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PRIME MINISTER

MEETING OF SHERPAS

The minimal progress on trade imbalances is the most important aspect. Economically Germany is strong, politically she is weak giving contradictory signals to the exchange rate. Protectionism, cf. the recent CBI is a major item.

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

Not an easy prospect - against the background of an uncertain stock market.

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

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

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

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

I'm not sure we are correcting imbalances. Japan or German continue to be heavy surplus countries. It is we who are taking up the deficit not they

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

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

The perennial economic subjects will inevitably come up for discussion.

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

because of approach on the adjustment

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

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Trade: beyond standard reiteration of our opposition to protectionism, what we say on trade will depend on progress in the GATT Round. An emerging aspect of the trade problem is the position of some Newly Industrialised Countries (principally South Korea, Taiwan and Singapore: Hong Kong remains a special case). They need to reduce their growing trading surpluses especially with the US (e.g. by opening their markets and letting their currencies rise against the dollar). They also need to be persuaded to graduate out of their preferential trading status as developing countries.

Recent US action to remove their GSP is a measure of US concern and an example of their enforced integration into the developed world's trading arrangements. Our Summit aim will be to find the right mix of carrot and stick to persuade these NICs to adjust in their own interest; Hong Kong's special position will need protection. There may be trouble next weekend between the Americans and the French over the Ministerial "Mid-Term Review" of the GATT Round next December (despite the attempt of the European Commission to outflank the French in Brussels). These disputes about dates have occurred before previous Summits. They are particularly futile and I shall seek to defuse this one if it occurs.

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

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

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

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

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

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

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

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

N.L.W.

N.L. Wicks

19 February 1988

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