PREM 19/2108

MT

PART ONE

CONFIDENTIAL FILING

Sherpa Administration

ECONOMIC

POLICY

[In attached folder: Briefing for SHERPA meeting in Quebec 27-29 Feb, and programme of events
Folder incorporated in file]

PT1: October 1987

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~15/2/88~~							
~~19.2.88~~							
~~23.2.88.~~							
~~25.2.88~~							
28.2.88							
PT 1							
6 NOS							

PREM 19/2108

PART 1 ends:-

CANADIAN HIGH. COMM to NCW 28.1.88

PART 2 begins:-

NCW to PM. 1.3.88

CF.
This is
where I
will be over
weekend to Monday

Canadian High Commission Haut Commissariat du Canada

January 28, 1988

N

Dear Colleague

I am writing to you at this time to confirm details regarding our second meeting of the Toronto Summit cycle.

The site that we have chosen for our second meeting is the "La Sapiniere" (tel: 819 322 2020), near Val David, Quebec - in the Laurentian Mountains, approximately 45 minutes north of Mirabel Airport. This site has the advantage of offering an atmosphere of relative seclusion, in a delightful setting which is close to Montreal.

As I have already indicated to you, we will begin our meeting with dinner on Saturday, 27 February. Our meetings will continue through to the morning of 29 February. As has been the case in previous years, the second meeting will include Finance and Foreign Affairs Sous-Sherpas. I currently envisage a scenario whereby we would meet always in plenary except at meal times when separate arrangements would be made for Sherpas, Foreign Affairs and Finance Sous-Sherpas. As we agreed in November, I will be sending to you by mid-February a paper concerning the main issues for Summit consideration. This paper will serve as the basis of our discussions when we meet in plenary sessions. As at the first meeting, arrangements will be made so that you may address to the appropriate officals any logistical questions that you may have (which may arise out of the first site advance visits in February).

Given the proximity of "La Sapiniere" to Mirabel Airport I would suggest that where possible it should be used as the arrival point in Canada. In this regard, I would be grateful if your staff could inform us as quickly as possible of arrvial and departure arrangements of yourself, of your Sous-Sherpas, and any other accompanying staff so appropriate arrangements can be made for your reception and accommodation.

As has been the tradition in previous Summit circles, I would like to extend my invitation to spouses to join us in

Quebec. "La Sapiniere" offers a wide variety of winter activities in the immediate vacinity (including downhill and cross-country skiing, skating and sleigh rides). As the temperature is likely to be below freezing I would point to the need for warm clothing even if you don't intend to participate in such outdoor activity.

I look forward to your participation as Mrs Thatcher's Personal Representative. As you will know, Sir Robert Armstrong kindly volunteered Leeds Castle as a venue for our third meeting in this Summit cylce. We will want to discuss arrangements when we meet. Until then I send you my cordial best wishes.

Yours sincerely

SYLVIA OSTRY

Mr Nigel Wicks, CBE
Principal Private Secretary
to the Prime Minister
Prime Minister's Office
10 Downing Street
LONDON SW1

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Foreign and Commonwealth Office

London SW1A 2AH

26 February 1988

N L Wicks Esq CBE
10 Downing Street

Dear Nigel,

BRIEFING FOR THE SECOND SHERPAS' MEETING

I have just two final points on the briefing for this weekend's meeting. Geoffrey Littler is discussing some changes to brief No 5 ('Financial Market Mechanisms') with the DTI; if a revised version is not available later today, Geoffrey will brief you on the 'plane.

2. The other point is that you might like to bolster the defence of the Community's decisions on agriculture provided in supplementary brief No 4 with a few statistics: the agreed package of stabilisers should cut the level of EC agricultural support by £205 million in 1988, £853 million in 1989 and £1272 million in 1990, a total saving of £2.3 billion.

Yours ever,

Rodric

R Q Braithwaite

cc Sir Geoffrey Littler KCB
HM Treasury

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NCW.

Imports in the US continue to be stronger than might be expected, because:

- the DM has appreciated less in real terms against the dollar than against the yen, hence the German surplus does not look like being reduced nearly as much as that of Japan;

- the real effective exchange rates of NICS (eg in Chart 1, Korean won and new Taiwan dollar) have depreciated, not

appreciated, against the dollar despite their surpluses;

- because trade surplus countries have had weak domestic economies, either currently or recently, export companies have been able to cut costs and pass on only about 50% of the higher exchange rates in higher dollar prices. In chart 1 a 100% pass-through on import prices would mean that export prices reflected fully the depreciation of the dollar. As can be seen from Chart 1, however, a major gap has emerged between a 100% pass-through import price and actual import price.

As the devaluation continues to have an effect, however, the balance of payments deficit should be reduced.

External Financing and the Dollar

Will the dollar continue to fall or has it fallen enough?

The most precise answer to this question came from Morgan Guarantee. They have a sophisticated analysis of the US balance of payments, very similar to the Fed.

If the dollar were to remain at around 125 yen and DM 1.65, and if the average annual growth rate were to be 2 1/2% in the United States, and 3 1/2% in Japan and Europe together, the US trade deficit would begin to rise again after 1989 and reach $150 billion in 1992. The US current account deficit would be even larger and reach $225 billion in 1992. As a result, on Chart 2, the US net foreign debt (official and private, bonds, equities, direct investment, etc) would be $1.3 trillion by the end of 1992 and rise rapidly even beyond. It is highly unlikely that this is an acceptable financial and political scenario. Assume that the next US President sets as a goal a US current account deficit close to zero by the end of his first term. Assume further that

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the average annual domestic demand growth rate for the United States be contained to only about 1.5%, and that those for Japan and Europe were to be raised to about 4% for 1988-1992. The model indicates that the dollar would then have to be corrected downward by an additional 12% on a real effective basis, or 22% in nominal terms. In this case, US net external liabilities would not rise much above $700 billion.

The assumptions in the analysis need of course not be true: the balance of payments need not balance by 1992; growth in Japan and Europe may fall well short of 4%; and the currencies of the four Asian tigers could be revalued.

But whatever the precise outcome, and however much it improves the US trade deficit looks like being large and therefore needing to be financed for the foreseeable future. This has two major implications:-

(a) direct foreign investment in the US and increased lending by foreign banks to US firms would seem likely to rise;

(b) the growth of consumption in the US is likely to be well below the growth of GDP: in the Morgan guarantee analysis it rises by well below 1% a year for a number of years.

The major lesson is that reducing a balance of payments deficit is never painless.

Europe: selected indicators
percent change per year

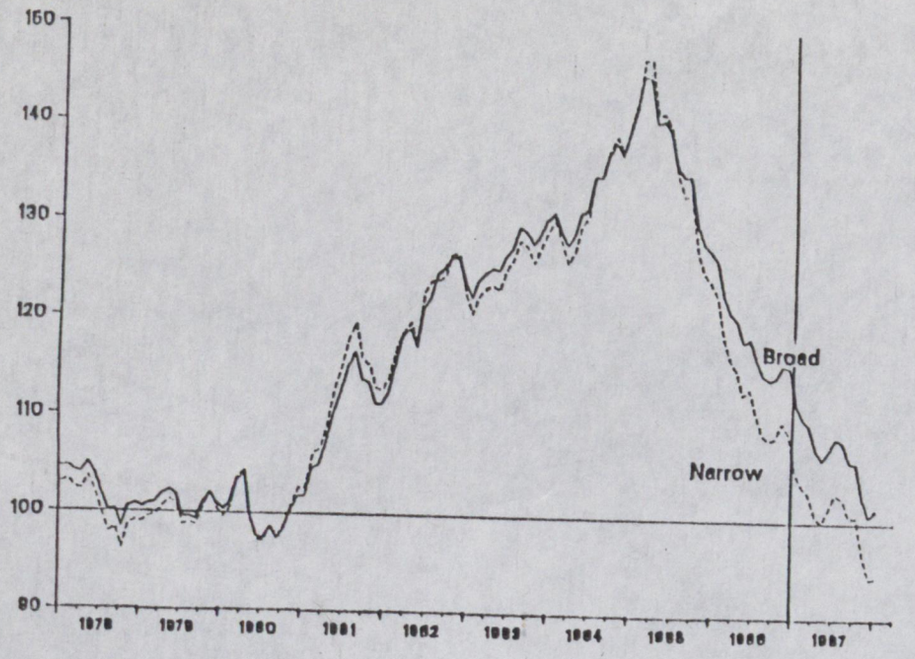
	1986	1987	1988
Real GNP growth	2.5	2.5	2.0
Germany	2.5	1.7	1.6
France	2.0	2.0	1.8
Italy	2.7	2.8	2.2
United Kingdom	3.0	4.3	2.7
Trade balance ($billions)			
Germany	58	73	67
Bilateral with			
United States	13	13	-
EC	24	34	-
France	-2	-8	-10
Italy	5	-1	-5
United Kingdom	-12	-16	-22

The international scene 1987- 88- 89

CHART 1

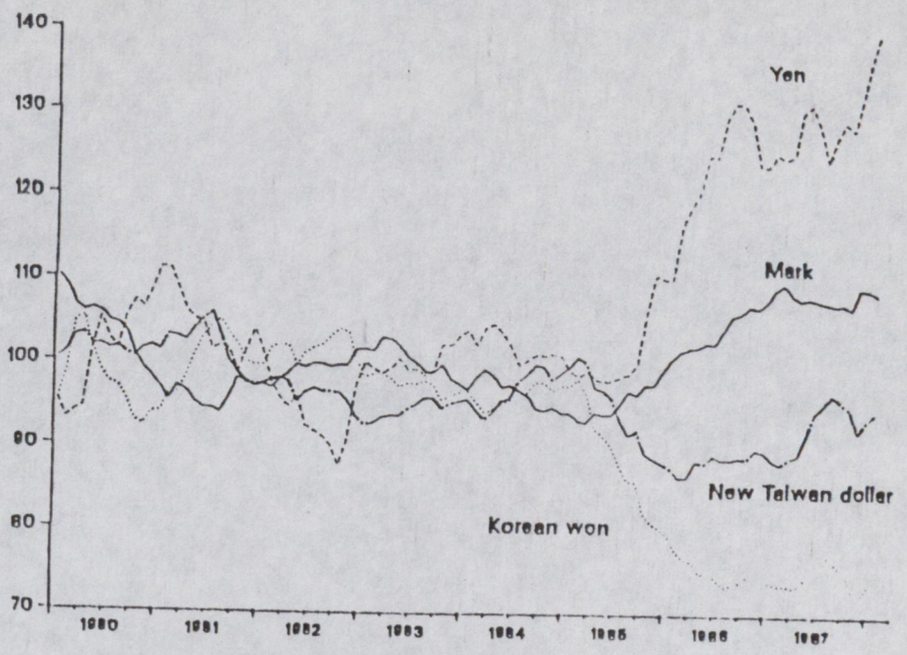
Real effective dollar

Index, 1980=100



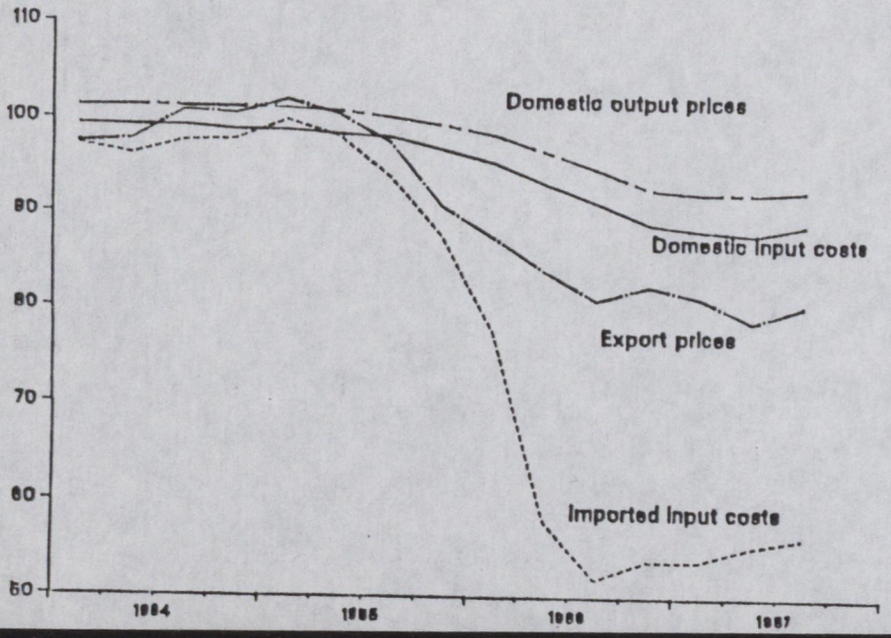
Real effective exchange rates

Index, 1980-82=100



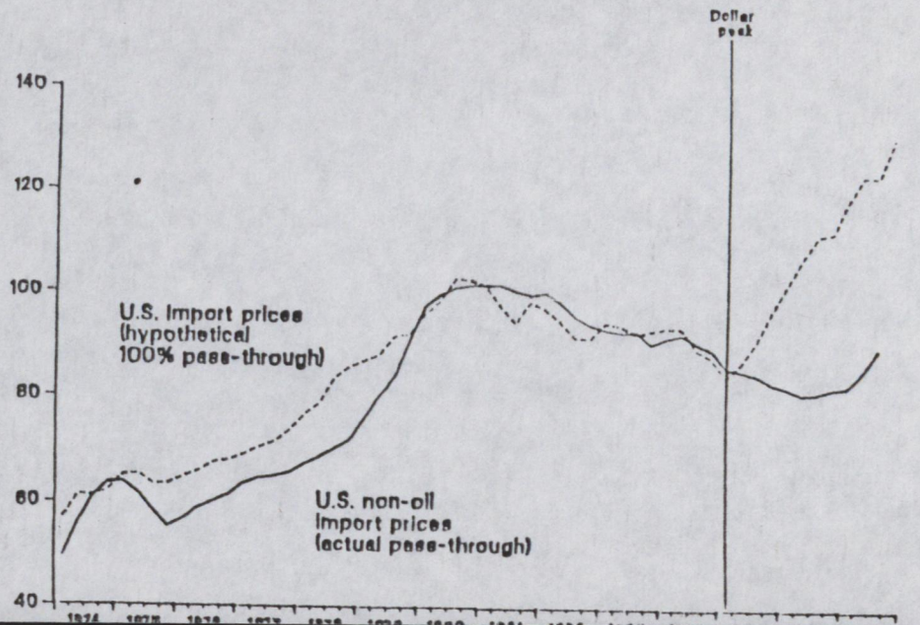
Japan: pricing for exports

1980=100



Import price pass-through

1980=100



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U.S. external financing vulnerability

	U.S. net foreign debt, end-1992		Effective dollar, % change to 1992*	Average annual real GNP growth 1988-92, %		U.S. inflation** 1988-92 average, %	CIF trade balance, 1992 $ bil.	Current account, 1992 $ bil.	Net interest payments, 1992 $ bil.	Peak unemployment	Per capita demand annual average, %
	$ bil.	% of GNP		United States	Japan & Europe						
1. No financing constraint	1300	21	0	2.5 (2.2)***	3.4 (3.5)	4.8	-155	-220	130	7.3	1.2
2. Accelerated cooperative adjustment to zero current account deficit by 1992, with dollar decline front-loaded and faster U.S. and foreign growth	720	11	-22 (-12)	2.3 (1.4)	3.7 (4.1)	5.4	10	0	55	8.2	0.5
3. Less adjustment: dollar decline front-loaded, less foreign growth.	920	15	-16 (-7)	2.3 (1.7)	3.4 (3.7)	5.2	-60	-80	75	8.0	0.6

*Percent change from January 1988 average. Figures in parentheses show the change in real terms.
**Manufactures wholesale prices.
***Domestic demand growth.

Table 6

Break-even exchange rates
(January 1988)

Average government bond yields, percent per annum

	One year	Three years	Ten years
United States	6.67	7.48	8.27
Germany	3.65	4.68	6.26
Japan	4.01	4.23	4.60

Implied break-even exchange rates

	1989	1992	1998
DM/$	1.64	1.56	1.40
Yen/$	125	117	91

Purchasing-power-parity exchange rates*

DM/$	1.48	1.40	1.29
Yen/$	121	113	101

*Notional exchange rates that maintain the bilateral purchasing-power-parity of the dollar at the level reached in the fall of 1980.

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the department for Enterprise

Christopher Roberts CB
Deputy Secretary

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R Q Braithwaite Esq CMG
Foreign and Commonwealth Office
Whitehall
London SW1

Direct line 215 5285
Our ref
Your ref
Date 25 February 1988

Dear Rodric,

JAPANESE PROPOSAL FOR AN INFORMAL MEETING OF TRADE MINISTERS

Thank you for your letter of 22 February file with New in reply to mine of 19 February.

2 In answer to specific points raised in your letter, I have spoken to my French, German and Italian opposite numbers. The French will go along with the new Japanese proposal. The Germans are rather more cautious, and are recommending to Dr Bangemann a solution on the lines of that set out below in this letter. My Italian opposite number had not heard of any approach to Ruggiero (the Italian Minister of Foreign Trade), as the Japanese claim to have made: he undertook to make enquiries, but has not yet come back to me. It looks therefore as if there would not be ready unanimity with the Commission view as set out in Lamy's letter of 16 February to Nigel Wicks.

3 The Germans have also told me that the Dutch may attend the Trade Ministers' meeting in Konstanz next month, in addition to the UK, France, Italy and the FRG. It would not surprise me if the Dutch have protested against their exclusion from these gatherings, and that the Germans have felt obliged to invite them.

4 On the substance of our response to the Japanese, I have consulted my Secretary of State and the Minister for Trade, and the following reflects their views. Your point about the dangers of extending the G7 and Economic Summit machinery is well taken. DTI Ministers believe, however, that it should be possible to avoid this risk while finding a face saving solution for Mr Tamura who has invested his personal pestige, within the Japanese Government, in this initiative and whom my Secretary of State will of course be meeting in Japan in the middle of March, just a few days before the Konstanz meeting. In this

ECON POLICY : Sherpa Admin Feb 88

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context the Minister for Trade has commented that it would be unwise for the UK to be seen as taking any sort of lead in frustrating the Japanese proposal. If others, for example the United States or the Commission, want to put in the boot we would not shed many tears: but we should not take on this task ourselves.

5 Against this background DTI Ministers believe that we should say to the Japanese that we are happy to go along with their proposal for Konstanz, although any gathering limited to G7 Trade Ministers plus the Commission would have to be kept very informal. (Lorenz Schomerus has told me that he is thinking of a late evening drink at which these 8 Ministers will just happen to get together - although we can leave the mechanics to the Germans and the Japanese.) In the view of DTI Ministers, we should go on to say to the Japanese that we see some difficulty about the proposal for a similar meeting in the margins of the OECD Ministerial, since it would risk being seen as an extension of the Economic Summit machinery. In the best Japanese style we would not in terms say either yes or no to their proposal for a meeting in the margins of the OECD Ministerial, but rather point to the difficulties and avoid giving any commitment to take part. The Japanese will get the message, and it will save the embarrassment of an outright refusal.

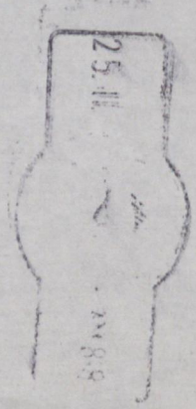
6 DTI Ministers hope that the UK Sherpa team will be able to follow this approach if the issue comes up at your meeting in Canada this week-end. Although I have promised to give a reply to the Japanese Embassy in London before long, I do not propose to do so until next week, after I know the outcome of any discussion among the Sherpas. Perhaps you would let me know on your return what was said on this subject.

7 I am sending copies of this letter to Nigel Wicks (10 Downing Street) and Geoffrey Littler (Treasury).

Yours ever

Christopher.

C W ROBERTS



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Direct line 215 5285
Our ref
Your ref
Date 25 February 1988

Dear Rodric,

JAPANESE PROPOSAL FOR AN INFORMAL MEETING OF TRADE MINISTERS

Two additions to my letter to you of earlier today. — with NCW?

2 As I mentioned to you on the telephone, my Italian opposite number (Sardi) telephoned to say that, as far as he was able to discover, the latest Japanese proposal had not been put to the Italian Government. He had, however, spoken to his Minister (Ruggiero). The Italians were opposed to any extension of the Economic Summit arrangements, but would see no difficulty in an informal gathering in the margins of the Konstanz meeting.

3 I had lunch today with Jim Taylor, the Economic Minister at the Canadian High Commission. He told me that the Canadian Prime Minister was (as we knew) firmly opposed to any meeting of Trade Ministers linked in time or location to the Economic Summit. However, the Canadians had independently reached much the same conclusion as DTI Ministers, namely that an informal discussion between G7 Trade Ministers and the Commission in the margins of Konstanz would be a convenient way to save the face of the MITI Minister with no risk to the existing arrangements for Economic Summits.

4 It may be therefore that a consensus can be built around the approach set out in my earlier letter.

5 I am sending copies of this letter to Nigel Wicks (10 Downing Steet) and Geoffrey Littler (Treasury).

Yours ever

Christopher.

Pl. file (PM's visit to Economic Summit)

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CP.

Some (fairly obvious) material for the PMs speech in Canada to the business group.
N.L.W
25-2

25 February, 1988

Mr. N.L. Wicks, CBE,
Principal Private Secretary
to the Prime Minister,
Prime Minister's Office,
10 Downing Street,
London, S.W.1.

Dear Nigel,

It was good to get together the other evening and talk about the Summit, and the sorts of issues which you and your fellow Sherpas will be covering this weekend at La Sapinière.

You asked about Canadian investment in the U.K. and I have attached a very brief note dealing, not only with the Canadian corporate presence here in Britain, but also some highlights of British investment in Canada. Two-way investment has been a real growth area in the last few years between our two countries, sparked by the new policy which Brian Mulroney brought in in 1984, to welcome foreign investment in Canada and, of course, the very lively performance of the British economy this decade and its obvious attraction as a point of accessing the European Community. Similarly, Canada is increasingly attractive for British firms to cover the whole North American market from their corporate presence in Canada, an attraction now enhanced with the prospect of the Free Trade Agreement between the U.S.A. and Canada, coming into force in January.

Enjoy your stay in my home province and look forward to seeing you on your return.

Yours sincerely,

L. James Taylor,
Minister (Commercial/Economic)

Enc:

LJT/pm

CANADIAN INVESTMENT IN THE UK

There are more than 160 Canadian companies in the UK with investments valued at $3.85 billion (£1.75 billion). This represented 7.6% of Canada's total direct investment abroad but more than one-quarter of Canada's offshore (non-USA) investment. An estimated 100,000 jobs in the UK are supported by Canadian investment.

Some leading Canadian holdings in the UK include:

- Bell Northern Research
- Northern Telecom/STC
- British Alcan Aluminium
- Massey Ferguson (Varity)
- Moore Paragon UK

Plus virtually all major Canadian banks, investment houses, insurance and trust companies; legal, accounting and management consulting firms.

BRITISH INVESTMENT IN CANADA

The UK is the second largest foreign investor in Canada with holdings valued at $10.17 billion (£4.6 billion) at the end of 1986. Two-thirds of the 150 largest UK companies have Canadian operations while there are some 1160 UK subsidiaries in Canada in total.

From the establishment of Investment Canada Act (June 30, 1985) to December 31, 1987, Investment Canada records 238 UK-origin investment cases. These comprised 52 new businesses (£34.2 million) and 186 acquisitions (£2.69 billion). The value of UK acquisitions in Canada has been sharply accelerated through such major deals as British Gas - Bow Valley ($500 million), Allied Lyons - Hiram Walker/McGuiness ($2.7 billion), Ultramar - Gulf ($400 million) and British Telecom - Mitel ($300 million).

OP

H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-270 3000
Direct Dialling 01-270 4329

Sir Geoffrey Littler KCB
Second Permanent Secretary

24 February 1988

Dear Nigel,

SUMMIT PREPARATIONS

This is extra reading for the plane journey on Saturday - if you are not already overloaded!

It is a short letter from Balladur to the Chancellor, and it will have been sent in parallel to other G7 Finance Ministers, enclosing a rather well-written French paper arguing for moves towards a system of fixed exchange rates.

I doubt whether this will be brought on to the agenda for the Summit by the French, and I would think it best handled first among Finance Ministers in any case. But there could be some references to it, and I thought you and Rod Braithwaite would like the chance to see a sub rosa copy now.

Yours,

Geoffrey

Nigel Wicks Esq CBE
10 Downing Street.

E.A. DIR. DU TRESOR 1988-1-22 04:58 03-48 5 #2

Le Ministre d'Etat
Ministre de l'Economie des Finances
et de la Privatisation

22 FEVR. 1988

Mister Chancellor and dear Nigel,

As you will remember, I had sent to you on October 22, 1987, some first thoughts on last year's financial crisis. I insisted, in particular, on the need for a concertation and an international coordination still stronger than had previously been the case.

Owing to the sense of responsibility and cooperation demonstrated by our countries, it has been possible to overcome the difficulties. This was a first result and certainly a very important one, if one considers that we were facing the most serious financial crisis since the second world war.

This success, which naturally has to be consolidated, should encourage us to go further.

In this respect, you will find hereafter a paper on the rebuilding of the international monetary system, which I intend to make public very shortly.

As you will observe, it was not my goal to outline a detailed draft of reform, but rather to suggest that we start now thinking about it, with no solution being excluded, in an open and pragmatic mind.

In this prospect, I propose that we agree on the constitution of a small group of eminent personalities, with undisputed moral authority and having demonstrated their capacities in the economic, monetary and financial fields.

In any event, I propose that we discuss this subject together, in Washington, during our next meeting of April 13, 1988.

Please accept my best regards.

E. BALLADUR

22 février

REBUILDING AN INTERNATIONAL MONETARY SYSTEM

Since the 1960s, the world's industrialized countries have gradually abandoned the discipline of stable exchange rates based on the gold exchange standard in favor of floating exchange rates.

That system has been a failure. In the final analysis, proving devoid of discipline or constraints, much too tolerant of poorly managed economies, and ultimately harmful for the world economy. Floating exchange rates are probably one of the essential causes of the economic disorders of the past 15 years : variations in the price of oil and raw materials, trade imbalances, financial anarchy brought about by international speculative capital flows, indebtedness.

The merits attributed to floating exchange rates in the early 1970s have not been borne out :

- When they were introduced, it was said that balance of payments adjustments would be facilitated, but not only have imbalances not disappeared, they have become worse.

- It was thought that speculation would be curtailed. On the contrary, never has it assumed such proportions nor had such destabilizing effects.

- It was believed that market forces, at last left to their own devices, would determine the correct exchange rate balance. But never have imbalances been so great, nor fluctuations so wide and erratic and so little justified by economic fundamentals.

- It was hoped that autonomy in economic and monetary policy would be preserved, allowing each country free choice of its monetary policy and rate of inflation. Facts have cruelly belied this illusion.

Those countries with primary responsability for the world economy now recognize the need for international cooperation. Last year's Louvre Agreements marked the beginning of the end of the floating exchange rate system. Concluded a year ago this week, by the US, Japan, France, Britain, West Germany, Canada and Italy, they contain two complementary aspects : the coordination of economic policy, and more stable exchange rates.

The seven signatories have agreed to policies aimed at reducing their internal and external imbalances. Thus they are making a contribution to stabilizing their exchange relations, jeopardized by the highly excessive deficits and surpluses that have developed in recent years. Moreover they are ready, if need be, to intervene on exchange markets.

Over the past year, the Louvre Agreements have been reconfirmed and adjusted, as required by economic and market developments. On December 23, 1987, the seven countries published a joint declaration, and agreed upon secret exchange rate clauses. This declaration is really a second Louvre agreement, occurring after the Autumn financial upheavals and containing the measures adopted in response. Economic policy commitments have been adapted and strengthened, including those of central banks.

With Louvre Agreements 1 and 2, the seven major industrialized countries have shown that they agree on the collective management of exchange rates and coordination of their economic policies, in the absence of a true international monetary system. It is thanks to this spirit of responsability and cooperation that it was possible to overcome the recent financial crisis, the most serious since World War II. This represents major progress compared with the situation prevailing two years ago.

Thus a first milestone has been reached on the road to rebuilding an international monetary order, though it rests on the will and ability of governments to impose self-discipline. Beyond this stage, how might one envisage a true international monetary system with a

standard unit of value, automatic mechanisms and sanctions that would be beyond the control of the countries involved ? The time is ripe for dispassionate consideration of this issue, since inflation has receded and the Louvre Agreements are working well.

There are three possible approaches. Each has advantages and disadvantages.

INTERNATIONAL COOPERATION

The first approach is a system based on international cooperation building on the spirit of the Louvre Agreements.

Their enforcement requires close surveillance of each of the major economies on the basis of such economic indicators as growth rates, inflation rates, fiscal balance, balance of payments, interest rates and exchange rates. This surveillance already is being established gradually .

It would be conceivable to perfect the Louvre Agreements by strengthening economic coordination, in budgetary matters for example, by strengthening cooperation among central banks, particularly on interest rates, and if need be by publicly announcing ranges for exchange rate fluctuations.I shall not dwell on the advisability of such measures.

A problem arises however in trying to perfect the decision-making mechanism.

The ultimate effectiveness of a system based on international cooperation such as the Louvre agreements rests on the willingness of the participating countries to agree. Would they be prepared to sacrifice some measure of national sovereignty ?

How can one build a system comprising automatic mechanisms and sanctions, the enforcement of which would be beyond the control of individual governments ? There is no doubt that while the Louvre system represents major progress over the anarchy of floating

exchange rates. it does not constitute a true international monetary system.

A WORLD EMS

The second possible approach is to build an exchange mechanism similar to the European Monetary System. The EMS, created in 1979, was Europe's response to international monetary disorders and was designed to provide protection for intra-European trade. It offers an illustration of automatic mechanisms and sanctions that could be restored at a world level.

The first feature of an EMS-style world monetary system is a monetary reference unit.

The monetary reference unit of the EMS is the ECU, a weighted average of european currencies, in relation to which all EMS currencies are defined. Similarly, a world EMS would need a basket of international currencies to serve as the standard for the new system. This is not a new idea. The Special Drawing Right or SDR, which was defined in 1974 as a "basket of international currencies", would work well as a world monetary reference unit. The SDR currently contains five currencies : the dollar, yen, pound , mark and franc.

(It should be pointed out that, as in the EMS, a world monetary reference unit would not be used as the main reserve and settlement instrument : national currencies would retain their international role in those respects).

The second feature of an EMS-style world monetary system is an automatic mechanism.

In the EMS, each country is required, to adhere to margins of fluctuation established around the "central" rates defined for each currency. The same would need to apply to a world EMS. Each central bank would have to be ready to intervene on exchange markets to ensure that its currency did not exceed its limits vis-à-vis another currency. This also is not a new idea. The Bretton Woods system included such

intervention obligations. (In fact, the fluctuation margins within the EMS - 2.25 % - are the same as the ones authorized by the Bretton Woods system as of December 18, 1971).

The third feature of an EMS-style world monetary system is sanctions.

Each central bank, under the obligation to intervene to maintain the value of its currency, would thus be made to spend its reserve assets or to borrow from its partners predetermined amounts in their currencies if its own currency were subjected to downward pressure. The lowering of exchange reserves would in and of itself be a form of sanction.

Moreover, if a parity realignment were required, it could be made only by mutual consent, and after examining the economic policies followed by all. This could be done under the aegis of , for example, the IMF. Devaluation or revaluation of a currency could not be decided unilaterally, from a unilateral decision. Monetary and economic adjustments would go hand in hand.

Again, there is nothing new about such sanctions in the world monetary system. The Bretton Woods agreements restricted each country's leeway to modify its par value and required IMF authorization for realignments exceeding certain limits.

The advantages of an EMS-style world monetary system, in which a world currency made up of a basket of currencies would be the reference monetary unit instead of the dollar, would be substantial when compared with those of the Louvre system. A monetary unit with universal scope would give the system the beginnings of a standard, which does not exist in the Louvre framework. The automatic mechanisms and the sanctions would be both known to all, and institutionalized, whereas the Louvre Agreements rest on constant appraisal of the "meeting of the wills" of the major countries.

Such a system would not however be flawless.

First of all, it would not provide built-in guarantees against an inflationary drift of all the currencies. Second it probably would contain certain asymmetries similar to those of the Bretton Woods system since a national currency could continue to play a dominant role both as a reserve and a settlement instrument.

In all, while a world EMS would represent major progress over the Louvre system, is it possible to go still further, in the direction of an even more objective system including automatic mechanisms and sanctions beyond the control of governments ?

A MONETARY STANDARD

The third approach is that of a system organized around a standard that would play the role of main world reserve asset.

The historical model for such a system is the 19th century gold standard, under which all currencies were defined on the basis of their gold content. All currencies in the system were freely convertible into gold.

Under a pure gold standard , the first automatic mechanism is that parity fluctuations are maintained naturally, without central bank intervention on exchange markets, within narrow bands defined by the "gold points". International settlements can be made at any time either by purchasing foreign exchange on the exchange markets, or by physically transferring gold. The band within which par values may fluctuate on exchange markets is limited by the two extremes defined by the central rate (the gold content ratio between two currencies), to which is added and subtracted the cost of physically transferring gold.

In the same fashion, the second automatic mechanism is that monetary inflation in each country is a direct function of gold transfers. A country with a large deficit has an unbalanced exchange market ; its gold is gradually transferred to surplus countries. The contraction of a nation's money supply - directly linked to the stock of gold at its central bank - leads to recession and lower prices. The counterpart to this contraction in surplus partner countries is credit expansion due to

the inflow of gold which leads to a higher level of activity and prices. Thus the competitiveness of the deficit country rapidly improves and its foreign trade balances out.

If such a system were applied today, countries with large deficits would be driven to important changes in their monetary policies and therefore in the level of their economic activity, surplus countries would be led to reverse changes. The gold standard -along with its automatic mechanisms and sanctions would be objective and beyond the control of governments and monetary authorities, who would be obliged to adapt their policies, on the basis of the results of their balance of payments.

Let us be realistic. The actual operation of the gold standard was in fact far more complex than the short summary just presented - in particular each country could always try to circumvent the discipline of the system by modifying the gold content of its own currency. This model of the gold standard would today give rise to very serious problems of enforcement. First the amount of gold available today depends on the gold producing countries, which are in a position to determine quantities and prices, and which do not necessarily share the values of the Western world. Second although the gold standard, in its purest sense, implies free convertibility into gold, internally as well as externally, no central bank today would be ready to restore the internal convertibility of its currency, a policy that was abandoned beginning with the 1930's. Finally, in every country today there is a consensus to limit inflation as much as possible. It would be difficult to implement a system that uses price increases in countries with surpluses as the major factor in restoring external equilibrium.

Once again, let us be realistic : no Central Bank is willing to relinquish its gold reserves. That proves how important holding gold still is to governments. Furthermore, gold is still valued by the market. In spite of the difficulties mentionned above , is it possible to rebuild a true system without allowing gold to play a role ? I for one do not believe so.

Could we today establish a monetary standard, automatic mechanisms and sanctions that would be just as objective and indepencent of governments ?

There are two possibilities : an objective standard, comprising gold and if it is possible commodities (a suggestion made last year by the U.S Treasury Secretary, James Baker) or a world currency based possibly on a basket of currencies to which gold might be added. Studies by the Committee of Twenty at the beginning of the 1970s could serve as inspiration. The Committee considered how to devise a reserve instrument with constant real value, in other words an instrument that would be revalued every year on the basis of world inflation.

What about automatic mechanisms ? One possibility would be to let the standard to act as the main world reserve asset. For that to be possible, it would be necessary for each national currency to be convertible into the world currency at a fixed exchange rate. Settlements among central banks would be made by transferring the world currency, the reserve asset held by each national central bank and the central reserve asset of the system.

What sanctions would apply ? The automatic mechanism would include its own sanction, as the system based on the gold standard. No country could remove itself from the external constraint, since all countries would have to maintain their solvency in the world currency.

If such a system was already in existence countries with external deficits would have lost their reserves of world currency. They would have to replenish their reserves to become solvent again and thus would be forced to adjust their economic policy, or failing that, their exchange rate in agreement with their partners. The latter should of course be exceptional. Technical modalities could make it possible to have a symmetrical constraint on surplus as well as on deficit countries.

Such a system - with a stable world currency as the main instrument of reserve and settlement - would have three advantages over

a world EMS : it would be more objective, more automatic and more symmetrical.

Its disadvantages would be related to the difficulties of implementation - the technical difficulty of defining a world currency and its rules of issuance and convertibility, and the very serious political difficulty of making it acceptable to all participating countries. The system would imply that the new standard of reference and value would gradually be recognized and accepted by all, so that governments and monetary authorities could not depart from it without being called to order, not only by an international body, but also by their own economic agents.This raises the whole problem of internal convertibility.

When all is said and done, will not the choice among these three approaches, which introduce an increasing degree of constraint into national economies, depend above all on the degree to which each country will be willing to join in international cooperation and relinquish national egotism ?

None of these three approaches is intended as a definite plan for reforming the international monetary system. But I think that the leaders of the major economies now have the duty to ponder the system best adapted to today's world. In this area as in others, it is the duty of decision-makers to prepare for the future, by studying all possible solutions in an unbiased manner.

Money is at the heart of all the political and social problems. It must not be handled solely by specialists. It is also a matter of policy.

How is it possible not to see the extent to which the Western World has been weakened over the past 15 years, by the monetary and economic disorders caused by the refusal to accept a common discipline ? How is it possible not to see that the economic crises we have suffered, inflation, indebtedness, fluctuations in the price of oil and raw materials, are bound up with monetary disorders ? How is it possible not to fear that these disorders may lead to political and social turmoil in all countries, be they industrialized or developing, turmoil that could alter the balance of the world ?

Inflation has been largely brought under control in the main industrialized countries. Thus, for the first time in fifteen years, this prerequisite for the restoration of an international monetary system has been fulfilled.

I would like the governments to work together to find answers to the questions I have put forward here. I would like us to do so with the greatest of caution and realism but also, with imagination and boldness. That is why I propose that the international community entrust a small group of distinguished people of unquestionable moral authority who have proven their economic, monetary and financial competence with the task of lighting our way.

The point is not to resuscitate an ideal state that has never existed. Order and freedom go together. Economic freedom will have little hope for the future unless it is based on a world order accepted by all and binding for all.

Handed round at Sherpa's meeting on 29 Feb.

NEXT MILESTONES

March 9-10	EPC WP III
March 18-20	Lake Konstanz Trade Mins.
March 21-25	Paris Club
March 22-23	EPC WP I
April 6-7	OECD S-T Forecasters
April 7-8	OECD Trade Committee
April 14-15	IMF-IBRD Meetings
April 15-17	Trade Mins Quadrilateral
April 24	French Elections - 1st round
April 28-29	OECD EPC
May 2-3	OECD ECSS
May 8	French Election - 2nd round
May 18-19	OECD Ministerial
May 19-21	3rd Sherpa meeting (Paris)

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Foreign and Commonwealth Office

London SW1A 2AH

24 February 1988

N L Wicks Esq CBE
10 Downing Street

Dear Nigel,

BRIEFING FOR THE SECOND SHERPAS' MEETING

In my letter of yesterday I promised you additional briefing, which I now enclose, on the recent decisions taken by the Community on agriculture. The Commission will no doubt offer a vigorous defence of the European Council agreement: the Canadians for one are likely to level the criticism that it does not amount to very much. We shall want to come in with strong support. The attached supplementary brief should provide you with some useful ammunition.

Yours ever,

Rodric

R Q Braithwaite

cc Sir Geoffrey Littler KCB
HM Treasury

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TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES
27-29 FEBRUARY 1988

BRIEF NO 4: TRADE AND AGRICULTURE
SUPPLEMENTARY BRIEF: CAP REFORM AND THE URUGUAY ROUND:
AND ROLLBACK

POINTS TO MAKE

CAP REFORM AND THE URUGUAY ROUND

- The agreement on CAP reform reached at the European Council on 11-12 February sets effective limits on CAP support and will ensure better control and slower growth of EC agricultural spending.

- This represents important move by the EC towards objectives defined at Punta del Este: reducing structural surpluses, cutting subsidies and making agriculture more responsive to market forces.

- The guideline limiting EC spending on agriculture has been reinforced and will now be legally binding. It will in future rise more slowly than Community GNP (at 74% of the latter). The proportion of EC budget expenditure devoted to agricultural support will therefore decline.

- Stabilisers now adopted for all agricultural products covered by CAP regimes (those for non-arable products confirmed by FAC on 22 February).

- Community will rightly take credit in GATT for the Brussels reforms. Look to other GATT Contracting Parties to make similarly constructive contributions.

(if necessary)

- The statement annexed to the Brussels European Council agreement on the finance/CAP reform package (implying inter alia that CAP reforms adopted since 1986 and those agreed in Brussels discharged the Community's OECD and Venice Summit commitments on agriculture) is intended primarily as a signal to other contracting partners that they should recognise EC achievements and make similarly positive contributions; and also as a deterrent to others against action in breach of OECD/Venice commitments.

ROLLBACK

- Foreign Affairs Council on 22 February approved Commission proposal on rollback (ie reductions in non-tariff barriers) for tabling in Geneva. This covers a range of quantitative restrictions operated by individual EC member states against third country trading partners.

- Constructive contribution to the Uruguay Round negotiations: looking to others to put forward similarly positive offers.

European Community Department (External)
February 1988

BACKGROUND

1. The agricultural package agreed at the European Council results from a UK initiative (stabilisers) and considerable Anglo-Dutch pressure, sustained up to and at the European Council.

2. The "guideline" which limits EC spending on agriculture has been reinforced and will now be legally binding. It will in future rise more slowly (74%) than Community GNP, and thus Community resources (for the ceiling on own resources has now been fixed as a proportion (1.2%) of total EC GNP). The proportion of EC budget expenditure devoted to agricultural support - now some 70% - will therefore decline - to some 55%.

3. The 1984 provision for exceptional circumstances (which proved to be a substantial loophole in the earlier guideline) has been ended. The only provision for spending in excess of the guideline is an automatic symmetrical scheme - the monetary reserve - to take account of the effects of the CAP of major (ie above 5%) fluctuations - in either direction - in the dollar-ECU exchange rate.

4. On cereals, penalties for production above the threshold (maximum guaranteed quantity) have been toughened cf the deal on offer at Copenhagen: the regime will now run for four years (not three), and the intervention price in the following year will be reduced by a full 3% (cumulative over the period) after any year in which production exceeds the threshold (maximum guaranteed quantity) even if the excess were only one tonne. Moreover the MGQ has been set at a level (160m tonnes) 8m tonnes below the forecast 1988 harvest, and 11m, 14.5m and 18m tonnes below the 1989, 1990 and 1991 forecast harvests. (We argued for a still lower MGQ, but at Brussels traded our agreement to 160 for the toughening of the stabiliser mechanisms: given the forecast harvests this plainly made sense, even though the effect on farmers' intentions of the prospective price cuts is likely over time to reduce production well below current forecasts.)

5. On oilseeds and proteins, MGQs of 4.5, 2.0, 1.3, 3.5 million tonnes for rapeseed, sunflower seed, soya and protein products respectively contrast with forecase harvests of 6.3, 2.7, 1.7 and 3.6 million tonnes (1988) and 6.4, 2.9, 2.0 and 4.0 million tonnes (1989 and 1990). There will be automatic in-year price cuts of 0.45% (1988) and 0.5% (subsequent years) for each 1% by which production exceeds these levels. At the forecast harvest levels, there will thus be large price cuts this year.

6. A comparable package of stabilisers on non-arable products (olive oil, cotton, sugar, wine, fruit and vegetables, tobacco, milk and sheepmeat) was approved at the Foreign Affairs Council on 22 February.

7. In addition to the European Council statement referred to in the points to make, a further statement in the European Council conclusions speaks of pressing for "an appropriate solution" to the problems of imports into the EC of cereal substitutes, oilseeds and proteins. This echoes language in the EC's agriculture papers (not formally approved by the Council) tabled by the Commission in Geneva. Any EC protectionist measures of this kind would be strongly resisted by other GATT Contracting Parties. Britain, the Netherlands and Italy (who together would constitute a blocking minority) made it clear in a separate statement for the minutes that they would not be bound by protectionist elements in these declarations.

Rollback

1. The Commission offer was agreed at the Foreign Affairs Council on 22 February. It will now be tabled in Geneva, as a contribution to the Uruguay Round. Like offers tabled by the EC and other Contracting Parties on other aspects of the negotiations, it is conditional on other major trading partners making similar contributions, so that the burden of rollback is fairly shared. The offers on products of interest to Japan and Korea (a few of the former are included, despite Italian reluctance) are specifically conditional on the implementation of satisfactory commitments by these two countries.

Canadian High Commission

Haut Commissariat du Canada

23rd February, 1988

Mr. Nigel Wicks, C.B.E.,
Principal Private Secretary to the Prime Minister,
Prime Minister's Office,
10 Downing Street,
LONDON,
SW1.

Dear Mr. Wicks,

As our second meeting in preparation for the Toronto Summit is now drawing near, I take this opportunity to send you a proposed programme of discussions which will serve to guide our conversations. As you will see, it is my intention that we meet in plenary sessions with sous-sherpas, except at meal times.

You will by now have received a copy of the "Issues for Discussion" paper which we circulated last week. I hope that when we meet in plenary we will address the specific questions which it raises, and any additional comments or questions you may have. As you will see, I have set aside time at our final meeting on Monday morning for us to attempt to bring together the "Views of the Meeting", and to outline our workplan towards our third meeting.

I look forward to seeing you soon and to a useful and productive meeting at La Sapiniere.

Yours sincerely,

Sylvia Ostry

Attachment

PROGRAMME OF DISCUSSION

MEETING OF SUMMIT PERSONAL REPRESENTATIVES

FEBRUARY 27-29 1988

LA SAPINIERE, QUEBEC

SATURDAY, 27 FEBRUARY:

MORNING/EARLY PM	ARRIVAL OF SHERPAS, SOUS-SHERPAS, SPOUSES AND ASSISTANTS AT MIRABLE AND DORVAL AIRPORT, AND TRANSPORT TO LA SAPINIERE
19:30	OPENING RECEPTION (ALL PARTICIPANTS, SUPPORT STAFFS AND SPOUSES)
20:30-22:30	SEPARATE DINNERS FOR SHERPAS, FOREIGN AFFAIRS SOUS-SHERPAS AND FINANCE SOUS-SHERPAS (SPOUSES TO DINE SEPARATELY)

SUNDAY, 28 FEBRUARY:

07:30-08:30	BREAKFAST (FREE)
09:00	FIRST PLENARY
12:00	ISSUES FOR DISCUSSION PAPER: MACROECONOMIC SITUATION: - CURRENT OUTLOOK - PROSPECTS FOR CO-ORDINATION STRUCTURAL POLICIES
12:15-13:45	SEPARATE LUNCHEONS FOR SHERPAS, AND RESPECTIVE SOUS-SHERPAS
13:45-14:45	SLEIGH RIDE
14:45-18:00	SECOND PLENARY
14:45-15:39	BRIEFING ON LOGISTICS (45 MINUTES)
15:30-18:00	ISSUES FOR DISCUSSION PAPER: MTN: - AGRICULTURE - MID-TERM MINISTERIAL REVIEW DEBT ISSUES
19:30-22:00	SEPARATE DINNERS

PROGRAMME OF DISCUSSION

CONTINUED

MONDAY, 29 FEBRUARY:

08:00-09:00	BREAKFAST (FREE)
09:00-11:45	PLENARY MEETING:
	VIEWS OF MEETING ON POSSIBLE DIRECTIONS FOR THE DRAFTING OF THE THEMATIC PAPER
	MILESTONES TOWARDS LEEDS CASTLE MEETING
12:00-13:00	LUNCHEON (FOR THOSE WITH LATE AFTERNOON DEPARTURES)
14:00	HOTEL CHECKOUT
	DEPARTURES ACCORDING TO FLIGHT ITINERARIES

FOR INFORMATION:

LA SAPINIERE - TELEPHONE NO: (819) 322 2020
- FAX NO: (819) 332 6510

AE

Foreign and Commonwealth Office

London SW1A 2AH

23 February 1988

N L Wicks Esq CBE
10 Downing Street
SW1

Dear Nigel,

at top of file

Thank you for your letter of 23 February, enclosing the communication from Lamy.

2. Lamy's argument is not unexpected. It is pretty much the one set out in paragraph 3 of my letter of 22 February to Christopher Roberts.

3. The Commission may want to get the European participants lined up before we all meet in Canada this weekend, in order to ensure that the Japanese face a common front. I would be content if you were to reply to Lamy before the weekend, agreeing with his arguments. But Christopher Roberts will wish to express his views first: I believe that he is consulting his Ministers.

Yours ever,

Rodric

R Q Braithwaite

cc Sir G Littler KCB, HM Treasury
C W Roberts Esq CB, DTI

ECON POLICY: Sherpa Admin: Feb 88

CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH

23 February 1988

N L Wicks Esq CBE
10 Downing Street
SW1

Dear Nigel,

BRIEFING FOR SECOND SHERPAS' MEETING (in attached folder)

I enclose a set of briefs for the meeting this weekend in Quebec province. The only departure from the list we agreed is a separate brief on the Canadian 'Issues for Discussion' paper: Sylvia Ostry may wish to take us through it section by section, so you may find it helpful to have short, page by page comments - many of which are drawn from Geoffrey Littler's commentary which you have already seen - in addition to the individual briefs.

2. As I suggested in my letter of 5 February, brief nos 6 - 11 are very much for your background information; I do not expect political issues to come up at this stage.

3. Perhaps we could discuss after the meeting whether you are happy with this style of briefing, so that I can put in train any changes you might like before the next Sherpas' meeting in May.

Yours ever,

Rodric

R Q Braithwaite

cc Sir Geoffrey Littler KCB
HM Treasury

P.S. I have asked the Dept to produce additional briefing on agriculture and roll back/quotas, since recent decisions in the Community are likely to be of particular interest to our non-European colleagues.

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TORONTO ECONOMIC SUMMIT, SECOND MEETING OF PERSONAL REPRESENTATIVES 27-29 FEBRUARY

BRIEF NO 1: SUMMIT ORGANISATION

OBJECTIVES

1. To reiterate Prime Minister's preference for traditional Summit format but to avoid detailed discussion of Summit logistics.

2. (If raised) To oppose any change in dates for the third Sherpas' meeting and to emphasise costs involved in cancelling Leeds Castle booking.

POINTS TO MAKE

Summit Format

1. My Prime Minister firmly in favour of maintaining traditional Summit format. What are Mr Mulroney's current plans?

Summit Logistics

2. (If raised) Discussions of logistics best left to experts who will be reporting to capitals on their recently completed reconnaissance tour.

Third Sherpas' Meeting - Leeds Castle

3. Arrangements in hand; at advanced stage; good co-ordination between UK officials and Canadian High Commission. (If raised) Too late to consider cancellation now; we should stick to agreed dates.

BACKGROUND

1. Summit Format

In her reply to Mr Mulroney's letter to Summit leaders of 12 January proposing an earlier than usual start to the Summit and a CHOGM-style' retreat', the Prime Minister stated firmly that she preferred to maintain the traditional format. (This entails a minor change to her suggestions, viz separate meetings on the morning of the first working day and plenary in the afternoon, rather than vice versa.) We understand that most Canadian officials are also against a retreat.

2. Summit Logistics

A reconnaissance team from Protocol Department, the Cabinet Office and No 10 Downing Street are going to Toronto on 22 February, and during the week will be meeting the Summit Management Office to cover all aspects of the administrative arrangements. They will report on their return.

3. Third Sherpas' Meeting

This is to be held at Leeds Castle on 15-17 May, and is being organised jointly by No 10 and Cabinet Office, together with the Canadian High Commission. A secretariat for the meeting will be provided by the Canadians, though we will be called upon to provide a co-ordinator. A draft working programme is attached. The French Sherpa, Attali, has advised Dr Ostry that the agreed dates would pose 'grave difficulties' for the French, in the light of the Presidential elections on 8 May; he suggests holding the meeting one week later, 22-24 May. The Italian Sherpa, Sarcinelli has supported the French line; the Japanese however are opposed to any change. Dr Ostry hopes to clear up the matter before the second Sherpas' meeting and has written to Attali to inform him that there is no consensus among the other Sherpas to change the agreed dates. Any change would involve cancelling the Leeds Castle booking and thus incurring cancellation charges.

PROVISIONAL PROGRAMME

Sunday 15 May

6.00 pm	Informal Reception
7.30 pm	Dinner

Monday 16 May

8.00 am	Working Breakfast
9.30 am	Plenary Meeting
12.30 pm	Drinks
1.00 pm	Lunch
2.30 pm to 5.30 pm	Plenary
7.30 pm	Drinks and Working Dinner

Tuesday 17 May

8.00 am	Working Breakfast (Sherpas only)
9.00 am	Plenary Meeting (possible but unlikely)

If not, all will pack bags and depart.

if.15.18.2

TORONTO ECONOMIC SUMMIT
SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 2. WORLD ECONOMY

OBJECTIVES

1. To counter excessive gloom or alarm about prospects following the Stock Market collapse.

2. To welcome the progress being made in achieving adjustment of trade imbalances, through policies set out in the G7 Agreements, and the need to get this progress more widely recognised.

3. To reaffirm commitments to the adjustment policies to promote further progress.

4. To stress importance of continuing to maintain exchange rate stability.

5. To stress importance of structural policies for improving economic performance.

6. To avoid Summit (or even Sherpa) discussions getting involved in detailed discussion of indicators - although taking the opportunity to promote the idea that global indicators are potentially useful.

POINTS TO MAKE

1. Indicators to appear since the Stock Market collapse show continuing strong economic activity, particularly in the US and Japan and UK.

2. On all major forecasts, 1988 is expected to be sixth consecutive year of growth in world output and trade.

3. The huge fluctuations in the dollar during the 1980s have clearly not reflected economic fundamentals. There is now a danger that the dollar will undershoot, and if this happened it would have to be reversed with renewed difficulties later on. Avoidance of such swings in exchange rates is an important factor in reducing uncertainty and improving prospects for investment and growth.

4. Since last February's Louvre Agreement, policies have begun to change in the right direction. And there are now firm signs that trade imbalances are diminishing. But to ensure an adequate momentum of adjustment is maintained, the US needs further to reduce its huge budget deficit while surplus countries pursue policies to sustain a satisfactory growth of domestic demand. Domestic demand is now growing satisfactorily in Japan but not in Germany.

5. Indicators for individual countries can help in the assessment of domestic policies and performance. But they must not be used for fine tuning or as triggers for automatic action or consultation. We hope that the idea of global indicators will be taken up in G7.

6. Structural policies (lower taxes, reform of taxes, reductions in subsidies, deregulation, privatisation, removal of obstacles to labour mobility, etc) would contribute generally to stronger growth over the medium-term and help to keep down inflation by strengthening competition and improving economic efficiency.

7. More particularly, structural reforms would help to promote domestically - generated growth in Japan and Germany and to reduce their current account surpluses. Japan should continue to implement recommendations of Maekawa Report (including those on land and agricultural reform). Germany should cut subsidies to declining industries and pursue policies to make labour market and corporate structure more responsive to changing patterns of demand and competitiveness.

8. The current account surpluses of East Asian NICs, (and particularly of Taiwan and Korea) are not only against the interests of the world economy (contributing to the major trade imbalances and inciting protectionist pressures in the West), they are against the interests of these countries themselves. Taiwan and Korea should complete their import liberalisation, and should allow their exchange rates to appreciate.

BACKGROUND

Current Situation and Prospects

Industrial production has been strong recently, particularly in North America and Japan.

Percentage changes in industrial production over latest 12 months:

US (Dec)	5.1
Japan (Dec)	8.6
Germany (Dec)	3.2
France (Nov)	4.0
UK (Dec)	4.9
Italy (Nov)	4.8
Canada (Nov)	8.8

2. Total output (real GDP) probably increased by some 2¾ per cent overall in the seven major countries in 1987. The OECD forecast shows growth slowing down only fractionally - to 2½ per cent - in 1988.

3. Inflation, which fell to exceptionally low levels in late 1986 following the fall in oil and other commodity prices, rose in most countries in 1987. But this acceleration is unlikely to be carried much further. In none of the major countries is inflation likely to rise above 5 per cent this year.

4. The trade volumes of the US, Japan and Germany are now clearly adjusting to the major realignment in exchange rates over the past three years and to the changes that have been made to economic policies. Because of time lags (the J-curve), there has not been much reduction so far in the current account imbalances in nominal dollar terms (though the Japanese and Germany surpluses declined in 1987 as percentages of GDP.)

5. From its peak in the first quarter of 1985 to last February, when the Louvre Agreement was struck, the US dollar depreciated by

one third in nominal effective terms. After eight months of near stability, the dollar has depreciated further since mid-October - to some 10 per cent below the Louvre level.

6. Short-term interest rates were increasing in North America during most of 1987 because of downward pressure on the dollar, but have declined since the Stock Market collapse in mid-October. In most major countries interest rates are lower currently, both in nominal and real terms,than on average in each of the last few years.

INDICATORS

The present position

1. The Venice Declaration in June 1987 noted the wish to continue economic co-ordination efforts and to strengthen surveillance of our economies through:

- "the commitment by each country to develop medium-term objectives and projections for its economy, and for the group to develop objectives and projections, that are mutually consistent both individually and collectively;"

and

- "the use of performance indicators to review and assess current economic trends and to determine whether there are significant deviations from an intended course that require consideration of remedial actions".

2. Ministers and Governors have since reaffirmed their commitment to economic policy co-ordination efforts, in Washington in September and in the G7 statement issued on 23 December.

Indicators for the G7 as a whole

3. The Chancellor, in his speech to the Annual Meetings in September, said that:

"We must ensure that there is no persistent inflationary (or for that matter deflationary) bias for the group as a whole. This can be helped by:

- the development of indicators for the group as a whole; these will be mainly financial but special attention should also be given to the trend of world commodity prices;

- a nominal framework for policy, in terms either of a path for GDP growth for the group as a whole, or one for the average inflation rate; and

- a medium-term perspective when setting out the path and in gauging actual performance. We should not become involved in an exercise in short-term fine tuning.

In recent meetings we have put a lot of effort into developing performance indicators for individual countries. I have to say that I have considerable doubts whether we can usefully take that exercise much further. I believe it would be far more useful to devote our efforts to monitoring the performance of the group as a whole, so that we can ensure that we maintain the correct non-inflationary policy stance".

Exchange Rates

4. The G7 Communique of 23 December re-emphasised the agreement to co-operate to foster exchange rate stability.

5. The Chancellor argued in his Autumn Statement Speech of 14 January that 'a readiness by countries to commit themselves to some form of exchange rate stability is a way of securing wider co-operation on economic policy..... If countries are indeed prepared to accept wholeheartedly..... exchange rate commitments..... they will find themselves obliged to pursue domestic policies which are consistent with their exchange rate objectives'.

6. The Chancellor was at pains to stress that he was 'not suggesting a return to anything like the rigid exchange rate system that applied under Bretton Woods. However, 'there are clear advantages in a more managed approach designed to prevent the wild gyrations of recent years, particularly in the dollar, and in so doing achieving greater international co-operation in economic policy more generally'.

STATISTICAL TABLES

A: Output and Demand

B: Inflation

C: Current Account Balances

D: General Government Budget Deficits

E: Short Term Interest Rates

F: Spot and Effective Exchange Rates

A. OUTPUT AND DEMAND (CHANGES IN PERCENT)

	1986	1987	1988	1989
Real GNP/GDP				
Canada	3.3	3¾	2¾	2¼
United States	2.9	2¾	2½	1¾
Japan	2.4	3½	3½	3
Germany, FED. REP. of	2.5	1½	1½	1¼
France	2.0	1½	1½	1¼
Italy	2.7	2¾	2	1¾
United Kingdom	3.3	3¾	2¾	1¾
Major Industrial Countries	2.8	2¾	2½	1¾
Real Total Domestic Demand				
Canada	3.9	4	2¾	2
United States	3.9	2	1	1
Japan	4.0	4¼	4	3¼
Germany, FED. REP. of	3.7	2½	2¼	2
France	3.7	3	1½	1¼
Italy	3.2	4½	2½	2¼
United Kingdom	3.8	3½	3¾	2¼
Major Industrial Countries	3.8	3	2	1½

Soyrce: OECD Economic Outlook, December 1987

B. INFLATION (CHANGES IN PERCENT)

	1986	1987	1988	1989
GNP/GDP Deflator				
Canada	2.9	4¾	4¼	3½
United States	2.6	3	3½	3¾
Japan	1.8	-¼	1	1½
Germany, FED. REP. of	3.1	2½	1¾	1¾
France	4.7	2¾	2¾	2½
Italy	8.0	5¾	5	4¼
United Kingdom	3.5	4	5¼	5
Major Industrial Countries	3.1	2¾	3¼	3¼
Consumer Prices				
Canada	4.2	4¼	4	3½
United States	2.2	4	4	3¾
Japan	0.6	¼	1¾	2
Germany, FED. REP. of	-0.5	¾	1¾	1½
France	2.5	3¼	2¾	2½
Italy	6.1	5	4¾	4¼
United Kingdom	3.6	3	4½	4¼
Major Industrial Countries	2.1	3	3¼	3¼

Source: OECD Economic Outlook, December 1987

C. CURRENT ACCOUNT BALANCES

	1986	1987	1988	1989
CURRENT ACCOUNT (IN BILLIONS OF US DOLLARS)				
CANADA	-7	-7	-7	-7
UNITED STATES	-141	-156	-134	-105
JAPAN	86	86	81	79
GERMANY, FED. REP. OF	37	44	41	32
FRANCE	3	-3	-5	6
ITALY	4	-2	-4	-4
UNITED KINGDOM	-2	-3	-6	-9
MAJOR INDUSTRIAL COUNTRIES	-20	-41	-35	-21
CURRENT ACCOUNT (IN PERCENT OF GNP/GDP)				
CANADA	-1.9	-1.7		
UNITED STATES	-3.4	-3.5		
JAPAN	4.4	3.6		
GERMANY, FED. REP. OF	4.1	3.9		
FRANCE	0.4	-0.3		
ITALY	0.7	-0.3		
UNITED KINGDOM	-0.3	-0.6		
MAJOR INDUSTRIAL COUNTRIES	-0.2	-0.4		

Source: OECD Economic Outlook, December 1987.

D. GENERAL GOVERNMENT BUDGET DEFICITS (IN PER CENT OF GNP/GDP)

	1986	1987	1988	1989
CANADA	5.5	4.4	3.3	4.0
UNITED STATES	3.5	2.4	2.4	2.3
JAPAN	0.9	1.2	1.1	1.0
GERMANY, FED. REP. OF	1.2	1.7	2.3	2.7
FRANCE	2.9	2.8	2.7	2.5
ITALY	11.2	10.3	10.0	9.8
UNITED KINGDOM*	2.6	2.1	1.9	1.9
MAJOR INDUSTRIAL COUNTRIES	3.2	2.7	2.6	2.6

Sources: OECD Economic Outlook, December 1987

* The OECD estimates for the UK are almost certainly significantly too high.

TABLE E: NOMINAL AND REAL SHORT TERM INTEREST RATES (IN PERCENT, PERIOD AVERAGES)

					1987				1988
	1984	1985	1986	1987	Q1	Q2	Q3	Q4	15 Feb
Nominal Rates									
Canada	11.1	9.4	9.0	8.4	7.5	8.4	9.0	8.9	8.6
United States	9.8	7.7	6.2	6.9	6.0	6.8	7.0	7.9	6.6
Japan	6.3	6.7	5.1	3.9	4.1	3.8	3.7	3.9	3.8
Germany, Federal Republic of	6.0	5.4	4.6	4.0	4.2	3.8	4.0	4.1	3.3
France	11.7	9.9	7.7	8.2	8.3	8.1	7.9	8.5	7.6
Italy	17.1	14.9	12.6	11.5	11.5	10.6	12.0	11.8	11.0
United Kingdom	9.9	12.2	10.9	9.7	10.6	9.2	9.8	9.2	9.3
Real Rates*									
Canada	7.1	5.2	4.2	4.0	3.3	3.6	4.2	4.7	4.4
United States	6.8	5.1	3.1	3.2	3.8	3.0	2.7	3.3	2.2
Japan	4.5	6.2	5.7	4.0	5.4	4.0	3.3	3.3	3.3
Germany, Federal Republic of	3.7	4.8	4.4	3.7	4.7	3.6	3.3	3.1	2.6
France	5.8	5.6	3.6	4.8	4.9	4.6	4.4	5.3	4.5
Italy	7.1	7.1	7.9	6.5	6.9	5.9	6.7	6.6	6.0
United Kingdom	4.3	6.8	6.2	5.4	6.4	4.8	5.3	5.1	6.0

* Deflated by increases in consumer prices.

35.3, lm.3276.25

TABLE F: SPOT EXCHANGE RATES AND NOMINAL AND REAL EFFECTIVE EXCHANGE RATES (PERIOD AVERAGES)

	1980	1985	1986	1987	1987 Q1	1987 Q2	1987 Q3	1987 Q4	1988 17 Feb
SPOT EXCHANGE RATES (CURRENCY UNITS FOR US DOLLAR)									
Canada	1.17	1.37	1.39	1.33	1.34	1.33	1.32	1.31	1.27
Japan	227	239	169	145	153	143	147	136	130
Germany, Federal Republic of	1.82	2.94	2.17	1.80	1.84	1.81	1.84	1.71	1.70
France	4.23	8.99	6.93	6.01	6.12	6.03	6.13	5.75	5.76
Italy	856	1909	1491	1297	1306	1300	1331	1249	1255
United Kingdom (US/Pound)	2.33	1.30	1.47	1.64	1.54	1.64	1.62	1.75	1.75
EFFECTIVE EXCHANGE RATE (1980=100)									
In Real Terms*									
Canada	100	114.2	105.5		106.2	104.9	106.6		
United States	100	143.7	110.3		97.4	93.4	95.3		
Japan	100	106.1	133.0		134.4	142.2	135.6		
Germany, Federal Republic of	100	89.3	99.0		108.1	106.9	107.0		
France	100	90.0	93.5		94.8	93.5	93.0		
Italy	100	110.0	112.9		117.1	115.0	115.7		
United Kingdom	100	85.6	80.2		75.9	79.9	79.0		
In Nominal Terms (1975=100)									
Canada				77.9	78.2	77.5	78.5	77.5	80.0
United States	93.8	140.7	114.9	101.2	104.2	101.1	102.5	97.0	95.4
Japan	126.2	160.7	202.6	219.6	210.1	222.9	218.0	229.0	237.8
Germany Federal Republic of	129.0	123.8	137.1	147.6	147.7	146.9	146.4	149.8	148.9
France	93.9	66.0	70.1	71.8	72.0	71.6	71.4	72.2	71.7
Italy	67.2	45.1	46.8	47.6	48.4	47.5	47.1	47.5	46.9
United Kingdom	96.1	78.2	72.8	72.7	70.0	72.7	72.7	74.9	74.3

* Relative unit labour costs.

TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES

27-28 FEBRUARY 1988

BRIEF No 3. DEBT

OBJECTIVES

1. To reconfirm key elements of present debt strategy.

2. To emphasise the distinction between middle income debtors and the low income debt distressed countries of sub-Saharan Africa.

3. To ensure summit gives credit for sub-Saharan African initiatives and avoids detailed discussion of middle income debt.

4. To resist calls for Government involvement in managing commercial bank debt.

5. To welcome further development of voluntary, market oriented schemes agreed between debtors and banks, against the background of a strengthening in the banks' financial position.

POINTS TO MAKE

1. Objective for all debtors remains a return to creditworthiness. Current strategy - economic adjustment by debtors supported, where appropriate, by finance from creditors - remains best way of achieving this.

2. Low income debt distressed countries (LIDDs) of sub-Saharan Africa have no hope of repaying their debt in full. Most of their debt is owed to governments and IFIs who can therefore act directly to relieve the burden. UK taking leading role; eg ESAF, Chancellor's initiative for relief of Paris Club debt, World Bank special programme of assistance. Essential that these additional resources are used to support sound economic reform. Must take credit at summit for various initiatives.

3. Will continue to argue for some form of interest relief in Paris Club, but prepared to consider alternative equivalent solutions involving reasonable burden-sharing.

4. Middle income countries have the resources to be able to service their debt in longer term provided appropriate policies are adopted. Most of their debt is owed to commercial banks: primarily a matter for negotiation between the debtors and the banks. Summit should not solely concentrate on middle income debtors. No scope for major new initiatives.

5. IMF and World Bank reviewing their roles in debt strategy in run up to Spring meetings. Summit will take its cue from them. IMF seeking ways of increasing and liberalising terms of lending to the middle income countries eg EFFs. Any expanded use of the EFF will require strong conditionality. Key role of IFIs must continue to be support of strong adjustment programmes by debtor countries.

6. Welcome recent innovative, market related voluntary schemes eg debt/equity, securitisation and recent Mexico scheme. No question of government funding or guarantees for commercial bank debt relief schemes. Carries major risk of bailing out the banks. Mexico scheme carries no cost to US Government. Must leave it to banks to decide whether they wish to participate and avoid indicating in any way that they should grant debt relief.

7. Recent statements by Brazil that moratorium caused greater losses than gains very welcome. Should discourage others from unilateral action.

8. Concerned about weakening reform process. Helps neither debtors nor creditors. Need coordinated G7 action through strengthened arrangements among EDs and between capitals. Attention now on Argentina. UK abstention on recent SBA a demonstration of our commitment to restoring stronger conditionality.

9. Paris Club has yet to agree reductions in interest rates for even the LIDDs. But reviewing its procedures and aware of calls from banks for more flexibility in rescheduling periods. UK hopes to play a constructive role here.

10. UK has welcomed increases in provisioning by commercial banks. A sensible prudential measure. But provisioning should reflect underlying riskiness of the debt concerned. Excessive provisioning may send wrong signals to debtors.

BACKGROUND

1. Canadians suggest that summit should mainly concentrate on middle income debtors. Since last year's Spring Meetings of the IMF/IBRD where the Chancellor launched his initiative for sub-Saharan Africa, the emphasis in coming forward with new initiatives has been on the poorest debtors:

a) Chancellor's initiative, launched last April has been followed by longer rescheduling periods in the Paris Club and we are still pressing for other creditors to agree to reduce interest rates or find alternative solutions of equivalent effect.

b) UK has played key role in the newly agreed Enhanced Structural Adjustment Facility (ESAF)

c) Also strongly support the World Bank's special programme of action for these countries.

These initiatives have yet to be implemented and many debtor countries still have to make painful adjustments to policies. So wrong to assume problems of the poorest countries have been solved: their problems have been widely recognised and some solutions adopted. But still a long way to go.

2. Even so, inevitable that summit will also cover middle income countries. UK, US and Canada are all reviewing the position of these debtors and the policy response. Key elements are:

a) Progress by debtors has been mixed, overall debt has continued to rise, debt ratios have continued to worsen and secondary market prices have fallen. For most debtors, creditworthiness is no closer.

b) Commercial banks have considerably increased their provisioning and strengthened their capital base.

c) Financing agreements between the banks and debtors, based on a menu approach, are increasingly taking over from straightforward concerted lending arrangements which are proving hard to negotiate..

d) On current plans, of the IFIs only the World Bank will be providing net new money.

e) Brazil has acknowledged that its recent moratorium was a mistake

f) The Mexico debt buy back scheme is seen by some as a first step towards commercial banks granting debt relief.

3. Handling of commercial bank debt must be for banks and debtors to decide between them. Concerted lending is playing a diminishing role. There is room for an increased range of market approaches, including securitisation, debt/ equity swaps and debt buyback. But any relief, as compared to full servicing of the debt, will represent a step away from creditworthiness. Important therefore to avoid endorsing debt relief as a general principle. Banks themselves are avoiding any suggestion that there should be debt relief and play down the significance of the Mexico scheme.

4. Even debtors who pursue effective adjustment policies are unlikely to regain early access to market finance on any significant scale. But debtors who establish a track record will be able to look to creditors, including non-bank investors for extra finance in the longer term.

5. Need to review role of IFIs and Governments in this context. Main role of IFIs will continue to be provision of funds in support of adjustment. But need to look closely at burden sharing issues if banks neither lending nor offering relief. World Bank General Capital Increase (GCI) should have been agreed by the time of the sherpas' meeting. Fund considering extending its lending to the middle income countries through the EFF: on current projections it will be providing no net new money to these countries in foreseeable future. It will be important to attach conditionality to any extra funds but difficult to do so. Further consideration of the Fund's precise proposals will be necessary. There is also a need for closer cooperation between the Fund and Bank if the Fund is to lend in support of longer term adjustment.

6. Over the last year there has been a weakening of conditionality at the Fund and Bank. Even though some debtors are not pursuing effective policies, eg Argentina, there is pressure, in particular from the US to provide funds nevertheless so as to avoid confrontation with the commercial banks. This pressure is likely to increase in US election year. UK has been trying to get increased cooperation among G7.

7. Also may be scope for IFI involvement in market related solutions. No proposals yet put forward. We would look very closely at the implications for the IMF's and World Bank's financial standing in any such proposals. World Bank decided not to offer to issue bonds to collateralise Mexico scheme.

8. Any proposals for either relief in the Paris Club or government funding of commercial bank debt likely to be non starters. Governments have been unable to agree to offer relief to the very small group of LIDDs. But the Paris Club is currently reviewing its procedures and in doing so will bear in mind calls from the commercial banks for increased flexibility. We have given the ADB/Warburgs scheme a cautious welcome as a possible fallback if the Chancellor's proposal for interest rate relief does not run.

9. Commercial banks in most industrialised countries, particularly the UK and US have announced increased provisioning against loan losses since May of last year. In the UK the Bank of England has produced a matrix which gives guidance on the appropriate level of provisions in the light of a number of factors which determine the riskiness of the debt of each country. The Governor has recently warned against provisioning which cannot be justified on an analytical basis of this sort.

10. Average level of provisions varies between countries. This is because of differences in exposure and tax regimes and does not necessarily imply different judgements about the quality of the debt or attitudes to the debt strategy.

KEY STATISTICS

	1980	1982	1984	1986	1987
RATIO OF DEBT TO GDP(%)					
Baker 15	32	43	47	49	52
SSA	36	51	57	68	77

RATIO OF DEBT TO EXPORTS(%)					
Baker 15	168	269	273	349	348
SSA	145	213	221	271	302
VALUE OF OUTSTANDING DEBT($BN)					
Baker 15	271	382	412	446	480
SSA	43	54	58	74	86

TORONTO ECONOMIC SUMMIT:

SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 4: TRADE AND AGRICULTURE

Objectives

1 To give further impetus to the GATT Uruguay Round as a defence against protectionism, and to promote UK aims for the Mid-Term Review.

2 To emphasise the importance of the new areas in the GATT Round, notably agriculture and services, and the need for an improved system of dispute settlement.

3 To endorse the need for reform of agricultural policy to remain high on the international agenda.

4 To continue to stress the potentially disruptive nature of protectionist proposals in draft US trade legislation and to reject bilateralism.

5 To stress the need for improved commercial relations between the EC and Canada notably through the early settlement of outstanding disputes.

Points to make

1 GATT system is the best defence against erosion of multilateral system and dangers of protectionism and bilateralism. Must seize opportunity of Uruguay Round not only to reinforce the existing GATT system but to extend disciplines into important new areas (services, intellectual property, investment). Integration of the developing countries and particularly NICs more closely into the GATT system must also be a priority.

2 Summit is an opportunity to secure political commitment to substantive progress. Must achieve best outcome possible to Mid-Term Review.

3 The Review will be in Montreal in early December. This will allow little time for preparation. MTR must mark significant progress on all main subjects covered at Punta del Este. Should try to reach agreement on specific items where ready (e.g. dispute settlement). Should aim to settle framework for further work on other complex issues (e.g. services).

4 Previous Summits have contributed importantly to progress on agriculture. Must prevent back-sliding. Heads of Government must strongly reaffirm their commitment to reform.

5 Useful statements of position tabled in Geneva. Must build on these to evolve a negotiation plan.

6 Important now to ensure that the negotiations are pursued energetically and constructively. We should aim to make real progress at the MTR, without deflecting our attention from the long term goals of reform. Too early to forecast what MTR result might be.

7 Uruguay Round alone not sufficient to prevent slide into protectionism. Essential that US Administration continue to resist such pressures in pending trade legislation. World trade has been subject to serious imbalances and heavy shocks in recent years. Some indication that US trade deficit beginning to decline in volume terms, Japanese surplus falling). Not time now to take action which would endanger this progress.

8 Must equally resist temptation to resort to bilateralism either for ostensibly liberal reasons (US/Korean agreement on intellectual property), defensive ones (US/Japan semi-conductors) or as a way of settling disputes.

9 Do not support proposal for a Trade Ministers' meeting linked to Summit. Would overload Summit machinery and risk getting institutionalised. Important of course that Trade Ministers meet and already several chances this year (Konstanz, OECD Ministerial, GATT MTR). Likely to be other opportunities in the future.

10 Welcome proposals for closer surveillance of development of

trade policies in GATT but do not see need for regular Ministerial meetings.

11 Welcome US/Canada FTA Agreement as trade liberalising move. Important that it should not entail new discrimination against trading partners. Concerned at number of current trade disputes between EC and Canada (liquor boards, blocked GATT panels etc.). Need to make a determined effort to resolve these problems within a multilateral framework.

BACKGROUND

GATT Uruguay Round

1 Substantive negotiations in the Uruguay Round got under way in January and the tempo of meetings is quick, with two negotiating groups meeting in each week. The supervising Trade Negotiations Committee agreed on 18 February that the Mid-Term Review should be held in Montreal on 5 December. A major UK (and increasingly a Commission) concern is that preparation for the MTR should not distract effort from the major long-term reforms of GATT structure and specific policies to which the Round is addressed.

2 Clearly the MTR will not be able to register equal progress across the whole of the negotiating field; but it should make progress on the main issues identified at the opening Ministerial meeting at Punta del Este in 1987. At present it seems generally accepted that the best prospects for progress lie in the institutional questions (dispute settlement, functioning of the GATT system); on the more 'difficult' and new issues, such as agricultural reform, the integration of the developing countries in the GATT system and rules on trade in services, it may be necessary to settle for agreement of broad principles to guide further work but we would not wish to settle for less, to prevent these issues slipping down the agenda for action.

3 Canada is vigorously supporting increased ministerial involvement in GATT. We support Ministerial meetings where they

have a role to play, but do not favour calling them for the sake of it. Thus we are against proposals for regular GATT Ministerial meetings but sympathise with Canada's wish to establish a more rigorous mechanism in GATT for surveillance of trade policy developments.

Agriculture in GATT

4 Agricultural policy reform is a major item within the Uruguay Round of multilateral trade negotiations which has now entered its second year. All the major players have submitted proposals, ranging from the US radical proposal for elimination of all support and protection by 2,000 (an objective shared - as an ideal, at least - by the Cairns Group including Canada) to the much more cautious and protectionist proposals of Japan and the Nordics. The EC proposals fall midway, making significant reductions in support the focus of long term reform, but noting the need to maintain the basic elements of the CAP (import protection and exportsubsidy, but at lower levels).

5 International attention is now focussing on the possibilities for the MTR in December 1988 (very much a US initiative). It remains unclear what of substance can be achieved for an MTR on agriculture. The Canadians will no doubt make proposals e.g. for short-term measures and a negotiating timetable for the rest of the Round. The US has not, however, accepted the need for a short-term package fearing that it could compromise the achievement of further substantial results.

6 Progress towards reform has been considerably helped by the Tokyo Summit, and particularly by the 1987 OECD Ministerial which laid out clear principles to govern this process which were reaffirmed at Venice last year. The GATT negotiation is now the forum in which practical progress must be made, and it is for the Toronto Summit to ensure that Heads of Government maintain the political impetus.

Protectionism

7 Protectionism is still a major danger, though the position has been improved through increased US competitiveness (following decline in the dollar) and the reduction in the Japanese surplus. It is still unclear whether there will be major US trade legislation this year. A strongly protectionist bill which the President would have to veto is less likely than it was, though a bill agreed between the Congress and the Administration could still have unwelcome features, some of which could be inconsistent with GATT (such as a requirement for automatic retaliation by the US in the event of alleged unfair trade actions by other countries).

Bilateralism

8 We deplore the increasing use by the US of bilateral solutions to trade problems so as to bypass agreed multilateral procedures (e.g. the US agreements on copyright protection with Korea and on semiconductors with Japan) and the provisions of the US trade bills which demand a bilateral approach.

Integration

9 Integration - getting the NICs to observe more of their GATT obligations and providing a basis for the LDCs progressively to integrate into the GATT system - remains a major UK priority for the Round.

Japanese proposals for a trade ministers' meeting

10 The Japanese are eager to get in on the act of trade ministers' meetings and had proposed such a meeting on the margins of or linked to the Summit, which we could not endorse. They are also angling for the closing meeting of the Uruguay Round (in 1990) to be held in Tokyo.

11 The latest Japanese proposal is for informal gatherings of G7 Trade Ministers in the margins of a wider Trade Ministers' meeting to be held atKonstanz (March 18-20) and of the OECD Ministerial (May). This proposal is being put to DTI Ministers, but our preliminary view is that it would be acceptable, provided that such meetings do not become institutionalised or linked in any way to the Summit.

12 Some representatives of the Commission are disputing Tokyo's claim to host the final meeting of the Round, arguing that at Punta del Este there was a gentlemen's agreement (of which we know nothing) that it should be in Brussels. We see no particular case against Tokyo, and holding the meeting there would give Japan a bigger political stake in observing agreements reached during the Round.

Canada

13 Canada is a vigorous participant in GATT and supporter of the GATT Round, particularly on agriculture.

14 The Canada/US Free Trade Area (FTA) Agreement is not comprehensive - certain topics like intellectual property have just been shelved as too difficult. But is is an important market-opening move. We are looking at it carefully to ensure that it does not entail unjustified discrimination against other trading partners. GATT provides for the conclusion of FTA agreements on customs unions, subject to the condition that overall levels of protection are not increased.

15 EC/Canada trade relations are often fairly tense and following an improvement last year are so again. Canada is currently blocking the adoption of four GATT Panels, three of which are cases where the panels found for the EC against Canada (discriminatory mark-ups of provincial liquor boards; beef; pasta). Attempts to negotiate a bilateral settlement with Canada to the liquor board problem have failed. An approach by Sir Geoffrey Howe to Joe Clark at the end of the UK Presidency in 1986 about ways of improving overall EC/Canadian trade relations met with a very sharp rebuff.

16 The total volume of EC/Canadian trade was US$17 bn in the year ended September 1987. Against this the issues in dispute

are minor irritants, but persistent. The Article 113 Committee recently concluded that the Canadians should be pressed hard to behave better on these specific points.

Department of Trade and Industry

19 February 1988

TORONTO ECONOMIC SUMMIT:

SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 5. FINANCIAL MARKET MECHANISMS

OBJECTIVES

1 To respond positively to the Canadian proposal but insist that further preparation needs to be done in advance of the Summit if there is to be any prospect of a useful discussion or follow-up.

2 To offer to help the Canadians work up a proposal.

3 To acknowledge the need for improved international co-ordination between those responsible for the supervision of banks and securities firms. There are currently no institutional arrangements for doing this.

4 To ensure that the follow-up involves the countries and institutions most directly involved: G10 cover the right countries and the Cooke Committee covers banking but there is need for a parallel committee covering securities, with links into the Cooke Committee and IOSCO. (The OECD coverage is too broad and academic in its approach; G7 is too narrow.)

BACKGROUND

5 The Canadian proposal has not been properly thought through: it apparently stems from a personal interest of Mrs Ostry. Nonetheless, it coincides with the feelings of the SEC in the USA and others in the G7 countries. There will be an opportunity before the summit to make informal soundings of those others to see what institutional framework is thought desirable.

6 Work is already going on in a number of fora. The OECD is conducting studies. The Cooke Committee is considering banks' securities business. It is regulators who are best placed to develop these initiatives.

7 On market structure - Each member country of G7 suffered to a greater or lesser extent from the crash in share prices in October 1987. The reports emanating from the USA are of interest to everyone but their recommendations (even when they are in accord with each other) are not always relevant or apposite to other countries. Different conditions, sizes, techniques and requirements all need different structures and mechanisms.

BRIEF NO 5. FINANCIAL MARKET MECHANISMS

OBJECTIVES

1. To respond positively to the Canadian interest in this subject and informally encourage them and others to pursue it with us, while expressing doubts over whether the Summit is the right forum for it.

POINTS TO MAKE

2. Clear need for increased cooperation between securities regulators has been widely recognised since the October crash.

3. Worth distinguishing three aspects of the problem, while recognising that they are to some extent inter-related:

- safeguards against systemic financial risks: these must be primarily for central banks, who have well established fora for policy coordination;
- market structure questions (such as some of the points raised in recent US reports): an area in which securities supervisors should lead and recognise the need for international cooperation; and
- investor protection: an area for securities supervisors in their own markets, but with a keen interest in the standards of other markets also.

4. Work is already going on in a number of fora. The OECD is conducting some fact-finding studies. The Cooke Committee is considering securities business of banks. But regulators have an important role to play, and there is at present no convenient and authoritative international forum for them.

5. We want to encourage further contacts between regulators in different countries, and the development of a forum covering regulators of the major markets between whom cooperation could be of particular value. Must go wider than the G7 Summit group. Not clear ourselves of the best answer, and conscious of problems in the different status of regulators in different countries.

6. On market structures. [As previously drafted]

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TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES
27-29 FEBRUARY 1988

BRIEF NO 5. FINANCIAL MARKET MECHANISMS

OBJECTIVES

1. To discourage Canadians from raising this subject in the Summit. There is no message that the Summit can usefully deliver, and the Summit is in any case too narrow a forum for this issue.

2. To distinguish the various aspects of this issue

- prudential/systemic concerns, primarily matters for central banks who have well established fora for policy co-ordination.

- market structure questions, such as those discussed in various US reports, an area in which securities supervisors should lead and are aware of need for international co-operation.

- investor protection, again, a matter for securities regulators.

3. To encourage further contacts between regulators, who are in best position to establish right framework, while accepting that we do not currently see an appropriate forum of securities regulators for taking this forward.

POINTS TO MAKE

4. Clear need for increased co-operation between securities regulators, widely recognised since the crash. Must clarify distinction between systemic issues, which are for financial authorities, and market structure/investor protection issues which are for securities regulators. We should support direct contact between securities regulators, to improve co-ordination. But immediate role for Governments is to deal with the macro-economic imbalances that contributed to the loss of confidence in October.

5. Work is already going on in a number of fora. The OECD is

conducting studies. The Cooke Committee is considering banks' securities business. It is regulators who are best placed to develop these initatives.

6. [(If raised) We would not object to extending the scope and functions of the "Wilton Park Group" if it was the wish of other G7 countries. (Its current membership covers the world's 11 leading seucrities markets.)]

7. **On market structure** - Each member country of G7 suffered to a greater or lesser extent from the crash in share prices in October 1987. The reports emanating from the USA are of interest to everyone but their recommendations (even when they are in accord with each other) are not always relevant or apposite to other countries. Different conditions, sizes, techniques and requirements all need different structures and mechanisms.

CONFIDENTIAL

BACKGROUND

1. The Canadians are keen to discuss recent proposals for changes in financial market mechanisms following the October crash and the various US studies (see para below). This is clearly not material suitable for the Summit, rather, it is for discussion amongst securities market (and banking) supervisors.

2. But there is a problem here, in that there is no tradition of co-operation between securities market supervisors, and none of the current fora are well suited for taking this forward. There are signs that the existence of this gap is now generally realised by the relevant supervisors, but the widely differing approach to securities regulation in different countries means that it may take some time to establish effective co-operation. The best strategy, at this stage, is to allow the regulators to establish co-operation mechanisms.

Stock Market Crash:

3. It is now generally accepted that the immediate cause of the stock market crash was the perception by investors world-wide that equities were overvalued. Uncertainty about governmental policies stemming from the budget and trade deficits of the US and the trade surpluses of Japan and Germany triggered the crash in prices.

4. The nature of the crash in prices has been the main area for examination in the studies which have been undertaken. The bulk of these (both in number and weight) have emanated from the USA. (None have emerged from Japan!) The speed with which prices fell was the unique element which tested market mechanisms. The areas under closest scrutiny are:

i. globalisation, the way markets influence one another, with possible spiral effect,

ii. new market technology and techniques; programme trading, index arbitrage, portfolio insurance,

iii. the relationship between stock index futures and options markets and the market in the underlying securities,

iv. the effectiveness of the national regulatory arrangements.

5. DTI is preparing a "study of the studies" for the Secretary of State, which is to be completed by end March. Other reports have been published (see Annex).

International Co-Operation

6. The "Wilton Park" group is an informal gathering of international securities regulators who have so far met three times since December 1986 (most recently February 1987). It meets at UK invitation and under UK chairmanship. Eleven countries took part in the February 1988 meeting; Australia, Canada, France, FRG, Hong Kong, Italy, Japan, Netherlands, Switzerland, UK and USA. It considers matters relating to the enforcement of regulations including the nature and operation of bilateral agreements and the exchange of information.

7. The International Organisation of Securities Commissions and Similar Agencies (IOSCO) and its committees meets primarily in order to examine technical problems. Participants include securities commissions and stock exchanges from a wide range of countries (including third world). The Canadians are heavily involved in this which is based in Montreal. Support is from a central secretariat. There are some doubts as to its effectiveness not least due to difficulties in funding and the wide range of participants. We would not consider this the right forum for major initiatives on securities co-operation.

8. The Cooke Committee of Banking supervisors is also looking at how to harmonise treatment of banks' securities business.

9. **CONFIDENTIAL**: There have been recent important bilateral initiatives: the Bank of England and the Securities and Investments Board held a meeting in February with the US Federal Reserve Board and Securities and Exchange Commission on co-operation in the area of the financial integrity of British and American markets and the firms operating in both. It is hoped that Japan will

join this initiative in due course. No publicity is being given to the real objective because of (i) possible adverse reaction of non-participating countries and (ii) European Community competence in the area of banking supervision. Multi-lateral co-operation should not be allowed to slow down these bilateral initiatives but the bilateral (or trilateral) discussions will need to be widened as soon as there is an appropriate multilateral forum to take this forward.

ANNEX : SUMMARY OF REPORTS SO FAR PUBLISHED

i. The International Stock Exchange report was the first formal UK study to be published. It concludes that the decision to keep the market open was correct because the cost of closure on users would outweigh the cost of adjustments which market makers can make to protect their position. It pointed out that the old pre Big Bang system, in the UK, could not have absorbed the £250m of stock which was absorbed during 19 October. In that week turnover in foreign equities and American Depository Receipts rose sharply, suggesting that foreign investors found London to be a relatively liquid and accessible market. It recommends the development of faster execution services with increased capacity to handle higher volumes. It also proposes the development of arbitrage techniques to prevent UK futures and cash markets getting out of step.

ii. The New York Stock Exchange commissioned a report on programme trading from Mr Katzenbach, a former Attorney General. He found that futures serve a legitimate hedging function but they can have an undesirable impact on equities when the two are linked through trading. His main recommendation is to merge the SEC and CFTC. His study made proposals about how stock index futures should be traded and recommends a new type of contract and increases in margins and capital requirements.

iii. The Brady Commission, appointed by the US President, has compiled a very lengthy report. It calls for action to protect the market from violent shifts. It recommends one "super regulator", preferably the Federal Reserve Board, to co-ordinate the financial system. The Brady Commission argued for changes to the clearing systems and for information to monitor transactions in related markets. Its other two main recommendations are that margins should be harmonised to control speculation and financial leverage, and that "circuit breaker mechanisms" (eg price limits and trading halts) should be formulated and implemented.

iv. The Commodities and Futures Trading Commission has published a three part report. This argues that futures connected trading did not constitute a major part of NYSE volume on or after 19 October. It suggests that many institutional investors used the futures market as a safety valve and that this lessened the decline in prices on the stock market. Recommendations include changes to the clearing system to improve capacity and information exchange, improved surveillance by self regulating organisations through increased central computerised data and the routine use of intra day margin calls.

v. The Securities and Exchange Commission has published a detailed analysis of the market break and its Chairman, David Ruder, presented a set of recommendations in testimony to the Senate Committee on Banking. The two fundamental conclusions were that the three markets (stocks, stock index futures, stock index options) are unified and that new trading mechanisms can cause peak volume and volatility, sufficient to overwhelm the capacity of markets. The recommendations include three types of operational reform; changes to increase the capacity of each of the individual markets to respond to new market structures and trading strategies; changes to improve co-ordination among the markets; changes to retard, at least during crisis periods, the increased velocity and volume of intermarket and intramarket trading. The SEC also recommends a temporary increase in margin requirements for stock index futures so that more permanent reforms may be studied. It argues that all equity related products should be regulated through mandated co-ordinated regulation, if not by one agency. It recommends improvements in specialist and market maker performance, capital adequacy and clearing and settlement. It acknowledges that the market for US equities includes the major foreign markets.

vi. The Chairman of the Federal Reserve Board, Alan Greenspan, gave evidence to the Senate Banking Committee. He argued that price limits and other circuit breakers may be inherently destabilising but may also be the "least bad" solution. Oversight should be the responsibility of a merged or joint authority but not solely that of the Federal Reserve. He agreed with

Brady that improvements are needed in the clearing system. He agreed to prepare a specific list of recommendations by 4 March 1988.

TORONTO ECONOMIC SUMMIT

SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 6 SCIENCE

OBJECTIVES

1. To support any moves by other Summit countries to raise broad issues of international co-operation in science at the Toronto Economic Summit and to stress that international co-operation rather than competition avoids duplication of effort (e.g. the Americans should increase their support for CERN rather than start their own ambitious SSC).

LINE TO TAKE (If raised)

International co-operation.

1. The costs of large scale scientific endeavours are becoming increasingly prohibitive. We all face hard choices. One answer is to collaborate internationally rather than to compete and duplicate. (The stimulus of intellectual competition will continue.) Cost pressures put a premium on improved management of international projects too.

2. It should not be necessary for Summit leaders to consider international scientific co-operation in any detail. But they could endorse this underlying philosophy, and ask the Chief Scientists of Summit countries to study the issues.

3. The US ideas on a framework of common principles for international co-operation in science and technology could merit some acknowledgement by Summit leaders if the continuing discussions on them in OECD make sufficient progress.

Human Frontier Science Programme (HFSP).

4. There are no issues here which need to be put to leaders at the Summit. Good progress has been made, under Japanese leadership, in narrowing down the scientific scope. But the practical administration is still unclear and needs to be discussed much more thoroughly. (If pressed) It is premature to speak of financial commitments but, as their initiative, we assume the Japanese will be showing the way.

BACKGROUND

1. Budgetary pressures have prompted the UK to make a rigorous re-assessment of its priorities and we have, for example, not increased our space funding and are pressing for lower contributions to CERN and to the new European Synchrotron Radiation Facility, ESRF. Our partners are not yet in similar difficulties although there are, for example, rumblings of doubt among the German scientific community about the scale of commitment to prestige projects such as space and the Americans want to share the huge costs of their superconducting super-collider, SSC, and research on fusion. The Toronto Summit could help push discussion in a direction helpful to us, especially if the European participants there gave a clear message to the Americans that they should increase their contribution to CERN.

At the same time as we are urging a cut in the Budget Deficit.

2. We should not, however, wish to give the Japanese the pretext to seek promises of financial contributions to their **Human Frontier Science Programme, HFSP**, for the joint study inter alia of molecular biology and brain function. They raised this at the Venice Summit in 1987. Officials and scientists are conducting a feasibility study which is due to be concluded in March 1988 when the Japanese Government is expected to consider its recommendations. Most Summit countries share our view that finance for the first three to five years should be provided by Japan as an earnest of their good intent but that our own related research efforts could complement the HFSP.

3. The **US Framework of Common Principles for International Co-operation in Science and Technology** follows an initiative by President Reagan's Science Adviser, Dr William Graham, at the OECD. Conceived as a blunt instrument to attack Japanese under-funding of basic science, it may provide a means for improving understanding on the importance of international co-operation and countering the "technology protectionists". But much work is still needed before it can be decided that a text is ready even for the OECD Ministerial in May.

4. High Energy Particle Physics, HEPP, is a prime example of expensive science. **CERN** has the leading experiments. Huge costs are against the Americans futuristic superconducting super-collider, **SSC**, but President Reagan has backed it in principle and US scientists want to take the lead back from

Europe. The Japanese too have their own major facility, Tristan.

5. The commercial application of **fusion** technology for power generation remains distant and the research is costly. JET at Culham financed by the EC is the leading experiment. The way forward may be to build on wider international collaboration, e.g. the ITER studies between EC, US, Japan and the Soviet Union instituted following the Reagan/Gorbachov Summit in Washington last year.

6. Another candidate for wider international collaboration is **sequencing the human genome** i.e. the human genetic blueprint. There is no proposal at present to bring together separate national work on this huge task. However, the Italians may mention that they will be hosting this year's conference on bioethical issues for Summit Seven countries. It will be held in Rome on 11-15 April on the subject of "Human Genome Sequencing : The Ethical Issues". We understand that the Americans may be ready to host the next conference in 1989. Thereafter only the UK among Summit countries will not have hosted such a conference.

7. The Working Group on **Technology Growth and Employment,** which was set up on French initiative at the Versailles Summit in 1982, reported to successive Summits until Tokyo in 1986. It then disbanded in accordance with the principle that permanent machinery should be avoided. It could equally easily be reconvened if Summit leaders agreed that international science and technology issues again required study.

International Group
Science and Technology Secretariat
Cabinet Office

19 February 1988

RESTRICTED

TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES

27 - 29 FEBRUARY 1988

BRIEF NO 7. Environment

OBJECTIVES

1. To resist proposals for taking environmental issues as a substantive agenda item.

2. To support any proposals for a general statement of welcome for the report of the World Commission on Environment and Development, while resisting detailed discussion of the report.

POINTS TO MAKE (IF NECESSARY)

1. Environmental issues were fully aired at the 1985 Bonn Summit, following the 1984 meeting of the Environment Ministers of Summit countries in London. Since then Summit leaders have twice reaffirmed their commitment to cooperation on the environment. No issues have arisen which merit their renewed attention.

2. General statement of welcome for the report of the World Commission on Environnment and Development would be appropriate. UK supports the report's basic message of "sustainable development". But not an appropriate subject for detailed examination by Summit.

BACKGROUND

1. Since the 1985 Summit the Germans have continually pressed for renewed prominence for environmental issues in the Summit context. They have had instead to be contented with references to "attaching importance to cooperation", "encouraging efforts to tackle problems" etc. in the 1986 and 1987 communiques.

2. They and possibly the Canadians may try again in 1988, but nothing new has occurred to justify this.

3. There is also a chance that the Canadians will want to give attention to the report of the World Commission on Environment and Development (WCED), published in April 1987. Other Summit countries have so far reacted less enthusiastically to WCED than the Canadians, but the UK has gained credit by its generally supportive stance, which we aim to build upon.

4. The detailed recommendations of the report (some of which cause us difficulty) are not appropriate for the Summit to involve itself with but the UK would support a suitable, general statement of welcome.

Department of the Environment
15 February 1988

TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES
27-29 FEBRUARY 1988

BRIEF NO 8: AIDS

OBJECTIVES

1. Secure brief reference in Summit communique to AIDS problem.

POINTS TO MAKE [if raised]

2. Important to maintain momentum gained over last few months in international cooperative efforts to control spread of HIV infection.

3. Though separate statement along lines of that issued at Venice perhaps not justified this year, valuable if communique referred briefly to:

continuing importance of international cooperation;

leading role of WHO's Global Programme on AIDS in directing international cooperation;

role of public education as the major element in national AIDS programmes;

success of World Summit of Ministers of Health on Programmes for AIDS Prevention, London, January 1988, in highlighting both points;

commitment of the Seven to the London Declaration on AIDS Prevention.

TORONTO ECONOMIC SUMMIT
SECOND MEETING OF PERSONAL REPRESENTATIVES
27-29 FEBRUARY 1988

BRIEF NO 8: AIDS

BACKGROUND

A 1. The Chairman issued a statement on AIDS at the Venice Economic Summit underlining the importance of international cooperation and the role of the World Health Organisation. The statement also highlighted the need for AIDS public education programmes and welcomed the convening of the World Summit of Ministers of Health on Programmes for AIDS Prevention, held in London on 26-28 January and jointly organised by HMG and the WHO.

B 2. The Director-General sent a telegram of appreciation to the Prime Minister (and the other Heads of State and Government), who,
C in her reply, expressed the hope that the statement would help to strengthen international commitment to the WHO and referred to the World Summit of Ministers of Health.

3. It is important to keep up momentum in the wake of the highly successful World Summit, at which 148 countries were represented, which provided an effective forum for the discussion of information and public education campaigns and which adopted a London
D Declaration on AIDS Prevention. Given the progress over the last few months in the strengthening of international cooperation on AIDS, a distinct statement at the Toronto Summit is probably unnecessary - though we would not oppose one in principle if others suggested it. On the other hand, it is important that the communique should confirm the continuing concern of the Seven and allude to the contribution of the World Summit of Ministers of Health.

/4.

4. The statement on AIDS issued at Venice also welcomed a proposal that President Mitterrand made at Venice - to general surprise - that there should be a committee on the ethical issues raised by AIDS. President Mitterrand subsequently invited the Twelve, the US, Canada and Japan each to nominate three experts to serve on the committee, which was to have had a first meeting in the autumn. The Prime Minister nominated the Government's Chief Medical Officer, Sir Donald Acheson, Rev Prof Gordon Dunstan and Sir Raymond Hoffenberg. We have heard nothing since. We are not convinced of the usefulness of a committee of this sort, but, if the idea is taken forward, are ready to play our part in its work.

NARCOTICS CONTROL & AIDS DEPARTMENT
18 February 1988

...E ECONOMIC SUMMIT, 8-10 JUNE 1987 ANNEX G

A

Chairman's statement on AIDS
(Text to be distributed to the press)

On the basis of the concern already shown in the past for health problems (London Chairman's oral statement on cancer and Bonn Chairman's oral statement on drugs), the Heads of State or Government and the representatives of the European Community affirm that AIDS is one of the biggest potential health problems in the world. National efforts need to be intensified and made more effective by international cooperation and concerted campaigns to prevent AIDS from spreading further, and will have to ensure that the measures taken are in accordance with the principles of human rights. In this connection, they agree that:

- international cooperation will not be improved by duplication of effort. Priority will have to be given to strengthening existing organizations by giving them full political support and by providing them with the necessary financial, personnel and administrative resources. The World Health Organization (WHO) is the best forum for drawing together international efforts on a worldwide level to combat AIDS, and all countries should be encouraged fully to cooperate with the WHO and support its special programme of AIDS-related activities;

- in the absence of a vaccine or cure, the best hope for the combat and prevention of AIDS rests on a strategy based on educating the public about the seriousness of the AIDS epidemic, the ways the AIDS virus is transmitted and the practical steps each person can take to avoid acquiring or spreading it. Appropriate opportunities should be used for exchanging information about national education campaigns and domestic policies. The Heads of State or Government and the representatives of the European Community welcome the proposal by the United Kingdom Government to co-sponsor, with the WHO, an international conference at ministerial level on public education about AIDS;

- further cooperation should be promoted for basic and clinical studies on prevention, treatment and the exchange of information (as in the case of the E.C. programme). The Heads of State or Government and the representatives of the European Community welcome and support joint action by researchers in the Seven countries (as in the case of the joint programme of French and American researchers, which is being enlarged, and similar programmes) and all over the world for the cure of the disease, clinical testing on components of the virus, and the development of a successful vaccine. The Heads of State or Government and the representatives of the European Community welcome the proposal by the President of the French Republic aiming at the creation of an International Committee on the ethical issues raised by AIDS.

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ETAT

THE RIGHT HONOURABLE

MARGARET THATCHER M.P.

NO. 10 DOWNING STREET

LONDON(S.W.)

15854 ON BEHALF OF THE WORLD HEALTH ORGANIZATION I HAVE THE HONOUR TO LET YOU KNOW HOW GREATLY WE ARE HEARTENED BY YOUR VENICE STATEMENT ON THE NEED FOR INTERNATIONAL COOPERATION AND CONCERTED ACTION TO FIGHT AIDS AVOIDING

/ /

COL 10 15854

International Telegram
British TELECO
For enquiries dial number shown in Phone Book

DUPLICATION OF EFFORT WE ARE MOST ENCOURAGED BY YOUR STATEMENT THAT YOUR WORLD HEALTH ORGANIZATION IS THE BEST FORUM FOR DRAWING TOGETHER INTERNATIONAL EFFORTS ON A WORLDWIDE LEVEL TO COMBAT AIDS AND THAT ALL COUNTRIES SHOULD BE ENCOURAGED FULLY TO COOPERATE WITH WHO AND SUPPORT ITS SPECIAL PROGRAMME ON AIDS

I CAN ASSURE YOU THAT THE WORLD HEALTH ORGANIZATION HAS ALREADY ASSUMED ITS CONSTITUTIONAL RESPONSIBILITY TO DIRECT AND COORDINATE THE GLOBAL STRATEGY TO COMBAT AIDS ENDORSED BY THE WORLD HEALTH ASSEMBLY IN GENEVA LAST MAY YOUR STATEMENT WILL ADD STRENGTH TO OUR EFFORTS HIGHEST CONSIDERATION

MAHLER DIRECTOR-GENERAL WORLD HEALTH ORGANIZATION

GENEVA

International Telegram
For enquiries dial the number shown in your Phone Book
British TELECOM

10 DOWNING STREET

THE PRIME MINISTER

24 June 1987

ZSI/14
07 JUL 1987

Dear Director-General,

Thank you for your message of 11 June.

The British Government hope that the Declaration on AIDS issued at the Venice Economic Summit will contribute to the strengthening of international commitment - both political and financial - to the work of the World Health Organisation in combating the spread of AIDS. We have every confidence that you and your staff will provide the leadership essential if international efforts are to be effectively co-ordinated, and we are particularly pleased to be co-sponsoring with the World Health Organisation the World Summit of Ministers of Health on AIDS in London from 26 to 28 January next year.

I should like to take this opportunity of assuring you of the British Government's continued support in this important task.

Yours sincerely

Margaret Thatcher

Dr. H. Mahler

WORLD SUMMIT OF MINISTERS OF HEALTH ON PROGRAMMES FOR AIDS PREVENTION

LONDON 26-28 JANUARY 1988

JOINTLY ORGANISED BY THE WORLD HEALTH ORGANIZATION AND THE UNITED KINGDOM GOVERNMENT

WORLD SUMMIT OF MINISTERS OF HEALTH

LONDON DECLARATION ON AIDS PREVENTION

28 January 1988

The World Summit of Ministers of Health on Programmes for AIDS Prevention, involving delegates from 148 countries representing the vast majority of the people of the world, makes the following declaration:

1. Since AIDS is a global problem that poses a serious threat to humanity, urgent action by all governments and people the world over is needed to implement WHO's Global AIDS Strategy as defined by the Fortieth World Health Assembly and supported by the United Nations General Assembly.

2. We shall do all in our power to ensure that our governments do indeed undertake such urgent action.

3. We undertake to devise national programmes to prevent and contain the spread of human immunodeficiency virus (HIV) infection as part of our countries' health systems. We commend to all governments the value of a high level coordinating committee to bring together all government sectors, and we shall involve to the fullest extent possible all governmental sectors and relevant nongovernmental organizations in the planning and implementation of such programmes in conformity with the Global AIDS Strategy.

4. We recognize that, particularly in the absence at present of a vaccine or cure for AIDS, the single most important component of national AIDS programmes is information and education because HIV transmission can be prevented through informed and responsible behaviour. In this respect, individuals, governments, the media and other sectors all have major roles to play in preventing the spread of HIV infection.

5. We consider that information and education programmes should be aimed at the general public and should take full account of social and cultural patterns, different lifestyles, and human and spiritual values. The same principles should apply equally to programmes directed towards specific groups, involving these groups as appropriate. These include groups such as:

- policy makers;
- health and social service workers at all levels;
- international travellers;
- persons whose practices may place them at increased risk of infection;
- the media;
- youth and those that work with them, especially teachers;
- community and religious leaders;
- potential blood donors; and
- those with HIV infections, their relatives and others concerned with their care, all of whom need appropriate counselling.

6. We emphasize the need in AIDS prevention programmes to protect human rights and human dignity. Discrimination against, and stigmatization of, HIV-infected people and people with AIDS and population groups undermine public health and must be avoided.

7. We urge the media to fulfil their important social responsibility to provide factual and balanced information to the general public on AIDS and on ways of preventing its spread.

8. We shall seek the involvement of all relevant governmental sectors and nongovernmental organizations in creating the supportive social environment needed to ensure the effective implementation of AIDS prevention programmes and humane care of affected individuals.

9. We shall impress on our governments the importance for national health of ensuring the availability of the human and financial resources, including health and social services with well-trained personnel, needed to carry out our national AIDS programmes, and in order to support informed and responsible behaviour.

10. In the spirit of United Nations General Assembly Resolution A/42/8, we appeal:

- to all appropriate organizations of the United Nations system, including the specialized agencies;

- to bilateral and multilateral agencies; and

- to nongovernmental and voluntary organizations

to support the worldwide struggle against AIDS in conformity with WHO's global strategy.

11. We appeal in particular to these bodies to provide well-coordinated support to developing countries in setting up and carrying out national AIDS programmes in the light of their needs. We recognize that these needs vary from country to country in the light of their epidemiological situation.

12. We also appeal to those involved in dealing with drug abuse to intensify their efforts in the spirit of the International Conference on Drug Abuse and Illicit Trafficking (Vienna, June 1987) with a view to contributing to the reduction in the spread of HIV infection.

13. We call on the World Health Organization, through its Global Programme on AIDS, to continue to:

(i) exercise its mandate to direct and coordinate the worldwide effort against AIDS;

(ii) promote, encourage and support the worldwide collection and dissemination of accurate information on AIDS;

(iii) develop and issue guidelines on the planning, implementation, monitoring and evaluation of information and education programmes, including the related research and development, and ensure that these guidelines are updated and revised in the light of evolving experiences;

(iv) support countries in monitoring and evaluating preventive programmes, including information and education activities, and encourage wide dissemination of the findings in order to help countries to learn from the experiences of others;

(v) support and strengthen national programmes for the prevention and control of AIDS.

14. Following from this Summit, 1988 shall be a Year of Communication and Cooperation about AIDS in which we shall:

- open fully the channels of communication in each society so as to inform and educate more widely, broadly and intensively;

- strengthen the exchange of information and experience among all countries; and

- forge, through information and education and social leadership, a spirit of social tolerance.

15. We are convinced that, by promoting responsible behaviour and through international cooperation, we can and will begin now to slow the spread of HIV infection.

TORONTO ECONOMIC SUMMIT: SECOND MEETING OF PERSONAL REPRESENTATIVES 27-29 FEBRUARY 1988

Brief No. 9 Terrorism

Objectives

To secure crisp, new wording on terrorism in the main political declaration.

(if raised)
Points to Make

i) Believe terrorism may well arise during discussion. Do not expect heads of government to spend much time on it.

ii) If we are to say something on terrorism needs to be crisp and new. Do not want to see tired reiteration of previous wording.

iii) If partners have suggestions for solid new elements for a separate declaration on terrorism we are happy to consider them. But believe it would be more realistic to include language on terrorism in main declaration.

BACKGROUND

i) The first meeting of the Summit Seven Counter Terrorism Experts under Canadian chairmanship is due to take place on 21/22 March.

ii) We have spoken informally to the Canadians about their intentions for a declaration on terrorism. Our view is that baring a major terrorist incident we should aim to include few terse sentences on standing firm against terrorism in a wider political statement.

iii) Separate statements on terrorism were made at previous summits (texts below) but there is a danger of making statements just for the sake of it. Anything which we do say must be relevant, new and convincing.

iv) Against a background of persistent rumours of French and German and even Italian deals on the release of hostages, it is hard to see what a new declaration might include without sounding hollow.

Security Coordination Department

19 February 1988

TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 10: TECHNOLOGY AND FOREIGN POLICY

OBJECTIVES

1. (If raised by others): To welcome further discussion by Foreign Ministers in September on assumption this will not appear on Toronto agenda.

POINTS TO MAKE

1. Sir G Howe sorry he was unable to manage March dates proposed by FRG for Foreign Ministers' meeting: unbreakable Cabinet and Parliamentary commitments. In principle discussion in New York over weekend before UNGA looks good.

2. Subject an intriguing one. Agree should not be handled bureaucratically. Discussion so far has drawn attention to several trends which need watching. But not clear what specific policy conclusions should be drawn.

3. Now that Foreign Ministers' meeting postponed to September, assume subject will not appear in its own right on Toronto agenda. (But would not want to exclude longer term analysis, eg evolution of East/West relations, in discussion of the normal range of foreign policy subjects).

BACKGROUND

1. At the Venice Summit, Shultz initiated a discussion of the implications of technological change for foreign policy. This was pursued at the Seven Foreign Ministers' dinner in New York in September at which it was agreed that the Germans would host an informal meeting in 1988 to take discussion forward. It has proved impossible to settle on mutually convenient dates in the Spring. The only ones convenient to Shultz (30-31 March) proved impossible for Sir G Howe, and the French and Japanese Foreign Ministers. Genscher has therefore proposed an informal meeting in or just outside New York over the weekend before the UNGA in September. The Americans are looking into this.

2. If this meeting does take place, it may not deal exclusively with the technology and foreign policy ideas. Genscher has suggested an even larger theme: "global trends" or "global imponderables". There is an obvious danger that discussion will move from the practical to the ethereal.

3. The key elements in the Shultz thesis, which have since been advanced in public in a speech in December 1987 (attached), are as follows:-

a) We are in the "information age" in which knowledge and the methods of communicating it are the key to progress. Human talent (not geographical size, possession of raw materials etc) becomes the key to economic prosperity: "the ability to use information is the cutting edge of modernisation";

b) The ever-accelerating pace of change in industrial etc processes;

c) The technological backwardness of the socialist world;

d) The steady erosion of the nation state as markets and productive processes are internationalised;

e) The emergence and development of regional and functional groupings, fragmenting the bipolar post-war framework;

f) The growth of terrorism and of Third World sources of weapons;

g) The possibility of countries dividing into three basic categories:

i) the technologically innovative and effective;

ii) the imitators, coping with but unable to influence the pace of change;

iii) the "lumpen proletariat" of those left behind.

(The Americans privately put the US, Western Europe and Japan in the first category, but think the Soviet Union is slipping from the first to the second).

4. The Americans have drawn the following conclusions:

a) The need to avoid protectionism and dismantle agricultural subsidies;

b) The need to cultivate regional organisations;

c) The need to be alert to Soviet attempts to exploit Third World disadvantage;

d) The need to deal with Soviet efforts to use the UN to compensate for their relative lack of influence on regional grouping such as ASEAN.

5. These conclusions, and the analysis underlying it, are not in dispute. Although further discussion might be illuminating, it is not clear that much more can be said; or that it will be possible to translate conclusions into specific policy options for the Seven.

Policy Planning Staff
18 February 1988

EMBARGOED UNTIL DELIVERY, SCHEDULED FOR APPROXIMATELY 3:45 P.M. EST, DECEMBER 4, 1987. NOT TO BE PREVIOUSLY QUOTED FROM, CITED, OR USED IN ANY WAY.

REMARKS BY

THE HONORABLE GEORGE P. SHULTZ

SECRETARY OF STATE

BEFORE

THE WORLD AFFAIRS COUNCIL OF WASHINGTON

WASHINGTON, D.C.

FRIDAY, DECEMBER 4, 1987

AS PREPARED FOR DELIVERY

National Success and International Stability in A Time of Change

Americans, and people just about everywhere, now know that big changes are underway in the world -- changes in virtually every subject from science to superpower relations.

So understanding and managing change is crucial. The United States has been trying to do that in recent years. And we have had some success in doing so, because our society thrives on change. We are open to it and we are ready for it.

The summit which starts next week is one mark of our success. Arms control gets most of the attention, but this summit will reflect hard work on human rights, in coping with conflicts around the world, in trying for a more stable relation between the two superpowers.

We have been doing pretty well. But we cannot be satisfied to rest on our accomplishments. This is a time to try to deepen our understanding of the changes taking place, to look ahead, and to assess what needs to be done if we are to keep control of our own future.

Now at this point in a speech about the world ahead an audience can expect to be inundated with a tide of vague generalities -- words like "interdependence," exhortations like "the challenge of global change," and recitations of the "gee whiz" variety about artificial intelligence, genetic engineering, and robotics.

Maybe it's impossible, but we have to try to talk about the world ahead without getting bogged down in this stultifying vocabulary. In ancient China, when familiar words and ways of thinking no longer accurately described the realities of the day, philosophers spoke of the need to "rectify names" so that concepts would correspond to the new order of things.

This is one of those times. Developments in science and social organization are altering the world profoundly -- too profoundly for conventional habits of thinking to grasp.

History suggests that mankind rarely understands revolutionary change at the time it is coming about. When concepts eventually catch up with the pace of change, new definitions and descriptions are applied: the Agricultural Age, the Bronze Age, the Industrial Revolution were named long after the fact.

So if we are in such a time of transformation, what kind of age is it that we are entering? What do we need to know and do about it?

I am not here to offer a definitive analysis of the global trends now underway, but to try to survey the present scene -- in Emerson's words -- from "an original relation to the universe." In this time of profound change, one of the hardest adjustments to make is intellectual adjustment. We must discard outdated habits of thinking and make room for new possibilities.

First of all, just how different is this era we have entered?

From one point of view, it was the 19th century's radical intellectual, ideological, spiritual, moral, and social revolutions that shattered the "eternal verities." In a way, we have not fully adjusted yet to those epic events.

Today's -- and tomorrow's -- revolutionary changes are of a different nature. They are characterized by greater size and speed; they are both centrifugal and centripetal in their impact, dispersing yet concentrating activities, influences, and decisions.

-- First, the very material substances that surround us in everyday life are being transformed. Physically, synthetic materials make objects lighter, stronger, more durable. But they are changing societies and economies too, because their emergence affects supply and demand for natural raw materials. One new material substance -- ceramics -- has led researchers around the world to superconductivity which in turn may profoundly alter one foundation-stone of all human activity: energy. Another such foundation -- food -- no longer limits by its production the possibility of world population growth. Biotechnology in agriculture has stood Malthus on his head.

The same scientific progress that has altered the nature of these basic substances has also accelerated the speed of human transactions. Time and space are calculated in ever-smaller units. Success in every field depends increasingly upon how quickly ideas can be transformed into reality. The speed at which information flows has already created a global financial market. Markets are no longer places, but electronic networks.

Along with these alterations in substance and speed have come changes in magnitude. Scientific, economic, political matters are global in dimension and enormous in extent. They are outstripping the traditional means by which governments dealt with them. The amount of money that changes hands in the global financial market in one day exceeds $1 trillion -- more than the entire budget of the U.S. government for a year. Such flows transcend national boundaries and can overwhelm rigid economic policies. Manufacturing processes similarly are becoming global in scale. I recently saw a snapshot of a shipping label for some integrated circuits produced by an American firm. It said, "Made in one or more of the following countries: Korea, Hong Kong, Malaysia, Singapore, Taiwan, Mauritius, Thailand, Indonesia, Mexico, Philippines. The exact country of origin is unknown." That label says a lot about where current trends are taking us.

The thread that runs through all these things is knowledge: its discovery, its rapid transmission as information, and the education needed to use it. Access to ideas, no matter where they are developed, becomes the key to scientific and economic progress.

For example, the growth sector for employment is the "service sector", particularly in finance, data processing, software, engineering and management consultation. "Services" is a misleading designation. These activities are centered on ideas, but have all the characteristics of the production of what we traditionally call "goods." So it is time, as the ancient Chinese would have recognized, for "a rectification of names".

Changes in materials, magnitudes, knowledge and the speed of its dissemination -- the opportunities offered by these changes are immense -- and America and other open societies are beautifully situated to make the most of this era ahead.

But there are troubling implications of change to consider as well. Emerson would put it down to his principle of "compensation" -- no aspect of progress comes free of some drawback.

For many nations, the emerging era means new problems. Countries which cannot or will not compete in the global marketplace and interact with ideas from other societies will find themselves falling behind the advanced innovators and producers.

Some of those countries may be able to absorb what the innovators develop and may register moderate growth. But the quality and technological content of that growth will remain limited by the inability of such countries to adjust to rapid change.

Other nations -- single commodity countries and agricultural and industrial subsistence economies -- are in danger of becoming marginal participants in the "Information Age" economy, living as in eras past. Some lack the human and physical infrastructure to create and exploit economic opportunities. Others are held back by the inflexible nature of their political and social systems.

Yet even those who fall further behind economically can partake of some of the fruits of the new age -- fruits that unfortunately are not sufficiently forbidden. Wars in the Third World are being fought with increasing sophistication and firepower. The spread of modern technical skill coincides with the modern resurgence of age-old ethnic, religious, and communal conflict. Beyond the Iran-Iraq war, we see fighting in Sri Lanka, ethnic conflict in Fiji, the devastation of Lebanon, Sino-Indian border tensions, the New Caledonia and Cyprus disputes, the continuing Arab-Israeli conflict.

Such tensions have always been part of human history. What is new is the heightened possibility that they will become wider and more deadly conflagrations through the misuse of relatively sophisticated weaponry. In the Iran-Iraq war, we see how readily available on the world arms market are missiles such as the EXOCET, the SCUD, and the SILKWORM. And many developing countries are becoming not just purchasers and users -- but adept manufacturers -- of military hardware considered highly advanced only a few years ago.

We have long feared the dangers of nuclear proliferation. Now we face a worldwide diffusion and use of chemical weapons -- thus breaching the international moral consensus of more than half a century. But this growing capacity to acquire or produce and employ such weapons unfortunately is not the whole story. Violence itself is undergoing a qualitative change, as terrorists and narcotics traffickers spread new forms of destruction around the world. We now recognize the long, tough battle we are fighting with these modern day barbarians, equipped with effective weaponry and uninhibited by traditional norms of civilized conduct.

In centuries past, advances in science and technology and warfare often far outstripped the abilities of statesmen and politicians. Today, political, economic, and social arrangements must be more closely harmonized with change.

Drawing from the example of science, we must create a more just and decent social order from the elements of our understanding. Human society has no unique or preordained social pattern. Our God-given goal is to fulfill ourselves through the social and cultural institutions that we ourselves create, and to leave this world a better place than when we entered.

As we face this phalanx of changing conditions, what principles stand out for us? I see three clear guidelines for dealing with the size, speed, and complexity of events today:

1. A society must be open to this new age of knowledge and information; to resist it deadens hope of progress. Today's transformations are products of our own system of openness and creativity. What we face are not vast impersonal "forces" or "trends" that sway us against our will, they are challenges created by our own past achievements. They offer opportunities for a better future, but only if they can be exploited.

   - The eighteenth century idea of democracy, with its qualities of openness, freedom, individual initiative and innovation remains the best way to deal with the stress and the opportunities of change.

2. For decision-makers, the margins for error are diminishing as the consequences of error increase in scope and gravity. Over-centralized plans and decisions increasingly will be inept. Thus the free operation of the marketplace -- for goods and ideas -- is the far more efficient arbiter of decisions.

   o Entrepreneurial initiative in a market environment is the engine of development and change. Global economic problems will keep coming at us in waves; we must remain open as we face them or be swept away.

3. The global nature of changes in science, in economics, in communication must be matched by political developments, particularly the strengthening and closer association of like-minded nations. To a greater degree than in revolutionary eras of the past, there is a synergistic interaction between scientific and technological advances and political, economic and social developments, with each element enhancing and accelerating the effect of change on the others.

- Today, regional associations of nations are fast becoming an important and effective new milieu for political and economic interaction in the world.

How do things stand in applying these principles? Not bad.

The Drive Toward Democracy

The most stirring political response to the new temper of our time has been the resurgence of democracy and the demand for political openness and participation.

Not so many years ago, democratic nations were thought to be a dwindling and embattled minority; today the idea of democracy is among the most important political forces of our time. Elites in the East and West recognize that advanced economic power comes from a high level of education, an openness to the world, a rational distribution of decision-making power, emphasis on individual initiative, decentralization of authority, greater freedom of information and association, and the right of the people to have a say in their own affairs and destiny.

Around the globe we see a powerful impulse toward democratic institutions and values. This recent phenomenon was first evident in Spain and Portugal a decade ago. Now, in Latin America, this drive has changed the complexion of the entire continent, from Argentina to El Salvador. In the Philippines, despite serious challenges, we see how tenaciously people are seeking to effect a transition to a new democratic way. In South Korea, there is a dramatic struggle to create new political institutions and achieve the peaceful transition of national leadership through open elections. And the Haitian people will not abide a return to the tyranny they so recently rejected.

Elsewhere the struggle continues, as in South Africa where the structure of apartheid is under increasing siege; and in Afghanistan, Angola, Nicaragua and Cambodia, where communist oppression has spawned resistance movements fighting for the rights denied them.

For the United States, these trends must be seen not only as an affirmation of the values we hold so firmly, but also as a test. The transition to democracy is a difficult and fragile process. And, it can be reversed.

Confronted by daunting internal and external challenges, new democracies will look to us for ideas, assistance and understanding. In response, we cannot shut our eyes or close our doors. If we do, the lamp of democracy will go out in many lands.

Freedom - Turning to the Market

With the new surge of democratic feeling, others have come to recognize what we have known all along - that democracy and free markets go together. As our free political system looks out for basic justice and opportunity and provides a safety net in case of adversity, our free markets ensure that our economy will function effectively.

-- Free markets cannot function in an environment of stifling political regulation or interference. Measures that would isolate an economy from the world or disengage it from the global community do enormous harm. The disintegration of the trade and financial structures during the 1930's provides ample evidence on this score.

-- All nations share a common responsibility, and must work together, to promote market forces and to ensure the maintenance of an open international economic system. The objective of cooperation is not to achieve a fixed, predetermined result, but to ensure that the free market is allowed to function.

There is real progress on all fronts here. The nations of Southeast and Northeast Asia were in the vanguard, but now with every passing year we see formerly socialist or command economies, in Africa, Latin America, and Asia, shucking off those rigid and limiting policies and relying more and more on open market practices and individual incentives.

There is progress as well in overcoming the lingering sentiment that governments can get together and somehow dictate economic results. In today's world that simply cannot be done. Markets, not governments determine economic results and there is no way to overrule the market more than momentarily -- especially given the vast quantities of goods, services, capital, information and technology flowing across national boundaries today.

However, governments can work together to promote procedures which allow markets to work more freely and efficiently -- that's what we are doing, for example, in the GATT trade talks in Geneva, in the annual economic summits, in the structural adjustment program of the OECD, and through the International Monetary Fund, the World Bank, and other international financial institutions.

The record of economic growth over the past four decades is one of amazing success. But at the same time there are plenty of problems and challenges facing the world's free enterprise, market economies. Just to name a few:

-- the size of government, whether measured by spending, or taxation, or regulatory influence, or income redistribution, or price distortions, has become a real burden to the efficient functioning of the market. There are many stories to be told, from the unconscionably expensive and distorting farm programs to the detailed regulation of opening and closing hours of retail stores. But our own recent experience in trying to trim the budget deficit may bring it home most clearly to this audience. Once established, government programs are virtually impossible to eliminate -- they spawn their own interest groups and become entrenched. Unless government is to grow without limits, we must find a way to make it shrink.

-- The trading imbalances in the global economy are most likely a symptom of more fundamental imbalances that need to be corrected. I suspect that we are farther along in facing up to our trade deficit than are many other countries whose economic growth has become all too dependent on an export surplus generally related to our deficit. Our challenge is to adopt policies at home that engender confidence in the strength of the U.S. economy, and promote policies overseas that will strengthen the economies of our major trading partners. If we fail, the process of correction is likely to be acute and painful.

-- The extraordinary cycle of inflation and disinflation over the past two decades has left a legacy of inflated debt, depressed commodity prices and stagnation in much of the developing world, especially in several countries close to home. The unpalatable mix of seeming political necessities and economic realities has made a debt workout hard slogging. Progress toward efficient, market-oriented solutions to the debt problem has been demonstrated in some key developing countries. But the problem remains a serious one, calling for unusual political resolve in debtor countries and genuine ingenuity in the international community.

Each country must pursue market-oriented policies and get its own house in order if the international economic system is to thrive. This is especially true for the United States as we are the largest player by far. The fact is that our size relative to that of other economies makes getting our house in order far more important for them than their housekeeping is for us. But we are not the only important player, and so others -- Japan, Germany, the other OECD countries, the newly industrialized countries, indeed all trading nations -- must contribute to a stronger international system by strengthening their own economies.

New Political Groupings

A third emerging reality on the world scene is that political, technological, and economic power and influence have been dispersing horizontally. Ours is no longer a bi-polar world -- the U.S. and Soviet share of world economic output is decreasing as the growth rates of other countries have been more rapid.

In the future, more nations will have the economic and human resources to contend for political, technological and commercial influence.

Already Brazil, Korea, China, India, Israel and the countries of ASEAN, for example, have become movers and shakers in one or more commercial or technological areas. The increasing number of students from developing countries in advanced training programs -- India alone has about 10 per cent of the world's total enrollment in higher educational institutions -- will put these countries in a position to create and take advantage of technological change.

In this new environment, the importance of regional country and functional groupings has been heightened.

Regional, political and religious blocs of nations -- such as the Organization of American States, the Organization of African Unity, South Asian Association Regional Cooperation, the Non-Aligned Movement, and the Islamic Conference -- now provide platforms for a number of countries to exercise influence in global affairs.

Other regional organizations are taking on growing economic and political importance -- from the Eastern Caribbean to Southern Africa, from the Americas to South Asia, from the Persian Gulf to the South Pacific. For example, the Pacific Basin, a region of phenomenal economic growth, is developing a web of cooperative realities.

ASEAN is showing the way to regional cooperation and is taking on more and more of a political dimension beyond its initial focus on economic affairs.

Just as with the new trends toward democratization and open economies, these developments in political cooperation are outgrowths of our efforts and aspirations for a better world.

The United States led the way after World War II in advocating the importance of the regional approach to the recovery of a devastated Europe.

Today, the institutions that resulted are thriving:

- o regional organizations such as the NATO alliance, the OECD, the European Economic Community and the Western European Union;

- o and functional organizations such as GATT, IMF, the World Bank and regional development banks, and the effective functional organizations of the UN, such as those dealing with nuclear energy, health, and civil aviation.

This cooperation, which began in large measure by focussing on post-World War II reconstruction needs in Western Europe, is an inspiration and a model for regional and functional approaches to challenges around the world. It is vital to recall that these groupings originated in efforts to reduce barriers. New associations must stay true to that purpose rather than evolve with protectionist enclaves which would spark devastating economic warfare.

Based on the clear success of the regional approach in advancing Western security and economic well-being, we are intensifying our efforts to strengthen regional cooperative efforts everywhere in meeting the common challenges we will face in the Information Age.

The East-West Dimension

What I have sketched out here is a picture of immense dynamism: of the creative energies of free peoples generating challenges which they -- and increasing numbers of those who would emulate them -- are meeting with considerable success. The West has no monopoly on clever people, and the world's centers of scientific creativity and economic power are proliferating.

Where in this picture do we find the nations of the communist world?

The Soviet Union will remain our central security concern for the foreseeable future. The United States' military strength, our framework of alliances and our other security ties, remain central to peace in the world. But there is also emerging a new dynamism in the East-West relationship.

In this respect, the current ferment in the communist world is a remarkable political development. Perhaps nowhere is this more evident than in China, which can be seen to be undergoing a new era of "rectifying names." The opening of a long-closed society to market forces, trade, technology and ideas is bringing significant benefits for the Chinese people.

Certainly, China and Western democracies are still divided over critical ideological issues. However, China has realized that the future belongs to those who open themselves up to global trends in the dissemination of knowledge, in the international economy, and in popular political participation.

Similar rethinking of old concepts and ways of doing things seems now to be underway in the Soviet Union and Eastern Europe. While the ultimate dimensions of this process remain to be seen, its potential importance is great.

Despite the constraints of a rigidly centralized society and economy, the Soviet Union is a leading scientific force in space science, in various fields of medical research, and in theoretical disciplines. Its massive economy, for all its inefficiency, generates a per capita GNP of about $8000.

But now Soviet leaders are telling their people that that is not enough -- that the system they inherited essentially unchanged from Stalin must be restructured. As General Secretary Gorbachev stated in his June Party Plenum speech, "command forms of managing society put a brake on our movement." Whatever "perestroika" may finally come to mean, the terms in which it has been defined thus far suggest that Mr. Gorbachev and his colleagues understand that a closed society is a dead-end for advanced development. And implicit in the parallel concept of "glasnost" may be a recognition that the free flow of ideas and information which will fuel growth in the future requires greater intellectual and political freedom.

The most telling indicator will be the Soviet human rights situation. The world is looking for results that bear out the rhetoric -- not only for the sake of the individuals and families involved, but because human rights as practiced at home ultimately are related to international security. For a government that does not respect the rights it has guaranteed to its own people will not respect its international obligations and the general norms of the world community.

There is nothing in the "new political thinking" to date which suggests that the end of the adversarial struggle is at hand. What will "new thinking" mean for the people of Eastern Europe, who continue to strive for greater autonomy in dealing with their daunting socio-economic agenda? And what about Afghanistan? Will Soviet leaders withdraw their troops and allow the Afghan people to decide by political means what kind of government, economy and political system they desire? Will the Soviet Union play a constructive role in Cambodia, Korea, southern Africa, and the Persian Gulf?

The winds of change blowing from Moscow may prove as revolutionary as Mr. Gorbachev has declared. But in determining their ultimate impact, historians will look to the answers to questions such as these.

But as for us today, the continuing reality before us means that American political resolve must remain constant, our defense robust. With those parameters, the challenge to us is to be sensitive to any opportunities which the changes now underway in the Soviet Union and other communist countries may hold.

In this time of global challenge and change, nations of the world look intensively and searchingly at the relationship between the U.S. and the U.S.S.R. That relationship today is meaty and substantial. A major reason for this is that we Americans stand up for our principles and our interests while remaining ready to test and to deal with changing realities in international life. This approach gets results, and we're going to stick with it.

Conclusion

In a world of blurring national boundaries, dispersed power and new players vying for influence in international affairs, there will be a continuing need for U.S. engagement and leadership.

Our alliances and our friends, and the growing number of regional associations around the world, provide a foundation for problem solving on the scale demanded by the world ahead.

We must not falter on the economic front. We can take great satisfaction knowing that the message of economic freedom is at last being heard and acted upon in country after country around the world. If we ourselves yield to the temptation to return to isolation, protection and structural rigidities we betray this movement -- and general prosperity in the era ahead will be a lost cause.

Economic progress and freedom go hand in hand. New democracies will require continuous support and encouragement.

The United States has an immense stake in seeing that the democratic idea works. And those who resist totalitarian governments must be able to know without doubt that they will be able to look to America to back their legitimate pursuit of liberty and justice.

And finally, in this period of profound historical change, both the United States and the Soviet Union must make the most of opportunities to transform the adversarial character of the U.S.-Soviet relationship to one that is better for both our peoples, and for the world at large.

We will leave it to future historians to give our age a name. Our task is to try to throw off outmoded concepts of the past as well as cloudy generalities about the future. What we need to see is the dynamism in the size, speed, and scope of global change.

And most of all we need to see that this change is of <u>our</u> doing. <u>We</u> can manage it better than anyone. <u>We</u> have to have the courage to stand fast to our own principles: democracy, free enterprise, the cooperative association of responsible nations.

With this as our vision and guide, we face a bright future indeed.

TORONTO ECONOMIC SUMMIT: SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 11 : SOUTH AFRICA

OBJECTIVES

1. To resist any pressure for major discussion, or for a declaration.

POINTS TO MAKE - IF RAISED

1. South Africa not an appropriate subject for this primarily economic forum.

2. Time is not right for making a new statement or launching an initiative. Neither side in South Africa in a position to respond constructively: P W Botha preoccupied with beating off serious right wing (Conservative Party) challenge; Black opposition divided.

3. Time may come for further international activity: but not now.

HD3ACS

ESSENTIAL FACTS

1. In the run up to last year's Economic Summit at Venice there was considerable pressure from some of the seven to bring South Africa to a prime place on the agenda. The Americans first proposed that the Summit should issue a declaration of principles governing an eventual settlement in South Africa. As American enthusiasm waned (mainly because we made clear to them our opposition to a declaration), the Canadians took up the running. They argued for a declaration and suggested a new mediating/contact group of seven Foreign Ministers.

2. In the event, the Canadians received no support at Venice. There was no separate formal declaration on South Africa, but one paragraph of the Chairman's closing Summary on Political Issues was devoted to South Africa.

3. The absence of a formal statement received some press attention. A Financial Times article claimed that 'full-scale criticism of South Africa' at the Summit was blocked by Britain. Press speculation had been fuelled well in advance. The indications are that Mr Mulroney will be much less keen this year. But we should attempt to head off (as early as possible, preferably in company with others) any suggestion of discussion of South Africa.

HD3ACS

TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES, 27-29 FEBRUARY

AGENDA: CANADIAN ISSUES FOR DISCUSSION PAPER: TEXT PLUS COMMENTARY

1. This brief offers short, page by page comments on the Canadian paper; the text appears on each left hand page, the commentary on the right.

2. Each section of the text starts with description and analysis followed, in the case of sections III-VIIIB, by questions for discussion (which have been sidelined in red for ease of reference).

General Comment

3. A worthy paper, if rather long and detailed. Provides a useful starting point for discussions. Addresses the right questions but poses them in a very general way. Real Summit preparations need to go further and identify a positive message and/or programme of action.

ECONOMIC RELATIONS DEPARTMENT
FCO
FEBRUARY 1988

CONFIDENTIAL
CONFIDENTIEL

February 15, 1988

ISSUES FOR DISCUSSION PAPER
SECOND SHERPA MEETING

I INTRODUCTION: Commitment, Credibility, Confidence

Since the Venice Summit, the world economy has been rendered vulnerable to turbulence in financial markets which could lead to a slowdown in growth. Concern centres on the sustainability of current account positions and the external debt problems of the developing countries. To minimize the risk of a downturn in world economic activity and defuse tension in the international trade and payments systems, governments must demonstrate commitment to the goals of sustainable economic performance and external positions. Government policies must be seen as credible in addressing those goals. Commitment and credibility will restore market confidence.

II DEVELOPMENTS SINCE VENICE SUMMIT

Economic activity in the Summit countries was stronger in 1987 than expected at the time of the Venice Summit, but unemployment rates declined only in North America and the United Kingdom. Inflation, which troughed in 1986 (or early 1987), remains moderate. The differential between real total domestic demand growth in the United States and the other countries as a group turned significantly negative in 1987, mostly on account of weaker US domestic demand growth. Real net exports made a positive contribution to output growth in the United States -- the first year since 1980 -- but a negative contribution in all other Summit countries except the United Kingdom.

In volume terms, trade flows adjusted considerably toward more sustainable positions, although in nominal terms the imbalances of the three major economies remained persistently large. The further realignment of exchange rates in 1987 will contribute to the ongoing international adjustment process. (The recent economic performance of the Summit countries and the latest OECD and IMF projections are summarized in the appended tables.)

I INTRODUCTION

'Commitment, credibility, confidence' - possibly the basis of a Summit theme.

Over-emphasis on 'the risk of a downturn in world economic activity', ie recession, and in general too much concentration on effects of stock market crash.

II DEVELOPMENTS SINCE VENICE SUMMIT

Descriptive section. It balances good against bad points - economic activity in 1987 stronger than expected in the Summit countries (see first paragraph) but weaker in developing countries (see sixth paragraph). No attempt at overall assessment.

Our view: evidence that we are now clearly moving in the right direction is becoming more visible; need commitment to continue right policies.

Specific criticisms: no mention of the failure of Germany to grow sufficiently fast since Venice; a contrast of Japanese and German performance would have brought this out

: Louvre accord of February 1987 barely acknowledged, and insufficient emphasis on the importance of exchange rate stability.

: unwelcome hint in Section III of wanting more dollar depreciation (fourth paragraph, page 7 of text).

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On the basis of unchanged policies and exchange rates (as of the end of 1987), no further large disturbances in financial markets, and stable terms of trade, the medium term outlook is one of moderate, but lower growth in the major industrial countries, a modest increase in inflation, and continuing large external imbalances among the three largest industrial economies. There is a high degree of uncertainty about the outlook, however, and the risks are on the downside.

The fiscal stance of the Summit countries as a group, as measured by changes in general government structural balances, moved toward restriction in 1987 and is projected to move further toward restriction in 1988 and 1989. Fiscal consolidation was particularly marked in the United States, though the federal deficit remains high in absolute terms. In Japan and Germany fiscal policy was moderately expansionary. The fiscal stance of the United States and Japan is expected to be approximately neutral in 1988 before once again turning restrictive in 1989. Fiscal policy in Germany is projected to remain mildly expansionary in 1988 and approximately neutral in 1989.

In the wake of the October stock-market decline interest rates fell in all major industrial countries, albeit unevenly, as central banks injected liquidity to support the financial system. US interest rates declined more than German and Japanese rates, leading to downward pressure on the dollar. In turn, the upward pressure on the Deutschmark created tensions within the EMS which were defused by reductions in German interest rates. Since October 1987, a number of coordinated interest rate reductions in Europe have largely reversed the increases earlier in the year. From about mid-November, short-term interest rates in the United States, Canada, and Japan have edged upwards as central banks withdrew much of the liquidity injected previously. Over the past year, interest rate developments, especially in the major surplus countries, have also been affected by the "trade-off" between exchange rate stabilization and domestic monetary objectives. This potential conflict remains.

Economic activity in the developing countries in 1987 was weaker than expected at the time of the Venice Summit. Moreover, the outlook for the next year has deteriorated. On a regional basis there are wide divergences, however. The Asian economies are continuing to grow strongly, whereas the Latin American economies have weakened considerably. Growth in Africa is weak.

- last sentence, third paragraph : clumsy treatment of "conflict" between domestic monetary and exchange rate objectives.

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The debt situation remains a matter of serious concern in many developing countries. Even barring unfavourable developments such as a further terms-of-trade deterioration or world interest rate increases, debt-export ratios are expected to show only modest reductions.

III MACROECONOMIC POLICIES AND EXCHANGE RATES

Two crucial factors impinging on the outlook are investor and consumer confidence, and the willingness of markets to continue financing the fiscal and current account deficits at prevailing interest rates and exchange rates. A further shock in equity markets could undermine confidence, thereby reducing business and consumer spending and making a recession more likely. As well, a strongly increasing reluctance by investors to absorb dollar-denominated assets would tend to raise US interest rates and dampen economic activity in the United States and abroad. Though these potential developments cloud the economic outlook, they should be considered in light of the progress that has been made in reducing underlying international imbalances. In particular, the favourable effects of past policy actions and exchange rate changes have begun to materialize, as witnessed, for instance, by the considerable adjustment of trade volumes over the past year. Nor should it be overlooked that in recent weeks a substantial degree of calmness has been restored to foreign exchange and equity markets. The challenge is to manage the transition to a more sustainable, that is, less vulnerable, position so as to reduce the downside risks.

The main issue is the adoption of macroeconomic policies that will facilitate the smooth adjustment of international current account imbalances while maintaining growth and avoiding a resurgence of excessive inflationary pressures.

On the basis of projections by the IMF and the OECD of the US current account balance over the next couple of years, the United States at the end of 1989 will have an external debt of about $700 billion, for which annual servicing payment will be in the range of $30 to $40 billion. Under current exchange rates and policy settings, many observers project large US current account deficits for some years to come, resulting in a rapid cumulation of US external debt. For instance, the latest IMF World Economic Outlook implies a US current account

III MACROECONOMIC POLICIES AND EXCHANGE RATES

pp 3-6: a good discussion of the imbalances problem, bringing out in particular the potential problems of cumulating US debt.

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deficit of about $130-140 billion in 1992. Of concern is whether the projected rate of debt accumulation is sustainable, i.e., whether the current account deficits would be financed by private capital flows at prevailing interest rates and exchange rates. Official flows are not a viable long-run alternative.

Concerns by market participants about the implications of rapid accumulation of US net external debt for future exchange rates, inflation and growth, could result in a drying-up of foreign lending and, consequently, strong downward pressure on the dollar and upward pressure on US interest rates. Furthermore, there is the risk that these pressures could erupt in a sudden loss of investor confidence with ensuing turmoil in financial markets.

At some point the US trade deficit will have to shrink significantly, as will, correspondingly, the trade surpluses of other countries. What is of concern is the manner and the speed with which these changes will come about and the economies' ability to shift resources across sectors smoothly. Specifically, what will be the roles of relative prices, expenditures, and structural flexibility in bringing about the adjustment? Before turning to the issues raised by these factors, one point needs to be underlined. Evidence from a range of multicountry models[1] indicates that the rise in the US current account deficit can be broadly explained by differences in policy stance between the United States and the other major industrial countries. The deficit took several years to accumulate and will likely take several years to reverse.

1 This evidence is from the Brookings Institution conference of March 1986 and workshop of January 1987, as well as other research. Some of this evidence may be found in R. Bryant, G. Holtham, and P. Hooper, eds., External Deficits and the Dollar: The Pit and the Pendulum, Washington, D.C., Brookings Inst. 1987, and R. Bryant, D. Henderson, G. Holtham, P. Hooper, and S. Symansky, eds., Empirical Macroeconomics for Interdependent Economies, forthcoming.

That the narrowing of international imbalances will be a slow process enhances the importance of cooperation amongst countries to ensure the adoption of policies which foster that process. The alternatives, including the prospect of an even longer period of adjustment and uncertainty, would be a disturbing signal to markets.

The Role of Expenditures and Exchange Rates in the Adjustment of International Imbalances

Expenditures

In the past five years the cumulative growth of real total domestic demand in the United States has exceeded considerably that of other industrial countries. The respective rates for the Summit countries are: United States, 25 1/2 percent; Canada, 23 3/4; Japan, 19 percent; and the four major European countries, 14 percent. This cumulative differential in domestic spending accounts for a considerable portion of the US current account deficit. Reduction of the external imbalances would require a reversal of this differential in domestic spending. US fiscal policy would have to be tightened to permit the transfer of resources from domestic absorption to net exports, whereas domestic demand in the other industrial countries (especially the external surplus countries) would have to grow more rapidly. This process is now underway and is projected to continue over the next couple of years, but, in view of the slow adjustment of external imbalances, the question remains as to whether further policy actions are necessary.

Exchange Rates

The other major proximate cause of the external imbalances of the three major economies was the large real appreciation of the US dollar between 1981 and March 1985 which eroded US international competitiveness. However, notwithstanding the sharp depreciation of the US dollar against other major currencies since March 1985, which has restored US competitiveness to 1979-1980 levels, the US current account deficit has continued to grow.

These persistently large external imbalances mask two important developments, however. First, US export volumes have risen sharply in the past year, whereas those of the two principal surplus countries have declined. Secondly, the current account imbalances in US dollar

terms reflect the use of a depreciating currency as the basis of measurement. Expressed as a proportion of GNP/GDP, the current account surpluses of Japan and the Federal Republic of Germany peaked in 1986.

A number of explanations for the persistence of the US trade deficit, and the surpluses elsewhere, have been offered. In addition to the traditional J-curve phenomenon and the fact that in 1985 the value of US imports was more than double that of exports, explanations include a number of microeconomic developments and special factors which have affected exports and imports asymmetrically:

- weak prices for agricultural products have depressed a usually strong US export sector;
- credit-constrained LDCs have reduced their demand for US products;
- US price competitiveness has not followed in step with the evolution of the exchange rate. Changes in bilateral exchange rates have not been completely reflected in changes in US import prices. Exporters to the United States have absorbed part of the appreciation of their national currency by maintaining their export prices in US dollar terms and reducing their profit margins in an effort to maintain their market share. In contrast, US export prices have been determined mostly by movements in internal markets and only to a limited extent by external events;
- adjustment costs make the recapture of lost market shares by US firms a slow process; and
- new competitors have entered world markets for manufactures, in particular the Asian NICs, which have experienced large increases in competitiveness in the past two-and-one-half years.(The U.S. dollar has depreciated little against the currencies of these countries.)

The above, and perhaps other, factors help explain the persistence of the US trade deficit, but in the final analysis a reduction of the deficit requires that US output grow faster than final spending. And conversely for the countries with trade surpluses. Inasmuch as the US economy is operating near capacity -- the unemployment rate and capacity utilization in manufacturing are at their lowest and highest levels, respectively, since the end of 1979 -- further improvement in the external balance will require a reduction of US

domestic absorption (either by reducing the fiscal deficit or through a drop in investment and consumption), thereby freeing resources for the export sector. Faster domestic demand growth in Europe and sustained growth in Japan would contribute to a narrowing of the imbalances and support world demand.

The Asian NICs also should play a role in the international adjustment process by further liberalizing trade, reorienting more of their savings toward domestic investment, and correcting exchange rate misalignments.

Conclusion and Issues for Discussion

If international payments imbalances are to be significantly reduced from present levels, the US current account balance would have to improve substantially, whereas the surpluses of Japan, Europe (largely the Federal Republic of Germany), and the NICs would have to shrink by a similar amount. The policy challenge is to correct the imbalances while avoiding a decline in world demand.

To maintain world demand any reduction in US expenditure should be offset by increases in other countries. Expenditure changes alone will likely not be sufficient to bring about the required adjustment. Even if the reduction in US expenditure is matched by an increase in spending in other countries of the same amount, the effect on trade balances would be only a small fraction of the changes in expenditures (since propensities to spend on domestic goods are much higher than propensities to spend on foreign goods.) Thus, changes in expenditures will have to be accompanied by a switch in expenditure toward US goods and services. Given the large real depreciation of the US dollar that has already occurred, any further depreciation necessary to induce the switch in expenditure is likely to be comparatively small.

What rate of reduction of international imbalances would be viewed as necessary to manage the transition to a sustainable outcome?

- page 7, fourth paragraph: muddled discussion on the maintenance of world demand. It seems to miss the point that there have already been large exchange rate shifts: now we need the accompanying demand changes. The discussion of import propensities seems to confuse "average" with "marginal": Therefore, doubt if it is true that demand changes will have a small impact on net imports. That then must cast doubt on the argument that further depreciation of the dollar is necessary (final sentence of this paragraph).

Questions for discussion

- asking about the 'rate of reduction' puts the question too much in the frame of econometric models; the real question is: given that we are in a long process of correction, which will need sustained and enhanced policy action, do we need to do more to secure financing over the transitional period?

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Are the differences in the projected rates of growth of domestic demand in the Summit countries concordant with the desired narrowing of international imbalances?

In view of the large cumulative domestic demand gap between Europe and the rest of the Summit countries, are there special factors which have to be considered in Europe?

What specific further fiscal and monetary policy measures by individual countries are necessary to bring about the desired adjustment of international imbalances?

How best can the NICs be integrated in the coordination process?

IV STRUCTURAL POLICIES

As trade imbalances narrow, the macroeconomic adjustments will be accompanied by structural adaptation. Regardless of how the gap between production and absorption in the deficit and surplus countries is achieved, it will involve large sectoral adjustments -- between tradables and non-tradables and within tradables -- which displace labour. The longer the trade imbalances persist, the greater will be the subsequent sectoral adjustments.

As the trade deficit and surpluses are reduced, producers in surplus countries have to shift from producing for the US market to producing for their domestic market, whereas US producers have to orient more of their production towards foreign markets. Given the structure of trade, much of the adjustment will fall on manufacturing. Agriculture might make some contribution to the improvement in the US trade balance, but in view of the excess supply of many agricultural products in world markets, any such contribution is likely to be small. Service exports cannot expand sufficiently to make a significant contribution -- the net investment income category will be in deficit, while the remaining categories are too small to make a sizeable contribution. Hence, manufacturing trade must bear the brunt of the adjustment. In this regard, the declining trend in the growth of world trade in manufactures is of concern, since adjustment is likely to be more difficult, and protectionist pressures more intense, in a climate of uncertainty and slow growth.

- Answer to first question on page 8, Yes (but see answer to next question).

- Intra-European imbalances are emerging as a major problem. France and Italy are likely to attack Germany, with the US cheering them on; we are concerned about the structure of the German economy.

- This question more suitable for OECD.

- Is this reference to 'integration' of the NICs really referring to how to get Taiwan and South Korea to drop their trade restrictions and raise their exchange rates? (The other two Asian NICs, Singapore and Hong Kong already have liberal trade regimes; latter special case for us of course).

IV STRUCTURAL POLICIES

Sir Geoffrey Littler comments on this section as follows: "this passage gets the balance wrong on timing. The really damaging structural changes arose from the effect of the high dollar in the US. As this is reversed, there may well be some problems for countries which excessively exploited the high US dollar, but of lesser order.
The worry about decline in the rate of growth of trade in manufactures is overdone. The distortion of the high US dollar included as one major effect the substitution of huge US imports for previous US domestic production - and contributed to a rapid growth of world trade in manufactures. Unwinding this will need to have the opposite effects (and the US must surely as part of their adjustment regain some of their lost domestic market share)."

In general, too little in the paper on structural policies and too much on macro demand management.

- last paragraph : The gloom on US agricultural exports seems overdone. They are already 30% up on 1985 (when the dollar was at its peak). Market shares are being regained.

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In view of the large adjustments required to correct existing international imbalances, and in view of the resistance that may be encountered from affected groups, there is a need for the encouragement of policies that will facilitate sectoral adjustments. This need is underlined by the fact that in the major European countries employment in manufacturing has declined throughout the 1980s despite strong exports of manufactures. Moreover, the growth of service-sector employment has not been sufficient to offset employment losses in manufacturing and absorb new entrants to the labour force. In contrast, in North America the decline in manufacturing employment in the first three years of the 1980s has since been reversed, and strong growth in service-sector employment has permitted a reduction of unemployment rates to 1979-80 levels. In Japan, employment has risen somewhat in manufacturing and more rapidly in the services sector, but not sufficiently to prevent some increase in unemployment.

What policies can countries implement or modify -- for instance, with regard to subsidies, government regulations, and taxation -- that would facilitate sectoral adjustments while contributing to demand growth?

In particular, are labour markets sufficiently flexible to allow the required sectoral adjustments to come about without undue frictions??

V MULTILATERAL SURVEILLANCE AND POLICY COORDINATION

The two major issues in this area concern the management of the transition to sustainable economic policies and performance for the Summit countries, and, once sustainability is achieved, ensuring that it is maintained. Multilateral surveillance and coordination of policies should facilitate the attainment of both these objectives.

Over the past two years the Summit countries, in conjunction with the IMF, have been formulating a surveillance mechanism based on a set of economic indicators proposed at the Tokyo Summit. Countries have also agreed to provide medium-term objectives and

It might have been helpful if the proposals on micro policy surveillance had been discussed here rather than in Section V.

Questions for discussion

The questions on structural policies are very general. In particular, no sign of Japan/Germany being picked out for special mention. OECD work in hand: some sign that German Finance and Economic Ministries would welcome focus on structural adjustment at OECD Ministerial, as way of putting pressure on German spending Ministries.

V MULTILATERAL SURVEILLANCE AND POLICY CO-ORDINATION

As Sir G Littler comments, this section gives useful backing for the Chancellor's proposals on indicators at the 1987 annual meetings (though is hardly the stuff of Summits). We strongly agree on the importance of global indicators, but should avoid detailed and quantitative questions about them.

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projections for their economies. These are now being assessed regularly in conjunction with the IMF's World Economic Outlook in order to highlight possible tensions.

At the IMF/World Bank Annual Meetings in September 1987, US Treasury Secretary Baker and UK Chancellor of the Exchequer Lawson proposed possible extensions to the use of indicators in the surveillance process. Both suggested the use of a commodity price index as a leading indicator of inflationary trends. More generally, the question is whether there is a need for global indicators to aid in monitoring the performance of the Summit countries as a group.

Work underway at the IMF, the OECD, and elsewhere suggests that a commodity price index could play a role as an indicator of inflation pressures in the Summit countries, individually and globally, complementary to that of other indicators. But given the relatively small contribution of commodity prices to the inflation forecast, their volatility and their high susceptibility to speculative forces that role would be limited. A commodity price index, however, is only one possible global indicator.

Is there a need for global indicators as:

- an aid to discussion amongst countries on the appropriate policy stance?, and/or

- a guide to the policy that individual countries should adopt (i.e., who does what)?

The rapid trend towards the global integration of securities markets and the recent turbulence of equities markets have raised the question of whether greater international cooperation in the supervision of securities markets is called for.

Is there scope for Summit consideration of how to catalyze the ongoing discussion in this area?

The scope for policy surveillance also extends to other areas. In an increasingly integrated world economy, the "spillover" of domestic microeconomic or structural policies cannot be neglected; especially as these have often been the motive force of protectionism. In the future, latent protectionist pressures may be exacerbated by the turnaround of current account positions and the

Fifth paragraph and question: Sir G Littler comments that "We must distinguish in discussion of securities markets two levels of problems:

- systemic financial threats, which certainly need some international co-ordination (of a kind which will also tend to help towards more level playing-fields);
- customer protection needs, where we can probably learn from each other, but where the need for international co-ordination arises in more limited senses.

In any case I am very doubtful about the aptness of this subject for Summit discussion, or even for handling by G7/8 (i.e. Summit groups)." It is certainly a highly technical subject and advice would have to be sought from the Bank of England. (See also DTI/HMT brief on Financial Market Mechanisms).

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ongoing force of structural change stemming from technological developments and shifting patterns of comparative advantage.

How can a method of domestic surveillance of micro or structural policies be developed?

VI MULTILATERAL TRADING SYSTEM

The international trading and monetary systems, national economic policies, international imbalances and developing countries' debt problems are all inter-related. Difficulties in resolving external imbalances exacerbate protectionist pressures. Also, to the extent that these difficulties adversely affect growth and the smooth functioning of financial and foreign exchange markets, they affect the ability of LDCs to service their international debt. On the other hand, further trade liberalization will contribute to international well being generally and assist in the adjustment of international imbalances and debt servicing problems of the developing countries.

Recent events - e.g. the October stock market shock - may have momentarily helped stem the forces of protectionism, but exchange rate and trade adjustments may well renew protectionist pressures.

A key issue is a credible and continuing fight against protectionism. A successful MTN, with its commitment to standstill and rollback, to improved market access, to improved rules of trade and to an expanded role for GATT, is essential.

Further, unless the GATT System itself is fundamentally strengthened, gradual erosion may over time render it obsolete. More effective multilateral surveillance of the full range of trade-related policies is imperative. At the very least, the system needs a strong vote of confidence. Substantive early progress toward a successful MTN thus remains a major goal.

How can the Summit best help prevent continuing erosion of the trading system and provide the momentum to maintain and improve the functioning of the GATT System?

On micro surveillance, this might be an opportunity to point to the OECD as the main forum for examining countries' structural policies. The monitoring of agricultural policies is a first step in this direction. The negotiations in the GATT on surveillance of trade policies also offers the beginnings of such a process.

VI MULTILATERAL TRADING SYSTEM

There is little new in the analysis in this ection. A number of difficult questions are set but no answers are offered.

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In particular, how can an effective system of multilateral surveillance be implemented to facilitate the adjustment process?

A major political and institutional consideration is the future role of developing countries in the GATT System. On the one hand, some developing countries - the NICs - are able to take on greater GATT responsibilities and to be less dependent on special treatment. On the other hand, a number of developing countries should play a larger GATT role - in their own developmental interests - but lack the resources to participate fully.

The developing countries and especially the NICs should be encouraged to undertake increased commitments and obligations and a greater role in the GATT, commensurate with their place in international trade and their respective stages of development. Moreover, developed countries must consider in this context what they are prepared to do to meet the legitimate need of developing countries for greater, more secure access for their exports into developed countries.

How should the NICs be encouraged to undertake increased commitments and obligations and a greater role in the GATT?

At the Venice Summit leaders reaffirmed the OECD Ministerial Agreement on agriculture, including the principles for policy reform and undertook to refrain from adverse practices which would exacerbate market imbalances and the trade environment. They agreed on the early tabling of negotiating proposals in the MTN (which has been done by Canada, the United States and the European Community) and committed themselves to review progress in the MTN at the 1988 Summit and consider the tasks that remain. Provisional results of OECD studies suggest little progress, however.

Assuming discussions in Geneva can be sufficiently advanced, what could be the elements of a framework agreement for the negotiation of long term reform of agricultural trade and trade-distorting domestic policies? What specific commitments on such a framework could Summit leaders make?

On the NICs, recent G7 statements about the need for them to correct their ways (through import liberalisation, appreciating exchange rates) are probably yielding diminishing returns. Task is to persuade them to change their policies in their own interests, with judicious mix of sticks and carrots (work in hand in Whitehall).

There is an element of circularity in the discussion of what might be agreed on agriculture and the role and purpose of the MTR. If the MTR is to be no more than a political round-up at the end of the Reagan administration, then there may not be much need for a substantive discussion on agriculture. If, on the other hand, the intention is to have a meeting to announce the fruits of a substantive negotiation than there may, indeed, be a need for Summit negotiation. It is too soon to tell at the moment.

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What undertakings could leaders make on short term measures which would: (a) lead to immediate improvements in the trade situation? (b) be consistent with longer term reform?

Ministers have also in more general terms committed themselves to further trade liberalization and the success of the MTN. It will be important to reaffirm this broad commitment particularly at a time of possible slower economic growth. The 1988 Summit will undertake the same kind of overall review of the state of play in the MTN, as in agriculture. The key issue will be to ensure that the MTN momentum is maintained. In this context the Ministerial level Mid-Term Review Conference is most important. The question of when (December) and where (Canada) has basically been settled. For the Toronto Summit the outstanding issue will be:

What is to be achieved at the Mid Term Review?

VII DEVELOPING COUNTRIES AND DEBT

A. MIDDLE INCOME COUNTRIES

The situation of indebted developing countries is characterised by uncertainty. There has been progress in strengthening the international financial system and commercial banks against the risks posed by the debt situation, and many indebted countries have implemented programs of macroeconomic adjustment, complemented in some cases by structural reforms. However, a generalized return of these countries to sustained economic growth and creditworthiness is proving elusive. There is a growing sense that recent developments may have marked a turning point in the international debt strategy, as the focus on "growing out of debt" begins to be complemented by techniques which actually reduce the stock of debt.

Perceptions of the middle-income debtors tend to be dominated by the three largest debtors: Brazil, Mexico and Argentina. The financial system has withstood Brazil's moratorium of 1987, and negotiations may result in a comprehensive agreement and a resumption of debt service. Mexico's situation is also encouraging, particularly since a sizeable increase in non-oil exports and a return of some flight capital have occurred. However, in Argentina's case there is a serious prospect the country will once again fall out of compliance with the IMF Standby Arrangement, possibly leading to a debt

Too early to say what Mid Term Review could achieve. We must avoid an argument on dates. Commission (in Geneva) has accepted MTR, but French still objecting.

VII DEVELOPING COUNTRIES AND DEBT

A good discussion but the key question of adjustment fatigue is not explicitly addressed on page 16 though set out on page 14. Also too much on middle income debtors and not enough on Africa (see brief).

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service moratorium. While that action would be a matter of deep concern, the international financial system and the debt strategy have already demonstrated their capacity to withstand the non-participation of one of the major debtors. While the situations of other middle-income debtors vary considerably, none can be characterized as on the brink of financial collapse. There are therefore grounds for assuming the international debt situation can be managed over the next period within the framework of the current strategy.

In addition to economic risks relating to interest rates and growth of world output and trade, there are intimately connected political and financial risks. Debtor commitment to adjustment, and new financial flows from commercial and official sources, are essential components of the strategy. The Acapulco summit, while eschewing confrontation and unilateral measures, demonstrated that regional leaders are under domestic political pressure to take action on the external front as well as on domestic policy. The pressure can only grow, as most of the countries in the region will be putting their recently recovered democracy to the test in elections in the next 12 to 18 months. Their dilemma is worsened since necessary declines in consumption have not been accompanied by the increases in investment required for an eventual growing out of the debt: recent small increases have still not made up for the precipitous declines of 1982/83, and the average growth rate of investment for the World Bank's Seventeen Highly Indebted Countries for the period 1980-87 is still -4.8 percent.

A disruption consisting of unilateral action by a debtor or debtors, therefore, cannot be ruled out in coming months. As noted above, a debt service moratorium by Argentina could be withstood by the international financial system. Were Brazil's negotiations, however, to falter badly or break down at roughly the same time, the situation could become a good deal more ominous. A coherent response could be impeded by the different levels of financial strength of various creditor banks.

The growing difficulties in assembling concerted lending packages attest to the differentiation in financial positions of creditor banks, and even more to the reluctance of private sector lenders to put up any more resources, even for countries whose adjustment records are fairly good.

Progress in developing and implementing the "menu of options" has been mixed, both because unrealistic expectations by debtors of what lenders will find attractive, and because some of the options are less ways of mobilising new resources than they are means to allow both debtors and creditors to exit from a financial relationship that both find constraining. The recent Mexico-Morgan Guaranty bond scheme may be a successful example of the latter, with the important new element that the debtor will now capture at least some of the benefit of an effective asset write down. While the Mexican scheme is not immediately applicable to other debtors (because, inter alia, of Mexico's strong reserves and relatively good debt service record), new and similar "options" may begin to appear for other debtors. Finally, debt-equity swap programs have been successful where debtors have a good macroeconomic policy record, and a welcoming legislative and regulatory regime for foreign investment. Chile, for instance, has retired well over $2 billion in this manner, some 12 to 14 per cent of its total debt burden.

The Mexico-Morgan Guaranty scheme can also be seen as a significant step in the process of developing a second track to the debt strategy, namely that of actually reducing the stock of debt. The process has its roots in the growth of secondary markets for LDC debt, and notably in the large discounts at which these assets are traded, as well as in last year's well publicized increase in commercial banks' loan loss provisions. The latter development in particular may have had the result of increasing expectations among debtors that banks' ability to withstand losses could readily be transformed into willingness to do so.

Burden-sharing amongst creditors could come under increasing pressure in the coming months. This would seem to pose questions to creditor governments, since different bank supervisory practices and regulations have clearly played a role in promoting different levels of financial strength among national groups of banks. Even more delicate is the question of official credits: the Paris Club would be ill-placed to reject burden-sharing as new approaches and techniques are developed, after having firmly insisted on it in earlier phases.

The role of official financing is likely to grow, particularly by the World Bank. Prospects for a substantial increase in available resources are good, as

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progress toward a GCI has been encouraging. An early conclusion to these negotiations, accompanied by a suitable clarification of the Bank's role in assisting the major problem debtors, is essential to achieving a significant strengthening of the debt strategy. This contribution will be particularly welcome, given that net transfers from the World Bank to LDCs in FY 1987 were only some $2.6 billion, of which only $776 million were to major debtors. The IMF's role as a source of financing seems set to diminish. This may be inevitable given the nature of the institution as compared to the fundamentally long-term, structural problems of the debtors. On the other hand, its policy role seems more necessary than ever, given the vital link between commitment to adjustment and prospects for an eventual return to creditworthiness. Official sources of financing, especially the Paris Club, will continue to require an IMF role. Thus it is important that the current review of conditionality, with an emphasis on greater flexibility, help debtors to overcome their reluctance to seek Fund assistance.

What scope for further progress does the "menu of options" provide? Can it be expanded further, through action by creditor governments or the international financial institutions? Are there "options" which creditor governments can adopt in the Paris Club vis-à-vis their own credits in heavily indebted countries?

What are the prospects for financial flows to debtors from commercial banks, official sources (including ODA and export credits), and private sector investors (both direct investment and purchases of LDC securities)?

How likely is a disruption to the current situation and strategy in coming months? Are creditor governments and banks positioned to cope with it, or is further preparation required?

How likely is the second track to complement the current strategy in coming months? What should be the role of international financial institutions and creditor governments, and especially their bank supervisors, if its development accelerates? How could equitable burden-sharing among different creditors be maintained? Would there be a role for conditionality under such a scenario?

The drafting here on the role of the Fund is rather odd. It could be read as suggesting that there is a need for weaker conditionality. The problem is not whether Fund programmes can be made more attractive by weakening conditionality. Rather the question is whether conditionality can be made more attractive by improving Fund facilities.

Last sentence : "Greater flexibility" means longer term Fund programmes, not conditionality which will remain vital.

Questions : Caution on first two sentences: negotiations are between debtor countries and commercial banks. Africa different because governments and IFIs hold much of the debt. Therefore agree with question in last sentence (Chancellor's initiative).

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B. DEBT OF THE POOREST

The Venice Summit made a commitment to address the debt problems of the poorest indebted countries, mainly in sub-Saharan Africa. Progress has been encouraging:

- the Paris Club has adopted extended rescheduling terms of 15 to 20 years for these countries;
- the World Bank, in conjunction with ODA agencies, has put in place an enhanced program of co-financing aimed at the region;
- the IMF Managing Director has announced the establishment of the Enhanced Structural Adjustment Facility, at close to the target level of SDR 6 billion on highly concessional terms.

While the proposal for concessional interest rates in the Paris Club has not been implemented, it can nevertheless be argued that the Venice commitment to greater action has been met.

What is less clear is whether the action taken is sufficient to allow these countries to overcome their debt burden and resume sustained development, hopefully with the aid of market-oriented adjustment programs. A variety of analyses have shown that most of these countries must be considered insolvent, and that only a substantial increase in concessional resources, either through increased ODA or concessional debt rescheduling, will allow them to break out of their current situation

However, despite the eighth replenishment of IDA, there are still shortfalls in meeting these countries' needs for concessional resources. Notwithstanding undertakings in international meetings, the strong adjustment programs which many of these countries are at last undertaking risk failure if concessional flows are not increased from their current levels.

Only a few years ago our populations were deeply concerned over the obvious failure of development effort in Africa. What actions can we take to ensure that this episode is not repeated? How can we ensure that strong adjustment programs in the region are successful?

We do not agree that Paris Club action is no longer required.

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	OECD Projections				IMF Projections			
	1986	1987	1988	1989	1987	1988	1989	1992
	US $ Billion				Percent of GNP/GDP			
Current Balance								
United States	-141.3	-156.0	-134.0	-105.0	-3.5	-3.0	-2.7	-2.3
Japan	85.8	86.0	81.0	79.0	3.6	2.7	2.5	2.2
Germany	37.1	44.0	41.0	32.0	3.8	3.3	3.1	3.0
France	2.9	-3.0	-5.0	-6.0	-0.2	-0.2	-0.3	-0.2
United Kingdom	-1.5	-3.0	-6.0	-9.0	-0.6	-0.7	-1.1	-1.0
Italy	4.0	-2.0	-4.0	-4.0	--	-0.1	-0.3	-0.6
Canada	-6.7	-7.0	-7.0	-7.0	-1.7	-1.8	-1.7	-2.5
Summit Countries	-19.7	-41.0	-35.0	-21.0	-0.4	-0.4	-0.4	-0.4
Unemployment	Percent of labour force							
United States	7.0	6.25	6.00	6.50	6.2	6.1	6.1	
Japan	2.8	3.00	3.00	3.25	2.8	2.8	2.8	
Germany	8.0	8.00	8.25	8.50	7.9	8.1	8.2	
France	10.5	10.75	10.75	11.75	10.8	11.4	11.9	
United Kingdom	11.8	10.75	10.25	10.50	10.4	9.5	9.3	
Italy	10.1	10.75	11.25	11.50	11.6	11.8	12.0	
Canada	9.6	9.00	8.75	9.00	8.9	8.4	8.4	
Summit Countries	7.3	7.00	7.00	7.25	7.0	6.9	7.0	

Source: OECD Economic Outlook 42, December 1987
World Economic Outlook - Preliminary Assessment of Prospects and Policy Issues, EBS/88/1, January 6, 1988.

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	OECD Projections				IMF Projections			
	1986	1987	1988	1989	1987	1988	1989	Average 1990-92
	Percentage changes from previous period							
Real GNP								
United States	2.90	2.75	2.50	1.75	2.8	2.6	2.8	2.8
Japan	2.40	3.50	3.50	3.00	3.8	3.7	3.6	3.6
Germany	2.50	1.50	1.50	1.25	1.6	1.6	1.7	2.3
France	2.00	1.50	1.50	1.25	2.0	1.8	1.8	2.2
United Kingdom	3.30	3.75	2.75	1.75	4.0	2.6	2.0	2.3
Italy	2.70	2.75	2.00	1.75	3.0	2.3	2.3	2.3
Canada	3.30	3.75	2.75	2.25	3.7	2.7	3.1	3.0
Summit Countries	2.80	2.75	2.50	1.75	3.0	2.6	2.7	2.8
Real Total Domestic Demand								
United States	3.90	2.00	1.00	1.00	2.3	1.6	2.2	
Japan	4.00	4.25	4.00	3.25	4.7	5.3	4.4	
Germany	3.70	2.50	2.25	2.00	2.8	2.6	2.0	
France	3.70	3.00	1.50	1.25	3.0	1.9	2.0	
United Kingdom	3.80	3.50	3.75	2.25	3.7	3.6	2.5	
Italy	3.20	4.50	2.50	2.25	4.5	2.8	2.7	
Canada	3.90	4.00	2.75	2.00	4.3	3.1	3.1	
Summit Countries	3.80	3.00	2.00	1.50	3.1	2.7	2.7	
Inflation (GNP/GDP deflator)								
United States	2.60	3.00	3.50	3.75	3.1	3.6	3.7	
Japan	1.80	-.25	1.00	1.50	-0.1	1.8	1.6	
Germany	3.10	2.50	1.75	1.75	2.1	2.0	2.0	
France	4.70	2.75	2.75	2.50	3.3	2.4	2.4	
United Kingdom	3.50	4.00	5.25	5.00	4.4	4.8	4.2	
Italy	8.00	5.75	5.00	4.25	5.4	4.8	4.6	
Canada	2.90	4.75	4.25	3.50	4.4	3.6	3.5	
Summit Countries	3.10	2.75	3.25	3.25	2.7	3.2	3.0	

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10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

MS SH

bc Braithwaite
Littler

23 February 1988

Dear Tony,

MEETING OF SUMMIT SHERPAS IN QUEBEC - 28/29 FEBRUARY

The Foreign Secretary and the Chancellor of the Exchequer will wish to know the Prime Minister's comments on my minute of 19 February about the meeting next weekend in Quebec to discuss the preparations for the Economic Summit in June.

The Prime Minister has generally endorsed the approach set out in my minute. She believes that the most important single task for the Summit is to secure further progress in the reduction of trade imbalances; she believes that reductions have been minimal so far. The position of Germany is key here. The continued fight against protectionism and agricultural subsidies and support for the GATT should, in the Prime Minister's view, be the second major item for the Summit's agenda. The Prime Minister has endorsed in particular the suggested Summit aim on macro-economic issues (summarised at the top of page 3 of my minute) that we should maintain pressure on the US and that the Japanese and Germans should take the action necessary to reduce their imbalances. On agriculture, she agrees with the suggested Summit aim (in the penultimate paragraph on page 3) that there should be no backsliding from the principles for reform agreed at last year's OECD. The Prime Minister accepts that none of this will be easy against the background of uncertain stock markets throughout the world.

On more particular points:-

- the Prime Minister is not convinced that trade imbalances are being corrected. Japan and Germany continue to be in heavy trade surpluses and it is countries like the UK who are absorbing the reduction in the US deficit. She therefore endorses the sentiment that the Japanese still have a long way to go in opening up their markets;

- she has endorsed too the suggestion that we should seek some way in persuading South Korea and Taiwan to reduce their growing trade surpluses. She accepts that Hong Kong remains a special case and that their position will need protection.

CONFIDENTIAL

I am sending a copy of this letter to Alex Allan (H. M. Treasury) and Trevor Woolley (Cabinet Office).

Yours sincerely,

Nigel Wicks.

N. L. WICKS

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

10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

23 February 1988

dated 16/2.

Dear Roderic,

I attach a copy of a letter which Pascal Lamy, Delors' Chef de Cabinet has sent me, and I assume other Sherpas, about the Japanese Minister of Trade's proposal regarding meetings of Summit Trade Ministers.

I should be glad for advice, from you or Christopher Roberts as appropriate, on what reply, if any, I should make to Lamy's letter. The best answer may simply be to say 'let us discuss this in Quebec', or words to that effect.

I am sending a copy of this letter to Geoffrey Littler (H. M. Treasury) and Christopher Roberts (Department of Trade and Industry).

Yours sincerely,

Nigel Wicks

N. L. WICKS

Roderic Braithwaite, Esq.,
H M Treasury

Foreign and Commonwealth Office

London SW1A 2AH

A C Hutton Esq
EEP
Department of Trade & Industry
1 Victoria Street
London SW1

22 February 1988

Dear Tony,

GATT: AGRICULTURE: MTR

1. As agreed at Rodric Braithwaite's meeting on 16 February, we have revised this paper on agriculture and the MTR. I should be grateful for any further comments as soon as possible.

Yours ever,

Rosemary

Rosemary Spencer

cc: R Carden Esq, MAFF
H Evans Esq, HM Treasury
Mr Braithwaite
Mr Richardson, ERD
Mr Rollo, Economic Advisers
The Hon M A Pakenham, UKRep Brussels
P W M Vereker Esq, UKMis Geneva
N P Bayne Esq, OECD Paris

GATT: AGRICULTURE: MID TERM REVIEW (MTR)

SUMMARY

This paper seeks to identify the agricultural issues that the UK will want to be addressed in the Uruguay Round Mid-Term Review (MTR), and points to the consequences of internal EC agreement on reforms that will affect the Community's approach. It draws attention to the need for UK contacts with other CPs, especially the like-minded, as well as with the Commission and other EC member states. A list of forthcoming meetings which will provide opportunities to pursue these issues, is Annexed.

INTRODUCTION

1. In trade terms, agriculture is not the UK's only objective (nor indeed the main one) for inclusion in the MTR; but our concerns about the effects of distortions in agricultural trade and their implications for the cost of the CAP, agriculture's central role in trade disputes with the US, and its high priority for other major GATT partners necessitate an early examination of our objectives and an appraisal of the difficulties ahead. The main pressure for agricultural reform in the Uruguay Round as a whole will no doubt continue to come from the US and the Cairns Group. We certainly do not want to get too far out in front within the Community since to do so could make it more difficult for the UK to exercise its familiar role of keeping the EC on track. This is particularly important while uncertainty remains as to how the US position for the MTR is shaping. They may not aim very high, partly because of the timing of the MTR in

relation to the US Presidential election and partly because of the implications for their farmers of rapid progress in reductions of support.

2. The agenda for agriculture for the coming year focusses on specific elements in the major papers (EC, US, Cairns, Japan, Nordics). A number of GATT members have promised specific papers on elements in their proposals. The Community submitted on 15 February outline papers on short term measures and on PSEs. The Americans also tabled a paper on PSEs and health and phyto-sanitary measures affecting trade. De Zeeuw, the Chairman of the GATT agriculture negotiating group also has his own ideas about consolidating current forms of protection price support into an import levy - which could well prove hard to negotiate.

3. The MTR is now to be in December 1988 as the US has proposed. The Americans and the Cairns Group will certainly want to include agriculture. However, it is not yet clear what the Americans have in mind in the agricultural sector. There are indications that Yeutter himself would be content with a very broad brush approach; and the US paper rejects short-term measures. The Cairns Group proposed specific short term measures in their Geneva paper (eg commitments to freezing subsidies), but they will need to consider how high to aim in the context of a December MTR. Their objectives should be clearer following their end-February Ministerial meeting in Argentina. Japan is likely to be cagey. Views within the EC will no doubt be mixed: the French seem indifferent to the MTR as a whole, and strongly oppose its taking any decisions on agriculture. even of the most general kind. Others within the

Community, notably the southern member states, and possibly the Germans too, may resist progress on agriculture particularly in view of the hard fought debate at the special European Council in Brussels (see paras 15-19 below). It is a reasonable assumption that the Community as a whole will not finalise its negotiating position on agriculture until all the other elements are in place.

4. Tactically, it would be as well to avoid seeking to define too soon in Geneva which aspects of agriculture should be dealt with in the MTR: the earlier a list of agricultural items is established, the more likely it is to represent a minimal common denominator of GATT members' objectives. We shall need to bear in mind the likelihood of a play-off with other issues for the MTR (cf the French on globality). Above all we will need to ensure that concentration on the agricultural content of the MTR does not distract attention from the substance of the agricultural negotiation, and that the debate does not get bogged down in procedural matters. All this suggests that our lobbying should not begin too soon, either.

UK OBJECTIVES

5. It will be in the UK interest for the MTR to cover a range of key GATT issues including reinforcement of the GATT system (notably through improved dispute settlement procedures) and services, as well as agriculture even if it is not possible (given the time available for preparatory work and US political constraints) to go deeply into the substance. Ideally the MTR should cover <u>all</u> GATT topics. The conclusions of the MTR should at

least provide a baseline on all subjects covered from which Contracting Parties (including the EC) will not be able to retreat in subsequent negotiations.

6. In order to define our objectives for the MTR, we will need a clearer idea of what we hope to achieve in the agricultural negotiation by the completion of the Uruguay Round in 1990. Broadly speaking, the UK is seeking an overall (ie covering at least all the major surplus commodities) reduction in support and protection in a way that can be measured comparatively between contracting parties. This suggests that we should seek reaffirmation of the principle of overall reductions and that there should be agreement on a yardstick which will in itself establish the nature of the negotiation for the rest of the Round. Assuming such a framework is in place, other elements in the negotiation should follow.

LIST OF AGRICULTURE ISSUES

7. Elements relating to agriculture for possible coverage in the MTR could be drawn from the following comprehensive lists of issues to be dealt with in the Round:

(a) Reaffirmation of general principles (cf statements from Punta del Este, last year's OECD Ministerial, Venice Summit).

(b) Agreement on PSE type aggregate measure (and its use as a framework for subsequent negotiation - see c-f below).

(c) Policy coverage.

(d) Commodity coverage.

(e) Timescale for reductions of support.

(f) Levels of reduction.

(g) Credit for reforms already undertaken.

(h) Special and differential treatment for developing countries.

ANALYSIS OF AGRICULTURAL ISSUES: POSSIBLE INCLUSION IN MTR

8. Reaffirmation of general principles should be the basic element of any conclusions on agriculture in the MTR. In practice, this means reading over the 1987 OECD principles (or as many as possible of them) to the MTR: this is an ambitious object in itself and we shall need to work hard on the LDCs. We should certainly resist any backward movement. It may be possible to go slightly further than previous texts but this is not essential. We should try to ensure that further impetus is provided by the 1988 OECD Ministerial and Toronto Summit. An OECD Communiqué which acknowledges the minimal impact that the general principles have had so far would no doubt help to underline the need for action.

9. Agreement on PSE type approach should be our main substantive objective for the MTR. Endorsement of this approach in 4 of the 5 main papers on the table in Geneva - and some recognition from LDCs - suggest that agreement is possible. Work is continuing on PSEs in GATT, in the

OECD, and within the Community where the momentum is building up well on the basis of Commission papers. Agreement on the use of an aggregate measure would establish by implication the basis of a negotiating framework - a considerable achievement by the time of the MTR. It would imply that negotiations would aim at reductions in subsidies and other support measures and protection across at least the surplus commodities measured against the PSEs at (or some variant), with perhaps a different form of negotiation for commodities causing fewer problems. The Japanese will be difficult, so an intermediate objective is to obtain endorsement of the OECD work on PSE the 1988 OECD Ministerial (see paragraph 14 below) but without attempting in that forum to seek acceptance of PSEs for GATT purposes.

10. Policy coverage, however, presents difficulties. Within the EC the French are insisting on clear definition of policy coverage so as to avoid creating loopholes (eg US deficiency payments linked to set-aside). The possibility of a lengthy debate on what measures do or do not have a significant impact on production and trade (and which should be included in the aggregate measurement) could make it extremely difficult to reach agreement on policy coverage by the time of the MTR. However, the question has been considered in the debate on PSEs and it might be possible to reach agreement on this in conjunction with the decision to go ahead on PSEs. Indeed the establishment of the framework for PSEs necessitates some agreement on policy coverage.

11. Agreement on the commodities to be tackled under the agriculture heading in the Round will be hard to achieve in the context of a PSE measured framework of reduction. There are particular sensitivities about certain commodities (eg the Japanese on rice). There is therefore a danger in pressing too hard for comprehensive commodity coverage at the time of the MTR: resistance from some could result in a minimal commodity coverage by the time of the MTR, which would be difficult to expand in the later stages of the Round. Within the EC, there is likely to be resistance to coverage of Mediterranean commodities. Nevertheless, the UK (and EC) accept the principle of overall reductions in agricultural support and protection. That ought logically to mean that coverage should be as wide as possible.

12. An agreed timescale for overall reductions will be more difficult to achieve. The EC and Japanese proposals contain no reference to an overall timescale. The US and Cairns Group are working on a 10 and 5 year basis respectively. There is no indication that these timescales will be pursued in the MTR by others. It is therefore unlikely that there could be any agreement by the time of the MTR.

13. Levels of reduction present perhaps the most difficult element. The Americans are unlikely to move away from their "zero option" until a fairly late stage in the negotiations.

14. Elements c, d, e, f will thus constitute the hard core of the substantive negotiations, and it may be unrealistic to expect too much progress at the MTR. But they all form part of the suggested PSE/framework, and

endorsement of a PSE alone (without agreement on these elements) will mean little more than a reaffirmation of general principles, as in a. This weaker endorsement could be our last point of retreat, but we should clearly aim higher (a measurement of specific support policies). The fallback position at least commits CPs to a measuring device - and thereby the principle of monitored reductions in support - even if what is to be measured cannot be agreed.

15. Agreement on short term measures is also probably unrealistic. The US remain opposed, though now indicate a willingness to listen. The Cairns Group, for whom early improvement in world markets remains a goal, may come forward with more detailed ideas after their meeting in Argentina in late February. Their initial proposal includes the idea of a freeze on export subsidies, which is not likely to be acceptable in current circumstances to either the US or EC.

16. The EC's position is not helped by the declarations on international reform of agriculture and trade policy annexed to the conclusions of the Brussels European Council. These will not have improved the negotiating prospects. EC proposals for short-term action comprise two elements: emergency measures on specific markets, and immediate reductions in support.

(i) Emergency Measures

17. Here the Commission's ideas (tabled in Geneva on 15 February) have little appeal to other CPs (or the UK): The proposals on the cereals market coupled with action on cereals substitutes are anathema to the US. Proposals to limit sugar exports in consultation

with other exporters look unrealistic in the light of recent failure to negotiate an ISO agreement with economic provisions. The suggestion that all CPs should project the IDA ring hollow against the background of the EC's breaching of the minimum price provisions which led to the US walkout from the IDA. The European Council Declaration on Trade Policy reinforces and extends the proposal on cereals substitutes by calling for "an appropriate solution to the problems arising in connection with imports of cereals substitutes, oilseeds and protein plants". This, with the accompanying Commission statement regarding the oils and fats tax will not help the negotiating atmosphere, and will be regarded as contrary to its Punta objectives and OECD commitments.

(ii) Immediate Reductions in Support

18. The Commission have not yet produced a further paper on this element for GATT. The European Council Statement unhelpfully suggests that the CAP reforms since 1984 "meet the commitments" made in OECD and at the Venice Summit, and that responsibility rests with others to improve "equivalent discipline". We would not accept that the EC has done more than make modest progress toward proper reform. Other CPs will hardly rate its achievement as high. The Declaration will almost certainly stiffen the resolve of those Member States, reluctant to move ahead with reform, either internally or in GATT.

19. In general, therefore, prospects for action do not look promising. In the case of emergency measures, where the UK would only reluctantly accept cereals and sugar market management arrangements this is not in itself

disappointing. We will, however, need to resist any EC move to block further CAP reform or to resist GATT negotiation on the long term, justified on the grounds that short term measures had not been agreed.

20. Agreement to give credit for reforms already undertaken is a generally agreed EC objective shared by the UK and reflected in the Commission paper. It is also implicit in the Punta del Este Declaration and explicit in the 1987 OECD Communiqué. It should be possible to restate this point in very general terms in the MTR with the support of all CPs.

21. Acknowledgement of special and differential treatment for developing countries is also a UK objective, and is advocated in the EC Cairns and Japanese proposals. Integration, the obverse of this coin, is one of our main objectives of the Round. The MTR may reaffirm this principle for the Round as a whole, but if not, a reference in the agriculture section should be aimed for. A very general statement for the MTR may be enough, but we shall need to identify for our own purposes what we expect of the NICs in the agriculture negotiation. For example, if agreement on a PSE type approach (para 8 above) is to be one of our major MTR objectives, we shall also need to be clear whether we expect LDCs to negotiate on that basis or whether (as some will urge) special and differential treatment should apply to some or all of them. The NICs may not be main agricultural producers, but we may still expect action from some of them on access.

PROCEDURE

22. Our preparations during the coming months and in the run up to the MTR itself, will need to be directed at creating a climate of opinion conducive to agreement on specific items by December. Overactive lobbying by the UK alone would be counter-productive. This suggests that in discussions with the Commission and like-minded GATT partners, we need to tread carefully, and not build up a campaign too early.

23. A series of meetings and bilateral consultations during the coming months will provide opportunities to pursue our objectives (timetable attached at Annex A). The visit of M Paye (24 February) and first meeting of Summit Sherpas (27 February) will have provided a first opportunity to gauge the thinking of others on the subject. A meeting of Cairns Group members at the end of February should reveal whether their intentions for the MTR. It would be helpful to share our ideas with like-minded contracting parties eg Australia, Canada, particularly in the period between the meeting in Konstanz in mid-March and the OECD Ministerial in mid-May. We shall also have regular opportunities to discuss ideas with Community partners. But, within the Community our main priority should be to convince the Commission that our ideas are the right ones - though we shall have to accept that any papers they put forward will take account also of French and other member states' views. Intra-EC coordination should continue as now in the Article 113 Committee, but there are questions over timing of discussion within the EC not least because of French sensitivities over their elections.

CONCLUSIONS

24. UK objectives for the agricultural negotiations in the Round as a whole are covered by the list in paragraph 6 above. UK objectives for the MTR should be as follows:

(I) Reaffirmation of principle of reduction of support and protection which goes at least as far as the 1987 OECD Ministerial.

(II) Agreement on PSE/framework (perhaps including policy and commodity coverage).

(III) General statement reaffirming that credit will be given for reforms already undertaken.

(IV) Reaffirmation of the principle of special and differential treatment and the need to pursue integration in agriculture.

25. Agreement on a timescale and levels of reduction would also be desirable, but this seems unlikely. If the US press the case in their own proposal (complete abolition by 2000) strongly, others will dig in. We doubt their inclusion is a realistic target. The likely content of the MTR will include I, II, IV and V above.

26. A UK "bottom line" would need to include I above which at the very least did not retreat from previous OECD statements on general principles; and II above which at the very least would accept that PSEs would have a role in the negotiation.

27. Once agreed, these ideas should be discussed with Commission and selected EC partners, and certain other CPs, notably leading Cairns Group members and US.

28. We should subsequently lobby those likely to be opposed to the UK "bottom line" eg Japan, Nordics, some EC member states.

ANNEX

TIMETABLE

Konstanz meeg on 18-20 March: possible first discussion of content. We need not aim at this stage to go further than general agreement to include agriculture in MTR.

IMF/IBRD spring meetings on 14-15 April at which we could focus, as the Chancellor did last Spring, on the benefits to LDCs of agricultural reform.

OECD Ministerial on 18-19 May at which we should aim for reaffirmation of last year's principles. In order to avoid watering down of principles it may be best to reaffirm last year's statement in general terms. We should also try to secure more specific language on PSEs than was possible last year.

Toronto Summit on 19-21 June may well involve discussion of MTR and content. By this time we should aim to have support for UK objectives and be in a position to react to objectives of other major GATT players. There is a danger of LDC resentment at what they see as Summit participants presenting them with MTR objectives as a fait accompli.

European Council in Hanover on 27-28 June at which EC position on stabilisers should be finalised and at which we should aim for some discussion of external issues; but it is unlikely to be possible by then to endorse EC approach for MTR in any detail.

CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH

22 February 1988

C W Roberts Esq CB
Department of Trade & Industry
1 Victoria Street
SW1

Dear Christopher,

JAPANESE PROPOSAL FOR AN INFORMAL MEETING OF TRADE MINISTERS

Thank you for your letter of 19 February.

2. I agree that we do not want to be disobliging to Tamura. But even in its revised form the MITI proposal causes some difficulties. A meeting of the Seven Trade Ministers does risk being seen as some kind of extension of the G7 and Economic Summit machinery. Nigel Wicks has confirmed to me that he thinks the Prime Minister would still be very averse to this. The risk would be increased if the meeting (or even worse two meetings) were held in the two months immediately preceding the Summit itself. We have in the past opposed even meetings of officials from the Seven countries on similar grounds, even where the meetings were proposed for a time frame quite different from the Economic Summit and its preparations. For example, a couple of years ago the Japanese proposed a meeting of Foreign Ministry legal advisers from the Seven: but Sir R Armstrong felt strongly that we should not go along with the idea.

3. There is in addition the point that a meeting of Trade Ministers of the Seven is likely to irritate those member states in the Community who do not attend. They will argue that trade is quintessentially Community business, and will wonder why we need a new forum in addition to the "quad", which brings together the Americans, Japanese, Canadians and the Community (in the shape of the Commission). You will remember the difficulties Brock ran into in the mid-1980s when he proposed informal gatherings of Trade and Finance Ministers. The Community immediately got itself into a tizzy.

4. Our preference therefore remains that there should be no meeting. If nevertheless one takes place, it should be clear th it is a one-off occasion only. A gathering in the margins of the OECD Ministerial meeting would be bound to come to the attention of Community member states not participating, and is therefore unattractive. An informal gathering in the margin of the Trade Ministers' meeting in Konstanz would run less of a risk of creating strife within the Community, if - as I understand from you - only the Four "Summit" members of the Community will be there.

/5.

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5. MITI will presumably continue with their traditional tactic of trying to persuade each of us that the others have already responded favourably to their proposal. I therefore suggest that, before you reply to Kitamura, you should sound out your french, German and Italian colleagues. If they are all willing to accept an informal gathering in Konstanz, then I doubt if we would want to hold out on our own. If you have no early opportunity to speak to them, we could instruct our posts to do so.

6. I am sending copies of this letter to Nigel Wicks and Geoffrey Littler together with a copy of your original letter. I am also circulating my letter inside the FCO.

Yours ever,

Rodric

R Q Braithwaite

CONFIDENTIAL

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Our ref
Your ref
Date 19 February 1988

Dear Rodric,

JAPANESE PROPOSAL FOR AN INFORMAL MEETING OF TRADE MINISTERS

Not surprisingly, the Japanese have returned to the charge. Kitamura of the Japanese Embassy called on me this morning, on instructions from his Minister and Kuroda, to make the following proposition:-

(i) There should be some kind of gathering of the Trade Ministers of G7 countries in the margins of the wider meeting of Trade Ministers to be held at Konstanz from 18-20 March.

(ii) There should also be a gathering (probably over dinner) of the Trade Ministers of G7 countries in Paris at the time of the OECD Ministerial in mid-May.

Kitamura claimed that this suggestion had been put to, and was supported by, Ruggiero (the Italian Minister of Foreign Trade), Landau (France) and some unidentified senior FRG official. It had not yet been put to the US or to the Commission (or, I suspect, to Canada). In answer to a question, Kitamura said that these would be one-off arrangements: the Japanese were not proposing that they should be institutionalised for future years.

2 I said that I would have to consult more widely and put this proposition to DTI Ministers before giving a clear response. Speaking personally, however, I thought that these ideas might be rather easier for British Ministers than the previous Japanese proposals which had been linked in time and place to the Summit itself.

dti

the department for Enterprise

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2

3 I know that DTI Ministers do not want to be more disobliging to Mr Tamura than essential UK interests require. The new proposals strike me as a face-saving arrangement to get Mr Tamura off the hook without complete rejection. If some kind of informal gathering of G7 Trade Ministers takes place in the margins of the Konstanz meeting and the OECD Ministerial I do not think that the relevant DTI Minister (certainly the Minister for Trade in the case of Konstanz, and probably so for the OECD Ministerial) will want to refuse to join in. At the same time we do not need to be unduly zealous in prompting these arrangements.

4 I would like to submit to my Ministers on this subject reasonably soon, but would first be grateful for an FCO view. Perhaps we could have a word on the telephone if you see any difficulty about the line I have it in mind to take.

Yours ever
Christopher

It may be helpful to you to have our line agreed before the Sherpas' meeting on 27 Feb -

C W ROBERTS

cc Mr Hutton EEP
Mr Cooke OT2
Mr Johnson EEP1
Mr D Jones OT2/2

pa

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PRIME MINISTER

MEETING OF SHERPAS

Despite my predecessor's efforts to reduce the number of Sherpa meetings, the Canadian Sherpa has called a meeting in Quebec on Sunday and Monday, 28 and 29 Febrary to discuss the preparations for June's Toronto Summit. I shall be accompanied by Sir Geoffrey Littler and Mr. Braithwaite.

French and US Elections: the Summit will be sandwiched between the French elections in May and the US elections (Presidential and Congressional) in November. The French elections will have been completed, but France could still be in some political turmoil, especially if elections to the General Assembly have to follow the Presidental elections. So French tactics at the Summit, and in its preparation , will be more than usually difficult to predict. American eyes will be on the Conventions in July, but our present guess is that the shadow of the US election will tend to undermine their credibility in economic discussion, rather than lead them to promote specific proposals.

The World Economy: the 'atmosphere' of the Summit in June will, no doubt, be determined to some large extent by the perception then of the prospects for the world economy.

If the prospects for growth, inflation and the gradual elimination of imbalances, look reasonable, as we would expect, the Summit's main task will be to demonstrate governments' commitment to the goal of a sustainable economic performance; that governments have credible policies for meeting those goals; and that this commitment and credibility is restoring market confidence. So the essential message from the Summit might be:

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- we are now clearly moving in the right direction (for the correction of imbalances without promoting either inflation or recession); the evidence of progress is becoming more visible; and we are committed to intensify policies in this direction.

All rather banal. But no reason to be apologetic about that: It would be surprising if the Summit suddenly came up with new answers after the many previous discussions.

If the world economy looked to be taking a turn for the worse, the Summit would have an important role in helping to steer the world economy into a better path. In those circumstances, the Bank/Fund Spring Meetings (14/15 April) and the OECD Ministerial Council (18/19 May) would have an even more important role in clarifying Summit objectives.

The perennial economic subjects will inevitably come up for discussion.

Macro economic issues: the analysis in your Guildhall speech (uncertainties stemming from the US Budget and trade deficits, Japan and Germany's trade surpluses, fears of protectionism and of returning inflation) and its prescriptions (sound money and low inflation, prudent finance, removing the obstacles to enterprise and the principle of free trade) still stand; and some progress has been made since the Autumn. The markets are more settled, though confidence remains vulnerable, especially to any bad US trade figures, or to any ill-judged reduction of interest rates. The US will need to do more on their budget deficit but the election is bound to be an impediment. Among surplus countries: the Japanese have moved a good deal, and effectively, although they have still a long way to go in opening their markets; the German economy is very sluggish, and they are likely to be strongly attacked by France and Italy (growing imbalance within Europe) as well as the US; South Korea and Taiwan must be a target - the scale of their supluses is now enormous.

Our Summit aim looks clear: maintaining pressure on the US, Japanese and Germans to take the action necessary to reduce their imbalances and seeking some way of getting at Taiwan and South Korea (on which more below).

Trade: beyond standard reiteration of our opposition to protectionism, what we say on trade will depend on progress in the GATT Round. An emerging aspect of the trade problem is the position of some Newly Industrialised Countries (principally South Korea, Taiwan and Singapore: Hong Kong remains a special case). They need to reduce their growing trading surpluses especially with the US (e.g. by opening their markets and letting their currencies rise against the dollar). They also need to be persuaded to graduate out of their preferential trading status as developing countries. Recent US action to remove their GSP is a measure of US concern and an example of their enforced integration into the developed world's trading arrangements. Our Summit aim will be to find the right mix of carrot and stick to persuade these NICs to adjust in their own interest; Hong Kong's special position will need protection. There may be trouble next weekend between the Americans and the French over the Ministerial "Mid-Term Review" of the GATT Round next December (despite the attempt of the European Commission to outflank the French in Brussels). These disputes about dates have occurred before previous Summits. They are particularly futile and I shall seek to defuse this one if it occurs.

Agriculture: our Summit aim here will be to ensure that there is no backsliding from the principles for reform agreed at last year's OECD.

Debt: two of the three biggest debtors, Argentina and Brazil, are still in deep trouble. Mexico is doggedly plodding forward (just about) and their new bond deal, involving retirement of some debt, offers them some hope. Our aim here is to avoid the Canadians putting undue emphasis on the middle income countries at the expense of the poorest debtor

countries. Governments have less locus in Latin American debt and we want to emphasise the good story we have to tell for Sub-Saharan Africa, including giving the Chancellor's initiative a further push.

Almost certainly there will be particular economic subjects raised; but we know of nothing firm yet. We will be considering possible initiatives of our own over the next few months. We are not aware of any particular initiatives which others have in mind for the Summit; the Quebec meeting in will be helpful in discovering whether anything is afoot.

Political: Although we will want economic subjects to be at the fore at this Economic Summit, political subjects will, inevitably, force themselves on to the agenda. Quite which, will depend on the climate in the run up to the Summit and recent unforeseen events (terrorist outrage, acts of God, etc.). Following the expected US-Soviet Summit in Moscow, the possibility of a START agreement and movement on Soviet withdrawal from Afghanistan, East/West relations is bound to be a dominant theme. Another important political subject will be the Middle East, both Arab/Israel and Iran/Iraq. The subject of terrorism may well arise; but it will probably be better to avoid a free standing terrorism declaration, and go for a few firm robust sentences on standing firm against terrorism in the wider political declaration. There are some indications from the Canadian side that Mr Mulroney is unlikely to revert to South Africa.

Finally, it is worth noting that this Canadian Summit will complete the second round of Summits. We expect the French to offer to begin the new round, as they did the previous two, by hosting the 1989 Summit.

I do not expect the Sherpas' meeting in Quebec to carry the Summit preparations beyond obvious generalities. But it would be helpful to know whether you have any views which you would like us to reflect at the meeting.

I am sending a copy of this minute to the Private Secretaries to the Foreign Secretary and the Chancellor of the Exchequer, and to Sir Robin Butler.

N.L.W.

N.L. Wicks

19 February 1988

CONFIDENTIAL

Foreign and Commonwealth Office

London SW1A 2AH

19 February 1988

N L Wicks Esq CBE
10 Downing Street
SW1

Dear Nigel,

File with MEW

Thank you for sending me a copy of your letter of 18 February to Geoffrey Littler with its enclosure.

2. I have some minor points on the latter:

(a) Page 2, penultimate paragraph

After "... to reduce their imbalances" add "The French and Italians may well press in the same direction: they are increasingly unhappy about their bilateral ~~surpluses~~ deficits with the Germans." (Geoffrey Littler's point)

(b) Page 3, end of first ~~sentence~~ paragraph

After ".... will need protection." add "There may be trouble next weekend between the Americans and the French over the Ministerial "Mid-Term Review" of the GATT Round next December (despite the attempt of the European Commission to outflank the French in Brussels). These disputes about dates have occurred before previous Summits. They are particularly futile and I shall seek to defuse this one if it occurs."

(c) Page 3, second paragraph

For "agreed at last year's OECD" substitute "set out in last year's Summit and OECD Communiques".

3. On page 2 (second paragraph) I found the word "crucial" a bit strong, and would suggest "important" instead. But that is primarily for you.

Yours ever,

Rodric

R Q Braithwaite

cc Sir G Littler KBE
HM Treasury

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H M Treasury
Parliament Street London SW1P 3AG
Switchboard 01-270 3000
Direct Dialling 01-270 4369

Sir Geoffrey Littler KCB
Second Permanent Secretary

19 February 1988

Dear Nigel,

SUMMIT PREPARATION MEETING

Just a few suggestions on the draft enclosed with your letter of 18 February. I am copying this to Rod Braithwaite.

French and US Elections

- for the last line and a half substitute: "but our present guess is that the shadow of the US election will tend to undermine their credibility in economic discussion, rather than lead them to promote specific proposals".

World Economy

- in fourth line add "gradual" before "elimination".

Macro-Economic Issues

- for the last long sentence I have a few nuances to offer: "The markets are more settled, though confidence remains vulnerable, especially to any bad US trade figures, or to any ill-judged reduction of interest rates. The US will need to do more on their budget deficit but the election is bound to be an impediment. Among surplus countries: the Japanese have moved a good deal, and effectively, although they have still a long way to go in opening their markets; the German economy is very sluggish, and they are likely to be strongly attacked by France and Italy (growing imbalance within Europe) as well as the US; South Korea and Taiwan must be a target - the scale of their surpluses is now enormous."

- Add at end of next para: "and seeking some way of getting at Taiwan and South Korea (see below)".

Yours,

Geoffrey

Nigel Wicks Esq CBE
10 Downing Street.

ECON POL: Sherpa Admin
Feb 88

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10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

18 February 1988

Dear Geoffrey,

I attach, on a personal basis, a draft of the minute which I intend to put to the Prime Minister, with copies to the Chancellor of the Exchequer and the Foreign Secretary, about the second Sherpa meeting. You will see that it draws on Roderic Braithwaite's letter of 9 February as well as taking in a few points from your commentary on Sylvia Ostry's paper.

I should be grateful if you could let me have any comments that you might have on the draft by 1500 hours, tomorrow Friday 19 February. I will then finalise the draft so that there are copies for Ministers' weekend boxes.

I am sending a copy of this letter to Roderic Braithwaite and Tom Richardson in the Foreign and Commonwealth Office and should be grateful for their comments on the same timetable.

Yours ever,

N.jal

N.L. Wicks

Sir Geoffrey Littler, KCB,
HM Treasury.

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DRAFT

PRIME MINISTER

MEETING OF SHERPAS

Despite my predecessor's efforts to reduce the number of Sherpa meetings, the Canadian Sherpa has called a meeting in Quebec on Sunday and Monday, 28 and 29 Febrary to discuss the preparations for June's Toronto Summit. I shall be accompanied by Sir Geoffrey Littler and Mr. Braithwaite.

French and US Elections: the Summit will be sandwiched between the French elections in May and the US elections (Presidential and Congressional) in November. The French elections will have been completed, but France could still be in some political turmoil, especially if elections to the General Assembly have to follow the Presidental elections. So French tactics at the Summit, and in its preparation , will be more than usually difficult to predict. American eyes will be on the Conventions in July, but we do not believe, at least at this stage, that this will much affect discussion at the Summit.

The World Economy: the 'atmosphere' of the Summit in June will, no doubt, be determined to some large extent by the perception then of the prospects for the world economy.

If the prospects for growth, inflation and the elimination of imbalances, look reasonable, as we would expect, the Summit's main task will be to demonstrate governments' commitment to the goal of a sustainable economic performance; that governments have credible policies for meeting those goals; and that this commitment and credibility is restoring market confidence. So the essential message from the Summit might be:

- we are now clearly moving in the right direction (for the correction of imbalances without promoting either inflation or recession); the evidence of progress is becoming more visible; and we are committed to

intensify policies in this direction.

All rather banal. But no reason to be apologetic about that: It would be surprising if the Summit suddenly came up with new answers after the many previous discussions.

If the world economy looked to be taking a turn for the worse, the Summit would have a crucial role in helping to steer the world economy into a better path. In those circumstances, the Bank/Fund Spring Meetings (14/15 April) and the OECD Ministerial Council (18/19 May) would have an even more important role in clarifying Summit objectives.

The perennial economic subjects will inevitably come up for discussion.

Macro economic issues: the analysis in your Guildhall speech (uncertainties stemming from the US Budget and trade deficits, Japan and Germany's trade surpluses, fears of protectionism and of returning inflation) and its prescriptions (sound money and low inflation, prudent finance, removing the obstacles to enterprise and the principle of free trade) still stand; and some progress has been made since the Autumn. The markets are more settled, though confidence is rather brittle; the US has acted to reduce its budget deficit, though further action is unlikely in an election year; the Japanese are moving, but have far to go; and the Germans' confidence in the rightness of their policies may be wavering, though they are unlikely to be willing to commit themselves to the necessary policy changes.

Our Summit aim looks clear: maintaining pressure on the US, Japanese and Germans to take the action necessary to reduce their imbalances.

Trade: beyond standard reiteration of our opposition to protectionism, what we say on trade will depend on progress in the GATT Round. An emerging aspect of the trade problem is the position of some Newly Industrialised Countries

(principally South Korea, Taiwan and Singapore: Hong Kong remains a special case). They need to reduce their growing trading surpluses especially with the US (e.g. by opening their markets and letting their currencies rise against the dollar). They also need to be persuaded to graduate out of their preferential trading status as developing countries. Recent US action to remove their GSP is a measure of US concern and an example of their enforced integration into the developed world's trading arrangements. Our Summit aim will be to find the right mix of carrot and stick to persuade these NICs to adjust in their own interest; Hong Kong's special position will need protection.

Agriculture: our Summit aim here will be to ensure that there is no backsliding from the principles for reform agreed at last year's OECD.

Debt: two of the three biggest debtors, Argentina and Brazil, are still in deep trouble. Mexico is doggedly plodding forward (just about) and their new bond deal, involving retirement of some debt, offers them some hope. Our aim here is to avoid the Canadians putting undue emphasis on the middle income countries at the expense of the poorest debtor countries. Governments have less locus in Latin American debt and we want to emphasise the good story we have to tell for Sub-Saharan Africa, including giving the Chancellor's initiative a further push.

Almost certainly there will be particular economic subjects raised; but we know of nothing firm yet. We will be considering possible initiatives of our own over the next few months. We are not aware of any particular initiatives which others have in mind for the Summit; the Quebec meeting in will be helpful in discovering whether anything is afoot.

Political

Although we will want economic subjects to be at the fore at this Economic Summit, political subjects will, inevitably,

force themselves on to the agenda. Quite which, will depend on the climate in the run up to the Summit and recent unforeseen events (terrorist outrage, acts of God, etc.). Following the expected US-Soviet Summit in Moscow, the possibility of a START agreement and movement on Soviet withdrawal from Afghanistan, East/West relations is bound to be a dominant theme. Another important political subject will be the Middle East, both Arab/Israel and Iran/Iraq. The subject of terrorism may well arise; but it will probably be better to avoid a free standing terrorism declaration, and go for a few firm robust sentences on standing firm against terrorism in the wider political declaration. There are some indications from the Canadian side that Mr Mulroney is unlikely to revert to South Africa.

Finally, it is worth noting that this Canadian Summit will complete the second round of Summits. We expect the French to offer to begin the new round, as they did the previous two, by hosting the 1989 Summit.

I do not expect the Sherpas' meeting in Quebec to carry the Summit preparations beyond obvious generalities. But it would be helpful to know whether you have any views which you would like us to reflect at the meeting.

I am sending a copy of this minute to the Private Secretaries to the Foreign Secretary and the Chancellor of the Exchequer, and to Sir Robin Butler.

N.L. Wicks

18 February 1988

CANADA

16 February

Mr. N.L. Wicks, CBE,
Principal Private Secretary
to the Prime Minister,
Prime Minister's Office.

Look forward to seeing you at dinner on the 23rd, when we could discuss attached.

L. James Taylor

With the Compliments
of the
Minister (Commercial/Economic)

de la part du
ministre (affaires commerciale/économiques)

Haut-Commissariat du Canada
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Canadian High Commission

External Affairs
Canada

Ambassador, Multilateral Trade Negotiations
and Personal Representative of the
Prime Minister,
Economic Summit

Affaires extérieures
Canada

Ambassadeur aux négociations commerciales multilatérales
et représentante personnelle du
Premier ministre
pour le sommet économique

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February 15, 1988

Dear Colleague:

I am forwarding to you the Issues for Discussion Paper for our second meeting at the end of the month.

I hope that at our meeting we will be able to concentrate on the questions and reach as far as possible a common approach to the issues they raise.

I look forward to seeing you in the Laurentians.

Yours sincerely,

Sylvia Ostry

Sylvia Ostry

125 promenade Sussex Drive
Ottawa, K1A 0G2

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February 15, 1988

ISSUES FOR DISCUSSION PAPER
SECOND SHERPA MEETING

I INTRODUCTION: Commitment, Credibility, Confidence

Since the Venice Summit, the world economy has been rendered vulnerable to turbulence in financial markets which could lead to a slowdown in growth. Concern centres on the sustainability of current account positions and the external debt problems of the developing countries. To minimize the risk of a downturn in world economic activity and defuse tension in the international trade and payments systems, governments must demonstrate commitment to the goals of sustainable economic performance and external positions. Government policies must be seen as credible in addressing those goals. Commitment and credibility will restore market confidence.

II DEVELOPMENTS SINCE VENICE SUMMIT

Economic activity in the Summit countries was stronger in 1987 than expected at the time of the Venice Summit, but unemployment rates declined only in North America and the United Kingdom. Inflation, which troughed in 1986 (or early 1987), remains moderate. The differential between real total domestic demand growth in the United States and the other countries as a group turned significantly negative in 1987, mostly on account of weaker US domestic demand growth. Real net exports made a positive contribution to output growth in the United States -- the first year since 1980 -- but a negative contribution in all other Summit countries except the United Kingdom.

In volume terms, trade flows adjusted considerably toward more sustainable positions, although in nominal terms the imbalances of the three major economies remained persistently large. The further realignment of exchange rates in 1987 will contribute to the ongoing international adjustment process. (The recent economic performance of the Summit countries and the latest OECD and IMF projections are summarized in the appended tables.)

On the basis of unchanged policies and exchange rates (as of the end of 1987), no further large disturbances in financial markets, and stable terms of trade, the medium term outlook is one of moderate, but lower growth in the major industrial countries, a modest increase in inflation, and continuing large external imbalances among the three largest industrial economies. There is a high degree of uncertainty about the outlook, however, and the risks are on the downside.

The fiscal stance of the Summit countries as a group, as measured by changes in general government structural balances, moved toward restriction in 1987 and is projected to move further toward restriction in 1988 and 1989. Fiscal consolidation was particularly marked in the United States, though the federal deficit remains high in absolute terms. In Japan and Germany fiscal policy was moderately expansionary. The fiscal stance of the United States and Japan is expected to be approximately neutral in 1988 before once again turning restrictive in 1989. Fiscal policy in Germany is projected to remain mildly expansionary in 1988 and approximately neutral in 1989.

In the wake of the October stock-market decline interest rates fell in all major industrial countries, albeit unevenly, as central banks injected liquidity to support the financial system. US interest rates declined more than German and Japanese rates, leading to downward pressure on the dollar. In turn, the upward pressure on the Deutschmark created tensions within the EMS which were defused by reductions in German interest rates. Since October 1987, a number of coordinated interest rate reductions in Europe have largely reversed the increases earlier in the year. From about mid-November, short-term interest rates in the United States, Canada, and Japan have edged upwards as central banks withdrew much of the liquidity injected previously. Over the past year, interest rate developments, especially in the major surplus countries, have also been affected by the "trade-off" between exchange rate stabilization and domestic monetary objectives. This potential conflict remains.

Economic activity in the developing countries in 1987 was weaker than expected at the time of the Venice Summit. Moreover, the outlook for the next year has deteriorated. On a regional basis there are wide divergences, however. The Asian economies are continuing to grow strongly, whereas the Latin American economies have weakened considerably. Growth in Africa is weak.

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The debt situation remains a matter of serious concern in many developing countries. Even barring unfavourable developments such as a further terms-of-trade deterioration or world interest rate increases, debt-export ratios are expected to show only modest reductions.

III MACROECONOMIC POLICIES AND EXCHANGE RATES

Two crucial factors impinging on the outlook are investor and consumer confidence, and the willingness of markets to continue financing the fiscal and current account deficits at prevailing interest rates and exchange rates. A further shock in equity markets could undermine confidence, thereby reducing business and consumer spending and making a recession more likely. As well, a strongly increasing reluctance by investors to absorb dollar-denominated assets would tend to raise US interest rates and dampen economic activity in the United States and abroad. Though these potential developments cloud the economic outlook, they should be considered in light of the progress that has been made in reducing underlying international imbalances. In particular, the favourable effects of past policy actions and exchange rate changes have begun to materialize, as witnessed, for instance, by the considerable adjustment of trade volumes over the past year. Nor should it be overlooked that in recent weeks a substantial degree of calmness has been restored to foreign exchange and equity markets. The challenge is to manage the transition to a more sustainable, that is, less vulnerable, position so as to reduce the downside risks.

The main issue is the adoption of macroeconomic policies that will facilitate the smooth adjustment of international current account imbalances while maintaining growth and avoiding a resurgence of excessive inflationary pressures.

On the basis of projections by the IMF and the OECD of the US current account balance over the next couple of years, the United States at the end of 1989 will have an external debt of about $700 billion, for which annual servicing payment will be in the range of $30 to $40 billion. Under current exchange rates and policy settings, many observers project large US current account deficits for some years to come, resulting in a rapid cumulation of US external debt. For instance, the latest IMF World Economic Outlook implies a US current account

Is it now. C.B interventions

deficit of about $130-140 billion in 1992. Of concern is whether the projected rate of debt accumulation is sustainable, i.e., whether the current account deficits would be financed by private capital flows at prevailing interest rates and exchange rates. Official flows are not a viable long-run alternative.

Concerns by market participants about the implications of rapid accumulation of US net external debt for future exchange rates, inflation and growth, could result in a drying-up of foreign lending and, consequently, strong downward pressure on the dollar and upward pressure on US interest rates. Furthermore, there is the risk that these pressures could erupt in a sudden loss of investor confidence with ensuing turmoil in financial markets.

At some point the US trade deficit will have to shrink significantly, as will, correspondingly, the trade surpluses of other countries. What is of concern is the manner and the speed with which these changes will come about and the economies' ability to shift resources across sectors smoothly. Specifically, what will be the roles of relative prices, expenditures, and structural flexibility in bringing about the adjustment? Before turning to the issues raised by these factors, one point needs to be underlined. Evidence from a range of multicountry models[1] indicates that the rise in the US current account deficit can be broadly explained by differences in policy stance between the United States and the other major industrial countries. The deficit took several years to accumulate and will likely take several years to reverse.

1 This evidence is from the Brookings Institution conference of March 1986 and workshop of January 1987, as well as other research. Some of this evidence may be found in R. Bryant, G. Holtham, and P. Hooper, eds., External Deficits and the Dollar: The Pit and the Pendulum, Washington, D.C., Brookings Inst. 1987, and R. Bryant, D. Henderson, G. Holtham, P. Hooper, and S. Symansky, eds., Empirical Macroeconomics for Interdependent Economies, forthcoming.

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That the narrowing of international imbalances will be a slow process enhances the importance of cooperation amongst countries to ensure the adoption of policies which foster that process. The alternatives, including the prospect of an even longer period of adjustment and uncertainty, would be a disturbing signal to markets.

The Role of Expenditures and Exchange Rates in the Adjustment of International Imbalances

Expenditures

In the past five years the cumulative growth of real total domestic demand in the United States has exceeded considerably that of other industrial countries. The respective rates for the Summit countries are: United States, 25 1/2 percent; Canada, 23 3/4; Japan, 19 percent; and the four major European countries, 14 percent. This cumulative differential in domestic spending accounts for a considerable portion of the US current account deficit. Reduction of the external imbalances would require a reversal of this differential in domestic spending. US fiscal policy would have to be tightened to permit the transfer of resources from domestic absorption to net exports, whereas domestic demand in the other industrial countries (especially the external surplus countries) would have to grow more rapidly. This process is now underway and is projected to continue over the next couple of years, but, in view of the slow adjustment of external imbalances, the question remains as to whether further policy actions are necessary.

Exchange Rates

The other major proximate cause of the external imbalances of the three major economies was the large real appreciation of the US dollar between 1981 and March 1985 which eroded US international competitiveness. However, notwithstanding the sharp depreciation of the US dollar against other major currencies since March 1985, which has restored US competitiveness to 1979-1980 levels, the US current account deficit has continued to grow.

These persistently large external imbalances mask two important developments, however. First, US export volumes have risen sharply in the past year, whereas those of the two principal surplus countries have declined. Secondly, the current account imbalances in US dollar

terms reflect the use of a depreciating currency as the basis of measurement. Expressed as a proportion of GNP/GDP, the current account surpluses of Japan and the Federal Republic of Germany peaked in 1986.

A number of explanations for the persistence of the US trade deficit, and the surpluses elsewhere, have been offered. In addition to the traditional J-curve phenomenon and the fact that in 1985 the value of US imports was more than double that of exports, explanations include a number of microeconomic developments and special factors which have affected exports and imports asymmetrically:

- weak prices for agricultural products have depressed a usually strong US export sector;
- credit-constrained LDCs have reduced their demand for US products;
- US price competitiveness has not followed in step with the evolution of the exchange rate. Changes in bilateral exchange rates have not been completely reflected in changes in US import prices. Exporters to the United States have absorbed part of the appreciation of their national currency by maintaining their export prices in US dollar terms and reducing their profit margins in an effort to maintain their market share. In contrast, US export prices have been determined mostly by movements in internal markets and only to a limited extent by external events;
- adjustment costs make the recapture of lost market shares by US firms a slow process; and
- new competitors have entered world markets for manufactures, in particular the Asian NICs, which have experienced large increases in competitiveness in the past two-and-one-half years.(The U.S. dollar has depreciated little against the currencies of these countries.)

The above, and perhaps other, factors help explain the persistence of the US trade deficit, but in the final analysis a reduction of the deficit requires that US output grow faster than final spending. And conversely for the countries with trade surpluses. Inasmuch as the US economy is operating near capacity -- the unemployment rate and capacity utilization in manufacturing are at their lowest and highest levels, respectively, since the end of 1979 -- further improvement in the external balance will require a reduction of US

domestic absorption (either by reducing the fiscal deficit or through a drop in investment and consumption), thereby freeing resources for the export sector. Faster domestic demand growth in Europe and sustained growth in Japan would contribute to a narrowing of the imbalances and support world demand.

The Asian NICs also should play a role in the international adjustment process by further liberalizing trade, reorienting more of their savings toward domestic investment, and correcting exchange rate misalignments.

Conclusion and Issues for Discussion

If international payments imbalances are to be significantly reduced from present levels, the US current account balance would have to improve substantially, whereas the surpluses of Japan, Europe (largely the Federal Republic of Germany), and the NICs would have to shrink by a similar amount. The policy challenge is to correct the imbalances while avoiding a decline in world demand.

To maintain world demand any reduction in US expenditure should be offset by increases in other countries. Expenditure changes alone will likely not be sufficient to bring about the required adjustment. Even if the reduction in US expenditure is matched by an increase in spending in other countries of the same amount, the effect on trade balances would be only a small fraction of the changes in expenditures (since propensities to spend on domestic goods are much higher than propensities to spend on foreign goods.) Thus, changes in expenditures will have to be accompanied by a switch in expenditure toward US goods and services. Given the large real depreciation of the US dollar that has already occurred, any further depreciation necessary to induce the switch in expenditure is likely to be comparatively small.

What rate of reduction of international imbalances would be viewed as necessary to manage the transition to a sustainable outcome?

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Are the differences in the projected rates of growth of domestic demand in the Summit countries concordant with the desired narrowing of international imbalances?

In view of the large cumulative domestic demand gap between Europe and the rest of the Summit countries, are there special factors which have to be considered in Europe?

What specific further fiscal and monetary policy measures by individual countries are necessary to bring about the desired adjustment of international imbalances?

How best can the NICs be integrated in the coordination process?

IV STRUCTURAL POLICIES

As trade imbalances narrow, the macroeconomic adjustments will be accompanied by structural adaptation. Regardless of how the gap between production and absorption in the deficit and surplus countries is achieved, it will involve large sectoral adjustments -- between tradables and non-tradables and within tradables -- which displace labour. The longer the trade imbalances persist, the greater will be the subsequent sectoral adjustments.

As the trade deficit and surpluses are reduced, producers in surplus countries have to shift from producing for the US market to producing for their domestic market, whereas US producers have to orient more of their production towards foreign markets. Given the structure of trade, much of the adjustment will fall on manufacturing. Agriculture might make some contribution to the improvement in the US trade balance, but in view of the excess supply of many agricultural products in world markets, any such contribution is likely to be small. Service exports cannot expand sufficiently to make a significant contribution -- the net investment income category will be in deficit, while the remaining categories are too small to make a sizeable contribution. Hence, manufacturing trade must bear the brunt of the adjustment. In this regard, the declining trend in the growth of world trade in manufactures is of concern, since adjustment is likely to be more difficult, and protectionist pressures more intense, in a climate of uncertainty and slow growth.

In view of the large adjustments required to correct existing international imbalances, and in view of the resistance that may be encountered from affected groups, there is a need for the encouragement of policies that will facilitate sectoral adjustments. This need is underlined by the fact that in the major European countries employment in manufacturing has declined throughout the 1980s despite strong exports of manufactures. Moreover, the growth of service-sector employment has not been sufficient to offset employment losses in manufacturing and absorb new entrants to the labour force. In contrast, in North America the decline in manufacturing employment in the first three years of the 1980s has since been reversed, and strong growth in service-sector employment has permitted a reduction of unemployment rates to 1979-80 levels. In Japan, employment has risen somewhat in manufacturing and more rapidly in the services sector, but not sufficiently to prevent some increase in unemployment.

What policies can countries implement or modify -- for instance, with regard to subsidies, government regulations, and taxation -- that would facilitate sectoral adjustments while contributing to demand growth?

In particular, are labour markets sufficiently flexible to allow the required sectoral adjustments to come about without undue frictions??

V MULTILATERAL SURVEILLANCE AND POLICY COORDINATION

The two major issues in this area concern the management of the transition to sustainable economic policies and performance for the Summit countries, and, once sustainability is achieved, ensuring that it is maintained. Multilateral surveillance and coordination of policies should facilitate the attainment of both these objectives.

Over the past two years the Summit countries, in conjunction with the IMF, have been formulating a surveillance mechanism based on a set of economic indicators proposed at the Tokyo Summit. Countries have also agreed to provide medium-term objectives and

projections for their economies. These are now being assessed regularly in conjunction with the IMF's World Economic Outlook in order to highlight possible tensions.

At the IMF/World Bank Annual Meetings in September 1987, US Treasury Secretary Baker and UK Chancellor of the Exchequer Lawson proposed possible extensions to the use of indicators in the surveillance process. Both suggested the use of a commodity price index as a leading indicator of inflationary trends. More generally, the question is whether there is a need for global indicators to aid in monitoring the performance of the Summit countries as a group.

Work underway at the IMF, the OECD, and elsewhere suggests that a commodity price index could play a role as an indicator of inflation pressures in the Summit countries, individually and globally, complementary to that of other indicators. But given the relatively small contribution of commodity prices to the inflation forecast, their volatility and their high susceptibility to speculative forces that role would be limited. A commodity price index, however, is only one possible global indicator.

Is there a need for global indicators as:

- **an aid to discussion amongst countries on the appropriate policy stance?, and/or**
- **a guide to the policy that individual countries should adopt (i.e., who does what)?**

The rapid trend towards the global integration of securities markets and the recent turbulence of equities markets have raised the question of whether greater international cooperation in the supervision of securities markets is called for.

Is there scope for Summit consideration of how to catalyze the ongoing discussion in this area?

The scope for policy surveillance also extends to other areas. In an increasingly integrated world economy, the "spillover" of domestic microeconomic or structural policies cannot be neglected; especially as these have often been the motive force of protectionism. In the future, latent protectionist pressures may be exacerbated by the turnaround of current account positions and the

ongoing force of structural change stemming from technological developments and shifting patterns of comparative advantage.

How can a method of domestic surveillance of micro or structural policies be developed?

VI MULTILATERAL TRADING SYSTEM

The international trading and monetary systems, national economic policies, international imbalances and developing countries' debt problems are all inter-related. Difficulties in resolving external imbalances exacerbate protectionist pressures. Also, to the extent that these difficulties adversely affect growth and the smooth functioning of financial and foreign exchange markets, they affect the ability of LDCs to service their international debt. On the other hand, further trade liberalization will contribute to international well being generally and assist in the adjustment of international imbalances and debt servicing problems of the developing countries.

Recent events - e.g. the October stock market shock - may have momentarily helped stem the forces of protectionism, but exchange rate and trade adjustments may well renew protectionist pressures.

A key issue is a credible and continuing fight against protectionism. A successful MTN, with its commitment to standstill and rollback, to improved market access, to improved rules of trade and to an expanded role for GATT, is essential.

Further, unless the GATT System itself is fundamentally strengthened, gradual erosion may over time render it obsolete. More effective multilateral surveillance of the full range of trade-related policies is imperative. At the very least, the system needs a strong vote of confidence. Substantive early progress toward a successful MTN thus remains a major goal.

How can the Summit best help prevent continuing erosion of the trading system and provide the momentum to maintain and improve the functioning of the GATT System?

In particular, how can an effective system of multilateral surveillance be implemented to facilitate the adjustment process?

A major political and institutional consideration is the future role of developing countries in the GATT System. On the one hand, some developing countries - the NICs - are able to take on greater GATT responsibilities and to be less dependent on special treatment. On the other hand, a number of developing countries should play a larger GATT role - in their own developmental interests - but lack the resources to participate fully.

The developing countries and especially the NICs should be encouraged to undertake increased commitments and obligations and a greater role in the GATT, commensurate with their place in international trade and their respective stages of development. Moreover, developed countries must consider in this context what they are prepared to do to meet the legitimate need of developing countries for greater, more secure access for their exports into developed countries.

How should the NICs be encouraged to undertake increased commitments and obligations and a greater role in the GATT?

At the Venice Summit leaders reaffirmed the OECD Ministerial Agreement on agriculture, including the principles for policy reform and undertook to refrain from adverse practices which would exacerbate market imbalances and the trade environment. They agreed on the early tabling of negotiating proposals in the MTN (which has been done by Canada, the United States and the European Community) and committed themselves to review progress in the MTN at the 1988 Summit and consider the tasks that remain. Provisional results of OECD studies suggest little progress, however.

Assuming discussions in Geneva can be sufficiently advanced, what could be the elements of a framework agreement for the negotiation of long term reform of agricultural trade and trade-distorting domestic policies? What specific commitments on such a framework could Summit leaders make?

What undertakings could leaders make on short term measures which would: (a) lead to immediate improvements in the trade situation? (b) be consistent with longer term reform?

Ministers have also in more general terms committed themselves to further trade liberalization and the success of the MTN. It will be important to reaffirm this broad commitment particularly at a time of possible slower economic growth. The 1988 Summit will undertake the same kind of overall review of the state of play in the MTN, as in agriculture. The key issue will be to ensure that the MTN momentum is maintained. In this context the Ministerial level Mid-Term Review Conference is most important. The question of when (December) and where (Canada) has basically been settled. For the Toronto Summit the outstanding issue will be:

What is to be achieved at the Mid Term Review?

VII DEVELOPING COUNTRIES AND DEBT

A. MIDDLE INCOME COUNTRIES

The situation of indebted developing countries is characterised by uncertainty. There has been progress in strengthening the international financial system and commercial banks against the risks posed by the debt situation, and many indebted countries have implemented programs of macroeconomic adjustment, complemented in some cases by structural reforms. However, a generalized return of these countries to sustained economic growth and creditworthiness is proving elusive. There is a growing sense that recent developments may have marked a turning point in the international debt strategy, as the focus on "growing out of debt" begins to be complemented by techniques which actually reduce the stock of debt.

Perceptions of the middle-income debtors tend to be dominated by the three largest debtors: Brazil, Mexico and Argentina. The financial system has withstood Brazil's moratorium of 1987, and negotiations may result in a comprehensive agreement and a resumption of debt service. Mexico's situation is also encouraging, particularly since a sizeable increase in non-oil exports and a return of some flight capital have occurred. However, in Argentina's case there is a serious prospect the country will once again fall out of compliance with the IMF Standby Arrangement, possibly leading to a debt

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service moratorium. While that action would be a matter of deep concern, the international financial system and the debt strategy have already demonstrated their capacity to withstand the non-participation of one of the major debtors. While the situations of other middle-income debtors vary considerably, none can be characterized as on the brink of financial collapse. There are therefore grounds for assuming the international debt situation can be managed over the next period within the framework of the current strategy.

In addition to economic risks relating to interest rates and growth of world output and trade, there are intimately connected political and financial risks. Debtor commitment to adjustment, and new financial flows from commercial and official sources, are essential components of the strategy. The Acapulco summit, while eschewing confrontation and unilateral measures, demonstrated that regional leaders are under domestic political pressure to take action on the external front as well as on domestic policy. The pressure can only grow, as most of the countries in the region will be putting their recently recovered democracy to the test in elections in the next 12 to 18 months. Their dilemma is worsened since necessary declines in consumption have not been accompanied by the increases in investment required for an eventual growing out of the debt: recent small increases have still not made up for the precipitous declines of 1982/83, and the average growth rate of investment for the World Bank's Seventeen Highly Indebted Countries for the period 1980-87 is still -4.8 percent.

A disruption consisting of unilateral action by a debtor or debtors, therefore, cannot be ruled out in coming months. As noted above, a debt service moratorium by Argentina could be withstood by the international financial system. Were Brazil's negotiations, however, to falter badly or break down at roughly the same time, the situation could become a good deal more ominous. A coherent response could be impeded by the different levels of financial strength of various creditor banks.

The growing difficulties in assembling concerted lending packages attest to the differentiation in financial positions of creditor banks, and even more to the reluctance of private sector lenders to put up any more resources, even for countries whose adjustment records are fairly good.

Progress in developing and implementing the "menu of options" has been mixed, both because unrealistic expectations by debtors of what lenders will find attractive, and because some of the options are less ways of mobilising new resources than they are means to allow both debtors and creditors to exit from a financial relationship that both find constraining. The recent Mexico-Morgan Guaranty bond scheme may be a successful example of the latter, with the important new element that the debtor will now capture at least some of the benefit of an effective asset write down. While the Mexican scheme is not immediately applicable to other debtors (because, inter alia, of Mexico's strong reserves and relatively good debt service record), new and similar "options" may begin to appear for other debtors. Finally, debt-equity swap programs have been successful where debtors have a good macroeconomic policy record, and a welcoming legislative and regulatory regime for foreign investment. Chile, for instance, has retired well over $2 billion in this manner, some 12 to 14 per cent of its total debt burden.

The Mexico-Morgan Guaranty scheme can also be seen as a significant step in the process of developing a second track to the debt strategy, namely that of actually reducing the stock of debt. The process has its roots in the growth of secondary markets for LDC debt, and notably in the large discounts at which these assets are traded, as well as in last year's well publicized increase in commercial banks' loan loss provisions. The latter development in particular may have had the result of increasing expectations among debtors that banks' ability to withstand losses could readily be transformed into willingness to do so.

Burden-sharing amongst creditors could come under increasing pressure in the coming months. This would seem to pose questions to creditor governments, since different bank supervisory practices and regulations have clearly played a role in promoting different levels of financial strength among national groups of banks. Even more delicate is the question of official credits: the Paris Club would be ill-placed to reject burden-sharing as new approaches and techniques are developed, after having firmly insisted on it in earlier phases.

The role of official financing is likely to grow, particularly by the World Bank. Prospects for a substantial increase in available resources are good, as

progress toward a GCI has been encouraging. An early conclusion to these negotiations, accompanied by a suitable clarification of the Bank's role in assisting the major problem debtors, is essential to achieving a significant strengthening of the debt strategy. This contribution will be particularly welcome, given that net transfers from the World Bank to LDCs in FY 1987 were only some $2.6 billion, of which only $776 million were to major debtors. The IMF's role as a source of financing seems set to diminish. This may be inevitable given the nature of the institution as compared to the fundamentally long-term, structural problems of the debtors. On the other hand, its policy role seems more necessary than ever, given the vital link between commitment to adjustment and prospects for an eventual return to creditworthiness. Official sources of financing, especially the Paris Club, will continue to require an IMF role. Thus it is important that the current review of conditionality, with an emphasis on greater flexibility, help debtors to overcome their reluctance to seek Fund assistance.

What scope for further progress does the "menu of options" provide? Can it be expanded further, through action by creditor governments or the international financial institutions? Are there "options" which creditor governments can adopt in the Paris Club vis-à-vis their own credits in heavily indebted countries?

What are the prospects for financial flows to debtors from commercial banks, official sources (including ODA and export credits), and private sector investors (both direct investment and purchases of LDC securities)?

How likely is a disruption to the current situation and strategy in coming months? Are creditor governments and banks positioned to cope with it, or is further preparation required?

How likely is the second track to complement the current strategy in coming months? What should be the role of international financial institutions and creditor governments, and especially their bank supervisors, if its development accelerates? How could equitable burden-sharing among different creditors be maintained? Would there be a role for conditionality under such a scenario?

B. DEBT OF THE POOREST

The Venice Summit made a commitment to address the debt problems of the poorest indebted countries, mainly in sub-Saharan Africa. Progress has been encouraging:

- the Paris Club has adopted extended rescheduling terms of 15 to 20 years for these countries;

- the World Bank, in conjunction with ODA agencies, has put in place an enhanced program of co-financing aimed at the region;

- the IMF Managing Director has announced the establishment of the Enhanced Structural Adjustment Facility, at close to the target level of SDR 6 billion on highly concessional terms.

While the proposal for concessional interest rates in the Paris Club has not been implemented, it can nevertheless be argued that the Venice commitment to greater action has been met.

What is less clear is whether the action taken is sufficient to allow these countries to overcome their debt burden and resume sustained development, hopefully with the aid of market-oriented adjustment programs. A variety of analyses have shown that most of these countries must be considered insolvent, and that only a substantial increase in concessional resources, either through increased ODA or concessional debt rescheduling, will allow them to break out of their current situation

However, despite the eighth replenishment of IDA, there are still shortfalls in meeting these countries' needs for concessional resources. Notwithstanding undertakings in international meetings, the strong adjustment programs which many of these countries are at last undertaking risk failure if concessional flows are not increased from their current levels.

Only a few years ago our populations were deeply concerned over the obvious failure of development effort in Africa. What actions can we take to ensure that this episode is not repeated? How can we ensure that strong adjustment programs in the region are successful?

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	OECD Projections				IMF Projections			
	1986	1987	1988	1989	1987	1988	1989	Average 1990-92
	Percentage changes				from previous period			
Real GNP								
United States	2.90	2.75	2.50	1.75	2.8	2.6	2.8	2.8
Japan	2.40	3.50	3.50	3.00	3.8	3.7	3.6	3.6
Germany	2.50	1.50	1.50	1.25	1.6	1.6	1.7	2.3
France	2.00	1.50	1.50	1.25	2.0	1.8	1.8	2.2
United Kingdom	3.30	3.75	2.75	1.75	4.0	2.6	2.0	2.3
Italy	2.70	2.75	2.00	1.75	3.0	2.3	2.3	2.3
Canada	3.30	3.75	2.75	2.25	3.7	2.7	3.1	3.0
Summit Countries	2.80	2.75	2.50	1.75	3.0	2.6	2.7	2.8
Real Total Domestic Demand								
United States	3.90	2.00	1.00	1.00	2.3	1.6	2.2	
Japan	4.00	4.25	4.00	3.25	4.7	5.3	4.4	
Germany	3.70	2.50	2.25	2.00	2.8	2.6	2.0	
France	3.70	3.00	1.50	1.25	3.0	1.9	2.0	
United Kingdom	3.80	3.50	3.75	2.25	3.7	3.6	2.5	
Italy	3.20	4.50	2.50	2.25	4.5	2.8	2.7	
Canada	3.90	4.00	2.75	2.00	4.3	3.1	3.1	
Summit Countries	3.80	3.00	2.00	1.50	3.1	2.7	2.7	
Inflation (GNP/GDP deflator)								
United States	2.60	3.00	3.50	3.75	3.1	3.6	3.7	
Japan	1.80	-.25	1.00	1.50	-0.1	1.8	1.6	
Germany	3.10	2.50	1.75	1.75	2.1	2.0	2.0	
France	4.70	2.75	2.75	2.50	3.3	2.4	2.4	
United Kingdom	3.50	4.00	5.25	5.00	4.4	4.8	4.2	
Italy	8.00	5.75	5.00	4.25	5.4	4.8	4.6	
Canada	2.90	4.75	4.25	3.50	4.4	3.6	3.5	
Summit Countries	3.10	2.75	3.25	3.25	2.7	3.2	3.0	

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	OECD Projections				IMF Projections			
	1986	1987	1988	1989	1987	1988	1989	1992
		US $ Billion			Percent of GNP/GDP			
Current Balance								
United States	-141.3	-156.0	-134.0	-105.0	-3.5	-3.0	-2.7	-2.3
Japan	85.8	86.0	81.0	79.0	3.6	2.7	2.5	2.2
Germany	37.1	44.0	41.0	32.0	3.8	3.3	3.1	3.0
France	2.9	-3.0	-5.0	-6.0	-0.2	-0.2	-0.3	-0.2
United Kingdom	-1.5	-3.0	-6.0	-9.0	-0.6	-0.7	-1.1	-1.0
Italy	4.0	-2.0	-4.0	-4.0	--	-0.1	-0.3	-0.6
Canada	-6.7	-7.0	-7.0	-7.0	-1.7	-1.8	-1.7	-2.5
Summit Countries	-19.7	-41.0	-35.0	-21.0	-0.4	-0.4	-0.4	-0.4
Unemployment			Percent of labour force					
United States	7.0	6.25	6.00	6.50	6.2	6.1	6.1	
Japan	2.8	3.00	3.00	3.25	2.8	2.8	2.8	
Germany	8.0	8.00	8.25	8.50	7.9	8.1	8.2	
France	10.5	10.75	10.75	11.75	10.8	11.4	11.9	
United Kingdom	11.8	10.75	10.25	10.50	10.4	9.5	9.3	
Italy	10.1	10.75	11.25	11.50	11.6	11.8	12.0	
Canada	9.6	9.00	8.75	9.00	8.9	8.4	8.4	
Summit Countries	7.3	7.00	7.00	7.25	7.0	6.9	7.0	

Source: OECD Economic Outlook 42, December 1987
World Economic Outlook - Preliminary Assessment of Prospects and Policy Issues, EBS/88/1, January 6, 1988.

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COMMISSION
DES
COMMUNAUTES EUROPEENNES

CABINET DU PRESIDENT

Le Chef de Cabinet

Brussels, le 16 February 1988

ref.2709

Dear N. Wicks

Japan's Minister of Trade and Industry recently proposed that the Trade Ministers of the participant countries and the Member of the Commission with special responsability for external relations should hold a meeting on the occasion of the Economic Summit.

Following the very negative reaction from the United States and serious doubts expressed by Canada and the European Community, Mr Tamura changed his proposal by suggesting that the Trade Ministers should meet outside the context of the Economic Summit.

There could be further meetings of this kind in the future, should circumstances so warrant.

We continue to have serious reservations about these proposals, which Mr De Clercq has already conveyed to his colleagues.

If these meetings are to be confined to trade, we do not see the need for them in addition to the quadripartite series of meetings. A number of the Member States of the Community would not be invited, and have already notified us of their concerns regarding such meetings in an area in which the Commission, in accordance with the Treaty of Rome, acts as spokesman for the Community.

If the meetings proposed by Mr Tamura were to deal with matters other than trade (such as investment, debt, etc), this would raise the issue of whether the Trade Ministers were competent to discuss such matters.

In the light of the above and in view of the fact that many international meetings are already held on this subject, I'm sure that you will agree that it would not be in the interests of sound coordination of commercial policy to agree to Japan's proposal.

I should be pleased to receive any comments you may have on this matter.

Looking forward to meeting you in Brussels

Yours sincerely,

Pascal LAMY

Mr Nigel WICKS
Principal Private Secretary
10 Downing Street
LONDON

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10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

15 February 1988

Dear Roderic,

The Third Sherpa Meeting

Sylvia Ostry telephoned me this afternoon to say that Mario Sarcinelli had apparently supported Jacques Attali's request for a change in the date of the third Sherpa meeting. They may have spoken at the European Council in Brussels. Sarcinelli had taken it on himself to suggest that if the UK's difficulties in moving the dates arose from problems of finding accommodation, Attali might himself volunteer suitable accommodation in France. The only other reply to her recent letter on the subject had been from the Japanese who for some inscrutable reason were firmly opposed to any change of the date. I said that our position was still the same. We were firmly against any change of the date. I warned Syvlia Ostry that a question of cancellation charges would arise if we cancelled our Leeds Castle booking at this late stage. She seemed to think that Sarcinelli had suggested to Attali that the French should bear any costs which fell on us in those circumstances. We shall see!

Dr. Ostry clearly feels herself to be in some predicament and will, I suspect, be telephoning other Sherpas.

I am sending a copy of this letter to Geoffrey Littler in the Treasury.

Nigel Wicks

N.L. WICKS

R.Q. Braithwaite, Esq., CMG,
Foreign and Commonwealth Office.

8/4

10 DOWNING STREET

From the Principal Private Secretary 12 February, 1988.

Thank you for your letter about my appointment as Personal Representative of Mrs. Thatcher for the Economic Summit.

It was most kind of you to write to welcome me to the Sherpa meetings. This appointment is indeed a great honour, and I look forward to continuing the good working relationship which I know my predecessor, Sir Robert Armstrong, enjoyed with you.

I too look forward to meeting you in Quebec on 27 February.

(N.L. Wicks)

Mr. Hiroshi Kitamura

file

10 DOWNING STREET

From the Principal Private Secretary

12 February, 1988.

Thank you for your letter of 10 February enclosing a letter from Mr. Hiroshi Kitamura about my appointment as Mrs. Thatcher's Personal Representative for the Economic Summit. I should be grateful if you could arrange for Mr. Kitamura to see my reply which I enclose with this letter.

(N.L. Wicks)

Mr. Tetsuo Ito

01-493 6030.

EMBASSY OF JAPAN,
46, GROSVENOR ST.,
LONDON,
W1X OBA

10th February 1988

Dear Mr. Wicks,

I am asked by Mr. Hiroshi Kitamura, Deputy Minister of Foreign Affairs, to transmit to you the text of his message regarding your appointment to the Personal Representative of Prime Minister, Mrs. Margaret Thatcher MP, for the Economic Summit.

I have pleasure in enclosing this text.

Yours sincerely,

Tetsuo Ito
Counsellor,

N. L. Wicks CBE Esq.,
Prime Minister's Office,
No.10 Downing Street,
London SW1.,

Enc.

Dear Mr. Wicks,

I was very pleased to be informed from the Embassy in Tokyo of your appointment to the Personal Representative of Prime Minister Thatcher for the Economic Summit. I would like to offer you my heartfelt congratulations and welcome you joining us in the Sherpa meetings. We all had a friendly and constructive working relationship with your predecessor, Sir Robert, and I am looking forward to working with you in the coming months for the preparation of the next Summit, starting from our meeting in Quebec on February 27.

Sincerely yours,

Hiroshi Kitamura
Deputy Minister
of Foreign Affairs,
Japan

Department of External Affairs

Canada

Ministère des Affaires extérieures

OTTAWA, ONTARIO
K1A 0G2

February 10, 1988

His Excellency Sir Alan B. Urwick
High Commissioner for the United Kingdom
80 Elgin Street
Ottawa, Ontario
K1P 5K7

Excellency,

It is with pleasure that I enclose the text of a lecture on Economic Summitry by Mrs. Ostry to be delivered tomorrow evening at the University of Toronto under the aegis of the Bissell Program on the Toronto Summit. You will note that the views expressed are Mrs. Ostry's own and do not necessarily represent those of the Canadian Government.

Yours very truly,

John L. Paynter
Director General
Economic Policy Bureau

Enclosure

c Mr Wicks No 10
Sir G. Littler HMT
Mr Braithwaite
M Roberti DTI

SUMMITRY : THE MEDIUM AND THE MESSAGE

by Sylvia Ostry

The Bissell Program
on the 1988 Toronto Summit

Centre for International Studies
University of Toronto
February 11, 1988

As I follow a series of distinguished speakers who have focussed on economic summits broadly, I thought I would share with you today my own personal experience of summitry, beginning with the Bonn Summit of 1985, as a means of exploring with you where the institution and the issues stand today.

When I speak of Summits, two parallel features of their institutional personality come to mind: the medium, by which I mean the Summit as an institution: and the message, or policy outcome. The two are intimately intertwined -- as will be clear from the remarks that follow -- but not quite to the point that would satisfy McLuhan's aphorism!

The innovation of the Summit can be seen as an institutional response to the combined effect of the weakening of the established system of cooperation occasioned by the breakdown of Bretton Woods and the advent of new problems requiring resolution at the highest level . In particular, the first oil price crisis of 1973-74 provided the prompting for a new departure. The initiative for the first Summit (held in Rambouillet in 1975) came from Valéry Giscard D'Estaing and Helmut Schmidt, both former Finance Ministers and well-versed in both domestic and international economic issues. The nature of their proposal was based in important ways on the "Library Group" of Finance Ministers in consequence of having taken place in the library of the White House. These meetings were characterized by the small numbers attending, relative informality, and a lack of bureaucratic preparation. Perhaps portentously, the most contentious issue at Rambouillet turned out to be the choice of countries to take part. The Italians managed to convince the French of their need to attend, but the French vetoed Canadian participation. Canada, however, was invited to attend the next Summit in Puerto Rico by the U.S. hosts, -- again, over stormy French protests. Later the President of the European Commission joined.

The views expressed in this lecture are those of the author and do not necessarily represent the policies of the Government of Canada.

In practice, the Library Group vision of the founders has been eroded in several respects, not only by the increase in size, but also by an escalation in formality, in the scope and preparation of agendas and an inevitable increase in publicity. French opposition to what is described as the "growing bureaucratisation" of the Summit has been a continuing refrain since 1975, and a desire for a return to the Library Group format by the French -- and perhaps others -- has never been fully abandoned. No doubt this "vision" has served to constrain attendance and to prevent the summits from being formally integrated into the machinery of international economic policy cooperation. In that sense, the "medium" has remained rather stable, in particular unencumbered by an international bureaucratic secretariat. At the same time, in each country summitry has become a focal point for forward planning involving key departments of each government. This is an important, but overlooked, benefit of the process in that it fosters more internationally-oriented decision making in the key industrialized economies. Further, the summit preparatory process now involves a meshing of domestic positions covering the policy scope of the three major multilateral institutions: the Fund, the World Bank and the GATT as well as the annual Ministerial Meeting of the OECD.

Thus the institution or medium of the Summit had two roots: a response to the weakening of international cooperation inherent in the breakdown of the fixed exchange rate system; and a crisis -- the first oil shock. In the early 1980's summits were dominated by the second oil shock and the initial policy response to it, and then by the Reagan or "dollar shock" and the emergence of a striking asymmetry in the world economy among the three major blocs, the U.S., Europe and Japan. These developments formed the economic backdrop to Bonn '85, a turning point in the message of summitry so let me briefly describe both.

II. THE BACKGROUND TO BONN '85

The policy response to the second oil shock of 1979-80 was -- unlike that to the first -- synchronized and targeted solely at fighting inflation. Monetary policy became a central instrument of control, most visibly in the U.S., with the appointment of Paul Volcker in 1979. While the deflationary impact of policy synchronization by the major OECD countries was both anticipated and desired, the severity of the 1982 recession was much greater than expected or intended. The

cumulative effects of a prolonged period of unprecedented monetary tightness, pursued simultaneously in major industrialized countries, were not well understood: the risks of the policy choice could not be adequately assessed in the face of genuine uncertainty. Certainly the impact on the LDC debt position of rising interest rates, a rising dollar and plummeting commodity prices, was not factored into the "planning equation".

The rebound from the severe 1982 recession was initiated by the strongly expansionary fiscal policy of the Reagan Administration launched in a vision of supply-side euphoria, and by an easing of monetary policy in the U.S. provoked by the eruption of the debt crisis in August of '82. In the rest of the OECD, the prime forces shaping the recovery were weak, consisting primarily of the disinflationary process itself. This contrast between the U.S. and other major countries was sharpened by a continuing and marked tightening of fiscal policy, especially in Germany and Japan, throughout the first half of the decade. Thus were the seeds of our present problems sown: synchronized cooperation in the absence of strategic information followed by uncoordinated national policies entirely governed by domestic political agendas.

The strikingly divergent growth pattern which resulted from the differing recovery impulses produced, as well you know, a number of serious, indeed gross, imbalances. Most dramatic was the sharply contrasting current account positions as between the U.S., with its unprecedented deficit, and comparably large and growing surpluses in Japan and Germany. Differential growth rates accounted for a major portion of the cumulative U.S. external deficit. Another significant factor -- in addition to the loss of dynamic LDC markets especially in Latin America -- was the stunning appreciation of the dollar. The resulting loss of competitiveness of U.S. exports added powerfully to the protectionist fury in Congress. The appreciation of the dollar was due to a massive capital inflow which was doubtlessly influenced by several factors, but chief among these were the high real interest rate differentials between the U.S. and other summit countries reflecting the starkly contrasting fiscal positions already mentioned as well as more fundamental disequilibria in savings patterns, especially between the U.S. and Japan.

It was these gross imbalances in the international economy and the strains they induced -- rising protectionist pressures in the U.S., the systemic

threat of the global debt problem and a growing fear of an exchange rate crisis -- that confronted the heads of government in May 1985 in Bonn.

On the macro front a unilateral U.S. solution -- i.e. a reduction in the fiscal deficit -- had been the standard prescription of all Summits since Reaganomics startled the world. But unilateral action to achieve the much-desired "soft landing" of the dollar, a more sustainable pattern of current account positions and a continuation of the economic growth necessary to prevent a new eruption of the debt crisis looked, by 1985, increasingly inadequate and was, in any case, politically out of reach. What was needed was coordinated action among the major powers to ensure more compatible policies. Equally urgent was a powerful and credible signal, such as the launching of a new GATT Round, to halt the increasingly serious erosion of the multilateral trading system.

III A BRIEF PARENTHESIS: TERMINOLOGY

Before moving onto the Bonn Summit, I want, parenthetically, to be quite clear about the terms I have just used, as the proper usage of these terms is not entirely settled or universally accepted.

I think this terminology is best described by former Federal Reserve Governor Henry Wallich and I quote:

> "Coordination, harmonization, cooperation, consultation; these, in descending order, are the terms by which nations recognize -- sometimes reluctantly -- that they are not alone in the world..."Cooperation" falls well short of "coordination", a concept which implies a significant modification of national policies in recognition of international economic interdependence." (emphasis added).

IV THE BONN SUMMIT 1985: The Little Summit that Wasn't

The most significant outcome of Bonn -- a "first" in the history of summitry -- was a declaration by each country of its own economic strategy and objectives. These were strikingly similar: reducing structural rigidities and maintaining prudent fiscal and monetary policies. As the New York Times noted: "for the Reagan Administration the endorsement of the free market, small

government views that the other countries had widely ridiculed when President Reagan first took office, marked a stunning ideological achievement". The Economist, perhaps more accurately, called it the "Ronald Thatcher Message".

But the remarkable degree of policy convergence on Ronald Thatcherism had a deeper implication. Policy convergence -- getting one's own house in order -- was the recipe for international economic cooperation which had dominated summitry since the onset of the 1980's. Policy convergence implies "hands off" both domestically and internationally. Policy compatibility on the other hand, would from time to time, require a differentiated package: "Singing in harmony not in unison". Compatibility of policy can imply significant coordinated policy differentiation among countries. The 1985 Bonn Summit endorsed convergence and cooperation at the precise time when compatability and coordination became the key, if elusive, requirements for achieving world economic stability. Indeed, risks of a financial eruption in exchange markets or a major protectionist assault by the U.S. Congress were widely perceived to have escalated. Yet international "hands off" prevailed at Bonn: the little Summit that wasn't, as it was dubbed by Business Week.

However on the way to the next summit at Tokyo an important change took place in Washington: the move to the Treasury portfolio of Jim Baker.

V TOWARDS COORDINATION: THE ROAD TO TOKYO

The events of 1985 which led to Tokyo were important in themselves, i.e. for what they accomplished, but perhaps equally or even more for what they signalled about the U.S. view of managing global interdependence. Those events -- the Plaza Accord which began the process of managed floating; the Baker Plan which laid out a new conceptual approach to global debt -- signalled a rejection of the philosophy behind convergence, "Get your own house in order and all will be well", as the recipe for international economic cooperation. They signalled a reassertion of U.S. world economic leadership or, taking another view, a recognition of the U.S. need for help.

Let me explain this further. Policy coordination, as already mentioned, implies a significant modification of national policies, when required, in recognition of international economic interdependence. In

the absence of a rule (like a fixed exchange rate or explicit target zones) and an enforcement agent (like the IMF), it is by no means clear whether a system of continuing coordination (rather than an occasional package of coordinated policies) is achievable -- although the alternative, in a fragile situation like the present, may be sufficiently threatening to encourage genuine efforts in that direction. Indeed the current debate about exchange rates is really a debate about international rules as a constraint on national sovereignty. That debate would be difficult and divisive at the best of times. It is made immeasurably more so today by the formidable challenge presented by global imbalances; the absence of an undisputed hegemon; the increasing economic power of new players like the Asian NIC's; the evolution of the European Community to one market; and perhaps most unsettling of all, genuine uncertainty among economists about the appropriate role and pattern of exchange rates.

The reassertion of U.S. leadership was, it must be stressed, a pragmatic step-by-step move to address the challenge of coordinated global management. It did not appear to stem from a coherent vision of the need for or desirability of a basic regime change.

The next step in this "creative ad hocery" was the Tokyo Summit of 1986.

VI THE TOKYO SUMMIT: 1986

The Tokyo Summit in its economic agenda for coordination or multilateral surveillance, as it was christened, did two things. It delineated the key forum for this phase of the evolution toward improved coordination (the G-7 Finance Ministers) and it began to spell out (at the initiative of the United States) the means by which such a process might be achieved.

As to the process, the Tokyo Summit enumerated a number of indicators, including exchange rates, by which the desired performance of individual countries might be evaluated. It was suggested that a country that deviated too far from the desired course would be subject to peer pressure to adopt "remedial" measures to alter its economic policies. The debate on the usefulness, and even appropriateness, of these and other indicators continues among G-7 Finance Ministers and their officials, as does the degree to which remedial action should be "automatic". It is the issue of automaticity that is most

controversial because, of course, it implies a move, however tentative, in the direction of "rules".

As well, the role of the IMF in providing analysis to the G-7 as a basis for its discussions is under debate. Were the IMF to assume full "secretariat" functions for the G-7, this, again, would imply a tougher form of international discipline than the present arrangement of peer pressure or suasion buttressed by Fund figures and analysis.

Finally, the Tokyo Summit achieved a major breakthrough in another crucial area of international cooperation, trade policy. Leaders gave a strong push towards the launch of a new Round of multilateral trade negotiations and gave prominence to the central role of agriculture in that Round for the first time in the history of the GATT. Building on this summit push, the Uruguay Round was launched in September 1986 in Punta del Este. It has been accurately described as the most important Round since the founding of the GATT. It is certainly the most ambitious and its outcome will determine the shape and nature of the future world trading system. The contribution of summitry in the trade field has been underestimated, perhaps because it continues to be overshadowed by the search for improved coordination in macroeconomic policy.

Thus the big news event after Tokyo was not Punta but the Louvre.

VII FROM TOKYO TO VENICE: LOUVRE 1987

The Louvre Accord of February 22, 1987, described by UK Chancellor Lawson as "Plaza Two", sought to give further substance to policy coordination efforts. It spelled out policy measures which member governments would undertake to reduce external imbalances among them and thus help to stabilize exchange rates. As the dollar had fallen by over 30% since the Plaza Agreement of 1985, and further downward pressure on the currency was clear to all, the media focussed almost exclusively on communiqué language in which the G-7 agreed to "cooperate closely to foster stability of exchange rates around current levels". Because the policy commitments, essentially budget deficit reduction by the U.S., and domestic demand stimulus by Japan and the F.R.G., were not "new" and thus not deemed "newsworthy", or even adequate, the Louvre Accord left the powerful impression that the chief focus of cooperation among G-7 Ministers was mainly the

stability of exchange rates. To many this meant focus on a symptom rather than the underlying cause of the threatening world imbalances.

VIII THE VENICE SUMMIT: June 1987

The drift in both policy and exchange rates following the Louvre Accord was not sufficiently pronounced as to arouse much disquiet at the political level last spring. Thus, on economic policy, at Venice, the communiqué endorsed again the concept and process of coordination, but provided no new advance in practice. On economic policy Venice was essentially a holding operation. The Economist leader was ascerbicly captioned "Deathly in Venice".

Again, however, the media underestimated progress in other areas. Venice did endorse and validate a major breakthrough on the need for domestic reform in agriculture (which had been pre-negotiated at the OECD some weeks earlier) as a prerequisite of trade reform. Further, by providing an unprecedentedly strong focus on the plight of the poorest debtors of sub-Saharan Africa, the Venice Summit also led to concrete measures to alleviate the situation of these countries, notably the SDR 6 billion expansion of the IMF's Structural Adjustment Facility announced by the Fund's Managing Director, Michel Camdessus, last December. Given the refusal of the U.S. to participate in this initiative, and the strong concerns of both Germany and Japan over burden-sharing among partners, it is likely that this useful proposal would have been seriously compromised had it not been for discussions among leaders at Venice and robust language in the Venice Communiqué making clear that the issue would be revisited at Toronto.

But the absence of advance in Venice on economic policy coordination, compounded by the lack of progress at the IMF/IBRD annual meetings in Washington last September, was, as we know, followed by Black Monday. The causes of the market crash have already been the subject of extensive analysis and debate and more will no doubt follow. One common theme in most commentary concerns the tenuous credibility of the coordination process as exemplified by the public row between the U.S and Germany over their alleged respective inability to live up to their policy commitments. The U.S. deficit reduction package and the German fiscal policy changes which soon followed represented attempts to restore market confidence

and prevent another Cassandra-like warning on the need for more effective global management.

CONCLUSIONS

So much for the chronology of summitry. What next, in Toronto?

The Challenge confronting Summit leaders at Toronto this June will be -- as is evident from my brief history of the medium and the message of Summitry -- both familiar and formidable. Just consider the political setting: the final period of the Reagan presidency and scarcely a month after a French election. Moreover, any measure of success will be made more difficult to achieve by the scrutiny of a sceptical media army of thousands searching for simple answers to intolerably complex questions and governed by a compelling maxim: "Good news is no news".

I have already argued that the requirement of effective international economic coordination runs head-on into the sensitive issue of the limits of national sovereignty. It is worthwhile spelling out how this is manifested in practice. Not only do countries have different preferences -- for example as between inflation and unemployment or between economic and non-economic objectives -- but also different views about the workings of the economy and the impact of policy, i.e. they operate with different "economic models" in mind. Further, the different institutional apparatus of policy-making among the big three -- U.S., Germany and Japan -- greatly adds to the difficulties of coordination, especially in fiscal policy. This has become painfully evident in the United States where the role of Congress has rendered repeated commitments by the administration questionable to say the least. But German federalism also seriously constrains the room to manoeuvre of the Bonn government as does the constitutionally guaranteed independence of the Bundesbank. In Japan the nature and role of the ruling LDP party has acted as a brake on raising the priority of international considerations in domestic policy-making, although major progress has been made in this respect over the past several years.

None the less, as I have also argued, the progress in policy coordination since the Bonn Summit has been considerable. Policy steps in the right direction if not, perhaps, of the desired magnitude, have been taken and a process of surveillance has been launched.

While in the international monetary sphere agreement on a new regime -- the committment to new "rules" -- is in my view some years away, there has been real progress in the trade field where a successful completion of the Uruguay Round should indeed produce new and more effective "rules" for the multilateral trading system. This is crucially important in reducing the climate of uncertainty and unpredictability which erodes the investment climate and eats away at the core of the market system. In the global debt field the threat to the world banking system has been contained and reduced, but there is further progress to be made in restoring growth and creditworthiness in the developing countries.

So the real question about Summitry is not whether it has been a catalyst for progress but whether the momentum for change launched since Bonn will be sufficient to prevent a rupture in the world monetary or trading system over the period of transition to more sustainable and balanced world performance. I won't -- indeed can't -- hazard an answer to that more pertinent question but would, as a final statement, argue that summitry is the only available medium to foster such progress.

Although episodic and unpredictable -- one need only recall Bitburg or Chernobyl in recent years -- summitry is the only forum which includes leaders of the major economic powers. Only these leaders have the authority to integrate nationally policies concerning several ministries (often with competing bureaucratic mandates and territorial imperatives) or to reconcile the demands of foreign and domestic policy, having responsibility for both. Further, Summits have a comparative advantage in generating institutional change since the multilateral institutions themselves are unlikely to break from inertial decision-making and established departmental policy positions in the absence of clear directions from the most senior political level.

The most apt comment on summitry then may be a paraphrase of Churchill: it is a reed too frail to support the process of managing interdependence -- except when you consider the alternatives.

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Mr Nigel Wicks, CBE
Principal Private Secretary
to the Prime Minister
Prime Minister's Office
10 Downing Street
LONDON SW1

10 February 1988

Dear Mr Wicks

I was pleased you were able to join us for dinner last Thursday and appreciated very much the useful exchange of views with you and your colleagues.

As we discussed, Sylvia has canvassed other Personal Representatives regarding the French request for a change in dates of the Third Sherpa Meeting, also indicating the near impossibility of changing dates. (A copy of her letter is attached). I will keep you abreast of any further developments.

We spoke at the dinner regarding lunch or dinner before the next Sherpa meeting. My secretary has been in touch with yours regarding a suitable date. Let's hope our calendars coincide.

Yours sincerely

L J TAYLOR
Minister (Commercial/Economic)

cc Sir G Littler HMT
Mr Braithwaite FCO
Mr Richardson FCO

Canadian High Commission

Haut Commissariat du Canada

Dear Colleague

You will recall discussing dates for our future meetings in preparation for the Toronto Summit when we last met in British Columbia in early November 1987. At that time we agreed, and subsequently confirmed, that we would hold or third meeting in the United Kingdom 15-17 May immediately prior to the OECD Ministerial Meeting.

When I visited Paris last week, our French colleague Jacques Attali advised me that these dates would pose grave difficulties for the French in light of Presidential elections to be concluded May 8. He therefore suggested holding the meeting one week later, i.e. 22-24 May.

When I visited London immediately thereafter, UK authorities informed me that it would be virtually impossible to shift the third Sherpa meeting, arrangements for which are already well in hand at Leeds Castle for the dates originally planned.

I am writing at this juncture to let you know of these factors and to solicit your views as soon as possible.

I hope that we will be able to resolve the issue of timing of the third Sherpa meeting before our next meeting at La Sapinere, Quebec, 27-29 February. I very much look forward to welcoming you there.

Yours sincerely

SYLVIA OSTRY

Foreign and Commonwealth Office

London SW1A 2AH

Mr N Wicks
No 10

9 February 1988

Dear Nigel,

TORONTO ECONOMIC SUMMIT

1. At our meeting on 3 February we covered the procedural side of preparations for the annual Economic Summit and touched briefly on the issues that might arise in Toronto. I shall shortly be sending a suggested list of briefs for the second meeting of Personal Representatives; but in addition you may find it useful, even at this early stage in the proceedings, to have a general overview of our thinking on substantive issues likely to come up in the Summit preparations. It is too soon to take a view on our detailed objectives. But we shall of course need to clarify our aims as we approach the Bank/Fund spring meetings (14/15 April) and the OECD Ministerial Council (18/19 May): these are a major part of the preparation for the Summit itself and it is indeed convenient to regard the three sets of Ministerial meetings as part of a single process.

2. As at Tokyo and Venice, four main economic subjects are likely to predominate: macroeconomic issues, trade, agriculture and debt. On the first of these, all Summit participants share common goals for the management of the world economy; in the medium term, an orderly unwinding of current account imbalances, and in the longer term sustained non-inflationary growth. But the difficulty of reconciling sharply divergent national interests inevitably gives rise to concerns that policy coordination may come to look increasingly unconvincing. We did not entirely avoid that danger at and after the Venice Summit. Nevertheless the Summit/G7 mechanisms provide the only framework to hand for managing the world economy in any concerted way and for the sake of market confidence at least we should make the best of it. We must hope that improved US trade performance restores a degree of stability to the foreign exchange markets; but we cannot expect any further action to reduce the budget deficit by either the Administration or Congress in an election year. The Japanese are moving, but have far to go. The Germans will probably remain unwilling to commit themselves to necessary policy changes, both macro and micro, though their confidence in the rightness of their policies may be wavering. Our influence in isolation is limited, so our aim must be to create an atmosphere which puts effective pressure on the three main players in the preparatory process and in the Summit itself.

3. The second main economic area to be covered at the Summit is trade. We shall of course want the Summit to reiterate general opposition to protectionism, but beyond that our position will depend on progress in the Round, and on developments on US trade legislation. We may wish to put down a marker opposing the inappropriate use of national security arguments as grounds for protectionist measures, for example in the energy field in view of current debate within the US.

4. A separate aspect of the trade problem is the scope - and need - for action from the Newly Industrialised Countries (principally South Korea, Taiwan and Singapore: Hong Kong must remain a special case). The surpluses run by the NICs are of course in part the mirror image of the US trade deficit. There is a macro-economic point here. The NICs do need to take early steps to reduce their growing trading surpluses, especially with the US; and in the medium term to 'graduate' out of the privileges associated with developing country status, and to assume responsibilities commensurate with their new economic weight. The recent US action to remove GSP status from these four countries is an example of enforced integration, and a measure of US concern at this growing component in the American trade deficit. Recent G7 communiques have spoken out forcefully on the subject, and I expect Toronto to do the same. We had a preliminary discussion of this on 1 February in the Executive Committee in Special Session of the OECD, and the Secretariat will be working up ideas which can be reflected at the Ministerial meeting. The DTI have launched their own campaign through the Brussels machinery. I detect a bit more willingness amongst our partners to tackle the problem. But the trick will be to find the right mix of carrots and sticks to persuade the NICs to adjust in their own self-interest. We are giving this further thought.

5. The Canadians will certainly want to highlight the closely related subject of agriculture. There is some risk that Toronto will do so in a less positive way than Venice or Tokyo now that real negotiations are imminent. At the least our objective should be to ensure that there is no backsliding from the principles for reform agreed at last year's OECD Ministerial and that the Prime Minister's position is fully protected in advance of the European Council in Hanover. These are essentially defensive objectives. We shall try to identify more positive ones over the coming months, because it is in our interests to continue to keep up the momentum of reform without necessarily going the whole way with the US and Canada.

6. We shall probably want to avoid any detailed discussion in Toronto of the mid term Ministerial review (MTR) of the Uruguay Round. The Summit is not the place for what would no doubt develop into a highly contentious and unproductive debate over the timing or content of the MTR. That is for GATT. We shall want to head off any attempt to pursue this in preparatory meetings.

7. As for discussion on debt, we shall probably want to resist Canadian ideas for shifting the emphasis of discussion unduly from the poorest indebted countries to the middle income, mostly Latin American

debtors. We have two reasons for wanting to avoid such a shift. First, governments have less locus in Latin American debt, most of which is owed to commercial banks; and secondly we do not wish to divert attention from the good story we have to tell on help for Sub-Saharan Africa (the Chancellor's initiative - which we must continue to advocate, our generous contribution to the enhancement of the IMF's Structural Adjustment Facility, our aid contribution and our support for World Bank co-financing programmes). But the American position may be closer to the Canadian because of their political preoccupation in Latin America, and the situation on Latin American debt is increasingly fluid (witness Mexico). We must leave some room for manoeuvre.

8. Among other economic issues which may come up are Canadian proposals, currently very much at the drawing board stage, on the regulation of financial markets, and competition in the provision of concessional export credits (eg our ATP scheme, for which there is no direct Canadian equivalent). The Summit is not the place for discussion of such technical subjects: and we should re-direct such initiatives towards the appropriate bodies if they are raised at preparatory meetings. Alan Wallis may raise direct foreign investment. We share the US interest in encouraging the removal of barriers to investment, whether in developed or in developing countries. But since the US are for the moment pursuing this through the OECD, I think the Summit could content itself with giving suitable encouragement in the communique.

9. Certain 'Other Issues' have featured in past Summit declarations that are not exactly 'economic' nor yet purely 'political'. It is particularly hard to predict initiatives in this sort of area. Prime Minister Mulroney is almost certain to want to make a show, though this may be in the political field (see below). We mentioned briefly on 3 February possible American interest in discussion of expenditure on social services. The Prime Minister was cautious about this subject when it was tentatively raised before the previous two Summits, but Allan Wallis is still interested and you will want to bear it in mind as a potential topic. As you know, there have been signs that science issues (especially big science) may be raised in Toronto. Sylvia Ostry reverted to that at dinner on 4 February, without indicating that there was much Canadian enthusiasm for the subject. But she was not aware that the Americans had lobbied the Canadian and other governments for support for the US superconducting supercollider projects (the US answer to CERN), and we may hear more. We need not spend time considering the Japanese Human Frontier Science Programme; this is something that should be pursued through normal science and education channels and not at the Summit. We might try to secure a reference to AIDS and the very successful international conference in London last month, to which the declaration on AIDS issued at Venice looked forward: but there will be little enthusiasm for an extended discussion. The French may wish to pursue Mitterand's initiative at Venice for an international ethical committee on AIDS, about which we have heard nothing since we nominated three British experts. There is no particular initiative on either energy or the

environment that we want to pursue at this stage, although the Canadians might want a further reference to the Brundtland Report, which we would not oppose.

10. As is customary, political directors will only attend the final preparatory meeting. It would be premature to attempt to set out the political agenda, which will be heavily dependent on the climate in the immediate run up to the Summit; and unforeseen events (terrorist outrage, acts of God etc) can of course force themselves onto the agenda at the last moment. Following the expected US-Soviet summit in Moscow and with the possibility of a START agreement and movement on Soviet withdrawal from Afghanistan, East/West relations is bound to be a dominant theme. We agree that the other main subject is likely to be the Middle East, both Arab/Israel and Iran/Iraq. The subject of terrorism may well arise, but we would not expect heads of government to spend long on it. Our initial view (discussed informally with the Canadians) is that, barring a major incident, we should aim to include a few crisp sentences on standing firm against terrorism in the wider political statement, rather than attempt a free-standing terrorism declaration.

11. We wish to avoid discussion of South Africa. Sylvia Ostry's colleague said at the dinner on 4 February that he thought it most unlikely that Mr Mulroney would want to revert to this divisive issue. I doubt if there will be much from the others.

12. Finally, there is a subject called 'technology and foreign policy' or 'global trends'. Shultz raised this in Venice and at the Seven Foreign Ministers' dinner in New York last September. Genscher has offered to host an informal ministerial meeting of the Seven to discuss it in the Spring (probably 30-31 March). We shall know after that whether the Foreign Ministers draw any conclusions which they wish to bring to the attention of heads of government.

Yours ever,

Rodric

R Q Braithwaite

cc Sir G Littler, H M Treasury
Sir J Fretwell
Mr Richardson, ERD

NB1AJH

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Mr Nigel Wicks, CBE
Principal Private Secretary
to the Prime Minister
Prime Minister's Office
10 Downing Street
LONDON SW1

February 2, 1988

Dear Mr Wicks

I have pleasure in enclosing the original letter from Dr Sylvia Ostry, a copy of which was sent to you on 26 January 1988.

Yours sincerely

L J TAYLOR
Minister (Commercial/Economic)

10 DOWNING STREET
LONDON SW1A 2AA

From the Principal Private Secretary

1 February 1988

Thank you so much for your letter of 28 January congratulating me on my appointment as Personal Representative for Economic Summits of the Prime Minister. It was most kind of you. It is indeed an honour to be appointed to this task and I look forward to it greatly and to continuing the good cooperation which existed between Sir Robert Armstrong and yourself.

(N.L. Wicks)

Dr. Hans Tietmeyer

10 DOWNING STREET

From the Principal Private Secretary 28 January 1988

Thank you for your letter of 26 January with which you enclosed a letter from Dr. Sylvia Ostry with regard to my appointment as the Prime Minister's personal representative for Economic Summits. I enclose a reply to Dr. Ostry's letter and I would be grateful if you could arrange for her to have it directly she is in London.

I look forward to meeting you at the Deputy High Commissioner's dinner on 4 February and I thank you for your congratulations on my new appointment.

(N. L. WICKS)

L. J. Taylor, Esq.

10 DOWNING STREET

From the Principal Private Secretary 28 January 1988

Thank you for your letter of 20 January which I received here yesterday.

It was extremely good of you to write in such kind terms. I count my appointment as Mrs. Thatcher's personal representative for Economic Summits as a great honour and I am much looking forward to working with you and your colleagues in the preparation for the Toronto Summit.

I look forward to seeing you next week.

(N. L. WICKS)

Dr. Sylvia Ostry

R1/2.

Dr. Hans Tietmeyer
Staatssekretär im
Bundesministerium der Finanzen

5300 Bonn 1, 28th January, 1988

Graurheindorfer Straße 108
Telefon: (0228) 682-4293
Fax.: (0228) 682-4420 Tx.: 886645
Ttx.: 2283735 = BMF

Mr. Nigel Wicks
Principal Private Secretary
to the Prime Minister
Downingstreet, 10

London, SW 1

Dear Mr. Wicks,

may I offer you my sincere congratulations on your appointment as Personal Representative for Economic Summits of the Prime Minister, the Rt Hon Mrs. Margaret Thatcher.

I am looking forward to seeing you and to continuing the fruitful cooperation I had with Robert Armstrong.

Sincerely,

H-Ti

Foreign and Commonwealth Office

London SW1A 2AH

26 January 1988

N Wicks Esq
Principal Private Secretary
No 10

Dear Nigel.

THE ECONOMIC SUMMIT

1. Congratulations again on your appointment! As promised I am sending you a first batch of basic Summit papers. I have enclosed bound copies of all the Economic Declarations and Political Statements issued since summits began in 1975 (the Venice documents are attached separately). You might also like to see the paper produced by ERD in June 1987, setting out the procedures followed in preparing for summits.

2. I am also assembling a collection of current papers on key issues likely to feature at Toronto, and shall send these to you after we have had a chance to go over the ground with Rodric Braithwaite next week. What about telegram distributions? You probably ought to see at least telegrams in the Monetary (IMF/IBRD) and Frame Economic and External series. There will be a fair amount of dross, but it may be better to err on the side of generosity. We can copy other relevant telegrams to you on an ad hoc basis.

3. You may already have come across Nicholas Bayne's excellent book on Summitry, Hanging Together. A new edition has just been printed and I can let you have a copy if you do not have one.

270-2671

Yours ever
Tom

T L Richardson
Economic Relations Department

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Mr Nigel Wicks, CBE
Principal Private Secretary
to the Prime Minister
Prime Minister's Office
10 Downing Street
LONDON SW1

26 January 1988

Dear Mr Wicks

I have pleasure in enclosing the text of a letter from Dr Sylvia Ostry, with regard to your appointment as the Prime Minister's Personal Representative for Economic Summits.

I look forward to meeting you on the evening of February 4 at the dinner the Deputy High Commissioner is hosting for Dr Ostry and establishing contact, since I have principal responsibility for Summit matters in the High Commission.

May I take this opportunity to congratulate you on your new appointment.

Yours sincerely

L J TAYLOR
Minister (Commercial/Economic)

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TELEX FROM MR NIGEL WICKS - PRINCIPAL PRIVATE SECRETARY TO THE PRIME MINISTER, LONDON (TELEX N. 00441/27582)

TO DOTT. MARIO SARCINELLI - DIRETTORE GENERALE DEL TESORO
MINISTERO DEL TESORO - ROMA

TELNO MISC 043

REF: 320107

DEAR MR. SARCINELLI,

IT WAS SO KIND OF YOU TO SEND ME YOUR MESSAGE WELCOMING ME TO THE CLUB OF PERSONAL REPRESENTATIVES FOR ECONOMIC SUMMITS.

IT IS INDEED A GREAT PRIVILEGE TO BE INVITED TO JOIN YOU AND YOUR COLLEAGUES IN THIS IMPORTANT TASK AND I LOOK FORWARD TO MEETING AND WORKING WITH YOU IN THE NEAR FUTURE.

WITH KIND REGARDS,

MR. N.L. WICKS

26 JANUARY 1988

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CABINET OFFICE

Please would you despatch the attached telex to Dott. Mario Sarcinelli, Direttore General del Tesoro,

Ministero del Tesoro,

Roma

N. L. WICKS
26.1.88

TELEX FROM MR . NIGEL WICKS TO DOTT. MARIO SARCINELLI,

DIRETTORE GENERALE DEL TESORO

MINISTERO DEL TESORO

ROMA

Ref: 320107

Dear Mr. Sarcinelli,

It was so kind of you to send me your message welcoming me to the club of Personal Representatives for Economic Summits.

It is indeed a great privilege to be invited to join you and your colleagues in this important task and I look forward to meeting and working with you in the near future.

With kind regards,

Mr. N. L. WICKS

26 January 1988

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FROM DOTT. MARIO SARCINELLI - DIRETTORE GENERALE DEL TESORO
MINISTERO DEL TESORO - ROMA

TO MR. NIGEL WICKS - PRINCIPAL PRIVATE SECRETARY TO THE
PRIME MINISTER, LONDON (TELEX N. 00441/27582)

==========

TELEX 320107 DEL 25.1.1988

DEAR MR WICKS,
I HAVE BEEN INFORMED BY SIR ROBIN BUTLER THAT YOU HAVE BEEN APPOINTED
BY THE PRIME MINISTER AS HE
26/01 09.59
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FROM DOTT. MARIO SARCINELLI - DIRETTORE GENERALE DEL TESORO
MINISTERO DEL TESORO - ROMA

TO MR. NIGEL WICKS - PRINCIPAL PRIVATE SECRETARY TO THE
PRIME MINISTER, LONDON (TELEX N. 00441/27582)

==========

TELEX 320107 DEL 25.1.1988

DEAR MR WICKS,
I HAVE BEEN INFORMED BY SIR ROBIN BUTLER THAT YOU HAVE BEEN APPOINTED
BY THE PRIME MINISTER AS HER PERSONAL REPRESENTATIVE FOR ECONOMIC
SUMMITS FOLLOWING THE RETIREMENT OF SIR ROBERT ARMSTRONG.
IT IS WITH GREAT PLEASURE THAT I WELCOME YOU TO OUR SMALL CLUB AND I
AM LOOKING FORWARD TO MEETING YOU SOON AND COOPERATING WITH YOU IN
THE CONTEXT OF THE SUMMIT PREPARATION.
SINCERELY YOURS

MARIO SARCINELLI

TRS: MARCO

NNNN

10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

22 January 1988

Thank you for your letter of 21 January.

It was good of you to write with your congratulations on my appointment as Mrs Thatcher's Representative for the Economic Summit. It is a most interesting assignment and I look forward to it immensely. I look forward, too, to continuing the close co-operation which I know has existed between the Personal Representative and yourself and your colleagues.

I should indeed like to come to the dinner which you are hosting on Thursday 4 February for Dr Sylvia Ostry. I shall do my very best to be there earlier, say at 7.30 pm, so that I can make Dr Ostry's acquaintance beforehand.

I look forward to meeting you.

N L WICKS

Mr L A Delvoie

CABINET OFFICE

70 Whitehall London SW1A 2AS Telephone 01-270 0067

CONFIDENTIAL

Hw 0648

N L Wicks Esq CBE
Principal Private Secretary to the
Prime Minister
10 Downing Street
London
SW1

22 January 1988

Dear Wicks

ECONOMIC SUMMIT : SCIENCE

I mentioned to you that there are growing signs that science issues may be raised at the Toronto Summit in June and that it might be appropriate, therefore, for the Chief Scientific Adviser to meet the Canadian Sherpa, Mrs Ostry, when she is in town at the beginning of next month. You asked for a note on the issues.

Science has been on Summit agendas before, most recently with the Japanese initiative at Venice in 1987 for their Human Frontiers Science Programme. Work is continuing on clarifying the objectives and form of such an effort. Before that, the Versailles Summit in 1982 set up on a French initiative a Working Group on Technology, Growth and Employment which reported to successive Summits until Tokyo in 1986. Thereafter, having lost its political impetus and in accordance with the general view that Summits should not spawn new permanent machinery, it disbanded.

Turning to the future, there are the following subjects of growing debate which lead us to believe that science could be raised in Toronto.

First, the Americans have proposed within OECD that there should be agreement on a general framework of common principles for international co-operation in science and technology. I shall be attending a meeting in Paris at the end of next week when this idea will be discussed further. The initiative stems largely from President Reagan's Science Adviser, Dr William Graham, and is directed primarily against the Japanese who are perceived as doing less than their fair share of the world's basic scientific research. European partners are at present sceptical about both the concept and the American draft in detail but accept the political imperative of not meeting the Americans with a rebuff. Our view, which I shall be canvassing with European partners, is increasingly that it may be in our interests to agree a shorter and less contentious text which the Americans could bring forward to the regular OECD Ministerial in May and thereafter table in Toronto.

The second current subject is the future of CERN where our European partners now accept our view that a major effort should be made to persuade the

Americans especially, but possibly also the Canadians and the Japanese, to participate and contribute more fully. Our common judgement is that this will require a push at a high political level. Toronto could provide the right forum.

The third element is the growing recognition that large scientific ventures must be undertaken co-operatively as the costs grow out of the reach of what any one country can bear. For example, the Americans are looking to their Western partners to participate in their planned Superconducting Supercollider, SSC, although this is a long way from being realised, and may increasingly be looking to collaboration in nuclear fusion research (as could the UK). This could build on the four way discussions (EC,US,Japan,Soviet Union) on fusion knwon as ITER, instituted following the Reagan/Gorbachov summit in Washington.

The Chief Scientific Adviser, in informal discussions with his opposite numbers from the Summit Seven and the European Commission in the margins of the OECD Science Ministers' meeting last October, has received clear confirmation that they have similar perceptions of this need for cooperation.

A final element, to which John Fairclough attaches special importance, is that major science nations should reach a common understanding on the good management and budgetary control which should apply to all large international science projects. He raised this with the Prime Minister last year and it is embodied in our negotiations on the future of CERN.

Putting these elements together, it could be in our interests if science were on the Toronto agenda. Discussion might take the following course. The Americans raise their framework of principles. European partners welcome them and draw attention to CERN as a world-leading current project where other Summit partners should play their part. In return they listen attentively, but without formal commitment, to American plans for the SSC. Fusion research could also be raised. Summit leaders conclude that there is an issue of management of world science and reconvene the Working Group of Chief Scientific Advisers to report the following year.

Such a strategy could be well worth examining further in the Sherpa framework. Sir Robert Armstrong, who was briefed by the Chief Scientific Adviser on his Paris discussions, raised the issue of co-operation informally at the last meeting in British Columbia and there was interest but no clear commitment. I believe that the game has moved on since then, particularly with regard to CERN, where we are very much in the lead motivated by the scientific community's reluctance to pay as much as present. Similar problems are dogging our role in other international science ventures; space is an example. It is therefore difficult for the UK to take the lead in the Summit context (although the Prime Minister's support would be consistent with the importance she has attached to the management of British science). The signs that the Americans may are therefore welcome. Moreover, the Canadian Chief Scientist, Bruce Howe (with whom John Fairclough has a very close relationship), was at their last discussion at the OECD Ministerial notably enthusiastic.

It seems to us, therefore, that it would be opportune for John Fairclough to have some exploratory discussions with Mrs Ostry on all this to see whether the Canadians from the Chair are ready to carry things forward. He would not commit the UK other than to confirm our basic approach as outlined above. I hope that

we may have your agreement to contact the Canadians to see whether this is possible. Alternatively, he might join in discusssions which have already been arranged.

We shall need in any case to ensure that you have a brief for the next Sherpas meeting in February. The line can be settled in the light of Mrs Ostry's views and our discussions in the OECD.

Yours sincerely

Richard Scott

R E ESCRITT

cc R Q Braithwaite Esq CMG, FCO
Sir G Littler KCB, HMT
Sir C Mallaby KCMG)
Mr J Fairclough) Cabinet Office
Mr R Wilson)
Mr T Woolley, PS/Sir R Butler)

010

Canadian High Commission

Haut Commissariat du Canada

Macdonald House
1 Grosvenor Square
London W1

January 21, 1988

Mr. Nigel Wicks, CBE
Principal Private Secretary
Prime Minister's Office
10 Downing Street
London SW1

Dear Mr. Wicks,

I wish to extend congratulations to you on being named the Prime Minister's Personal Representative for the Economic Summit. In the past I and my colleagues, James Taylor and Glen Bailey, have worked closely with Sir Robert and his FCO and Treasury colleagues; we look forward to continuing close liaison with you as we prepare for the Toronto Economic Summit in June.

The announcement of your appointment at this time is particularly welcome, as Prime Minister Mulroney's personal representative, Dr. Sylvia Ostry, will visit London February 3 to 5 and I will be hosting a dinner for her the evening of the 4th. The dinner is at 8:00 p.m., and I very much hope you will be able to attend. If you could come earlier, say 7:30 p.m., this would give an opportunity for you and Dr. Ostry to make each other's acquaintance beforehand.

I hope to have the pleasure of meeting you then.

Yours sincerely,

L. A. Delvoie
Deputy High Commissioner

10 DOWNING STREET

Press Notice

PRIME MINISTER'S PERSONAL REPRESENTATIVE

FOR ECONOMIC SUMMITS

The Prime Minister has appointed Mr. Nigel Wicks, C.B.E., her Principal Private Secretary, as her Personal Representative for Economic Summits.

20 January 1988

NOTES FOR EDITORS

1. Mr Wicks succeeds Sir Robert Armstrong, G.C.B., C.V.O. who retired as head of the Civil Service and Cabinet Secretary on 31 December 1987.

2. The Personal Representatives ('Sherpas') help to prepare the discussion at the Summits on behalf of each of the Summit participants. The next Summit takes place in Toronto between 19-21 June 1988.

Telephone 01-930 4433

BACKGROUND NOTES

Mr. Wicks is 47. He was educated at Beckenham and Penge Grammar School, Portsmouth College of Technology and at the Universities of Cambridge and London. He worked for the British Petroleum Co. Ltd. before joining the Treasury in 1968 as an Assistant Principal. He has filled a number of posts in the Treasury involved with, for example, public expenditure, the Community Budget, financial institutions and energy. He was a Private Secretary to the Prime Minister between 1975 and 1978. He then rejoined the Treasury as Head of Energy Division. He was Economic Minister, British Embassy Washington and the United Kingdom Executive Director, IMF and World Bank between 1983 and 1985. Since then he has been Principal Private Secretary to the Prime Minister.

file

MR. INGHAM

Herewith the draft Press Notice and supporting material regarding the appointment of the UK Sherpa.

N. L. WICKS
20 January 1988

P R E S S N O T I C E

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SL3AZD

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SL3AZE

DRAFT Q AND A BRIEF FOR PRESS NOTICE

1. **WHY MR. WICKS?**

Mr. Wicks has had long experience of Treasury work before he came to No. 10, including over 2 years as United Kingdom Executive Director on the Boards of IMF and World Bank in Washington, and Minister Economic in the British Embassy, Washington. Obviously he, as Principal Private Secretary, works closely with the Prime Minister. So he is well qualified for the job both by experience and by his present position.

2. **MR. WICKS IS ONLY A GRADE 2; DOES THIS MEAN THAT THE IMPORTANCE OF THE POST HAS BEEN REDUCED?**

No; the functions of the post and its importance remain unchanged.

3. **THE FORMER HEAD OF THE CIVIL SERVICE AND CABINET SECRETARY, SIR ROBERT ARMSTRONG HAD BEEN THE U.K. SHERPA. WHY DID NOT THE NEW CABINET SECRETARY AND HEAD OF THE CIVIL SERVICE, SIR ROBIN BUTLER, ASSUME THE POST?**

With the Prime Minister's support, Sir Robin Butler wants to give priority to his other responsibilities, particularly as Head of the Home Civil Service.

4. **IS IT NOT UNUSUAL FOR SOMEONE FROM THE NO. 10 PRIVATE OFFICE TO BE THE SHERPA?**

There have been only 2 Sherpas before Mr. Wicks. There cannot really said to be any settled practice about who should fill the post. Mr. Wicks is clearly well qualified for the post. (See 1. above).

5. **IS IT NOT WRONG IN PRINCIPLE FOR SOMEONE FROM A PRIVATE OFFICE TO FILL THE POST?**

No; the important point is that the Sherpa is well qualified and well placed to do the job.

6. **IS NOT THIS ANOTHER MANIFESTATION OF MRS. THATCHER EXTENDING HER PERSONAL CONTROL OVER THE WHITEHALL BUREAUCRACY?**

No. Mr. Wicks is well qualified for the post, and that is what mattered.

7. **SHOULD NOT THE TREASURY OR THE FOREIGN OFFICE HAVE PROVIDED THE SHERPA?**

No reason why this should necessarily be the case. Mr. Wicks will work closely with the Treasury, the Foreign Office and other departments. The Personal Representative should have good contacts with the Prime Minister.

8. **WILL MR. WICKS RETAIN THE POST WHEN HE LEAVES NO. 10?**

Remains to be seen.

9. **WILL NO. 10 TAKE ON ADDITIONAL STAFF TO COMPENSATE FOR THE EXTRA WORK MR. WICKS IS ASSUMING?**

No; much of the work takes place over weekends.

10. **WHO WERE PREVIOUS U.K. SHERPAS?**

Sir Robert Armstrong and Sir John Hunt (now Lord Hunt of Tamworth .

11. **WHO ARE OTHER COUNTRIES' SHERPAS AND WHAT ARE THEIR POSITION?**

The other Sherpas and their posts are:

Canada	Mrs. Sylvia Ostry	Ambassador for Multi-Lateral Trade Negotiations
USA	Mr. Alan Wallis	Under Secretary of State for Economic Affairs, State Department
France	M. Jacques Attali	Sepcial Adviser to the President
W Germany	Hans Tietmeyer	Official State Secretary, Federal Ministry of Finance
Italy	Mario Sarcinelli	Director General, Treasury
Japan	Hiroshi Kitamura	Deputy Minister for Foreign Affairs
EEC Brussels	Pascal Lamy	Chef de Cabinet of the President

12. **HOW MANY TIMES DO THE SHERPAS MEET EACH YEAR**

Some three or four times.

SL3AZF

External Affairs
Canada

Ambassador, Multilateral Trade Negotiations
and Personal Representative of the
Prime Minister,
Economic Summit

Affaires extérieures
Canada

Ambassadeur aux négociations commerciales multilatérales
et représentante personnelle du
Premier ministre
pour le sommet économique

January 20, 1988

Mr. Nigel Wicks, CBE
Principal Private Secretary
to the Prime Minister
Prime Minister's Office
10 Downing Street
Whitehall
London
United Kingdom

Dear Mr. Wicks,

I learned today from Sir Robin Butler of your appointment as the Personal Representative for Economic Summits of Prime Minister Thatcher. I was delighted with this excellent news, and look forward to welcoming you at the second meeting of Sherpas in preparation for the Toronto Summit, February 27-29. Later this week I will be sending you and other Sherpas further information on this meeting. In the meanwhile, I hope it will be possible for us to meet when I am next in London, February 4-5.

Allow me to extend my warmest congratulations on the occasion of your appointment.

Yours sincerely,

Sylvia Ostry

Sylvia Ostry

125 promenade Sussex Drive
Ottawa, K1A 0G2

Ref. A088/213

MR WICKS

cc Mr Ingham

Sherpa

Thank you for your minute of 19 January to Sir Robin Butler. Sir Robin Butler is content with the material attached to it for use in connection with the announcement on the Sherpa appointment but has suggested the following additional sentence which might be included after the first sentence of the answer to question 7: "The Personal Representative should have good contacts with the Prime Minister".

2. Sir Robin Butler has suggested the following as an answer to question 3: "With the Prime Minister's support, Sir Robin Butler wants to give priority to his other responsibilities, particularly as Head of the Home Civil Service.

3. There was only one United Kingdom Sherpa before Sir Robert Armstrong - Sir John Hunt.

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5. Sir Robin Butler has no further questions to propose for inclusion in the question and answer brief.

Trevor Woolley

T A WOOLLEY
PS/Sir Robin Butler

20 January 1988

E.R.

PRIME MINISTER

You should know that we will issue a Press Notice at 1700 hours tomorrow announcing that I will be the next Sherpa. The time is determined by the courtesy of letting the other Sherpas know first.

N.L.W.

N. L. Wicks

19 January 1988

D R A F T P R E S S N O T I C E

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{F.E.R.B. to draft}

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No reason why this should necessarily be the case. Mr. Wicks will work closely with the Treasury, the Foreign Office and other departments.

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Sir Robert Armstrong and { }.

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{To come}.

SL3AZF

Cab DSG

cc BI

10 DOWNING STREET

From the Principal Private Secretary

SIR ROBIN BUTLER

SHERPA

I should be glad to know that you and Mr. Ingham are content with the material attached for use in connection with the announcement of the Sherpa.

BF. Could you please let me have the answer to Question 2; and could your office confirm the names of the previous UK Sherpas, and let me know the names of the six other Sherpas now in office.

Finally, could both you and Mr. Ingham let me know whether there are any further questions which should be included in the Q & A brief.

N. L. Wicks

19 January 1988

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~~{F.E.R.B. to draft}~~ X X

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{To come}.

4 4

12

SL3AZF

Mr Wicks

RESTRICTED

per

CABINET OFFICE

70 Whitehall London SW1A 2AS
01-270 0101

From the Secretary of the Cabinet and Head of the Home Civil Service
Sir Robin Butler KCB CVO

Ref. A088/189

19 January 1988

Dear Patrick,

Since the appointment of Nigel Wicks as the Prime Minister's Personal Representative at the Economic Summit will undoubtedly become known, it seems best that we should formally announce it. I suggest that we do this by means of a press notice by No 10 at 5.00 pm tomorrow afternoon. I suggest that the Personal Representatives of the other six Summit countries should be informed by means of a personal message from me to Mrs Ostry which I would send by signal tomorrow morning to be passed on by the posts concerned. I attach a draft telegram to this end on which I should welcome your comments and those of Peter Middleton and Nigel Wicks during the course of today.

I am copying this letter to Peter Middleton and Nigel Wicks.

Yours ever,

Robin

Sir Patrick Wright KCMG

RESTRICTED

DRAFT TELEGRAM

TO IMMEDIATE OTTAWA, WASHINGTON, PARIS, BONN, ROME, TOKYO AND BRUSSELS

FROM CABINET OFFICE

An announcement that Nigel Wicks is to be the UK Sherpa for the Toronto Economic Summit will be made by No 10 at 1700Z today. In advance of this (except for Tokyo, where it may not be practicable) could you please convey to the Sherpa of your host country the following message from Sir Robin Butler to Mrs Ostry:

"Dear Mrs Ostry,

I am writing to tell you that the Prime Minister, the Rt Hon Mrs Margaret Thatcher, has appointed Mr Nigel Wicks, her Principal Private Secretary, as her Personal Representative for the Toronto Economic Summit in succession to Sir Robert Armstrong. Mr Wicks has been Principal Private Secretary to the Prime Minister since 1985 and was formerly Private Secretary to the then Prime Ministers from 1975 to 1978. As Principal Private Secretary he attended the 1986 Economic Summit. He has spent most of his career in the UK Treasury with periods as Economic Minister, British Embassy, Washington and UK Executive Director, IMF. This appointment will become public in London at 5.00 pm London time today.

I am copying this message to the other Personal Representatives.

Yours sincerely

Robin Butler"

MO2 BVN

File

10 DOWNING STREET

LONDON SW1A 2AA

From the Principal Private Secretary

SIR ROBIN BUTLER

ECONOMIC SUMMIT - SHERPA

The Prime Minister discussed with you about the identity of our Sherpa. She asked that I should take on this work.

Please could you let me know when this is promulgated to Departments so that I can make the necessary arrangements to talk to those concerned in Departments.

N.L. Wicks

15 January 1988

Per

Prime Minister. E

I agree with F.E.R.B. that Sir Geoffrey Littler is the best choice. But you can discuss with Robin on Friday. N.C.U.

Ref. A088/64

MR WICKS

Economic Summit: Sherpa

One of the matters I should like to discuss with the Prime Minister on Friday is the identity of our Sherpa. We need to settle this because we are now getting near to the next meeting on 27-29 February and Whitehall and the other Sherpas are asking. 12.1

2. These Sherpas' meetings have got out of hand. Four meetings plus the Economic Summit itself are excessive. The contribution the Sherpas make to the Summit does not justify this effort. We ought to try to get the number of meetings down, but this is not of course in our sole power.

3. The Personal Representative needs to be sufficiently aware of the nuances of the Government's stance on a wide range of subjects and sufficiently close to the Prime Minister to be able to speak with authority and to be accepted by the other Sherpas as doing so. He also needs to be sufficiently switched into Whitehall to be able to organise the briefing effort.

4. It has been my impression - and closer acquaintance reinforces this view - that the work does not fall naturally out of the Cabinet Secretary's other work. Sir Robert Armstrong made a major personal contribution because of his standing and his drafting skills. But the Cabinet Secretary does not deal with international economic business continuously enough or in sufficient depth to make the subject matter come naturally to him without substantial preparation.

SMTABX

5. Given that it is an Economic Summit, the person whose normal work fits with it best is Sir Geoffrey Littler. He also has long experience of Sherpas' meetings, which he has attended as our economic "expert"; and so the role would not be a substantial extra call on his time. Sir Geoffrey Littler himself may only have a year to go, and in some ways that is an advantage because we could review the arrangement before his successor took over.

6. An alternative - if I am not to do it myself - is one the two Deputy Secretaries in the Cabinet Office, either Mr Richard Wilson or Sir Christopher Mallaby (though in practice it would be the latter's successor, Mr Weston). Either could do it very acceptably. From the point of view of the distribution of work in the Cabinet Office, it would be better if it were Mr Weston, since Mr Wilson is very heavily stretched with a wide range of issues in the Government's domestic programme. Given the amount of overseas visits which the role demands I doubt whether it is practicable or sensible that someone from your office should take it on. Why not?

7. If the Prime Minister wishes me to do so, I will of course take it on myself. Left to myself I should prefer not to do so because I believe I could use the time more productively for other purposes. There is little enough time when I can get away from the office and I think that a higher priority is representational work as Head of the Home Civil Service, through which I can also help to put over the message of "Next Steps".

8. I do not think that it would work for me to be the nominal Sherpa but in practice to send a deputy. That would simply mean that the deputy did not carry enough authority to influence events.

9. My recommendation is that the Prime Minister could safely rely on Sir Geoffrey Littler to take on this job. If she were

I never see him and he knows does not my views.

SMTABX

not happy with the way this worked, we could take the opportunity to re-think when Sir Geoffrey retires. If the Prime Minister preferred someone from "the centre" it could be Sir Christopher Mallaby's successor or, less ideally, Mr Wilson or myself.

R.B.

ROBIN BUTLER

11 January 1988

SMTABX

Handed round at Shapiro Meeting 28/2/88 Tab 4
by US Rep.

THE UNITED STATES TRADE REPRESENTATIVE
WASHINGTON
20506

October 30, 1987

The Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

We are writing to offer our views on trade issues before the House-Senate Conference on H.R. 3. Constructive trade legislation could offer an opportunity to help reassert American economic leadership and industrial competitiveness.

Since the President took office in January 1981, his Administration has worked closely with the Congress to rebuild the American economy. We have joined on a bipartisan basis to reduce the tax burden on the American people, to build a fairer, more equitable tax system, and to eliminate unnecessary regulations that were hamstringing American business. The underlying fundamentals of the American economy are healthy. We have enjoyed five years of growth, the longest peacetime expansion in our history. Inflation has been sharply reduced from the extraordinary levels in effect when the President took office. We have created 14 million new jobs in the U.S. just since November 1982. And we expect the economy to continue to grow, at a reasonable and sustainable rate.

Additional challenges, however, confront us. The post-war international trading system is under unprecedented pressure today. We should all take care not to repeat the error of the 71st Congress in 1930 by enacting protectionist trade legislation, which would harm rather than help the economy. Since World War II, the United States has taken the lead in fashioning an open world trading system, a system that has contributed significantly to American prosperity and has led to the rebuilding of much of Europe and Asia on the basis of stable democratic values.

The President has continued this leadership tradition in sending to the Congress last February a major trade competitiveness initiative. He has also initiated a new round of multilateral trade negotiations to extend and strengthen international trading disciplines. These negotiations, known as the Uruguay Round, are vital if we are to further

open foreign markets to American goods and services and bring impoverished developing countries into the world trading system. To facilitate these negotiations and ensure timely Congressional review of their results, we need new trade agreements authority.

In addition, the President wants to retain strong, flexible authority for the Administration's section 301 program to end unfair barriers to American exports. Inflexible rules and forced retaliation would weaken the President's ability to achieve this objective, and would end up closing markets. We also need legislation to better protect America's intellectual property. The United States is today losing billions of dollars of potential exports because of international piracy of our patents and copyrights. Finally, the President has proposed a major new series of reforms--such as amendments to the Foreign Corrupt Practices Act, antitrust laws and export control laws; reforms regarding product liability and economic regulations; and new initiatives for worker readjustment, science, education and training. These measures are designed to put American industry in a position of unquestioned world leadership.

We are prepared to work with you on a bipartisan basis to develop forward-looking 'trade legislation. We could support a strong, responsible bill, which will indeed enhance the ability of U.S. firms to compete in a global market and encourage other nations to open their markets further.

However, we are concerned about a myriad of provisions in both the House and Senate bills that go in precisely the wrong direction.

- We strongly oppose provisions that mandate American retaliation. Trade problems are too complicated for that. The Executive Branch must have discretion to determine whether retaliation would be helpful or harmful to our interests. Mandatory retaliation provisions would come back to haunt us, and could be counterproductive to our efforts to further open markets.

- We oppose proposals to strip the President of authority to consider the national economic interest in import relief cases. Only the President can evaluate the delicate tradeoffs that are involved in such cases--tradeoffs between and among the affected industry, other domestic industries, other importers and exporters,

and consumers. Tying the President's hands on decisions of this magnitude makes no sense at all.

- We oppose the transfers of Presidential authorities in both bills. The involvement of the President is essential to ensure that our broad and diverse national interests are taken into account in any trade action, and to make sure that we retain maximum leverage in negotiations on trade cases.

- We oppose provisions that would violate our international obligations. We cannot encourage others to engage in constructive multilateral or bilateral agreements to expand trade, if we unilaterally abrogate past agreements and are seen to be an unreliable trading partner.

- We oppose provisions that have superficial appeal, at least for the short run, but will be damaging to our interests in the long run. In many instances these are provisions that will likely provoke "mirror" legislation in other nations, severely damaging our exports.

- We oppose changes that will further retard rather than promote adjustment, such as the significant expansion and extension of the ineffective Trade Adjustment Assistance program, whose intended replacement is created by the same bill.

These and other shortcomings of the legislation can be overcome if there is the bipartisan political will to do so. The undesirable provisions of the bills can be jettisoned and the desirable ones retained. Attached to this letter is a paper outlining the Administration's positions on the most contentious issues before subconference #1. It is not by any means an exhaustive list of Administration concerns; we will convey our views more fully as the subconference proceeds. We hope it will focus attention on some of the key issues, however.

We hope that, working together, we can craft a responsible trade bill that satisfactorily resolves the serious concerns we have identified in the present bills. However, if the final product retains provisions that will be counterproductive

to our objectives of enhancing the competitiveness of U.S. business and expanding global trade opportunities, we will not be able to recommend that the President sign the bill.

The Office of Management and Budget advises that there is no objection to the presentation of these views and that enactment of H.R. 3 as passed by the House or amended by the Senate would not be in accord with the President's program.

Sincerely,

Secretary of the Treasury

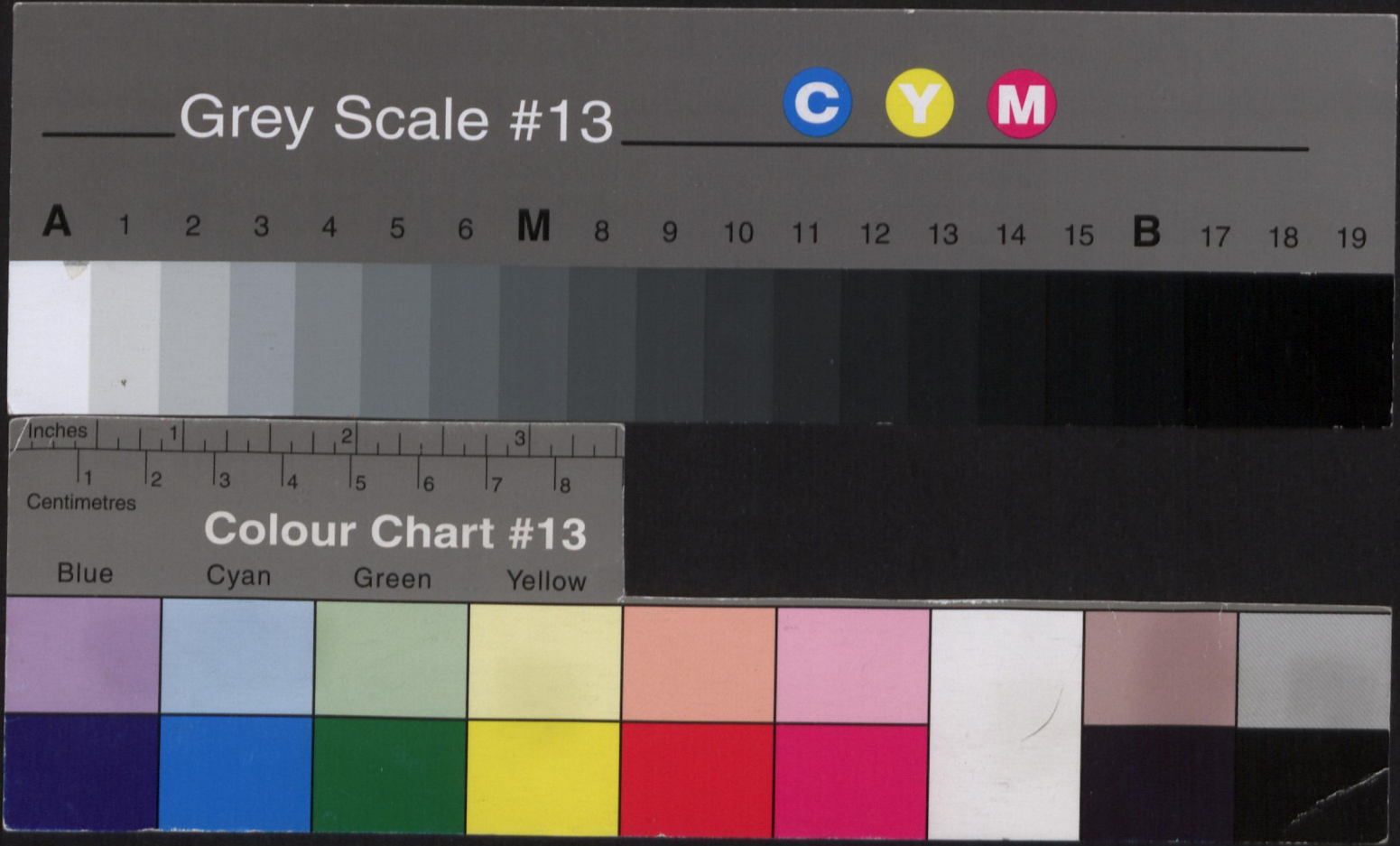
U.S. Trade Representative

Secretary of Commerce

Secretary of Agriculture

Secretary of Labor

Director, Office of
Management and Budget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C
Y
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Inches
1 2 3
1 2 3 4 5 6 7 8
Centimetres
Colour Chart #13
Blue
Cyan
Green
Yellow