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DEPARTMENT OF TRADE AND INDUSTRY

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PPS/The Prime Minister
10 Downing Street

Your reference

Our reference

Date 19 September 1983

Dear Butler,

HIGH-LEVEL TRADE MISSION FROM NEW ZEALAND: OCTOBER 11-14 1983

I am writing to you about a Mission organised by the Wellington Chamber of Commerce which is due to visit the UK from October 11 to 14. The Mission will consist of 20 high-level industrialists, almost all of them being Chairman or Managing Directors of New Zealand's largest companies. It has been claimed that this is the most important Trade Mission ever to leave the shores of New Zealand. Certainly the interests represented by the Members account for more than 95% of all New Zealand exports. (A list of Members is attached). The Mission will be accompanied for part of the time by Mr Warren Cooper, New Zealand Minister of Foreign Affairs and Foreign Trade.

By way of background, I should explain that in October last year the London Chamber of Commerce and Industry (LCCI) organised a Mission to New Zealand (and also Australia) comprising industrialists of similar standing, led by Sir David Steel (President of the London Chamber). That Mission was prompted by concern, expressed in New Zealand as well as in the UK, at the relative decline in trade between the two countries. Its purpose was to draw the attention of influential people to the opportunities that existed and to foster contacts in commercial circles at a high level. The forthcoming visit is a return Mission for that of the London Chamber and is a part of the same process. In fact it follows an invitation given by Sir David Steel when he was in New Zealand.

The British High Commissioner in Wellington has asked if it would be possible for at least some Members of the Mission to be received by the Prime Minister. This would enable the Prime Minister to stress the importance attached to trade with New Zealand and to bilateral relations more generally. It would also reciprocate the treatment accorded to the LCCI Mission, some leading Members of which had a short meeting (of slightly under half an hour) with Mr Muldoon.

While at any other time we would have recommended this meeting very strongly, Mr Channon thought it inappropriate to bother the Prime Minister in the week of the Party Conference. (This was confirmed by two separate telephone discussions between Mr Channon's office and No 10). We think that the delegation should understand if the Prime Minister declines to meet them in London.

We have learnt, however, that the LCCI, on its own initiative, is exploring the possibility of hiring a plane to fly the Mission Members up to Blackpool on the afternoon of Wednesday 12 October. The New Zealand High Commission is also planning independently to take Mr Cooper to Blackpool so that he can attend a session of the Conference.

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In view of their evident determination, it be a possible embarrassment if the Prime Minister declined to meet the delegation, either in London or in Blackpool. It should be noted, however, that the delegation (and Mr Cooper) are to meet Mr Jopling and Mr Channon. In addition Mr Cooper (alone) is to meet Sir Geoffrey Howe.

Yours sincerely

Brian N. Parsons

B N PARSONS

cc PS/Minister for Trade
Mr G R Sunderland OT2
Mr J Chick
South Pacific Department FCO

VISITING NEW ZEALAND TRADE MISSION

(ORGANISED BY THE WELLINGTON CHAMBER OF COMMERCE)

LONDON, OCTOBER 1983

Mr R.R. Trotter	Leader Chairman, Fletcher Challenge Corporation
Mr A.M. Begg	Chairman, New Zealand Meat Board
Mr J.T. Graham	Chairman, New Zealand Dairy Board
Mr K.W. Kiddle	Chairman, New Zealand Apple and Pear Marketing Board
Mr P.T. Barry	Deputy Chairman, New Zealand Wool Board
Mr L.M. Papps	Chairman ANZ Banking Group Chairman U.E.B. Chairman, New Zealand Forest Products Chairman, New Zealand Railways Corporation
Sir Alan Hellaby	Chairman, New Zealand Steel Chairman, New Zealand South British Group Chairman, R and W Hellaby Ltd
Mr W.J. Shaw	General Manager, Bank of New Zealand
Mr H.M. Titter	Managing Director, Feltex
Mr B.H. Picot	Chairman, Progressive Enterprises Ltd
Mr P.S. Yates	Managing Director, Yates Corporation
Mr B.S. Cole	Managing Director, L.D. Nathan and Co.
Mr J.C. Fair	Chairman, Ceramco
Mr A.R. Hutton	Managing Director, Waitaki NZ Refrigerating Ltd
Mr B. Ryan	Deputy Chairman, The Shipping Corporation of NZ Ltd
Mr J.O. Haworth	Managing Director, Watties Industries Ltd
Mr J.B. Ede	Managing Director, Winstone Ltd
Mr J.A. Hazlett	Immediate Past President, Wellington Chamber of Commerce
Mr W.L. Allen	Executive Vice President, Wellington Chamber of Commerce Partner, Young, Swan, Morrison and McKay
Mr R.T.N. Matthews	Member, Management Committee, Wellington Chamber of Commerce

Robin -

could you ring Sir David Steele's office this morning if possible, about New Zealand Mission

Number is 920 7062.

Cameron (10.20am)

Sir David Steel

Telephone
01-920 7062

(SWITCHBOARD 01-920 8000)

Britannic House,
Moor Lane,
London, EC2Y 9BU

15th September, 1983

Dear Mr. Butler -

NEW ZEALAND HIGH LEVEL TRADE MISSION

I failed to reach you on the telephone today and so I am writing in my capacity as President of The London Chamber of Commerce about the visit of this Mission to London from Monday 10th October to Friday 14th October. I enclose a list of the members of the party which they say is the most powerful ever to have left the shores of New Zealand. Warren Cooper, their Overseas Trade Minister will be with them and they have the personal backing of Prime Minister Muldoon.

At yesterday's Magnus Function I mentioned this visit to the Prime Minister and said I knew it would be the highlight of their trip and would make a wonderful impression if she was able to receive them for a few minutes. She confirmed her soft spot for New Zealand "as part of the family" and suggested that I spoke to you about this possibility.

I realise that the Conservative Party Conference is on at that time, but I know that if necessary they would fly to Blackpool if there was a chance of seeing the Prime Minister.

Yours sincerely

David Steel

F. E. R. Butler Esq.,
Principal Private Secretary,
10, Downing Street,
LONDON SW1

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London Chamber of Commerce and Industry

69 Cannon Street, London EC4N 5AB. Tel: 01-248 4444.
Telex: 888941 LCCI G

Director: W.F. Nicholas OBE

THE NEW ZEALAND TRADE MISSION

MONDAY OCTOBER 10TH - FRIDAY OCTOBER 14TH

Mr. R. R. Trotter	Leader Chairman, Fletcher Challenge Corporation
Mr. A. M. Begg	Chairman, New Zealand Meat Board
Mr. J. T. Graham	Chairman, New Zealand Dairy Board
Mr. K. W. Kiddle	Chairman, New Zealand Apple and Pear Marketing Board
Mr. P. T. Barry	Deputy Chairman, New Zealand Wool Board
Mr. L. M. Papps	Chairman, ANZ Banking Group Chairman, U.E.B. Chairman, New Zealand Forest Products Chairman, New Zealand Railways Corporation
Sir Alan Hellaby	Chairman, New Zealand Steel Chairman, New Zealand South British Group Chairman, R. and W. Hellaby Ltd.
Mr. W. J. Shaw	General Manager, Bank of New Zealand
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Mr. A. R. Hutton	Managing Director, Waitaki NZ Refrigerating Ltd
Mr. B. Ryan	Deputy Chairman, The Shipping Corporation of NZ Ltd
Mr. J. O. Haworth	Managing Director, Watties Industries Ltd.
Mr. J. B. Ede	Managing Director, Winstone Ltd.

A company limited by guarantee and registered in England no. 15993
Registered office: 69-75 Cannon Street, London EC4N 5AB

Mr. J. A. Hazlett	Immediate Past President, Wellington Chamber of Commerce
Mr. W. L. Allen	Executive Vice President, Wellington Chamber of Commerce Partner, Young, Swan, Morrison and McKay
Mr. R. T. N. Matthews	Member, Management Committee, Wellington Chamber of Commerce

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10 DOWNING STREET

From the Private Secretary 27 July 1983

The Prime Minister has asked me to thank you for your letter of 25 July enclosing an article by the Prime Minister of New Zealand on world trade and payments problems. Mrs Thatcher looks forward to reading this article during the coming Parliamentary recess.

AJC

His Excellency The Hon. W.L. Young

NEW ZEALAND HIGH COMMISSION

NEW ZEALAND HOUSE · HAYMARKET · LONDON SW1Y 4TQ
Telephone: 01-930 8422 Telex: 24368

From the High Commissioner
H.E. The Hon W. L. Young

25 July 1983

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Dear Prime Minister

I am enclosing a copy of an article on the theme of world trade and payments problems which my Prime Minister, Mr Muldoon, has recently written for the U.S. Council of Foreign Relations journal, Foreign Affairs, which I hope you may find of interest.

Kindest Regards
Yours sincerely,
Bill Young

The Rt. Hon. Margaret Thatcher, MP
Prime Minister,
No. 10 Downing Street,
Whitehall,
LONDON SW1.

FOREIGN AFFAIRS

RETHINKING THE GROUND RULES FOR AN OPEN WORLD ECONOMY

Robert D. Muldoon

Summer 1983 NO. 61506

FOREIGN AFFAIRS

SUMMER 1983

Vol. 61, No. 5,

Robert D. Muldoon

RETHINKING THE GROUND RULES FOR AN OPEN WORLD ECONOMY

An Opportunity for American Political Leadership

Just as farmers might react to the end of a long drought, I and presumably every other Minister of Finance have been heard to issue a collective sigh of relief at the first clear signs of a U.S. recovery. This incipient recovery and the successful rescheduling of the largest debtor countries seem to have averted, for the time being at least, the very real danger of a collapse into global depression, financial crises and wholesale disruption of world trade flows. I understand "implosion" of the world economy is the current favored term to describe that particular chain of events.

It would be as well to keep in mind the extent of uncertainty that prevailed even late last year. Consider the mood at the last annual meetings of the International Monetary Fund and World Bank. If there is a banker's equivalent to the whiff of cordite, I think I detected it in the corridors and lifts of the Sheraton Hotel in Toronto last September. By all means let us admire the speed, flexibility and finally the total pragmatism with which the Federal Reserve, the U.S. Treasury, the IMF, the Bank for International Settlements (BIS), the major international banks and the biggest debtor countries put together the reschedulings. My concern now, however, is that we should not forget how close we came to teetering over onto the other side of the knife edge.

It would be consistent with everything I understand from roughly 20 years of experience with the politics of international finance for the mood to swing 180 degrees in the opposite direction. We must resist the temptation to believe that the tentative recovery and financial rescue operations relieve us of the obligation to consider

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The Rt. Hon. Robert D. Muldoon, C.H. was New Zealand's Minister of Finance from 1967 to 1973. He has been Prime Minister and Minister of Finance since 1976. He is a former Chairman of the Joint Boards of Governors of the International Monetary Fund and World Bank, and of the Council of Ministers of the Organization for Economic Cooperation and Development (OECD).

a number of fundamental long-term political and economic issues. I do not mind in the slightest being regarded as a Jeremiah on this subject. One of the advantages of being the Minister of Finance of a very small country is that I do not feel compelled to share the onerous responsibility of talking up the recovery.

Economic analysis tells us change is better managed in times of growth; political analysis gives us a somewhat different message. Change normally occurs only after an existing system sustains a series of severe shocks. The art in all of this is to find a time and a way of reconciling the two points of view.

While the sense of shock is still with us, we must initiate the necessary process of rethinking the ground rules for an open world economy. Putting any changes into effect can be done as the recovery proceeds and thereby gives us a little flexibility to adjust to change. Indeed, this would strengthen the recovery itself. Failure to address structural issues of debt, protectionism, exchange rate volatility and effective macroeconomic policy coordination will, I believe, seriously constrain the recovery now underway.

With skillful management and good luck, the present conjunction of events offers a real opportunity for sovereign governments. The time is certainly propitious. In my view, we should aim to channel into a constructive international debate the pervasive political concern that has arisen from a decade of stagflation and dislocation of the trade and payments system.

Buried within the declaration of the Williamsburg Summit is a commitment to governments beginning such a debate in a formal sense. The Ministers of Finance of the summit countries are to work with the Managing Director of the IMF "to define the conditions for improving the international monetary system and to consider the part which might in due course be played in this process by a high-level international monetary conference." No matter that the conditional diplomatic language suggests some misgivings on the part of some of those who have put their names to this document. If we all agreed at the outset what needed to be done, we could dispense with the study and proceed directly to the political step of securing agreement at a conference. No matter that the exercise is seen as something for the summit countries only to undertake. It would be naïve to believe that fuller participation at this stage was within the limits of political possibility or in fact a practical proposition. In any case, the Managing Director of the Fund is not a civil servant of only the rich and powerful. I, for my part, will be making sure he is aware of the New Zealand govern-

ment's views as he undertakes to commit the resources of the Fund to this important endeavor.

Nor need we be too concerned that the focus of the study—international monetary issues—omits mention of the trade side of the overall trade and payments equation. The limitations of looking only at the monetary system will become quickly apparent. Nine months ago in London at the Commonwealth Ministers of Finance meeting, and then at the annual meeting of the IMF, I called for a second Bretton Woods type conference. At the time I used this descriptive term to be deliberately provocative and thus fix the dimensions of the task in people's minds. Today, of course, great statesmen and magazine editors are all calling for another Bretton Woods. In the meantime, the study of my proposals commissioned by Commonwealth Finance Ministers is nearing completion. I see this study, and its much higher-powered summit counterpart, as part of the same medium-term task—initiating a process which is sufficiently divorced from the day-to-day concerns of governments—so as to prevent a sterile restatement of national positions—and yet avoid being diverted to those wonderful devices for inaction, groups of wise men.

What I am proposing here, therefore, is that there be set underway a systematic process looking to significant changes and adjustments in the structure of trade, payments, development efforts and exchange rates. New and powerful linkages have been formed among these issues and between economies. Interdependence has leapt out of the textbooks and has arrived on ministers' desks everywhere. We need to find ways of managing that interdependence. I have proposed such an examination in a number of forums over the last nine months. I now renew that proposal with a strong sense of urgency.

II

We now have a reasonably clear idea of how the international community arrived at the present state of affairs. The sad chronology running from the collapse of the Bretton Woods system in the early 1970s, through the 1976 second amendment to the IMF's articles of agreement, through the two oil shocks, and the dogged persistence of unemployment and debt, has been well documented by others. Throughout this series of shocks and policy failures, some of us have been sustained by the dream that these have been aberrations. In the day-to-day preoccupation with managing these issues we have, I believe, failed to realize that the cumulative effect has been to change the economic framework in which the world is operating. We cannot simply wish for a return to the certainty which delivered reliable growth for a generation. It is not a question of putting Humpty Dumpty together again—much of the wall is no longer there.

Those who have reflected on the implications of those events have divided roughly into two schools. There are those who see the recovery, the successful reschedulings and the recent decisions on Fund quotas and the General Arrangements to Borrow (GAB), as having essentially resolved the problem. The other group, in which I count myself, believe that some of our present problems are more fundamental, that we will have to dig deeper to lay the foundation for any sustained return to world prosperity, and that there are now problems with which our existing institutions are not well equipped to deal.

The first group, and I would say they are still in the ascendancy amongst developed countries, see events over the last three to six months as having once more proved the resilience of "the system." The more responsible of them would not argue that we are out of the woods yet: the recovery is simply at too early a stage for that assessment. Some would go further and assert that there are likely to be some new and unhelpful shocks around the corner, particularly in the form of further financial crises. Any such shocks would, however, be dealt with on a case-by-case basis.

Of this view, one thing puzzles me. Does it reflect a conscious policy of inspired ad hocery for its own sake, or is it simply a reflection of their assessment of the difficulties of steering anything more systematic through a U.S. Congress in its current mood? Whatever the case may be, the priorities of this first group are very clear: consolidate the recovery, keep the banks chasing their own money in further rescheduling exercises, and steer the quota increase through the American political system.

The second group has something of an identity problem—as frequently occurs with those who see merit in the middle ground. It is not that they disagree with the above short-term agenda; on the contrary, success with this checklist is vital. It is just that this does not seem to go far enough. I subscribe to the view that a failure to grapple with some of the more important structural issues could choke off or at least constrain the recovery itself.

Advocates of the middle ground have a real problem in differentiating their views from the far more radical calls for restructuring the whole system—the viewpoint associated with "global negotiations" (a curious misnomer for talks that have not and are not

likely to get off the ground). I have experienced this at first hand on several occasions over the last 9 to 12 months since I began to call for a comprehensive examination of trade and payments. This was clearly apparent at the meeting of Commonwealth Finance Ministers in London last August. I was arguing for the Commonwealth to initiate a detailed study of trade and payments issues. If we appear to be inundated with such studies now, the idea was relatively novel at the time. Commonwealth Ministers will be receiving the report within the next few months. I am quite sure that a number of those who supported my views did so because it all sounded vaguely reminiscent of past debates in the developing countries' Group of 77. Those few who opposed me probably did so for exactly the same reason.

There is a series of dangerous international codewords operating in this field. To criticize Fund conditionality is immediately to be cast in the camp of those who do not believe in prudent domestic economic management. To point to shortcomings in the collective behavior of the banks is to risk being categorized as opposing private capital flows. Communications in the actual international marketplace may reflect the computer age in which we live. At international economic meetings we prefer to communicate by semaphore.

III

Underlying all this debate are differences of view about domestic economic policy and differences of view about international economic linkages. I shall put the former issue to one side for two reasons. First, it is an all too familiar subject for debate. Second, it appears to be an area from which it is difficult to derive acceptable generalizations of much greater use than emphasizing the importance of promoting non-inflationary growth. In any case, during my normal working day I can, if I choose, explore the full and rich diversity of views which exists within the small community of New Zealand economists.

It is the question of the international economic linkages that I wish to explore here. That is the area that deserves far greater attention than it has had in recent years. Of course the Organization for Economic Cooperation and Development (OECD) countries had to squeeze inflation and inflationary expectations out of their economies. If some major countries were not, for whatever reason, prepared to follow other majors down the rugged path of disinflation, then so be it. The system of floating exchange rates was supposed to reflect each country's particular policy choice.

However, having explored that terrain for two or three years, we are now coming up against the limits to domestic policy. There is a need to exercise care with one's choice of words here. The argument is not that the primacy of domestic economic management over recent years was misplaced. Indeed, if we are now in a position to concentrate on certain international issues—the possibility of more stable exchange rates is the best example—it is due in no small part to the hard-won gains of domestic policy. It is, nevertheless, becoming clearer that the task of building a widespread, durable recovery has an international dimension. This is why I believe that each country must now be encouraged to pursue its own adjustment path within a more coordinated international policy framework.

Dependence is a familiar enough concept for New Zealanders and most of our friends in the Pacific region. For years our economies have been profoundly influenced by, or dependent upon, external events over which we have only the most limited control. I used to think "interdependence" belonged to the misty language of diplomats and idealists. Now I know better: it is simply dependence that flows two ways. Someone could perform a great service if they could think of another word that better reflected the fact that interdependence has a real material base to it. One example quoted recently by Mr. Regan, the U.S. Secretary of the Treasury, demonstrates this point clearly enough. Mr. Regan observed that, by 1980, 29 percent of total U.S. exports went to less-developed countries (LDCs), and that in the case of one country alone, Mexico, debt problems caused a ten billion dollar annual-rate drop in U.S. exports between 1981 and 1982.

The examination of trade and payments that I am proposing could, without too much violence to reality, be described as a first attempt to work out how we might deal with interdependence. By following the rules of the old Bretton Woods system we have built a world economy. It is not surprising that the old rules are less than adequate to tell us how to deal with the consequences.

There is nothing particularly new about interdependence in terms of the underlying theory. We have known for years that there were linkages between, say, trade and finance, between economic growth and structural adjustment. The point is, however, that the practical significance of these linkages has increased to such an extent and with such rapidity that in terms of public policy it warrants being treated as a substantially new phenomenon.

Because of this, it is critically important to make every effort to get our management of it right from the start. In my experience,

there is nothing more important. Later on our thinking becomes ossified; we have created bureaucracies, interest groups and other inhibitions to change. What we then do, when the system jams and progress is painfully slow, is blame our politicians for failing to show "political courage." The political realist knows that once the broad parameters have been set, it is immeasurably more difficult for governments to alter them.

In New Zealand's case, for example, we somehow got our agricultural sector organized on the right footing from the start. The capacity of New Zealand agriculture to adjust to the harsh realities of the market has been a remarkable feature of our economic history. We did less well in industry. Our industry, based on policies of high protection over several decades, is only now emerging on a more competitive, export-oriented basis. New Zealand analysts tend to debate endlessly whether our forebears adopted a very sensible approach. It is rather reminiscent of a definition of historians I once came across—people who endlessly provide answers to questions nobody has asked them. A mere Prime Minister has to operate within the reality of the policies he inherits.

The lesson in all this is one of brutal simplicity: when you see something big developing, get it right from the start. That is how I see the present situation facing the trade and payments system in the light of the complex and rapidly evolving interdependent world economy. That is why I have advocated a comprehensive examination along the lines of the process that led to the Bretton Woods Conference.

Before analyzing the issues on which such an examination might focus, I should emphasize that I see this as a medium- to long-term exercise requiring the highest order of intellectual and political commitment. One objection that has been raised in past discussions is that this is not a time for reshuffling the deck. Rather, so the argument goes, this is a time when we should concentrate all our attention on the task of extricating ourselves from the immediate threat of further financial crises and a collapse in the incipient recovery. Some even say that any discussion of fundamentals would be a powerful force for uncertainty.

The case for concentrating on the immediate task at hand is a strong one, but I believe the conclusion drawn from it is fundamentally misplaced. It ignores the political point that now *is* the acceptable time to channel the political concern into a constructive debate. It passes quickly over the enormous uncertainty that exists about structural aspects of the present trade and payments situation. One only has to look at current U.S. interest rates to know that uncertainty is more likely to arise from doubts about aspects of the real economy than any policy initiative aimed at the medium term. Finally, let us not forget that the British and U.S. governments launched that remarkable process of discussion and negotiation, led by John Maynard Keynes and Harry White, in 1942 when there were one or two other pressing matters of state to be dealt with.

IV

In the past, I have defined the task of such an examination in fairly general terms. There are dangers in being too specific at this stage, in attempting to attain a premature precision. The role of politicians is presumably to point to broad objectives, to channel concern in worthwhile directions and provide the framework for experts to take up the challenge of identifying technically sound and viable options to be fed back into the political process. If that sounds simplistic, the alternative—attempting to map out a complete blueprint at the outset—is, in my view, a gross conceit.

In very broad terms, the agenda practically writes itself. The concept of interdependence provides the theme. It is an interdependence of countries and regions and an interdependence of issues, such as economic growth, trade and debt. The basic objective is to find ways of giving greater coherence to our policy response to these complex linkages.

The enormous overhang of developing country debt and the threat of inadequate financial flows to facilitate orderly adjustment provide one convenient starting point.

I am not much reassured that the recovery will wash all these problems away. Obviously it will help, as will the Fund quota and GAB decisions. However, let us not deceive ourselves that the "rescheduling exercises" have solved all the basic difficulties built up over several years.

It is now reasonably clear that no sovereign government will be allowed to default in anything other than a technical sense unless it leaves the international community absolutely no possible alternative. The experience of Zaïre in the late 1970s, or Sudan more recently, suggests that if we are attempting to analyze the prospects for default we are looking to the outermost limits of political irresponsibility or collapse of the real economy.

If, then, our yardstick for measuring the gravity of the current debt problem is the chance of default, I suggest we are using the wrong yardstick. In today's world there are other more complex manifestations of serious financial difficulties. For the banks—and the U.S. banks in particular—it possibly lies in the valuation of their assets. At the moment the most exposed banks are, in effect, paying themselves their own profits. I am told that few banks doing this are too worried about this happy and profitable pastime, and that there would be no takers for any discounted bonds along the lines of various proposals currently under debate. Of course there is a rational basis to the apparently limitless possibilities of rescheduling: they are taking greater risk and greater exposure and thus attracting higher margins.

If, however, things do not turn out for the best—say the recovery turns out to be less robust than we all hope, or the recovery takes place against a backdrop of a continuation of very high real interest rates—do not discount the possibility of the banks quite quickly adopting a rather different collective stance. We can accept the argument that the "herd instinct" of bankers is fundamentally rational. That is not at issue. The point is that it could be quite rational for the banks to respond rather differently to a different set of circumstances. The attitude of smaller, contributory banks may well be relevant here. It may be as well, therefore, to consider the appropriate response of governments and various regulatory authorities in anticipation of such a possibility. If we do enter that sunny world where all turns out for the best, then we can quite happily scrap any such plans.

A good deal of this could latch on to work that is already underway. The BIS and the IMF are both working on projects to improve the information available to banks on aggregate lending to individual countries. The establishment of the International Institute of Finance by commercial and central banks should improve the analysis and dissemination of country data. I am normally skeptical in policy discussions of arguments that emphasize the need for better data. My experience has been that the improvement in decision-making derived from improved data is generally rather marginal. In this case, however, I have heard sufficient horror stories about the level of ignorance pertaining to individual country debt to encourage me to suspend my skepticism.

There is a tendency in recent analyses I have read to neglect the interests of the borrowing countries in all this. If banks get it wrong they refer to their inability to assess "the downside risks." Again the comfortable neutralizing effect of the phrase obscures the reality behind the concept. In extreme cases, what are downside risks to a banker can represent social, economic and political chaos to a country, and consequent strategic problems to its allies. We cannot afford to ignore the linkages between maintaining an adequate flow of funds on reasonable terms, structural adjustment and

Fund conditionality. There is more to structural adjustment than bludgeoning imports.

The issue is not and never has been conditionality or no conditionality. Extremists on both sides of the fence have consistently obscured the real issues. One side, the self-proclaimed hard heads, has argued for even tougher conditionality than at present because they see the reluctance of borrowing countries to adjust. The other—we might loosely call them the radicals—thinks adjustment is a moral not an economic question, and that adjustment should be undertaken only by "rich" developed countries.

The hard heads overlook the fact that countries with the option of borrowing on private capital markets will do so precisely to avoid excessively harsh Fund conditionality. As numerous moderate critics of the Fund have now pointed out, the aim must be to involve the Fund at an earlier stage before the need for adjustment becomes acute and before the nervousness of the country's private creditors is such as to propel the Fund into the unaccustomed role of lender of first resort, as is characteristic of many current rescheduling exercises. The radicals are equally wrong—and for much the same reason. A senior Fund official once put it to me this way: "What has the Fund got to offer except conditionality—money? Anyone can lend money."

The point is well made. The Fund's role is to promote adjustment that is consistent with its global responsibilities. The central fact in this debate is that the experience of recent years indicates the need for more appropriate adjustments to events than has occurred. That in turn implies inadequacies in the way the Fund—the world's premier institution for adjustment, to borrow the description provided by the Brandt Commission—has operated or, at the very least, has been used by its clients.

The way in which developing countries pursue adjustment policies is of more than academic interest to developed countries. At the May 1982 OECD Ministerial Meeting, ministers were all encouraged to expect a so-called "technical" recovery—that is a recovery arising from the anticipated behavior of the stock cycle. In fact, the downturn in demand for OECD exports by non-OECD countries was sufficient to change what became an expected zero growth estimate for the OECD area as a whole into a decline of 0.5 percent for 1982. In such ways, the concept of interdependence acquires a concrete meaning. Structural adjustment must take a more sophisticated form than simply slashing imports. If, however, we leave no other option to developing countries facing massive cumulative current account deficits, we will be putting the strength of our own recovery

at risk.

There are now some well-established general propositions, which a fundamental examination of these issues would consider: stronger emphasis by the World Bank on structural adjustment lending is one. Close liaison between the adjustment programs of the Fund, which generally have a shorter-term horizon, and those of the Bank is another, along with strengthened cofinancing arrangements involving the private banks.

The fact is that the Fund was conceived primarily as an institution to overcome short-term cyclical balance-of-payments difficulties. The cumulative current account deficits which weigh down so many countries these days are structural, not cyclical, in nature. In many cases adjustment to these deficits must, therefore, be spread out over a longer period of time than is traditional for Fund programs. The major sources of lending for balance-of-payments difficulties—the Fund, the World Bank and the private banks—must work toward that common objective.

V

No examination of trade and payments could ignore the questions of "development." Development has become almost an unrespectable word. Maybe it is because the more radical developing countries have used the catchcry of "development" to conceal a multitude of their own economic sins and political shortcomings.

We need to recognize some fundamental facts about development. First, the demands for development assistance will not go away. They may be accompanied by all kinds of shortcomings in domestic policy, but in more cases than not they also reflect pressing human needs, the like of which developed country politicians and officials can scarcely imagine. Second, it is no use telling the least developed countries to rely on private capital flows. Historically these are insignificant sources of finance for such countries. A recent OECD report points out that private market debt accounts for only six percent of the total debt of low income countries—and 21 percent of their debt servicing.

Development also raises the thorny question of its role in trade policy. The North has generally—and in my view correctly—tried to base the operations of the Fund and the General Agreement on Tariffs and Trade (GATT) on the economic concept of "efficiency" rather than "equity." This is not, of course, an absolute position, as evidenced by the concept of "special and differentiated" treatment in the GATT—or, in less technical language, preferential treatment for developing countries. The concept of efficiency is not in any sense an obstacle to the objective of development. On the contrary, an efficient trade and payments systems is essential for the development of LDCs. That said, official aid flows remain an unavoidable ingredient in the development process.

If the developed world wishes to preserve efficiency as the central feature of our trade and payments system, then it must also acknowledge that for a considerable number of countries development means the continuation of satisfactory aid flows in a quantitative and qualitative sense.[1]

An examination of trade and payments would have to consider how to raise the level and quality of official development assistance. We have to accept that democratic parliaments in present circumstances are not going to vote substantially increased amounts for either bilateral aid or multilateral aid. One proposal designed to increase aid flows on a more automatic basis—the so-called SDR-link proposal, which would dispense new SDR issues on the basis of need—has been debated back and forth for years. If this particular proposal could not find favor, and I would be disappointed if that were so, then other alternatives that might put aid on a more realistic and dependable footing must be explored. The dependence on periodic replenishments of the International Development Association—the World Bank's "soft-loan" subsidiary—is another issue that must be given serious consideration, since the current position means that IDA's development efforts are being put in jeopardy by whatever political mood happens to prevail at the time of the replenishments.

VI

Nowhere is the reality of interdependence brought more sharply into focus than in the areas of debt and trade. There is no need to chronicle here the way in which trade is conducted more and more outside the GATT rules. By the modest standards of international cooperation, GATT must be regarded until recently as an outstanding success. It has substantially accomplished its major objective: removing tariffs on trade in most industrial goods. It has, however, not been capable of coming to terms with the growth of non-tariff

[1] If anyone doubts this, they should visit some of the small island developing countries in the South Pacific. Take, for example, the independent sovereign state of Tuvalu. It has a population of only 8,000 and consists of nine inhabited islands. Apart from coconut trees and fish it has no natural resources. I can see no practical alternative to maintaining a reasonable level of official development assistance to such island states. New Zealand's aid program, which is so very small in absolute terms, but which is significant and highly effective amongst these countries, is one reason why I cannot accept the prevailing modern negative view of aid.

barriers. With respect to agriculture, New Zealand's experience has indicated that it has been a near total failure.

There is nothing inherent in the GATT concept—the negotiation of reciprocal concessions—that is deficient. GATT *could* be made to embrace agriculture, trade in services, and non-tariff barriers. The failure lies with the contracting parties to the GATT, which have not been prepared to use the institution, rather than with the institution itself. Its political mandate, in other words, is all but exhausted.

The enormous growth in world trade since the war—far faster than growth in world production—has been one of the key sources of economic dynamism. The fact that the volume of world trade actually declined by two percent last year should sound loud warning bells in all capitals. It cannot be restated too often that deficit countries can cope with the volume of debt that has been built up over recent years only if they can trade their way out of difficulties.

Given the linkages between trade and finance, there is now a need to move beyond the customary philosophical denunciation of protectionism: we need to tackle the underlying political and economic roots of creeping protectionism. This brings the analysis back to the linkages with macroeconomic policy coordination, structural adjustment and volatile exchange rates. Protectionism has gained ground not so much because people doubt the validity of the case for freer trade. On the contrary, we never miss the opportunity of reaffirming the dangers of protectionism every time governments meet to issue yet another communiqué. As I write this article I suspect I could quite easily draft the relevant paragraphs of the declaration or statement which will emerge from the next summit.

Protectionism has rather deeper roots. Until we recognize this and find alternative ways to manage the underlying forces that sustain protectionism, we will continue to see a widening gap between actions and words. The recovery *will* help to counter protectionist forces. Equally, however, unless we use whatever flexibility the recovery gives us to cut back protectionism, there will be a serious danger of the recovery itself being choked off or constrained.

I referred earlier to the now well-known phenomenon of the linkage between the structural adjustment path pursued by deficit countries (the newly industrializing countries in particular) and the OECD growth process. It is now abundantly clear that the large debtor countries face a contraction in the volume and hardening of the terms of private bank lending. If protectionism limits their opportunities for earning foreign exchange through exports of goods and services, then—given real lending constraints—the adjustment process will simply have to take the form of further cutbacks in imports. In economic terms, equilibrium will be reached at a lower level of world output and trade than would otherwise be necessary.

This implies a rather interesting shift in the political equation facing developed countries: they can attempt to save (or mitigate the decline in) jobs in industries sensitive to imports from developing countries *only* at the expense of jobs in their own export industries which depend on demand from non-OECD countries. In this context, behind the OECD-speak of "structural adjustment," lies a simple proposition. If, say, you stop deeply indebted developing countries exporting more textiles in an attempt to preserve jobs in an ailing textile industry, then those developing countries have less foreign exchange than would otherwise be the case. Unless they or their creditors are prepared to see further growth in debt to compensate for that shortfall of foreign exchange—and that is most unlikely in present circumstances—then the only other means of covering the shortfall of foreign exchange is to restrict imports. Those imports may be your exports of, say, transport equipment. For the OECD as a whole, the choice can be put quite crudely: "Which jobs do you want to preserve—those in a less efficient import-substitution textile industry or those in an export-oriented transport equipment industry?" This is why debt is often referred to as deferred trade.

Frankly, I do not believe the recovery will be strong enough to allow a generalized attack on protectionism in all its many forms. We can certainly call for an all-out assault on protectionism, but nothing much will happen if we do. However, assuming that the recovery is consolidated and that this in turn gives a little more flexibility to move against protectionist measures, then I suggest there are two priority areas to utilize whatever degree of flexibility exists.

The first priority would be to develop a negotiating framework designed to lead to a reduction in barriers to trade in items and sectors of greatest export interest to developing countries. The political rationale is simple enough: it would be designed to encourage the developing countries to emphasize positive adjustment policies of export-led growth and thus avert the current bias toward contractionary, import-cutting adjustment measures. Such a trade strategy would be fully consistent with the OECD's own macroeconomic requirements. It would contribute to greater confidence in financial markets. It would, I consider, be a classic example of the type of policy response required in an interdependent world.

The second priority area for trade liberalization, and one in which I openly declare New Zealand's strong self-interest, is the area of agricultural trade. This does not have an identifiably North-South dimension to it. Rather, it is a political and economic imperative in terms of relationships amongst developed countries. The tensions and contradictions implicit in the exclusion of agriculture from the normal disciplines of world trade have now reached a point where they threaten the very basis of political and trading relationships between developed countries.

Whether we are looking at a full-scale trade war between the United States and Europe over this issue or simply lesser variants of it such as a competitive bidding-up of subsidized agricultural trade in third markets, the consequences for the world trading system could be severe. I do not subscribe to the theory that out of the ashes of a war over export subsidies a brave and wiser new world would arise. The basic problem with trade retaliation, in whatever form it might take, is that it is impossible to control the end result. I should also add, though it is rather more than an afterthought in my calculations, that New Zealand's economy could be irreparably damaged in the process, given our disproportionate role in certain areas of world agricultural trade.

I am enough of a realist to appreciate that after all these years of agricultural protectionism, any progress in introducing greater discipline would be very slow. However the first step that is required is a commitment by the majors to remove some of the worst distortions in agricultural trade and domestic pricing practices.

If then the recovery permitted even the most modest anti-protectionist initiatives in these two priority areas, it would be a breakthrough indeed.

VII

Finally in my illustrative list of structural trade and payments issues deserving serious attention is the question of exchange rates. The limitations inherent in the current regime are now becoming quite apparent. An increasing number of commentators have come to recognize the linkages between volatile exchange rate movements and protectionism. We know too that with the collapse of the Bretton Woods system and the subsequent endorsement of a floating rate regime we also lost a means of imparting greater international discipline to the task of domestic economic management.

I do not think we are yet ready to embrace a new system of setting the major exchange rates. The intellectual swing away from floating rates is of quite recent origin. However, the fact that inflation rates are now converging to a much lower level brings this within the realm of medium-term possibilities.

We cannot hope to return to the Bretton Woods system of fixed parities as it was. Its key linchpin—unchallenged U.S. economic hegemony—no longer exists. The objective is to arrive at comparable conditions of stability and discipline through economic policy coordination.

VIII

It is not easy to identify a way to approach a medium-term examination of all those issues. We are looking for a process that commits governments to it up to a point and yet preserves their freedom to negotiate at a much later point. The Bretton Woods analogy is pertinent. Here Keynes and White, backed by the resources of the British and U.S. treasuries, spent some two years arriving at a statement of principles which then formed the basis for negotiations not only between the United Kingdom and the United States but among some 40 other countries as well. Some four decades later, the agreement to a study by the summit countries which might in due course lead to an international monetary conference is not too dissimilar. This time, because economic and political power is more evenly distributed, we have seven, not two, treasuries, along with the resources of the International Monetary Fund, involved in the first step of defining the issues, establishing basic principles and thus preparing the groundwork for broader-based political consideration.

On a much more mundane level, we and the Australian government have just successfully completed the negotiation of a timetable and a schedule for removing all remaining barriers to trade between the two countries. The resultant agreement—known generally as the "CER" or Closer Economic Relations Agreement—came into effect on January 1 this year. The scale of this undertaking may be vastly different to the matter being discussed here. But its modus operandi is instructive. The then Australian Prime Minister, Mr. Fraser, and I, established a series of principles, an agenda for study and a clear statement of objectives. Politically, the governments were committed to a process of study and negotiation, yet uncommitted to any final decision. That way we avoided all the various interest groups adopting defensive positions which would have killed the initiative at the outset. By the end of the process most groups had long since worked out a way round their own particular problems, but consistent with the broad framework we had set out. The final negotiations between myself and the then Australian

Deputy Prime Minister, Doug Anthony, came down to a series of manageable issues.

The point here is that choosing a successful process was much more than half the battle. By the time we came to negotiate the hard bits, the fundamental political difficulties had more or less resolved themselves.

A comprehensive examination of trade and payments to take account of the facts of global interdependence is a daunting prospect. Ultimately the major actors would have to define a process of their own that would take account of their particular political concerns. Whatever form it might take, it would have to involve people of undisputed technical competence with ready access to the resources and opinions of their governments, to ensure that the development of ideas was within the bounds of political reality. The group would have to be of manageable size and reasonably representative of aggregates of economic and political power. To allow the process of study and negotiation to develop in a flexible way, it would have to find its own method of political engagement and disengagement.

The end result of such an examination need not directly concern us here. I believe, and have been saying so for close on a year, that ultimately a conference along the line of the Bretton Woods Conference would be required. I would see an examination of the type referred to above as essentially a preparatory phase to such a conference. That is very close to what the heads of government at Williamsburg agreed on. As at Bretton Woods, the conference would then be examining a joint statement of principles which would be reasonably acceptable to the countries that ultimately determine the limits of negotiation. No one would be bound to accept the conclusions of such a conference, not even the governments whose quasi-representatives might have developed the basic documentation and ideas for debate.

IX

Inevitably, such a conference would need to consider whether new institutional mechanisms are required. My strong belief is that they are.

Those who espouse new institutions are usually radical critics who seek the replacement of existing institutions by new bodies. That seems senseless to me. Whatever their inadequacies—and there are some serious inadequacies—we have built up competent and worthwhile institutions in the GATT, IMF, OECD, World Bank and BIS that we can ill afford to throw away in the naïve belief that we can recast the entire pattern of international economic diplomacy. Let us keep what is worthwhile, change what is not and build on the structure as a whole. The critical institutional gap is the lack of any effective coordinating mechanism between the operations of these key international institutions and their clients—the officials and ministers in charge of central banks and treasuries. That institutional gap must be filled. This is why I have suggested an "Economic Security Council." Its field would be international economic policy coordination.

We have all discovered interdependence with a vengeance, but we have little idea how to manage it. In fact the word "manage" may be inappropriate since it conjures up an image of intervention, controls and international rules. The management of interdependence may be better achieved in other ways. We are dealing with sovereign governments. I do not consider that we have anywhere near reached the point where governments will cede sovereignty in the area of economic policy by entering into contractual arrangements along the classic lines of the GATT. We need, therefore, a body with sufficient *political* weight, whose findings might influence, but not bind, the sovereign economic decisions of governments and help to achieve more effective coordination among the major international economic institutions—hence the codeword of an Economic Security Council.

Channels already exist, of course, for coordinating various aspects of international economic life. However, for one reason or another, they are incapable of performing the political function I have in mind: that is, promoting policy solutions in a way that takes adequate account of interdependence between issues such as protectionism and exchange rate policies, between institutions such as the IMF and the BIS, and between the economies of nations.

To have real influence in these areas requires a body of the highest political profile. That characteristic is singularly lacking in existing coordinating mechanisms such as the development committee of the Fund and the World Bank or the committee used by OECD treasury officials to discuss macroeconomic issues—"Working Party Three." They do a fine job to be sure. It would be a true test of the political significance of their deliberations if a single minister of finance could point to any decisions he had made in which the pronouncements of this working party had been an important factor. Much the same thing could be said of the IMF's "Interim Committee." As a politician I am a firm believer in the significance of body language. A body with such a delightfully compromised name as the "*Interim* Committee" could not possibly command

sufficient influence over policy. Yet such influence is precisely what is required.

I would not wish to try to impart a premature degree of precision to what is at this stage only a concept. It may be useful, however, to indicate one or two of the possible elements of an Economic Security Council.

First, while the analogy to the United Nations may be risky given current cynical attitudes to that institution, the choice of words is deliberate. As with the Security Council, it would need to reflect the realities of global economic and political power. Coming from a small country, it would be nice to imagine a different world. Yet there is an enduring reality to the proposition that he who ultimately bankrolls the system should have a major say in how the system works.

Having said that, it would need to devise a means of representing smaller countries so as to reflect world opinion. Economic policy U-turns over the last ten years indicate that those who hold a monopoly on power do not hold a monopoly on truth. If we are living in an interdependent world, there is no choice but to recognize the stake all nations have in affairs. That is why the existing forums of OECD, and all those mystical groups of five, groups of ten, and so forth, cannot command the requisite degree of authority. In plain terms, interdependence means asking all governments to modify their behavior to take account of the effects of their policies on others. That is a difficult proposition for politicians in any political system. It is a little easier if it can be said: "This is what has been agreed by the world community. Now, are we in or are we out?" I do not expect miracles from this process—just a marginal improvement in coordination would do. We might even get the taste for it over time.

It might be sensible to base such an Economic Security Council in the Fund. There is in fact provision for setting up a council of sorts in the 1976 second amendment of the articles of agreement. As an institution, the Fund has near universal membership and enjoys greater confidence than a number of obvious alternatives.

Clearly, this can be approached in numerous ways. I believe, however, that the call for a coordinating institution with the political weight to influence the behavior of nations and institutions is overwhelming. The debt crisis has cast the requirements of interdependence into sharp relief. It no longer makes sense for trade ministers and officials of GATT to solemnly pledge themselves to resist protectionism when the forces that have caused a wave of new protectionism lie outside the ambit of their responsibilities. I am well aware that thinking inside the current U.S. Administration is moving in this direction. I would hope they have the courage to extend their vision a little more. Such a far-reaching proposal would take a long time to work out. It could be an integral part of the comprehensive examination of the international trade and payments system I propose. The problems are not new. The failure to agree at Havana in 1948 on the formation of an International Trade Organization is testimony to that. The only difference now is that the need for greater coherence in our approach to these interdependent issues is so much more pronounced.

X

I referred previously to some advantage I enjoy in being the Minister of Finance and Prime Minister of a small country. It is possible for me to put forward these ideas for discussion without causing too many difficulties at international meetings for my officials, whose welfare is always uppermost in my considerations. Imagine the ramifications if a leader of a major financial power proposed such ideas. He and his officials would have to spend the next six months explaining them away.

Nonetheless, the problems I have analyzed have still to be faced by the major countries. In searching for the answers, the United States has the major role. It also has a major opportunity.

In everyone's haste to criticize the United States for this or that failing in past economic management, we should not overlook the fact that the United States has now accomplished two necessary conditions for an overall improvement in all our economic prospects. First, and with considerable pain to the American people, they have brought their rate of inflation right down. Second, the Administration has steered the economy toward a recovery. To assert that these accomplishments are not sufficient for global recovery is not to understate their importance.

For over 30 years, since we and Australia established the ANZUS alliance with the United States, New Zealanders have looked across the Pacific for political leadership. It has not always been an obvious feature of American policy over that long period, but no other country can come close to matching the American record.

When the pressure of economic events, some of which were admittedly directly attributable to American policy miscalculations, forced the U.S. government to close the gold window in 1971, thereby effectively ending the Bretton Woods system, the world entered a period of profound economic and political instability. As I look at the events of the last decade in terms of the framework for international economic relations, the dominant picture that

comes to mind is the United States on the back foot—reacting to events rather than providing its traditional leadership. Because of its commitment to a trade and payments system that rewards efficiency, the United States has devoted its energies to opposing either sophisticated protectionism from its otherwise close allies, or grandiose calls for global negotiations.

I see the present period as an opportunity for the United States to get off the defensive, reassert its political leadership and attempt to construct a framework for international economic debate that might lead to a strengthened liberal trade and payments system. The first requirement is for the United States to convince itself that a framework for coping with this interdependent world that has arrived on our doorstep is actually required.

We can wait. We have already waited for two years for the United States to put its own house in order. What people rather unkindly refer to as the "United States' discovery of the outside world" is of very recent origin. We cannot wait too long, however: otherwise the opportunity for channelling the pervasive political concern into a constructive direction will be dissipated.

There can be no question of returning to the old Bretton Woods system. In the past, the U.S. economy was, in effect, the only game in town. Now the U.S. economy is closer to what could be described as *primus inter pares*. The challenge is to construct a framework for international economic relations that can accommodate not only several large and more equal players but is also sufficiently flexible to accommodate new aggregates of power as they emerge.

This has a political as well as an economic dimension. The last time a change in the economic and political aggregates occurred—when one or two OPEC countries suddenly acquired sufficient economic power to influence the course of the game—the system did not cope well except in the sense of funneling money around the globe. The real issue of the interdependence between oil producers and oil consumers was bypassed. We, and they, are still paying a heavy price for it.

An examination of trade and payments, with the aim of establishing a more coherent approach to the problems posed by interdependence, could divert international economic discussion away from the ill-conceived ideas that have dominated debate over the last decade. The agreement reached at the Williamsburg Summit, under the chairmanship of President Reagan, to undertake an examination of the international monetary system, provides an opening for American political leadership if its current leaders choose once more to exercise the United States' traditional role.