AS CAN BE ACHIEVED. THEY WILL BE CONTENT IF MITTERRAND'S INITIATIVE IS ADOPTED AND SEE THE PROBLEM OF BURDEN-SHARING AS ONE WHICH CAN BEST BE DEALT WITH BY TECHNICIANS LATER. ALTERNATIVELY THEY WOULD LIKE THE CANADIAN COMPROMISE, BUT COULD ALSO SUPPORT MR LAWSON'S INITIATIVE. WHICHEVER INITIATIVE IS ADOPTED, THEY HOPE AND EXPECT THAT DUE CREDIT WILL BE GIVEN TO BRIATIN AND CANADA FOR THEIR CONTRIBUTIONS. THE CANADIANS BELIEVE THAT ALL SUMMIT COUNTRIES ARE ON BOARD FOR AN INITIATIVE OF SOME KIND.

7. AS FOR MIDDLE INCOME DEBT, THE CANADIANS ARE UNLIKELY TO PUT FORWARD ANY INITIATIVE OF THEIR OWN BUT WILL WISH TO SEE WHAT OTHERS PROPOSE. THEY EXPECT THAT THE FRENCH AND JAPANESE WILL MAKE PROPOSALS AT THE SUMMIT. THE CANADIAN FINANCE MINISTER SPOKE TO THE PRESS ON 15 JUNE OF A GROWING ROLE FOR THE INTERNATIONAL FINANCIAL INSTITUTIONS ON MIDDLE INCOME DEBT.

#### LONG-TERM ISSUES

8. THE CANADIANS ARE CONTENT THAT EDUCATION SHOULD BE THE PRINCIPAL TOPIC, ALTHOUGH THEY WILL NEED TO TREAD CAREFULLY IN ORDER NOT TO ENCROACH ON PROVINCIAL JURISDICTIONS AND ARE LIKELY TO CONCENTRATE ON THE IMPORTANCE OF SCIENCE AND TECHNOLOGY. THEY EXPECT REAGAN NOT TO ADDRESS THIS SUBJECT DIRECTLY. MULRONEY WILL NOT PRESS ANY PARTICULAR ENVIRONMENTAL ISSUES.

#### REGIONAL SUBJECTS AND OTHER ISSUES

9. THE CANADIANS ARE NERVOUS ABOUT THE US WISH TO EXPAND THE

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SUBJECTS FOR POLITICAL DISCUSSION. THE MORE THE US INSIST ON OTHER ISSUES, THE MORE DIFFICULT IT WILL BECOME FOR MULRONEY TO EXCLUDE SOUTH AFRICA. THE CANADIANS THEREFORE HOPE THAT THE SUBJECT OF THE PHILIPPINES WILL BE DROPPED. AS FOR DRUGS, THEY DO NOT WANT THIS TO BECOME A DOMINATING ISSUE, BUT WOULD NOT OBJECT TO A BRIEF DISCUSSION LEADING TO THE SETTING UP OF A TASK FORCE.

10. A COPY OF THE FORMAT FOR THE SUMMIT, WITH AGENDA ITEMS INCLUDED, IS BEING FAXED TO ERD.

URWICK

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YOUR TELNO 487 AND OUR TELNO 600  
JAPANESE IDEAS ON DEBT AT THE TORONTO SUMMIT

1. THE LEAD ARTICLE ON 16 JUNE IN THE NIKKEI, JAPAN'S LEADING ECONOMIC DAILY, REFERRED TO A NEW JAPANESE GOVERNMENT PROPOSAL DESIGNED TO ENCOURAGE PRIVATE BANKS TO PROVIDE FINANCE TO MIDDLE INCOME DEBTOR NATIONS. THOUGH LESS DETAILED THAN THE REUTERS REPORT (FIRST TUR), THE NIKKEI SUGGEST THE PLAN WILL HAVE TWO MAIN STRANDS:

- A) THE PROVISION FROM A JOINT IMF/PRIVATE BANK FUND OF LONG-TERM FINANCING TO PROMOTE GROWTH ADDITIONAL TO THAT ISSUED TO COVER CURRENT INTEREST REPAYMENTS.
- B) THE ESTABLISHMENT OF A CROSS DEFAULT SYSTEM WHEREBY THE IMF WOULD NOT ISSUE NEW FINANCE IF THE DEBTOR NATIONS STOPPED INTEREST PAYMENTS TO PRIVATE SECTOR CREDITORS.

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TORONTO SUMMIT: SOVIET COMMENT

SUMMARY

1. FIRST SOVIET COMMENT ON TORONTO SUMMIT HIGHLIGHTS PROBLEMS OF CO-ORDINATION, AND "ECONOMIC ILLS" OF THE WEST. IT ADDS THAT THE SEVEN'S DECISIONS AFFECT SOCIALIST COUNTRIES TOO, AND SAYS THAT OTHER AGENDA ITEMS COULD BE DISCUSSED MORE WIDELY.

DETAIL

2. THE FIRST SUBSTANTIVE COMMENT ON THE TORONTO SUMMIT WAS A SIGNED "VIEWPOINT" PUBLISHED IN PRAVDA ON 17 JUNE. IT WAS CONTRIBUTED BY GALIYA BASHIROVA, A POST-GRADUATE RESEARCHER IN ECONOMICS.

3. THE COMMENT BEGINS WITH A FAIRLY SNIDE ACCOUNT OF THE SUMMIT AGENDA, AND THE ACCUSATION THAT THE DECLARATIONS WILL PRESENT A FACADE OF UNITY AMONG THE "FREE WORLD", WHEREAS IN FACT THERE ARE SHARP DIFFERENCES AND CONFLICTS OF INTEREST BETWEEN THE UNITED STATES, WESTERN EUROPE AND JAPAN. HOWEVER, THE REMAINDER OF THE ARTICLE IS MUCH MORE BALANCED.

4. BASHIROVA DESCRIBES THE SEVEN'S TASK AS RESOLVING SIMULTANEOUSLY PROBLEMS:- FOUR MAIN AREAS SEMICOLON 'AVERTING ECONOMIC CRISES' - MAINTAINING AN ACCEPTABLE LEVEL OF UNEMPLOYMENT, CONTROLLING INFLATION, AND MANAGING ECONOMIC RELATIONS. THE MAIN DIFFICULTY IS THAT THE SOLUTION TO ONE OF THESE CAN COMPLICATE THE OTHERS.

5. BASHIROVA IS NON-COMMITTED ABOUT WHETHER COORDINATION



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WILL WORK. PROBLEMS SUCH AS US AGRICULTURAL SUBSIDIES REMAIN SEMICOLON BUT ON THE OTHER HAND THE PROCESS OF COORDINATION IS CLEARLY GROWING WIDER AND DEEPER.

6. SHE THEN COMMENTS ON THE RELEVANCE OF THE SUMMIT. ALTHOUGH THE COORDINATION PROCESS 'AT FIRST SIGHT DOES NOT CONCERN THE SOCIALIST COUNTRIES, IN ONE WAY OR ANOTHER IT EFFECTS, AND WILL DO SO INCREASINGLY, OUR INTERESTS BY VIRTUE OF THE INTERDEPENDENCE OF THE CONTEMPORARY WORLD'. IT THEREFORE DESERVES SERIOUS, UNPREJUDICED STUDY.

7. BASHIROVA THEN TURNS TO THE NON-ECONOMIC SIDE OF THE TORONTO AGENDA WHERE THE SEVEN WILL DISCUSS PROBLEMS WHICH ARE 'TRULY UNIVERSAL AND TOUCH ON THE INTERESTS OF THE ENTIRE WORLD COMMUNITY'. THESE ARE TOO COMPLEX FOR THERE TO BE A MONOPOLY OF THE TRUTH. THE ONLY WAY TO SOLVE THEM IS BY THE JOINT EFFORTS OF COUNTRIES, 'IRRESPECTIVE OF THEIR SOCIO-ECONOMIC SYSTEMS'.

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FROM: S W MATTHEWS  
DATE: 17 June 1988

CHANCELLOR

Please minute  
thanks

cc: Sir G Littler  
Mr Byatt  
Mr Lankester  
Mr Evans  
Mr P Davis  
Mr Gieve  
Mr Savage  
Ms Symes

**TORONTO SUMMIT: FINANCE MINISTERS' DISCUSSION OF REGIONAL TRADE BLOCS**

You may like to have some background material for the discussion of the challenges and opportunities presented by regional trading arrangements such as the Canada/US Free Trade Agreement and the European Single Internal Market, proposed by Mr Wilson for the Finance Ministers' final dinner on Monday evening.

Canada/US Free Trade Agreement

2. The final text of the Free Trade Agreement (FTA) was signed on 2 January 1988. It has still to be ratified by the US Congress, but should come into effect in January 1988. Its main provisions are set out in the attached table.

3. The Canadian Department of Finance estimate that the real income gains for Canada from the FTA to be around 2½ per cent of GNP. The reduction in tariffs involved is not particularly large, as average tariff levels are already low - a weighted average of 4.5 per cent for Canada and 2.8 per cent for the US - but some high tariffs remain in particular sectors (eg textiles and clothing).

4. Canada, as the smaller economy, perhaps has most to gain from economies of scale and increased specialisation, but there are fears that this could make Canada over-dependent on the US market - the US already takes 75 per cent of Canadian exports (equivalent to about 20 per cent of GNP). The Canadians attach considerable importance to the establishment of impartial procedures under the FTA for the resolution of trade disputes, as they feel that they are often the victim of arbitrary US protective action and that the uncertainty which this generates damages their industry.

5. Among the advantages of the FTA for the United States are being treated as favourably as Canadian nationals in access to oil and in the right of establishment of banks and other financial institutions.

#### Single European Market

6. The Cecchini report claimed that the benefits from the "completion of the internal market" could be some 4-6 per cent of Community GDP. The Community still has a long way to go in the negotiations on precisely how a single market is to be achieved, although there has been more progress in some areas than others. It is likely to take many years for all the potential gains to be realised.

7. The main sources of gains identified in the Cecchini report are:

a. Direct savings from reduced frontier formalities (perhaps  $\frac{1}{4}$  per cent of GDP).

b. Reduced costs from reducing the number of different regulations about technical standards and from public procurement from the cheapest Community source rather than domestically (perhaps 2 per cent of GDP).

c. Increased economies of scale due to enlarged market (about 2 per cent of GDP).

d. Improved efficiency and cost savings within firms due to increased competition (about 1 per cent of GDP).

#### Bilateral versus multilateral free trade

8. The major cost of bilateral, rather than multilateral, trade agreements is that trade may be diverted from lower cost areas (which continue to face tariffs and/or non-tariff barriers) to higher cost areas (which are tariff free). The importing country loses because it no longer buys from the cheapest source (in resource cost terms) while efficient exporters in third countries lose markets.

9. Studies of the effects of creating a Canada/United States free trade area and the European Single Market have paid little attention to the potential costs of trade diversion. It could, however, be of some significance in particular sectors. For instance in the US and Canada, although average tariff levels are low, tariffs on items like textiles and clothing remain of the order of 10-20 per cent leading to the possibility of significant trade diversion.

10. Japan, as the Summit country outside both these regional trade blocs, has already indicated that it feels under some threat - see for instance the attached extract from yesterday's Financial Times. The threat perhaps stems less from the formal provisions of the Canada/United States FTA or reduced non-tariff barriers within Europe than from the possibility that these regional blocs could raise their external tariffs.

11. Such increases in trade barriers could also be very costly for the countries imposing them:

- there would be additional trade diversion losses;
- the competitive stimulus to enterprise and efficiency would be blunted;
- retaliation and emulation would be encouraged, reducing world trade and the scope for specialisation and economies of scale.

12. Your Summit colleagues should have few difficulties in accepting these arguments in principle. Nevertheless, strong protectionist pressures remain. Comparative advantage is clearly not dependent on a country's endowment of land, labour, capital etc as nineteenth and early twentieth century economists thought. For many manufactured goods there is significant two-way trade between countries and comparative advantage derives from factors such as gaining economies of scale, cumulative experience in production and cumulative marketing expenditure, advantages from innovation and new products etc.

13. Comparative advantage is thus not written in stone and this encourages governments to protect "infant industries", subsidise R and D expenditure, provide aid for restructuring, respond quickly to perceived "dumping" by other countries rather than leave market forces to operate freely, especially if other governments are doing the same. These arguments provide ready stalking horses for mercantilists and it will be important to ensure that development of regional trade blocs does not lead to the erection of barriers to external trade.

*P. Albett*

PP S W MATTHEWS

PS / Chancellor



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Missing attachment  
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of 17 June "Toronto

Summit: Finance

Ministers' Discussion

Treasury Chambers

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Summary of the Free Trade Agreement

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Main provisions

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Manufactured goods	Removal of all bilateral tariffs starting on 1st January 1989, over a maximum period of 10 years.
Automotive	US - Canada Auto Pact continues. Canada's embargo on imports of used cars to be eliminated. Duty remissions to be phased out. To benefit from tariff exemption, at least 50 per cent of the value of goods must originate in North America.
Agriculture	Elimination of tariffs on agricultural trade within 10 years and the agreement not to use direct export subsidies on bilateral agricultural trade.
Energy	Restrictions on exports of Canadian oil and gas can be imposed, however, any reduction in exports to the United States must be proportional to the total supply of oil and gas available in Canada, without price discrimination.
Banking	Canada to eliminate restrictions on acquisition of Canadian assets by US banks. Canadian banks will receive equal treatment under US Securities laws.
Financial Services	Improved access and competition; national treatment for financial institutions.
Road haulage, maritime and air transport	No change; but further restrictions ruled out.
Other services	Liberalised access of enhanced telecommunications, computer services, tourism and architectural services.
Government procurement	Exclusion of national preference on government contracts worth more \$25,000; exceptions for defence procurement.
Direct investment	Restrictions on establishing new firms relaxed; extension of national treatment.
Technical standards	Harmonisation of technical standards based on the GATT code.
Emergency action and arbitration	More stringent standards for the application of emergency safeguards. Establishment of a dispute settlements mechanism and an independent arbitration panel.

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Source: External Affairs Canada, The Canada-US Free Trade Agreement.

★★  
**OVERSEAS NEWS**

Ian Rodger reports on Japanese preparations for a leading role at the Toronto meeting  
**Modest Takeshita prepares to storm summit**

I AM by nature reticent, Mr Noboru Takeshita, Japan's Prime Minister, told a group of foreign reporters in Tokyo yesterday.

It was his way of saying that he would not try to take a leading role at the summit of the heads of government of the seven largest Western industrialised nations in Toronto next week.

However, these annual economic summits are often as much about appearances as about issues and it would be surprising indeed if some event, either staged or spontaneous, did not occur in Toronto to underline the dramatic increase in Japan's importance and reputation in the world in the past year or so.

Those increases are due to Japan's surprisingly vigorous, if belated, actions to open some of its markets to imports, to the big boost in its aid to developing countries and to its success in stimulating the domestic economy. In a very short space of time, Japan has gone from being the West's favourite whipping boy to a respected locomotive of world economic growth.

The Japanese themselves, Mr Takeshita's rather endearing modesty notwithstanding, are clearly ready to take a bigger role on the world stage. As they see it, they have both the resources and the motivation to influence events, while other leading nations, particularly the US, have less and less room to manoeuvre.

Last week, a senior Japanese foreign ministry official expressed with uncharacteristic bluntness the new status quo as seen from Tokyo. "Without Japan, the world cannot do anything," he said.

He also highlighted the contrast between Mr Takeshita's position at the summit and that of his colourful predecessor, Mr Yasuhiro Nakasone. Mr Nakasone had a much tougher role to play, tending off the criticisms of his peers while trying - with considerable success - to demonstrate to the people back home that Japan now merited a place near the centre of the group photograph. "Mr Takeshita does not have to dramatise Japan's position," the official said.

Mr Takeshita, for all his self-styled modesty, has taken great care to prepare for the summit. In the past six months, he has visited every one of the leaders who will be attending the summit and so, while he may be self-effacing in public, he is unlikely to be a wallflower in the private discussions.

Appearances apart, the Japanese are heading for the summit with fairly modest objectives. Their main concern is about the world's trading system. They say they are worried about the trend towards the formation of big trading blocks, such as the proposed free trade zone between Canada and the US and the planned unification of the European Community market in 1992.

The Japanese say they fear that these blocks will discriminate against outsiders and they like to point out that the majority of the world, including Japan, lies outside these blocks. So they will wag their fingers at the Europeans and the North Americans, admonishing them not to stray from the rules of the multi-

lateral trading system.

In fact, Japan is also busily creating its own trading block, cementing economic and trade relations with the newly industrialising economies of East Asia. (The widely-used term newly industrialising countries has been dropped lately because Taiwan and Hong Kong cannot be called countries.) And that leads to its second main objective at the summit.

The Japanese see themselves as the defenders of the NIEs against the attacks of the US and others who want these countries to revalue their currencies substantially, open their markets and generally take on the pressures and responsibilities of normal developed countries.

The Japanese view is that the NIEs should be congratulated for their contribution to world economic growth. It should also be recognised that the NIEs are still rather fragile and should not be overburdened with responsibilities.

In Japan's view, some US Administration officials, particu-

larly Mr James Baker, the Treasury Secretary, are too aggressive in their demands on the NIEs. However, it is acknowledged in Tokyo that the US is the only country supporting huge trade deficits with the NIEs. Japan, by contrast, has large surpluses with them, although imports into Japan from the NIEs are rising rapidly.

The Japanese are also disparaging about the European tendency to look on the NIEs as a disruptive element in the world economic order.

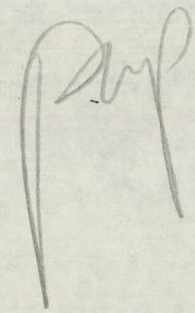
For the rest, the Japanese are hoping for what one official here has called a "satisfactory" summit, which means that not much will happen. They are eager to spend a lot of time giving US President Ronald Reagan what they call a *hanomachi*, a flower strewn farewell from the stage, although at least one Japanese official last week seemed to be not quite in the spirit of things. He managed to give a 20-minute briefing on the summit without once mentioning the name Reagan.



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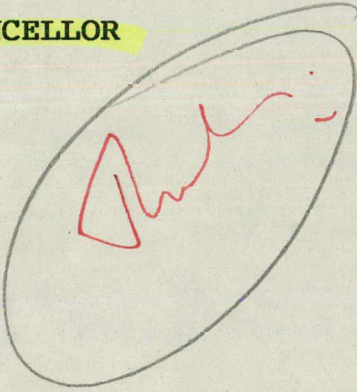
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FROM: H G WALSH  
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cc Sir Geoffrey Littler  
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Mr Gieve  
Mr Matthews  
Ms Life o/r  
Mr Kilpatrick  
Mr Kroll

**JAPANESE DEBT PROPOSAL AT THE SUMMIT**

The Japanese have now confirmed that they will introduce a proposal for dealing with middle income debt at the Summit, referred to in my minute of 14 June. Prime Minister Takeshita will make a brief comment to introduce it and Miyazawa will follow this up at the session for Finance Ministers on 19 June. A copy is attached.

2. While the exact details of the scheme are still not entirely clear, it appears to be considerably different from the earlier version and in particular the Japanese no longer (if they ever did) propose to contribute collateral to back LDC securities issued in exchange deals for existing debt. So - aside from export finance at market rates - the Japanese do not propose to put up any money.

3. Instead the Japanese are proposing a change to the present system of concerted lending by banks so that those banks that wished could contribute by the writing down of principal rather than the provision of new money. Written down debt would be guaranteed as to both principal and interest by deposits made by debtors (presumably in zero coupon bonds) at a reserve account at the IMF. A second reserve account, also wholly financed by debtors but less secure because it would be funded out of a proportion of debtors' prospective balance of payments surpluses, would collateralise conventional new lending from those banks choosing to participate in that way.

4. The plan also proposes that the flow of new money from the IFIs and bilateral official capital should be increased. Since the World Bank is now almost the sole provider of net new money to debtor LDCs, there are obvious dangers in extending it (or the IMF) more and the UK would have difficulty in matching the offer of the Japanese to increase untied bilateral finance issued through its EXIM Bank. The most we could do would be to continue to provide DX cover to provide ECGD guarantees to rescheduling countries that adopt reform programmes to get back on track. This could not be made available on a large scale if ECGD portfolio quality was not to decline, and would have to be tied, under the terms of our legislation, to UK exports.

5. In sum the plan proposes to change the Baker approach by partly substituting writedown of debt for the provision of new money by banks in concerted lending packages without any direct official contributions to the writedown process. One new feature is the proposal that debtor countries should collateralise conventional new lending by banks.

#### Line to take

5. It is quite consonant with our policy that the use of the menu approach should be extended by agreement between the banks and the debtor countries. This may well mean that concerted lending packages will increasingly involve securitised writedown arrangements instead of new money from the banks. We have no objection to the IMF being used as stakeholder for the collateral payments made by debtor countries under these schemes, provided the IMF makes no contribution itself. But we do not see scope for vastly increased new flows from IFIs beyond what has already been agreed for a revitalised EFF at the Fund and a \$74.8 billion GCI at the World Bank, although we hope the \$23 billion seventh replenishment of the IADB gets back on track. We doubt whether we could make any large contribution to bilateral flows through increased export credits.

H. W.

H G WALSH

A NEW SCHEME FOR RESOLVING THE DEBT PROBLEMS  
OF THE MIDDLE-INCOME COUNTRIES

1. BASIS VIEWS ON THE DEBT PROBLEMS

(1) THE BAKER STRATEGY OF 1985 SUCCESSFULLY AVOIDED A RECURRENCE OF THE DEBT CRISIS AND SUPPORTED GROWTH-ORIENTED ECONOMIC ADJUSTMENT BY DEBTOR COUNTRIES WITH NEW MONEY FROM PRIVATE BANKS AND INTERNATIONAL FINANCIAL INSTITUTIONS ON A CASE-BY-CASE BASIS. THE MENU APPROACH EVOLVED AS PART OF THIS STRATEGY ALSO CONTRIBUTED SIGNIFICANTLY TO BROADENING THE OPTIONS FOR CREDITOR BANKS, AS SHOWN BY THE RECENT MEXICAN DEBT-BANK-SWAP SCHEME.

THIS CASE-BY-CASE APPROACH HAS PROVED ITS WORTH, AND IT IS NEITHER APPROPRIATE NOR REALISTIC TO TRY TO RESOLVE THE DEBT PROBLEMS BY ADOPTING A GLOBAL OR GENERALIZED STRATEGY.

FOLLOWING THIS BASIC STRATEGY, THE TRADITIONAL APPROACH WITHIN THE FRAMEWORK OF BANK ADVISORY COMMITTEE, BASED ON STAND-BY ARRANGEMENTS WITH THE FUND, HAS PROVIDED SHORT-TERM RESPONSES OF ONE TO TWO YEARS. IN ADDITION TO THIS BASIC APPROACH, IT NOW APPEARS USEFUL TO EXPLORE OTHER MEASURES TO STRENGTHEN MEDIUM-TERM RESPONSES ON A CASE-BY-CASE BASIS.

(2) IN CONSIDERING MEDIUM-TERM RESPONSES, THE FOLLOWING POINTS DESERVE SPECIAL ATTENTION.

1) THE MOST IMPORTANT CONSIDERATION IN RESOLVING THE DEBT PROBLEMS IS TO SUSTAIN GROWTH THROUGH STRUCTURAL ADJUSTMENT IN THE DEBTOR COUNTRIES AND THEREBY TO RESTORE THE DEBTOR COUNTRIES' ABILITY TO SERVICE THEIR DEBTS. SIMPLY DISCOUNTING THEIR DEBTS OR WRITING THEM OFF IS NOT AN APPROPRIATE SOLUTION.

2) IN ORDER TO SUPPORT ECONOMIC ADJUSTMENT EFFORTS BY DEBTOR COUNTRIES, IT IS NECESSARY TO ENHANCE THE FLOW OF CAPITAL FROM PRIVATE BANKS, INTERNATIONAL FINANCIAL INSTITUTIONS, AND INDUSTRIALIZED COUNTRIES.

3) IN ADDITION TO CONTINUING TO FACILITATE THE DEBTOR COUNTRIES' ECONOMIC ADJUSTMENT EFFORTS THROUGH CONVENTIONAL MEASURES, THE FUND MIGHT EXPLORE SOME NEW SCHEME UNDER WHICH THE FUND AND THE DEBTOR COUNTRIES COULD COOPERATE MORE CLOSELY TO ENHANCE THE CERTAINTY OF REPAYMENT.

(3) GIVEN THESE CONSIDERATIONS AND IN LIGHT OF THE IMPORTANCE OF STRENGTHENING THE MENU APPROACH THAT WAS EMBODIED IN THE RECENT MEXICAN DEBT-BOND-SWAPS SCHEME, JAPAN WOULD LIKE TO PROPOSE, AS ONE POSSIBLE MENU ITEM, A NEW SCHEME WHICH WOULD ALLOW FLEXIBLE RESPONSES ON A CASE-BY-CASE BASIS AND PROVIDE FOR FAIR BURDEN-SHARING AMONG THE PARTIES CONCERNED.

## OUTLINE OF THE SCHEME

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- I. THE DEBTOR COUNTRY WOULD FIRST AGREE WITH THE FUND ON A MEDIUM-TERM PROGRAM FOR STRUCTURAL ADJUSTMENT.
  - II. PREMISED UPON THE FUNCTIONING OF THIS PROGRAM FOR STRUCTURAL ADJUSTMENT, THE DEBTOR COUNTRY AND ITS CREDITOR BANKS WOULD AGREE TO PUT SOME OR ALL OF THE TOTAL DEBT UNDER THIS SCHEME.
  - III. THE BANKS WOULD BE ABLE TO DECIDE FOR THEMSELVES WHETHER OR NOT THEY PARTICIPATED, AND EVEN PARTICIPATING BANKS WOULD BE ABLE TO OPT FOR PARTIAL PARTICIPATION INVOLVING ONLY SOME OF THEIR CREDITS. THE NON-PARTICIPATING BANKS AND BANKS THAT HAVE OPTED TO KEEP SOME OF THEIR CREDITS OUT OF THIS SCHEME WOULD CONTINUE TO WORK ON TRADITIONAL RESPONSES, INCLUDING THE PROVISION OF NEW MONEY UNDER THE BANK ADVISORY COMMITTEE.
  - IV. A CERTAIN PORTION OF THE CREDITS UNDER THIS SCHEME WOULD BE SECURITIZED, THE SECURITIZATION RATIO TO BE DECIDED BY TENDER OR THROUGH NEGOTIATIONS BETWEEN THE DEBTOR COUNTRY AND ITS CREDITOR BANKS BASED ON MARKET CONDITIONS. THE SECURITIZATION COULD BE PHASED OVER A PERIOD OF YEARS IN ACCORDANCE WITH THE FUND'S PROGRAM.
  - V. THE CREDITOR BANKS WOULD THEN RESCHEDULE THE NON-SECURITIZED PORTION'S PRINCIPAL. THE CONDITION OF RESCHEDULING WOULD BE AGREED BETWEEN THE CREDITOR BANKS AND THE DEBTOR COUNTRY ON A CASE-BY-CASE BASIS.
  - VI. THE DEBTOR COUNTRY WOULD ESTABLISH TWO RESERVE ACCOUNTS TO BE HELD IN TRUST BY THE FUND TO ENHANCE THE CERTAINTY OF REPAYMENT.
    - A. THE FIRST RESERVE ACCOUNT; FUNDED BY THE DEBTOR COUNTRY'S FOREIGN EXCHANGE RESERVES, AND USED TO GUARANTEE THE PRINCIPAL OF THE SECURITIZED PORTION OF THE DEBT AND ALSO AVAILABLE TO SUPPORT INTEREST PAYMENTS.
    - B. THE SECOND RESERVE ACCOUNT; FUNDED AS A SINKING FUND FOR THE NON-SECURITIZED PORTION OF THE DEBT BY TRANSFERRING A CERTAIN PERCENTAGE, AS AGREED BETWEEN THE DEBTOR COUNTRY AND ITS CREDITOR BANKS, OF EACH YEAR'S ANTICIPATED BALANCE OF PAYMENT SURPLUS.
3. NEED FOR COOPERATION FROM THE INDUSTRIALIZED COUNTRIES AND MULTILATERAL INSTITUTIONS

THE FLOW OF NEW MONEY FROM THE INTERNATIONAL FINANCIAL INSTITUTIONS AND THE FLOW OF BILATERAL CAPITAL FROM THE INDUSTRIALIZED COUNTRIES SHOULD BE ENHANCED. JAPAN WILL CONTRIBUTE HERE MAINLY WITH UNTIED LOANS FROM THE EXPORT-IMPORT BANK OF JAPAN.

THIS NEW MONEY WOULD NOT HOWEVER BE TO PROVIDE FUNDING TO THE RESERVE ACCOUNTS OUTLINED ABOVE.

THE PARIS CLUB WILL CONTINUE TO SUPPORT DEBTOR COUNTRIES WITHIN THE FRAMEWORK OF MULTI-YEAR RESCHEDULING.

4. FEATURES OF THE SCHEME

- 4
- (1) THIS SCHEME IS BASED ON THE CASE-BY-CASE DEBT STRATEGY.
  - (2) PRIVATE BANKS CONTINUE TO PLAY AN IMPORTANT ROLE IN SUPPORTING THE DEBTOR COUNTRIES' STRUCTURAL ADJUSTMENT EFFORTS THROUGH ADEQUATE AND APPROPRIATE FINANCING OPTIONS.
  - (3) THIS SCHEME INCLUDES NEITHER GLOBAL DEBT-FORGIVENESS PROPOSALS NOR ANY TRANSFER OF RISK FROM THE PRIVATE SECTOR TO THE INTERNATIONAL FINANCIAL INSTITUTIONS OR CREDITOR GOVERNMENTS.
  - (4) FOR THE CREDITOR BANKS, THERE IS A STRONG POSSIBILITY THAT THE TOTAL PRINCIPAL INCLUDING THE NON-SECURITIZED PORTION CAN BE RECOVERED.
  - (5) THE DEBTOR COUNTRIES ARE REQUIRED TO MAKE STRONG COMMITMENTS TO REBUILDING THEIR ECONOMIES BY EXECUTING MEDIUM-TERM STRUCTURAL ADJUSTMENT PROGRAM AGREED WITH THE FUND.
  - (6) THE DEBTOR COUNTRIES CAN SECURE FINANCING FOR THEIR STRUCTURAL ADJUSTMENT FROM MULTILATERAL AND BILATERAL FINANCIAL INSTITUTIONS.

5. IMPLEMENTATION

THE DETAILS OF THIS SCHEME SHOULD BE FLESHED OUT BASED ON THE INDIVIDUAL CASE BY THE PARTIES CONCERNED WHEN THEY CONSIDER THE SCHEME'S APPLIICATION APPROPRIATE.

CC: G7 DEPUTIES

END\*  
262405 TRSY G

*Paul*

**SECRET**

Paul Gray, Esq.,  
Private Secretary,  
10 Downing Street,  
London, S.W.1.

CH/EXCHEQUER	
REC.	17 JUN 1988 <i>17/6</i>
ACTION	MR WALLER
COPIES TO	

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Our ref  
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Date

215 5422

June, 1988

*Dear Paul,*

As agreed on the telephone this morning, I enclose briefing on Rover for the Prime Minister's meeting with M. Delors at the Toronto Economic Summit.

There are three points worth mentioning:

- (i) the briefing assumes flexibility on the part of the BAe to the extent of £100m on the £800m proposed injection. At present, BAe set a limit of £50m although my Secretary of State believes that, if pressed, they would be prepared to live with the higher figure. He is not, however, confident that BAe could be pushed to move significantly beyond this;
- (ii) we are looking for a settlement with the Commission in terms of the overall number by which the financial injection should be reduced. It would be for the Commission in conjunction with ourselves and other interested parties to determine how best this sum should be allocated and presented to the various audiences; and
- (iii) M. Delors has expressed interest in our view of how Commission treatment of Renault compares with the current treatment of RG. We have already provided some material (see Annexes) to suggest that the differences are apparently marginal though we do not know the confidential detail of frank exchanges with the Commission.

**SECRET**



dti

the department for Enterprise

SECRET

I am copying this letter and enclosures to Alex Allen (Treasury)  
and Lyn Parker (FCO).

*Yours*

*Stephen Ratcliffe*

Stephen Ratcliffe  
Private Secretary

SECRET

SECRET

dti

SECRET

the department for Enterprise

PRIME MINISTER'S MEETING WITH DELORS: 19 JUNE

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- A. STEERING BRIEF/LINE TO TAKE
  
- B. DEFENSIVE BRIEFING
  - (i) Price
  - (ii) Debt
  - (iii) Restructuring
  - (iv) Timetable
  - (v) Comparison with Renault Case
  
- C. ADDITIONAL BACKGROUND

Briefing note already provided to M. Delors

SECRET

SECRET

CB8AAT

## NAMED DISTRIBUTION ONLY

## PRIME MINISTER'S MEETING WITH PRESIDENT DELORS, 19 JUNE

OBJECTIVE

To secure support for a settlement of the Rover Group (RG) state aid case at not more than a £75-£100m worsening of the net terms negotiated with BAe.

LINE TO TAKE

- 1 Support Commission's forceful application of the state aid rules. We co-operate fully and promptly as demonstrated in the present RG case.
- 2 Issue is the return of RG to the private sector and the disciplines of the market. No more state intervention. Fully in line with the Commission's objectives.
- 3 Extreme commercial and political sensitivity surrounds Rover Group. Sale to BAe viewed as popular by workforce, dealers, suppliers and general public. Failure would be placed firmly at the Commission's door. Major political and public backlash would damage general UK perception of the Community and frustrate progress on many fronts.

## NAMED DISTRIBUTION ONLY

Price

4 The price BAe have offered reflects RG's real situation. Commission must be realistic. RG has not made a bottom line profit since 1976. Its current trading profitability is marginal in an unusually strong domestic market. Its US business faces serious problems. Its overall strategy depends on its achieving a position as a 'niche', high quality producer. Honda must also be kept on board. Major risks.

5 And businesses too fragile to stand a public auction to establish a 'market' financial package. Controversial history (Ford) proves that.

Debt

6 Fundamental BAe condition is that the company should be acquired debt-free. Understandable condition given that RG will not be able to fund investment in new models etc from own resources. Reality is that, over next five years, BAe will need to contribute several hundred million pounds to support essential investment.

7 Aware that there is dispute between the Commission and HMG on the definition of debt. But £724m of the £800m is either audited debt (£585m) or sums (£139m pay-out on previous Leyland-Daf privatisation) which auditors confirm remains appropriate.

## NAMED DISTRIBUTION ONLY

8 Ready to juggle on the margins but Commission must also show recognition of the real costs involved for BAe.

Future Restructuring

9 Commissioner Sutherland has been briefed in the strictest confidence of the real, substantial degree of closure/restructuring inherent in the BAe-endorsed plan. 28% on car assembly capacity. More on components. Believe he is broadly satisfied. There will be alongside better utilisation of other existing capacity but changes confirm that RG has no ambitions to become a 'volume' producer. Total production over next decade will be more or less flat.

Timing

10 Serious risk that if formal Commission approval is not forthcoming by mid-July, public and Parliamentary speculation will further damage the business irrevocably. Should not be allowed to drag through the summer.

17 June 1988

## NAMED DISTRIBUTION ONLY

## DEFENSIVE BRIEFING

(i) PRICE

LINE TO TAKE

1 £150m is reasonable for the following reasons:

RG track record appalling - last made a bottom line profit in 1976;

improvements achieved in last two years only in exceptionally favourable climate;

budgeted trading profit in 1988 (ie before interest and tax) is very small - £30m odd on turnover of over £3bn.

negative cash flow until early 90s, if everything is on track;

major investment of well over £1bn required in next 5 years, to which BAe itself will need to contribute several hundred million;

risks for any purchaser are enormous.

Value of minority holdings

2 DAF (RG hold 40%) link relevant to BAe military interests.

## NAMED DISTRIBUTION ONLY

3 Unipart, Istel etc vital functional links to Austin Rover.

4 Total book value of minority holdings c£100m. But not immediately realisable. And any analysis must set risks and liabilities against assets.

5 Total break up cost £2bn.

Value of fixed assets

6 Readily disposable assets sold already by Day.  
Only major disposable site remaining is Bathgate in Scotland. Planning permission uncertain. Might perhaps realise £15m.

7 But must put this in perspective. Set risks and liabilities against assets.

8 Redundancy costs at least £½bn.

9 Total break up cost £2bn.

## NAMED DISTRIBUTION ONLY

Value of tax losses

Mechanical addition of trading tax losses, capital losses and capital allowances leads to total amount of £265m-£345m.

But with the tax losses ring fenced within the Rover Group businesses uncertainty of utilization means tangible value is substantially less.

Have indicated to Sutherland we are willing to look again at the extent to which carried forward tax losses are constrained.



## NAMED DISTRIBUTION ONLY

## DEFENSIVE BRIEFING

## (ii) DEBT

Debt at 30 June estimated at £801m composed of:

- A        £585m audited debt at 31 December 1987. (This includes  
B £25m long term accruals.)
- C        £139m provision for restructuring of commercial vehicle  
          businesses.
- D        £25m cost of Land Rover strike.
- E        £51m increase in debt due to normal operations in first  
          half of 1988.

—————  
£801m

AREAS OF COMMISSION ATTACK

Within A        £155.8m provided by Wholesale Vehicle Finance.

LINE TO TAKE    Audited by Coopers & Lybrand as part of total debt  
at end 1987.

Fragility of banking confidence in RG led to growth  
in importance of this financing option.

**NAMED DISTRIBUTION ONLY**

No different from other finance raised on pledges on current assets.

Finance would come from a clearing bank if it did not come from Wholesale Vehicle Finance.

Not working capital.

**BACKGROUND**

Constitutes finance provided by WVF against finished goods on consignment.

Commission argue that this element in fact represents a revolving working capital arrangement.

Previously netted off against stocks in 1986 accounts.

## NAMED DISTRIBUTION ONLY

B £25.1m long term accruals

LINE TO TAKE Represent long term liabilities of RG - due after more than 12 months - in relation to warranties etc.

Reflect the true level of debt in RG.

BACKGROUND Represent mainly liabilities in relation to second and third year of warranties given on cars sold in US.

Arguably working capital.

Weakest area of our argument on debt.

C £139m provision for restructuring of commercial vehicle businesses.

LINE TO TAKE Part of the £680m settlement reached with the Commission on the Rover truck and bus businesses.

Coopers & Lybrand confirmed in May 1988 that they still consider the provision appropriate.

Most costs will need to be met within next year but some relating to contractual agreements on redundancies between Rover and DAF run on until 1991.

## NAMED DISTRIBUTION ONLY

Interest benefit to Rover Group in the interim taken into account in £680m settlement.

No reason now to envisage either overspend or underspend likely.

BACKGROUND

Commission have strong suspicions that there could be a major underspend - perhaps of the order of £50m. But on information provided they certainly cannot substantiate a specific figure.

Best defence is auditors reaffirmation in May '88 that the accounting provision is still appropriate.

Tight management by RG of the plants to be closed and a slower rate of expenditure than originally envisaged may indeed result in an underspend. During BAe's due diligence investigation, Rover Group told them they thought an underspend of £21m likely. But it could be higher. We have pointed out to BAe the prospect of an underspend ie a cash reserve to set against any reduction imposed by Brussels. But to date we have defended with the Commission the proposition that an underspend is no more likely than an overspend.

## NAMED DISTRIBUTION ONLY

D £25m cost of Land Rover strike.

LINE TO TAKE In addition to immediate loss of contribution to fixed costs of £25m, the loss of goodwill, dealer confidence, and damage to company image is likely to add a further £10m.

Self evident that immediate loss of revenue and damage to company image will have to be funded.

BACKGROUND In latest exchanges two new Commission arguments emerged. First, the effect of the strike was positive in that the management "won". We dismissed this as totally speculative while the effect on revenue and company image was real.

Second, Commission asked how the strike would be treated in the 1988 accounts. It will not be treated as an extraordinary item. The Commission are likely to argue in consequence that the strike costs are already taken into account in reducing 1988 trading profit. Therefore it cannot also be counted as a funding cost in the debt calculation.

The £25m charge was necessarily an imprecise estimate; we now have some reason to believe that most of the strike costs will be offset by better than anticipated trading conditions.

## NAMED DISTRIBUTION ONLY

E £51m debt increase in first half of 1988.

LINE TO TAKE Estimate was composed of accumulating interest charges (£42m) and crystallisation of legal claims and other non- trading liabilities (£10m).

In addition recent requirement to buy out American partner in US distribution subsidiary has added £24m to costs previously estimated to Commission.

RG trading profits in 1988, will not offset these costs.

BACKGROUND Commission suspect that this is an artificial "make up" item to reach £800m.

Recent deployment of £24m Arcona costs have buttressed our arguments. However, the interest charge in the first half of 1988 could in fact prove significantly less than £42m.

Arguments vulnerable if the Commission were to make agreement conditional on audited half year figures.

NAMED DISTRIBUTION ONLY

LEAVING DEBT ON THE BALANCE SHEET

LINE TO TAKE Totally unacceptable to BAe.

Thin profits and negative cash flow cannot support  
an interest burden.

## NAMED DISTRIBUTION ONLY

## DEFENSIVE BRIEFING

## (iii) RESTRUCTURING INFORMATION

LINE TO TAKE Lord Young has given Commissioner Sutherland confidential draft letters on the planned pattern of restructuring of capacity, and on the handling of this delicate subject.

DEFENSIVEDegree of restructuring

Very extensive. Reflects careful scrutiny of RG plans by BAe. See no scope for increasing it.

Pattern of restructuring/underutilization of Cowley North

Precise pattern of restructuring must be for commercial management to determine.

Binding commitment by BAe to restructure capacity?

HMG has discussed plans extensively with BAe. Received written assurances from chairman of BAe. Investment programmes aligned to model rationalisation already in train.



## NAMED DISTRIBUTION ONLY

Within the context of overall privatisation objective cannot go further.

Background

Copies of the draft letters on restructuring handed to Commissioner Sutherland by Lord Young on 26 May are attached.

## DEFENSIVE BRIEFING

## (iv) TIMETABLE

LINE TO TAKE Vital to reach understanding very shortly. Recent press speculation on difficulties has underlined this need.

Ministerial colleagues becoming anxious.

Relying on formal Commission decision early July at latest.

Politically untenable to leave position unresolved over the summer recess.

If the BAe deal were to break down, Ministers would need time to address other options and develop a public position in July, before the House rises.

## DEFENSIVE BRIEFING

## (v) ROVER GROUP AND RENAULT STATE AID CASES

BACKGROUND M Delors has expressed concern that the Commission should deal evenhandedly with major state aid cases, and that the RG case compares unfavourably with Renault. The following two tables have been provided to his Cabinet at their request.

## COMPARISONS BETWEEN BL/ROVER AND RENAULT

<u>Group</u>	1977		1987	
	<u>BL</u>	<u>Renault</u>	<u>Rover</u>	<u>Renault (2)</u>
Sales Revenue (£bn)	2.6	5.1	3.1	13.8
Manpower ('000)	194	244	45	196
Profit after tax (£m)	(5)	1	(27)	345
<u>Cars manufacturing (3)</u>				
Sales revenue (£bn)	1.7	3.0	3.1	7.8(2)
Manpower ('000)	120	106	45	[108]
Unit sales ('000)	708	1737	512	1530
Market share: (%)				
Domestic	24.3	33.6	15.0	30.5
European	2.0	15.7(4)	4.4	10.6
Profit before tax (£m)	(32)	23	(27)	18.6

Notes:

1. Exchange rates used: 1977 £1 = FF 9.65  
1987 £1 = FF 10.7
2. 1986 figures
3. Includes Austin Rover and Land Rover
4. 1982 figures

Sources:

BL documents relating to possible collaboration project with Renault in late 1970s; RG's 1987 facts and figures booklet; EC Commission documents on Renault state aid case; and SMMT statistics.

**GOVERNMENT ASSISTANCE FOR BL/ROVER AND RENAULT**

	FFm	£m	ECUm
<u>BL/ROVER</u>			
Aid 1975-1981		1,770	2,700
Aid 1982-1987		1,140	1,700
		<u>2,910</u>	<u>4,400</u>
Aid 1988		800	1,200
		<u>3,710</u>	<u>5,600</u>
<u>Renault</u>			
Aid 1945-1981	3,100	300	450
Aid 1982-1987	12,250	1,150	1,750
	15,350	1,450	2,200
Aid 1988 (2)	20,000	1,900	2,900
	<u>35,350</u>	<u>3,350</u>	<u>5,100</u>

Notes

- Exchange rates used: FF 10.7 = £1 = ECU 0.655
- Includes: Debt write-off FF 12,000  
Capital injection 8,000  
20,000  
but not: FIM loans 1,250

Sources

DTI record of Government assistance for BL/RG, and French Senate proceedings record of question and answer of 7 April 1988 on Renault.

VM2/DTI  
June 1988

## SECRET AND PERSONAL

DRAFT COVERING LETTER FROM SECRETARY OF STATE FOR TRADE AND  
INDUSTRY TO COMMISSIONER SUTHERLAND

## ROVER GROUP FUTURE RESTRUCTURING

I am very grateful to you and your officials for the speed with which you have taken forward the formal procedures and detailed examination of the Rover Group state aid case.

I understand the importance you attach to the Commission's questions about future restructuring plans in respect of the Rover Group businesses. I believe the attached draft letter provides a detailed and comprehensive answer to these questions. However I must emphasise the extreme sensitivity of this information, and I would be grateful if you would treat this as provided on a strictly personal basis.

I should welcome a confidential discussion with you on how you would envisage conveying to your fellow Commissioners in due course your views on the assurances given by Her Majesty's Government in relation to future restructuring.

I fear I must also repeat the point I raised when we met on 23 March that we would wish to be very closely consulted about any reference to restructuring in the Commission's letter eventually closing the procedure.

While I fully recognise that both the letter closing a procedure and the formal notice in the Official Journal are expressions of the Commission's views, given the sensitivities it would be difficult for us to contemplate wording on restructuring beyond an indication that the Commission have received satisfactory assurances from HMG that BAe plans to ensure that Rover Group will in future operate fully in accordance with market disciplines.

I hope you will understand that in this delicate area I would find it helpful to address together discussion of the substance and handling of the attached letter.

## SECRET AND PERSONAL

DRAFT LETTER FROM THE SECRETARY OF STATE FOR TRADE AND INDUSTRY TO  
COMMISSIONER SUTHERLAND

## ROVER GROUP FUTURE RESTRUCTURING PLANS

The purpose of this letter is to meet the Commission's request for detailed information on future restructuring plans for the Rover Group businesses under the ownership of British Aerospace. This letter responds to the questions contained in the Commission's letter of 29 March opening an Article 93 procedure in response to HMG's notification of 14 March of our intention to provide a further capital injection to Rover Group.

Reflecting the extreme political and commercial sensitivities which surround future restructuring of the Rover Group businesses, I would ask you to treat this letter as delivered in the strictest personal confidence.

In seeking to sell its shareholding in Rover Group to British Aerospace, the objective of HMG is to return the Group to the disciplines of the market. HMG strongly believes that this provides the best possible assurance that the Rover Group businesses will operate in relation to competitive pressures and will not distort trade within the Community. In this context I would wish to emphasise that, under the terms of the proposed deal, whilst within British Aerospace's ownership no restrictions whatsoever have been placed by the Government on the normal commercial management of the Rover Group businesses.

SECRET AND PERSONAL

In the negotiations which took place in March 1988, British Aerospace considered the Rover Group businesses against the background of Rover Group management's own plans for restructuring capacity. Having now had an opportunity to examine Rover Group's own management plans more fully, British Aerospace have confirmed to me that they will take forward the management of the Rover Group businesses on the basis of these plans.

These plans include major reductions in capacity as set out in detail in the Annex to this letter. In essence:-

Austin Rover's assembly capacity will be cut by 28% including the closure of the whole of the Cowley South plant in 1991;

Austin Rover's engine capacity will be reduced by 64% by end 1992 following the closure of the Drews Lane plant in 1991; and

Austin Rover's pressing capacity will be reduced with the closure of the Llanelli Pressings plant in 1990.

These physical reductions in capacity are part of the wider existing Rover Group strategy, endorsed by British Aerospace, to move Austin Rover from a comparatively small multi-product manufacturer to a producer of a limited range of up-market, highly specified vehicles. This strategy is fundamental to the focus which Rover Group have adopted over the last two years of

improving financial performance rather than expanding market share, contributing to the objective of establishing securely the long term viability of the Group.



## SECRET AND PERSONAL

## ROVER GROUP FUTURE RESTRUCTURING

PLANT AND LOCATION	PRODUCTION BY MODEL OR COMPONENT	CAPACITY 1987 (000')	CAPACITY 1991 (000')	PRODUCTION BY MODEL OR COMPONENT
LONGBRIDGE PLANT 1 (B'HAM)	MINI METRO	300	338	R6 (successor to Metro) R8 (successor to Rover 200 and Maestro) and Concerto (its Honda counterpart)
LONGBRIDGE PLANT 2 (B'HAM)	ROVER 200 BALLADE	91	85	R9 (Saloon version derivative of R8)
COWLEY NORTH (OXFORD)	ROVER 800	127	127	Rover 800
COWLEY SOUTH (OXFORD)	MAESTRO MONTEGO	242	CLOSED	
		<u>760</u>	<u>550</u>	
DREWS LANE (B'HAM)	ENGINES	n/a	CLOSED	
LLANELLI PRESSINGS (SOUTH WALES)	PRESSINGS	n/a	CLOSED	

THE ROVER GROUP STATE AID CASE

Note for the President of the European Commission

Policy Objectives of the UK Government

1. The UK Government believe that the sale of its 99.8% shareholding in the Rover Group plc (RG) to British Aerospace plc (BAe) will achieve shared UK and Community objectives by:
  - i) enabling the UK Government to complete its withdrawal from intervention in the vehicle manufacturing industry;
  - ii) enabling RG to contribute to restructuring in the European vehicle industry by responding freely to the disciplines of the open market;
  - iii) preserving competition between European and other vehicle manufacturers.

The Terms of the Deal

2. Following a time limited exclusive negotiation with BAe, on 29 March 1988 the UK Government announced agreement to sell its shareholding in Rover Group to BAe for £150m. The agreement is subject to EC Commission approval of the state aid element involved in meeting RG's £800m indebtedness, and to BAe shareholder approval.
3. RG's tax losses have been constrained by extinguishing two thirds of its trading tax losses, and by preventing any RG tax losses being offset against profit or capital gains in other BAe businesses. The residual value of these tax losses has thus been reduced.
4. The Government have declined to give any warranties to BAe relating to RG's performance or products. BAe will assume responsibility for all RG's existing, future and contingent liabilities. The result is a clean break for the UK Government from all future financial risks and liabilities of RG.
5. BAe have given an undertaking to retain the RG businesses for at least five years. Should BAe sell either the RG cars business or Land Rover within five years, the UK Government is empowered to recoup any economic benefits. BAe will thus bear very major risks in running these businesses for five years.
6. The UK Government have not sought to constrain in any way BAe's freedom to manage the RG businesses. This includes the freedom to make such changes to capacity as market conditions suggest necessary.

Exchanges with the Commission

7. The development of exchanges with the Commission is set out at Annex A. The UK Government have endeavoured to keep the Commission as fully and promptly informed as possible about the progress of commercial negotiations and the details of the terms agreed with BAe.

8. On the substance of the case Commissioner Sutherland has expressed concern that the exclusive negotiation with BAe failed to establish a market price; and that the price is too low. However, the UK Government agreed with the independent commercial judgement of the RG Directors that the RG businesses were too fragile to survive an auction. The disclosure of preliminary talks with Ford in Spring 1984 led to RG's share of the UK car market falling two percentage points and to RG losing £250m in sales revenue; RG has never recovered.

9. The price negotiated with BAe reflects the very poor past record of RG which last made a profit (before extraordinary items) in 1976; the current minimal trading profit; the constraints on the use of RG's tax losses; and forecast negative cash flow and poor profits for several years to come.

10. On debt Commissioner Sutherland has expressed concern that £300 million of the estimated £800 million indebtedness at completion is composed of what the Commission regard as ineligible items. The UK Government have explained that £725 million of the indebtedness is derived from the independently audited RG 1987 statutory accounts. The remainder is accounted for by the adverse effect of the strike at Land Rover this Spring and the interest charges on the historic debt between 1 January 1988 and estimated completion in Summer 1988.

11. Commissioner Sutherland has also expressed concern that Rover Group is being sold debt free. BAe will not purchase RG except on a debt free basis given its track record, poor financial prospects for the rest of the decade and the risks associated with the RG businesses.

Timing Constraints

12. RG remains a highly fragile business. There is a grave danger that any prolonged uncertainty about its future ownership will severely damage it. The commercial vulnerability of the Group is compounded by the acute level of political interest in RG. Doubts about the outcome of negotiations with the Commission are already attracting attention in the UK Parliament. If it does not prove possible to announce Commission clearance before the UK Parliament rises in the second half of July political speculation and commercial uncertainties will threaten the future of RG. If this is to be avoided Commission approval is needed by early July at the latest.

## CONFIDENTIAL: MARKET SENSITIVE

## ROVER GROUP STATE AID CASE

## Timetable of key events

- 1 March            HM Government announced its intention to enter exclusive negotiations with British Aerospace for the sale of Rover Group. Lord Young had telephoned Commissioner Sutherland in advance of the public statement.
- 14 March            HM Government formally notified Commission under Article 93(3) of its intention to provide capital to Rover Group.
- 23 and 28 March    Lord Young reported developments in commercial negotiations to Commissioner Sutherland.
- 29 March            Terms of agreement between UK Government and British Aerospace announced, subject to approval of European Commission and British Aerospace shareholders.
- European Commission opened formal procedure.
- late April           Commission letter circulated to other member states seeking comments.
- April/May           Provision of detailed information to DGIV.
- 26 May              Lord Young discussed DGIV appraisal of Rover case with Commissioner Sutherland.
- 7 June
- 15 June