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From the  
Minister for Trade

DEPARTMENT OF TRADE  
1 VICTORIA STREET  
LONDON SW1H 0ET

(2)

TELEPHONE DIRECT LINE 01 215 5144  
SWITCHBOARD 01 215 7877

The Rt Hon Francis Pym MC MP  
Secretary of State for  
Foreign & Commonwealth Affairs  
Foreign & Commonwealth Office  
Downing Street  
London SW1

Prime Minister

To note.

A.S.C. '91

17 November 1982

MF

Francis

In Arthur Cockfield's absence in the United States I am writing about the line to be taken at the Foreign Affairs Council on 22/23 November which should finalise the Community line for the GATT Ministerial Meeting which opens in Geneva on 24 November. We had a substantial round of correspondence about this in July and our current policy rests on Arthur Cockfield's letter to you of 21 October and replies from Peter Walker of 22 October and your minute of 25 October. As I know you realise, the pace of negotiations in Geneva is now quite fast, and the line I outline below may need to be modified in the light of developments there, and of Arthur's discussions with Bill Brock, the US Trade Representative, in Washington.

E Committee agreed on 28 October (E(82)22nd Meeting) that we should use the opportunity of the GATT Ministerial Meeting to draw attention to the damage caused to the multilateral trading system by some trading partners unfairly restricting access to their markets, particularly when our own market is open to their exports.

This point has been made several times publicly by the Prime Minister, Arthur Cockfield and myself. As E(82)71 recognise, I do not think we can expect the outcome of the GATT Ministerial Meeting to respond fully to our concerns, although we and the Community will continue to press as hard as we can for the maximum recognition of them. We shall also be putting papers to E Committee

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on specific points shortly.

The Community's position for the GATT Ministerial Meeting rests on the common position agreed on 29 October taking account of some suggestions the French put forward after some discussion at the October FAC which I attended in Luxembourg. The Commission is currently negotiating on the basis of these guidelines in the intensive preparatory work in Geneva now fully underway, and we shall not know in detail until just before the FAC next Monday exactly how far the Commission has been able to get the Community line accepted, and where the outstanding difficulties the Council will have to address may arise. I summarise briefly below for the information of colleagues our latest information on developments, but at this stage I have no reason to ask colleagues to agree any modification to the UK policy lines already established, particularly in Arthur's letter of 21 October. If in pursuing these, I run into serious difficulties at the Council or at the Ministerial Meeting itself I shall naturally get in touch urgently with colleagues.

The latest state of play in what is a very fluid situation in Geneva is as follows:-

- (a) There are two rather different diagnoses of what underlies the recession in trade and rise of protectionism. Broadly the EC view, most clearly articulated by the French, is that it results from a range of wider economic causes; on the other hand the GATT view, which among others, the West Germans tend to share, is that the failure of Contracting Parties to observe GATT rules is responsible. We find the French view much more convincing, and the EC is therefore working to get their assessment incorporated into the Ministerial Declaration. Even so, we may find ourselves unable to move beyond a draft which presents both assessments, and then goes on to bring out areas of agreement. This does not seem to me to be an unsatisfactory outcome. It would avoid the embarrassment of a row on the question of diagnosis, in which France and W Germany are in opposite camps, becoming the major crisis of the Ministerial Meeting. I therefore hope that we can accept a draft which reflects the EC view, but does not necessarily exclude all reference to other views as well.





- (b) Earlier texts on a ceasefire, on new protective measures (in origin the Australian "standstill" proposal), have been considerably watered down and the agreed Community position is in terms of resisting protectionist pressures with any ceasefire on a "best endeavours" basis. I see no point in an agreement at the Ministerial Meeting if it creates unjustified expectations on the part of others that the Community is prepared to limit its GATT rights or forego opportunities to take protective measures consistent with its GATT obligations in grey areas.
- (c) On safeguards, several partners continue high profile last minute manoeuvrings but it seems most likely that agreement will be limited to a mandate for continuing negotiations, with perhaps an interim agreement on transparency for inter-governmental (but not inter-industry) grey area measures. I have no intention in any case of abandoning our insistence that in the last resort we must be able to take selective action.
- (d) On agriculture, the basis for an agreement which we thought we saw earlier on a substantial GATT work programme seems to be imperilled by American insistence on a political acceptance that export subsidies are the main problem and need to be tackled urgently. It is most unlikely that the Community will accept such an explicit statement and, in tactical response, to this pressure the Commission has also stood firm on established positions. However this is a fast moving negotiation in which events will inevitably overtake this letter. I expect this will be one of the crunch points at the Ministerial Meeting but is not one where the UK is directly engaged or will be seen as a principal obstacle to progress.
- (e) There are the first signs that the Community idea, on which we are close to the Swiss, that there should be a feasibility study of methods of negotiation between developed and developing countries is gaining greater acceptance. I appreciate that the US will view this as a weaker approach than that advocated





by them. But it is clear from attitudes in Geneva that a tougher approach will not succeed in forcing the NICs to the table. Multilateral work in the GATT cannot be our main method of tackling major inequalities of access with the NICs, and would not be inconsistent with any decisions that E Committee might take, but it would be a useful step forward if we could get agreement on GATT work. This would amount to acceptance in a multilateral framework that our concerns were legitimate and be a useful way of pressing forward our views.

- (f) I am clear that there must be improvement in the present procedures for dispute settlement and in particular there must be no additional scope for a party in clear breach of its GATT obligations to veto the conclusions of a Panel Report. However the Community appears to be isolated in resisting some rather simplistic proposals. We believe these go too far in limiting the right of the Contracting Party, against whom complaint has been brought, to participate in the GATT consensus forming process and veto the adoption of decisions which it feels completely unacceptable. But the Commission has not yet deployed fully the degree of flexibility which the agreed Community mandate gives it and I by no means despair of the possibility of an agreement that should prevent mis-use of a veto, as the Americans did in the DISC case.
- (g) Progress on services has proved difficult. We are giving the US all possible support in working for agreement on a GATT study of service trade issues, though they are playing their hand very clumsily. If agreement can be reached, we will be able to point to this as a substantial plus point for the UK to have come out of the meeting. In any case I think it of growing importance that the USA - and indeed ourselves - should not leave Geneva "empty handed"; the protectionist pressures which already exist in the US Congress would only be aggravated by any "failure" in Geneva, with very serious dangers to the whole future of the world open trading system.

I am sending copies of this letter to the Prime Minister, to the members of the OD(E) and to Sir Robert Armstrong.

*Yours ever  
Peter*

PETER REES



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Prime Minister

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- SECRETARY OF STATE FOR ENERGY  
THAMES HOUSE SOUTH  
MILLBANK LONDON SW1P 4QJ  
01-211 6402

The Rt Hon Lord Cockfield  
Secretary of State for Trade  
1 Victoria Street  
London SW1H 0ET

19 November 1982

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*Baron Arthur*

TRADE POLICY

I agree with you that the time is now ripe for a concerted push against the barriers to free trade in manufactured goods and services which some countries maintain. I particularly agree that we should back the USA in pressing the NIC's progressively to apply GATT rules. The IMF could have a significant role here. However, I believe that in the case of Japan, the unilateral action which you propose is likely to be less effective than international action.

Japan's exports are, of course, narrowly focussed on a handful of industrial sectors. Nevertheless, there are significant dangers in the growing use of voluntary restraint agreements. In particular, they fail to deal with the crucial problem of the undervaluation of the Yen. Blocking Japanese exports, product by product, is like trying to repair a tyre without removing the nail; the leak simply reappears in another place. Our previous restrictions have shifted Japanese competitiveness first from steel to ships, then to cars and now to electronics and machine tools. Moreover, voluntary restraints are increasingly likely to be circumvented as Japanese firms relocate production in other countries eg cars.

Since 1978, the Yen is supposed to have been cleanly floating, but tight fiscal policy combined with a slack monetary regime has driven Japanese interest rates below those elsewhere and resultant capital outflows have maintained the undervaluation.

The Japanese current account has turned around from a deficit in 1980 to a surplus of nearly \$6 billion in 1981; for 1982 the OECD forecast a surplus of \$17 billion with the prospect of a further doubling in 1983.



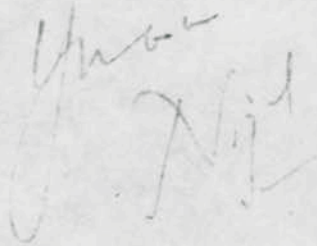
What needs to be done is for the international community to exert more pressure on Japan to place greater reliance on domestic growth. This involves bringing investment into line with the high levels of savings and adopting an appropriate structure of Yen interest rates so that an unduly easy monetary policy does not hinder the recovery of the Yen exchange rate. Much could be done to promote an international market in Yen banking as making Yen easier to hold would help get its exchange rate to more appropriate levels.

At next week's GATT meeting I would hope you would be arguing for the international community to exert active pressure on recalcitrant economies to liberalise their trade and to adopt the appropriate exchange rates that would enable them to uphold the spirit of previous negotiations. On a superficial reading, Article 23 of the GATT seems to be the appropriate instrument for exerting that pressure. Does this not point to our pressing for a GATT panel to be set up under Article 23 (2) to hear evidence on Japan and to end the inertia into which bilateral consultations under 23(1) have drifted?

Moreover, to the views of Geoffrey Howe, it might be possible to back up pressure in GATT by actions in the IMF. IMF members reacted strongly to Sweden's competitive devaluation earlier this year and they may be prepared to put more teeth into the annual round of surveillance reviews which the IMF conducts with each member on exchange rates, fiscal and monetary balances etc. As you will know, Article VII of the IMF is the appropriate article for dealing with scarce currencies and its clause 3b provides for members collectively to impose limitations on freedom of exchange in the scarce currency. It is true that the scarce currency clause has never yet been invoked and it may be arguable whether the Yen would technically meet the criteria of a scarce currency. Nevertheless, if the Japanese current account grows as sharply as has been projected and if the Yen undervaluation is pushing the world into trade restrictions there is surely a case for considering using Article VII as a means of exerting international pressure on Japan to modify its macroeconomic stance. Perhaps the Treasury could look at this.

I am copying this letter to colleagues on E Committee.

NIGEL LAWSON





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