



Foreign and Commonwealth Office

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6 October 1988

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Dear Nigel,

PREPARATIONS FOR THE 1989 ECONOMIC SUMMIT: FIRST MEETING OF
PERSONAL REPRESENTATIVES

1. This is our usual briefing letter for the first Sherpas' meeting. I agree (your minute of 29 September) that it is too early to discuss in detail the substance of next July's Summit, though some preliminary points can be made. Most of this letter, however, is about the current economic and political situation.

2. The Foreign Secretary, who has seen your minute of 29 September, saw this letter in draft. The Treasury were of course also consulted and provided much of the macroeconomic material.

Procedure

3. I agree that the meeting in Rambouillet on 8/9 October should focus on procedural matters: the dates for the remaining preparatory meetings (preferably only three), and administrative arrangements for the Paris Summit. I think you should press Attali quite hard on the suggestion that developing countries should somehow be associated with the Summit. Any formal link would be most unwelcome to us, and an undesirable precedent.

Themes for the Paris Summit

4. I have seen your later minute of 4 October recording the Prime Minister's views. Geoffrey Littler and I had earlier suggested some likely themes in our letters of 9, 15 and 29 September, which are consistent with the Prime Minister's thinking.

5. I think your main objective at Rambouillet should be to probe French positions. Mitterrand may well have grand ambitions for the Summit. He has proposed a new initiative on middle-income debt. He may revive French plans for international monetary reform. Depending on the outcome of

/ Montreal,



Montreal, he may be difficult on trade and agriculture. Although Rambouillet comes too early to lock a new US Administration into the existing economic approach of Summits, you should be able to lay the groundwork for a useful discussion at the next meeting.

Toronto follow up/economic situation

A. World economic outlook

6. At the moment, the economic outlook is generally favourable. Economic growth in the industrialised countries was exceptionally rapid in the second half of 1987 and into early 1988. Though it may now have moderated somewhat, G7 growth this year is likely to be, at 4%, higher than any year since 1984. IMF forecasts for 1989 suggest that growth will slacken to 3%. The main risk, acknowledged at Berlin, was inflation. Many commodity prices rose sharply between mid-1987 and mid-1988; the obvious exceptions were coffee, cocoa and of course oil. Rates of capacity utilisation have risen particularly high in the US and, to a lesser extent, Japan. But although there are signs of a slightly faster rise in prices and wages in some countries, inflation rates have generally remained low. All the major countries have responded appropriately by raising interest rates since May. Average inflation is expected to pick up just a little in 1989 (to 3.5%), but a serious acceleration is not in prospect on present policies.

7. Another encouraging sign is the decline of the current account imbalances of the G3 as a percentage of their GNP (though nominal figures for trade, particularly in Germany, look less good). The IMF estimates that the Japanese surplus will have declined between 1986 and 1988 from 4.5% to 2.75% and the German from 4.5% to 3.75%, while the US deficit should decrease from a peak of 3.5% in 1987 to 2.5% in 1988. The imbalances are expected to decline further, but more slowly, in 1989. The latest G7 communique, issued in Berlin on 24 September, covers all these points and the Chancellor devoted much of his speech at the Annual Meeting to the question of imbalances.

B. Debt

8. Arrangements for implementing the Toronto consensus on sub-Saharan debt have now been worked out, well in advance of the end-of-year deadline set at Toronto. The US have agreed to extend repayment periods to 25 years. The FRG agreed at Berlin to join the UK, Italy and Canada in reducing interest

/ rates.



rates. France will offer a write-down of principal. Japan will combine the latter two options. We expect the Paris Club to agree to the first concessional rescheduling (for Mali) when it meets later this month.

9. Both France and Japan have recently proposed initiatives for middle-income debtors. We do not know the full details, and you will not need to give a formal UK response. We shall wish to discourage any initiatives which might undermine the current case-by-case voluntary approach to middle-income debt, or transfer the risk on commercial bank debt to creditor governments. The Japanese plan, floated at Toronto and restated at Berlin, involves debtors contributing foreign exchange into special escrow accounts at the IMF as security for bond issues, for which banks might be willing to swap their existing unsecured debt at a discount provided an approved Fund programme was in place. In itself this does not transfer the risk to the public sector. But as few debtor countries possess adequate reserves, the plan is likely to lead to pressure contributions from creditor governments. The Japanese are willing to do this, through their Export-Import Bank. At the UN General Assembly, President Mitterrand suggested that developed countries should devote their share of a new SDR allocation (which in any case we oppose) to these escrow accounts. Such a scheme would, in effect, provide a guarantee to the ~~debtors~~, which would be unacceptable.

creditors

C. Aid

10. The French may also want to use their Summit to draw attention to their own good record on meeting UN aid targets: in 1987 their aid (including that to the Dom-Tom) stood at 0.75% of GNP. As at Venice, this could be awkward. We shall have to repeat our commitment to the UN target, but our firm resistance to a timetable for implementation, and the importance of the quality as well as the quantity of aid.

D. Trade and Agriculture; the Uruguay Round

11. You have, I hope, seen our delegation's report (Islamabad tells nos 1248 and 1249) on the informal meeting of Trade Ministers in Islamabad on 1-3 October. This meeting usefully advanced our view that the Mid-Term Meeting in Montreal should be more than a simple review of progress. At Montreal we hope for substantive agreement in priority areas such as dispute settlement (underlined at Toronto), functioning of the GATT system, and tropical products. In other areas, particularly services, investment and intellectual property, the MTM should reach agreement on a clear framework for the rest of the negotiations. Islamabad encouraged these prospects.



12. Agriculture remains one of the key elements in the Uruguay Round, both politically and economically. At Montreal we hope to achieve agreement on a detailed framework approach as outlined in Toronto, involving short-term commitments in line with the longer term aim of market orientation for agriculture, requiring substantial reductions in support and protection. This will require a flexible and constructive approach by all the main participants. We believe that the package of measures put forward by the Cairns Group offers the best starting point for discussion and possible agreement in Montreal. The US and others have shown interest in this package; the Americans made their interest clear at Islamabad. In the UK view, it contains a number of elements matching the EC's own objectives; the EC will need to turn these elements to its advantage in order to stay in the negotiations. The Commission largely share our view on this, but other member states, including France and Germany, have so far resisted movement. So the Community could not move at Islamabad and is now relatively isolated.

13. At the Paris Summit we shall want to build on whatever agreements are reached in Montreal, ensure that commitments are met and keep up the momentum for the second half of the Uruguay Round.

Political issues

14. The Summit Seven Foreign Ministers had their usual dinner on the margins of the UN General Assembly. They covered the Middle East, chemical weapons, the role of the UN and terrorism, as well as trade. You have seen the telegrams.

15. There has been movement in a number of the foreign policy areas covered by Heads of Government in Toronto; the Party Conference in the Soviet Union and other events affecting perestroika, including last week's Central Committee and Supreme Soviet meetings; the ceasefire in the Iran-Iraq war; completion of the first phase of Soviet withdrawal from Afghanistan; South African withdrawal from Angola and progress in the US-led talks on Namibia and Angola; and some encouraging signs of movement on Cambodia.

16. On terrorism, there will be a Summit Seven experts meeting in Ottawa on 13-14 October which will discuss follow-up to the Kuwaiti hijacking, including work under way in ICAO (mentioned in the Toronto Declaration following the UK initiative in April). The obvious point to make to other Sherpas is that the Toronto Declaration gave impetus to the work in ICAO; Summit Seven countries should continue to give their full support.



17. The Toronto Foreign Ministers' statement on the Middle East included an expression of concern over ballistic missile proliferation. There was a meeting of officials in early September to discuss the Summit Seven ballistic missile control regime. This is an extremely difficult subject, made no easier by differences of approach among the Europeans. The Russians have just informed the US that they will not join the Western (i.e. G7) scheme, but have proposed a wider-ranging bilateral agreement on missile restraint. Our line should be to continue to urge the need to make progress as a contribution to the settlement of dangerous regional conflicts.

Drugs

18. A task force of officials from the G7 countries (except France) met in Washington in September to follow up the US Toronto Summit initiatives, though it is unclear how matters are to be taken forward. However, there was general recognition that the task force should report to the French Economic Summit. The UK sees the US initiative as a useful means of giving impetus to aspects of drugs co-operation to which we attach priority (e.g. to press all countries to introduce strong asset seizure legislation and to demonstrate the commitment of Summit countries to demand reduction). But we wish to avoid new permanent machinery which would duplicate existing channels of co-operation. The French have been sceptical of the US initiative from the outset, for the reasons reported by Washington (letter enclosed with mine of 3 October). Lamy, as my letter of 3 October explained, has complained that the Commission was not invited. He may well bring this up again, though no further meetings have been set.

The Environment

19. The environment is now firmly on the international political agenda. The Prime Minister has made her position clear in her Royal Society speech and I see that she considers that environmental measures could be prominent in Paris. In the context of Summit preparations, we shall want to avoid ill-prepared discussion on the basis of texts submitted at the last minute (as before Venice and Toronto). However, it is rather too early to decide the next moves on this; the Department of the Environment will need to be closely consulted. We spoke about the handling at this weekend's meeting. I suggest that you could stress the need for proper preparation in this complex and wide-ranging area, where many other bodies are active. The French will probably endorse this.

Yours ever,

Nicholas Bayne

N P Bayne

Copy to
Sir G Littler, HMT



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