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His Excellency Sir Alan B. Urwick
High Commissioner for the United Kingdom
80 Elgin Street
Ottawa, Ontario
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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

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SUMMITRY : THE MEDIUM

AND THE MESSAGE

by Sylvia Ostry

The Bissell Program
on the 1988 Toronto Summit

Centre for International Studies
University of Toronto
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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.

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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 <u>medium</u> 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 <u>message</u> 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.