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Foreign and Commonwealth Office

London SW1A 2AH

23 February 1988

N L Wicks Esq CBE
10 Downing Street
SW1

Dear Nigel,

BRIEFING FOR SECOND SHERPAS' MEETING (*in attached folder*)

I enclose a set of briefs for the meeting this weekend in Quebec province. The only departure from the list we agreed is a separate brief on the Canadian 'Issues for Discussion' paper: Sylvia Ostry may wish to take us through it section by section, so you may find it helpful to have short, page by page comments - many of which are drawn from Geoffrey Littler's commentary which you have already seen - in addition to the individual briefs.

2. As I suggested in my letter of 5 February, brief nos 6 - 11 are very much for your background information; I do not expect political issues to come up at this stage.

3. Perhaps we could discuss after the meeting whether you are happy with this style of briefing, so that I can put in train any changes you might like before the next Sherpas' meeting in May.

Yours ever,

Rodric

R Q Braithwaite

cc Sir Geoffrey Littler KCB
HM Treasury

P.S. I have asked the Dept to produce additional briefings on agriculture and roll back/quotas, since recent decisions in the Community are likely to be of particular interest to our non-European colleagues.

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TORONTO ECONOMIC SUMMIT, SECOND MEETING OF PERSONAL REPRESENTATIVES
27-29 FEBRUARY

BRIEF NO 1: SUMMIT ORGANISATION

OBJECTIVES

1. To reiterate Prime Minister's preference for traditional Summit format but to avoid detailed discussion of Summit logistics.
2. (If raised) To oppose any change in dates for the third Sherpas' meeting and to emphasise costs involved in cancelling Leeds Castle booking.

POINTS TO MAKE

Summit Format

1. My Prime Minister firmly in favour of maintaining traditional Summit format. What are Mr Mulroney's current plans?

Summit Logistics

2. (If raised) Discussions of logistics best left to experts who will be reporting to capitals on their recently completed reconnaissance tour.

Third Sherpas' Meeting - Leeds Castle

3. Arrangements in hand; at advanced stage; good co-ordination between UK officials and Canadian High Commission. (If raised) Too late to consider cancellation now; we should stick to agreed dates.

BACKGROUND

1. Summit Format

In her reply to Mr Mulroney's letter to Summit leaders of 12 January proposing an earlier than usual start to the Summit and a 'CHOGM-style' retreat', the Prime Minister stated firmly that she preferred to maintain the traditional format. (This entails a minor change to her suggestions, viz separate meetings on the morning of the first working day and plenary in the afternoon, rather than vice versa.) We understand that most Canadian officials are also against a retreat.

2. Summit Logistics

A reconnaissance team from Protocol Department, the Cabinet Office and No 10 Downing Street are going to Toronto on 22 February, and during the week will be meeting the Summit Management Office to cover all aspects of the administrative arrangements. They will report on their return.

3. Third Sherpas' Meeting

This is to be held at Leeds Castle on 15-17 May, and is being organised jointly by No 10 and Cabinet Office, together with the Canadian High Commission. A secretariat for the meeting will be provided by the Canadians, though we will be called upon to provide a co-ordinator. A draft working programme is attached. The French Sherpa, Attali, has advised Dr Ostry that the agreed dates would pose 'grave difficulties' for the French, in the light of the Presidential elections on 8 May; he suggests holding the meeting one week later, 22-24 May. The Italian Sherpa, Sarcinelli has supported the French line; the Japanese however are opposed to any change. Dr Ostry hopes to clear up the matter before the second Sherpas' meeting and has written to Attali to inform him that there is no consensus among the other Sherpas to change the agreed dates. Any change would involve cancelling the Leeds Castle booking and thus incurring cancellation charges.

PROVISIONAL PROGRAMME

Sunday 15 May

6.00 pm Informal Reception

7.30 pm Dinner

Monday 16 May

8.00 am Working Breakfast

9.30 am Plenary Meeting

12.30 pm Drinks

1.00 pm Lunch

2.30 pm
to Plenary
5.30 pm

7.30 pm Drinks and Working Dinner

Tuesday 17 May

8.00 am Working Breakfast (Sherpas only)

9.00 am Plenary Meeting (possible but unlikely)

If not, all will pack bags and depart.

TORONTO ECONOMIC SUMMIT
SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 2. WORLD ECONOMY

OBJECTIVES

1. To counter excessive gloom or alarm about prospects following the Stock Market collapse.
2. To welcome the progress being made in achieving adjustment of trade imbalances, through policies set out in the G7 Agreements, and the need to get this progress more widely recognised.
3. To reaffirm commitments to the adjustment policies to promote further progress.
4. To stress importance of continuing to maintain exchange rate stability.
5. To stress importance of structural policies for improving economic performance.
6. To avoid Summit (or even Sherpa) discussions getting involved in detailed discussion of indicators - although taking the opportunity to promote the idea that global indicators are potentially useful.

POINTS TO MAKE

1. Indicators to appear since the Stock Market collapse show continuing strong economic activity, particularly in the US and Japan and UK.
2. On all major forecasts, 1988 is expected to be sixth consecutive year of growth in world output and trade.

3. The huge fluctuations in the dollar during the 1980s have clearly not reflected economic fundamentals. There is now a danger that the dollar will undershoot, and if this happened it would have to be reversed with renewed difficulties later on. Avoidance of such swings in exchange rates is an important factor in reducing uncertainty and improving prospects for investment and growth.

4. Since last February's Louvre Agreement, policies have begun to change in the right direction. And there are now firm signs that trade imbalances are diminishing. But to ensure an adequate momentum of adjustment is maintained, the US needs further to reduce its huge budget deficit while surplus countries pursue policies to sustain a satisfactory growth of domestic demand. Domestic demand is now growing satisfactorily in Japan but not in Germany.

5. Indicators for individual countries can help in the assessment of domestic policies and performance. But they must not be used for fine tuning or as triggers for automatic action or consultation. We hope that the idea of global indicators will be taken up in G7.

6. Structural policies (lower taxes, reform of taxes, reductions in subsidies, deregulation, privatisation, removal of obstacles to labour mobility, etc) would contribute generally to stronger growth over the medium-term and help to keep down inflation by strengthening competition and improving economic efficiency.

7. More particularly, structural reforms would help to promote domestically - generated growth in Japan and Germany and to reduce their current account surpluses. Japan should continue to implement recommendations of Maekawa Report (including those on land and agricultural reform). Germany should cut subsidies to declining industries and pursue policies to make labour market and corporate structure more responsive to changing patterns of demand and competitiveness.

8. The current account surpluses of East Asian NICs, (and particularly of Taiwan and Korea) are not only against the interests of the world economy (contributing to the major trade imbalances and inciting protectionist pressures in the West), they are against the interests of these countries themselves. Taiwan and Korea should complete their import liberalisation, and should allow their exchange rates to appreciate.

BACKGROUND

Current Situation and Prospects

Industrial production has been strong recently, particularly in North America and Japan.

Percentage changes in industrial production over latest 12 months:

US (Dec)	5.1
Japan (Dec)	8.6
Germany (Dec)	3.2
France (Nov)	4.0
UK (Dec)	4.9
Italy (Nov)	4.8
Canada (Nov)	8.8

2. Total output (real GDP) probably increased by some 2½ per cent overall in the seven major countries in 1987. The OECD forecast shows growth slowing down only fractionally - to 2½ per cent - in 1988.

3. Inflation, which fell to exceptionally low levels in late 1986 following the fall in oil and other commodity prices, rose in most countries in 1987. But this acceleration is unlikely to be carried much further. In none of the major countries is inflation likely to rise above 5 per cent this year.

4. The trade volumes of the US, Japan and Germany are now clearly adjusting to the major realignment in exchange rates over the past three years and to the changes that have been made to economic policies. Because of time lags (the J-curve), there has not been much reduction so far in the current account imbalances in nominal dollar terms (though the Japanese and Germany surpluses declined in 1987 as percentages of GDP.)

5. From its peak in the first quarter of 1985 to last February, when the Louvre Agreement was struck, the US dollar depreciated by

one third in nominal effective terms. After eight months of near stability, the dollar has depreciated further since mid-October - to some 10 per cent below the Louvre level.

6. Short-term interest rates were increasing in North America during most of 1987 because of downward pressure on the dollar, but have declined since the Stock Market collapse in mid-October. In most major countries interest rates are lower currently, both in nominal and real terms, than on average in each of the last few years.

INDICATORS

The present position

1. The Venice Declaration in June 1987 noted the wish to continue economic co-ordination efforts and to strengthen surveillance of our economies through:

- "the commitment by each country to develop medium-term objectives and projections for its economy, and for the group to develop objectives and projections, that are mutually consistent both individually and collectively;"

and

- "the use of performance indicators to review and assess current economic trends and to determine whether there are significant deviations from an intended course that require consideration of remedial actions".

2. Ministers and Governors have since reaffirmed their commitment to economic policy co-ordination efforts, in Washington in September and in the G7 statement issued on 23 December.

Indicators for the G7 as a whole

3. The Chancellor, in his speech to the Annual Meetings in September, said that:

"We must ensure that there is no persistent inflationary (or for that matter deflationary) bias for the group as a whole. This can be helped by:

- the development of indicators for the group as a whole; these will be mainly financial but special attention should also be given to the trend of world commodity prices;
- a nominal framework for policy, in terms either of a path for GDP growth for the group as a whole, or one for the average inflation rate; and
- a medium-term perspective when setting out the path and in gauging actual performance. We should not become involved in an exercise in short-term fine tuning.

In recent meetings we have put a lot of effort into developing performance indicators for individual countries. I have to say that I have considerable doubts whether we can usefully take that exercise much further. I believe it would be far more useful to devote our efforts to monitoring the performance of the group as a whole, so that we can ensure that we maintain the correct non-inflationary policy stance".

Exchange Rates

4. The G7 Communique of 23 December re-emphasised the agreement to co-operate to foster exchange rate stability.

5. The Chancellor argued in his Autumn Statement Speech of 14 January that 'a readiness by countries to commit themselves to some form of exchange rate stability is a way of securing wider co-operation on economic policy..... If countries are indeed prepared to accept wholeheartedly..... exchange rate commitments..... they will find themselves obliged to pursue domestic policies which are consistent with their exchange rate objectives'.

6. The Chancellor was at pains to stress that he was 'not suggesting a return to anything like the rigid exchange rate system that applied under Bretton Woods. However, 'there are clear advantages in a more managed approach designed to prevent the wild gyrations of recent years, particularly in the dollar, and in so doing achieving greater international co-operation in economic policy more generally'.

STATISTICAL TABLES

- A: Output and Demand**
- B: Inflation**
- C: Current Account Balances**
- D: General Government Budget Deficits**
- E: Short Term Interest Rates**
- F: Spot and Effective Exchange Rates**

A. OUTPUT AND DEMAND (CHANGES IN PERCENT)

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
<u>Real GNP/GDP</u>				
Canada	3.3	3 $\frac{3}{4}$	2 $\frac{3}{4}$	2 $\frac{1}{4}$
United States	2.9	2 $\frac{3}{4}$	2 $\frac{1}{2}$	1 $\frac{3}{4}$
Japan	2.4	3 $\frac{1}{2}$	3 $\frac{1}{2}$	3
Germany, FED. REP. of	2.5	1 $\frac{1}{2}$	1 $\frac{1}{2}$	1 $\frac{1}{4}$
France	2.0	1 $\frac{1}{2}$	1 $\frac{1}{2}$	1 $\frac{1}{4}$
Italy	2.7	2 $\frac{3}{4}$	2	1 $\frac{3}{4}$
United Kingdom	3.3	3 $\frac{3}{4}$	2 $\frac{3}{4}$	1 $\frac{3}{4}$
Major Industrial Countries	2.8	2 $\frac{3}{4}$	2 $\frac{1}{2}$	1 $\frac{3}{4}$
<u>Real Total Domestic Demand</u>				
Canada	3.9	4	2 $\frac{3}{4}$	2
United States	3.9	2	1	1
Japan	4.0	4 $\frac{1}{4}$	4	3 $\frac{1}{4}$
Germany, FED. REP. of	3.7	2 $\frac{1}{2}$	2 $\frac{1}{4}$	2
France	3.7	3	1 $\frac{1}{2}$	1 $\frac{1}{4}$
Italy	3.2	4 $\frac{1}{2}$	2 $\frac{1}{2}$	2 $\frac{1}{4}$
United Kingdom	3.8	3 $\frac{1}{2}$	3 $\frac{3}{4}$	2 $\frac{1}{4}$
Major Industrial Countries	3.8	3	2	1 $\frac{1}{2}$

Source: OECD Economic Outlook, December 1987

B. INFLATION (CHANGES IN PERCENT)

	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
<u>GNP/GDP Deflator</u>				
Canada	2.9	4 $\frac{3}{4}$	4 $\frac{1}{4}$	3 $\frac{1}{2}$
United States	2.6	3	3 $\frac{1}{2}$	3 $\frac{3}{4}$
Japan	1.8	- $\frac{1}{4}$	1	1 $\frac{1}{2}$
Germany, FED. REP. of	3.1	2 $\frac{1}{2}$	1 $\frac{3}{4}$	1 $\frac{3}{4}$
France	4.7	2 $\frac{3}{4}$	2 $\frac{3}{4}$	2 $\frac{1}{2}$
Italy	8.0	5 $\frac{3}{4}$	5	4 $\frac{1}{4}$
United Kingdom	3.5	4	5 $\frac{1}{4}$	5
Major Industrial Countries	3.1	2 $\frac{3}{4}$	3 $\frac{1}{4}$	3 $\frac{1}{4}$
<u>Consumer Prices</u>				
Canada	4.2	4 $\frac{1}{4}$	4	3 $\frac{1}{2}$
United States	2.2	4	4	3 $\frac{3}{4}$
Japan	0.6	$\frac{1}{4}$	1 $\frac{3}{4}$	2
Germany, FED. REP. of	-0.5	$\frac{3}{4}$	1 $\frac{3}{4}$	1 $\frac{1}{2}$
France	2.5	3 $\frac{1}{4}$	2 $\frac{3}{4}$	2 $\frac{1}{2}$
Italy	6.1	5	4 $\frac{3}{4}$	4 $\frac{1}{4}$
United Kingdom	3.6	3	4 $\frac{1}{2}$	4 $\frac{1}{4}$
Major Industrial Countries	2.1	3	3 $\frac{1}{4}$	3 $\frac{1}{4}$

Source: OECD Economic Outlook, December 1987

C. CURRENT ACCOUNT BALANCES

	1986	1987	1988	1989
CURRENT ACCOUNT (IN BILLIONS OF US DOLLARS)				
CANADA	-7	-7	-7	-7
UNITED STATES	-141	-156	-134	-105
JAPAN	86	86	81	79
GERMANY, FED. REP. OF	37	44	41	32
FRANCE	3	-3	-5	6
ITALY	4	-2	-4	-4
UNITED KINGDOM	-2	-3	-6	-9
MAJOR INDUSTRIAL COUNTRIES	-20	-41	-35	-21

CURRENT ACCOUNT (IN PERCENT OF GNP/GDP)

CANADA	-1.9	-1.7
UNITED STATES	-3.4	-3.5
JAPAN	4.4	3.6
GERMANY, FED. REP. OF	4.1	3.9
FRANCE	0.4	-0.3
ITALY	0.7	-0.3
UNITED KINGDOM	-0.3	-0.6
MAJOR INDUSTRIAL COUNTRIES	-0.2	-0.4

Source: OECD Economic Outlook, December 1987.

**D. GENERAL GOVERNMENT BUDGET DEFICITS
(IN PER CENT OF GNP/GDP)**

	1986	1987	1988	1989
CANADA	5.5	4.4	3.3	4.0
UNITED STATES	3.5	2.4	2.4	2.3
JAPAN	0.9	1.2	1.1	1.0
GERMANY, FED. REP. OF	1.2	1.7	2.3	2.7
FRANCE	2.9	2.8	2.7	2.5
ITALY	11.2	10.3	10.0	9.8
UNITED KINGDOM*	2.6	2.1	1.9	1.9
MAJOR INDUSTRIAL COUNTRIES	3.2	2.7	2.6	2.6

Sources: OECD Economic Outlook, December 1987

* The OECD estimates for the UK are almost certainly significantly too high.

TABLE E: NOMINAL AND REAL
SHORT TERM INTEREST RATES
(IN PERCENT, PERIOD AVERAGES)

	1984	1985	1986	1987	1987				1988
					Q1	Q2	Q3	Q4	15 Feb
<u>Nominal Rates</u>									
Canada	11.1	9.4	9.0	8.4	7.5	8.4	9.0	8.9	8.6
United States	9.8	7.7	6.2	6.9	6.0	6.8	7.0	7.9	6.6
Japan	6.3	6.7	5.1	3.9	4.1	3.8	3.7	3.9	3.8
Germany, Federal Republic of	6.0	5.4	4.6	4.0	4.2	3.8	4.0	4.1	3.3
France	11.7	9.9	7.7	8.2	8.3	8.1	7.9	8.5	7.6
Italy	17.1	14.9	12.6	11.5	11.5	10.6	12.0	11.8	11.0
United Kingdom	9.9	12.2	10.9	9.7	10.6	9.2	9.8	9.2	9.3
<u>Real Rates*</u>									
Canada	7.1	5.2	4.2	4.0	3.3	3.6	4.2	4.7	4.4
United States	6.8	5.1	3.1	3.2	3.8	3.0	2.7	3.3	2.2
Japan	4.5	6.2	5.7	4.0	5.4	4.0	3.3	3.3	3.3
Germany, Federal Republic of	3.7	4.8	4.4	3.7	4.7	3.6	3.3	3.1	2.6
France	5.8	5.6	3.6	4.8	4.9	4.6	4.4	5.3	4.5
Italy	7.1	7.1	7.9	6.5	6.9	5.9	6.7	6.6	6.0
United Kingdom	4.3	6.8	6.2	5.4	6.4	4.8	5.3	5.1	6.0

* Deflated by increases in consumer prices.

**TABLE F: SPOT EXCHANGE RATES
AND NOMINAL AND REAL EFFECTIVE EXCHANGE RATES
(PERIOD AVERAGES)**

	1980	1985	1986	1987	1987				1988
					Q1	Q2	Q3	Q4	17 Feb
SPOT EXCHANGE RATES (CURRENCY UNITS FOR US DOLLAR)									
Canada	1.17	1.37	1.39	1.33	1.34	1.33	1.32	1.31	1.27
Japan	227	239	169	145	153	143	147	136	130
Germany, Federal Republic of	1.82	2.94	2.17	1.80	1.84	1.81	1.84	1.71	1.70
France	4.23	8.99	6.93	6.01	6.12	6.03	6.13	5.75	5.76
Italy	856	1909	1491	1297	1306	1300	1331	1249	1255
United Kingdom (US/Pound)	2.33	1.30	1.47	1.64	1.54	1.64	1.62	1.75	1.75
EFFECTIVE EXCHANGE RATE (1980=100)									
<u>In Real Terms*</u>									
Canada	100	114.2	105.5		106.2	104.9	106.6		
United States	100	143.7	110.3		97.4	93.4	95.3		
Japan	100	106.1	133.0		134.4	142.2	135.6		
Germany, Federal Republic of	100	89.3	99.0		108.1	106.9	107.0		
France	100	90.0	93.5		94.8	93.5	93.0		
Italy	100	110.0	112.9		117.1	115.0	115.7		
United Kingdom	100	85.6	80.2		75.9	79.9	79.0		
<u>In Nominal Terms (1975=100)</u>									
Canada				77.9	78.2	77.5	78.5	77.5	80.0
United States	93.8	140.7	114.9	101.2	104.2	101.1	102.5	97.0	95.4
Japan	126.2	160.7	202.6	219.6	210.1	222.9	218.0	229.0	237.8
Germany Federal Republic of	129.0	123.8	137.1	147.6	147.7	146.9	146.4	149.8	148.9
France	93.9	66.0	70.1	71.8	72.0	71.6	71.4	72.2	71.7
Italy	67.2	45.1	46.8	47.6	48.4	47.5	47.1	47.5	46.9
United Kingdom	96.1	78.2	72.8	72.7	70.0	72.7	72.7	74.9	74.3

* Relative unit labour costs.

TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES

27-28 FEBRUARY 1988

BRIEF No 3. DEBT

OBJECTIVES

1. To reconfirm key elements of present debt strategy.
2. To emphasise the distinction between middle income debtors and the low income debt distressed countries of sub-Saharan Africa.
3. To ensure summit gives credit for sub-Saharan African initiatives and avoids detailed discussion of middle income debt.
4. To resist calls for Government involvement in managing commercial bank debt.
5. To welcome further development of voluntary, market oriented schemes agreed between debtors and banks, against the background of a strengthening in the banks' financial position.

POINTS TO MAKE

1. Objective for all debtors remains a return to creditworthiness. Current strategy - economic adjustment by debtors supported, where appropriate, by finance from creditors - remains best way of achieving this.
2. Low income debt distressed countries (LIDDs) of sub-Saharan Africa have no hope of repaying their debt in full. Most of their debt is owed to governments and IFIs who can therefore act directly to relieve the burden. UK taking leading role; eg ESAF, Chancellor's initiative for relief of Paris Club debt, World Bank special programme of assistance. Essential that these additional resources are used to support sound economic reform. Must take credit at summit for various initiatives.

3. Will continue to argue for some form of interest relief in Paris Club, but prepared to consider alternative equivalent solutions involving reasonable burden-sharing.

4. Middle income countries have the resources to be able to service their debt in longer term provided appropriate policies are adopted. Most of their debt is owed to commercial banks: primarily a matter for negotiation between the debtors and the banks. Summit should not solely concentrate on middle income debtors. No scope for major new initiatives.

5. IMF and World Bank reviewing their roles in debt strategy in run up to Spring meetings. Summit will take its cue from them. IMF seeking ways of increasing and liberalising terms of lending to the middle income countries eg EFFs. Any expanded use of the EFF will require strong conditionality. Key role of IFIs must continue to be support of strong adjustment programmes by debtor countries.

6. Welcome recent innovative, market related voluntary schemes eg debt/equity, securitisation and recent Mexico scheme. No question of government funding or guarantees for commercial bank debt relief schemes. Carries major risk of bailing out the banks. Mexico scheme carries no cost to US Government. Must leave it to banks to decide whether they wish to participate and avoid indicating in any way that they should grant debt relief.

7. Recent statements by Brazil that moratorium caused greater losses than gains very welcome. Should discourage others from unilateral action.

8. Concerned about weakening reform process. Helps neither debtors nor creditors. Need coordinated G7 action through strengthened arrangements among EDs and between capitals. Attention now on Argentina. UK abstention on recent SBA a demonstration of our commitment to restoring stronger conditionality.

9. Paris Club has yet to agree reductions in interest rates for even the LIDDs. But reviewing its procedures and aware of calls from banks for more flexibility in rescheduling periods. UK hopes to play a constructive role here.

10. UK has welcomed increases in provisioning by commercial banks. A sensible prudential measure. But provisioning should reflect underlying riskiness of the debt concerned. Excessive provisioning may send wrong signals to debtors.

BACKGROUND

1. Canadians suggest that summit should mainly concentrate on middle income debtors. Since last year's Spring Meetings of the IMF/IBRD where the Chancellor launched his initiative for sub-Saharan Africa, the emphasis in coming forward with new initiatives has been on the poorest debtors:

- a) Chancellor's initiative, launched last April has been followed by longer rescheduling periods in the Paris Club and we are still pressing for other creditors to agree to reduce interest rates or find alternative solutions of equivalent effect.
- b) UK has played key role in the newly agreed Enhanced Structural Adjustment Facility (ESAF)
- c) Also strongly support the World Bank's special programme of action for these countries.

These initiatives have yet to be implemented and many debtor countries still have to make painful adjustments to policies. So wrong to assume problems of the poorest countries have been solved: their problems have been widely recognised and some solutions adopted. But still a long way to go.

2. Even so, inevitable that summit will also cover middle income countries. UK, US and Canada are all reviewing the position of these debtors and the policy response. Key elements are:

- a) Progress by debtors has been mixed, overall debt has continued to rise, debt ratios have continued to worsen and secondary market prices have fallen. For most debtors, creditworthiness is no closer.
- b) Commercial banks have considerably increased their provisioning and strengthened their capital base.
- c) Financing agreements between the banks and debtors, based on a menu approach, are increasingly taking over from straightforward concerted lending arrangements which are proving hard to negotiate..
- d) On current plans, of the IFIs only the World Bank will be providing net new money.
- e) Brazil has acknowledged that its recent moratorium was a mistake
- f) The Mexico debt buy back scheme is seen by some as a first step towards commercial banks granting debt relief.

3. Handling of commercial bank debt must be for banks and debtors to decide between them. Concerted lending is playing a diminishing role. There is room for an increased range of market approaches, including securitisation, debt/ equity swaps and debt buyback. But any relief, as compared to full servicing of the debt, will represent a step away from creditworthiness. Important therefore to avoid endorsing debt relief as a general principle. Banks themselves are avoiding any suggestion that there should be debt relief and play down the significance of the Mexico scheme.

4. Even debtors who pursue effective adjustment policies are unlikely to regain early access to market finance on any significant scale. But debtors who establish a track record will be able to look to creditors, including non-bank investors for extra finance in the longer term.

5. Need to review role of IFIs and Governments in this context. Main role of IFIs will continue to be provision of funds in support of adjustment. But need to look closely at burden sharing issues if banks neither lending nor offering relief. World Bank General Capital Increase (GCI) should have been agreed by the time of the sherpas' meeting. Fund considering extending its lending to the middle income countries through the EFF: on current projections it will be providing no net new money to these countries in foreseeable future. It will be important to attach conditionality to any extra funds but difficult to do so. Further consideration of the Fund's precise proposals will be necessary. There is also a need for closer cooperation between the Fund and Bank if the Fund is to lend in support of longer term adjustment.

6. Over the last year there has been a weakening of conditionality at the Fund and Bank. Even though some debtors are not pursuing effective policies, eg Argentina, there is pressure, in particular from the US to provide funds nevertheless so as to avoid confrontation with the commercial banks. This pressure is likely to increase in US election year. UK has been trying to get increased cooperation among G7.

7. Also may be scope for IFI involvement in market related solutions. No proposals yet put forward. We would look very closely at the implications for the IMF's and World Bank's financial standing in any such proposals. World Bank decided not to offer to issue bonds to collateralise Mexico scheme.

8. Any proposals for either relief in the Paris Club or government funding of commercial bank debt likely to be non starters. Governments have been unable to agree to offer relief to the very small group of LIDDs. But the Paris Club is currently reviewing its procedures and in doing so will bear in mind calls from the commercial banks for increased flexibility. We have given the ADB/Warburgs scheme a cautious welcome as a possible fallback if the Chancellor's proposal for interest rate relief does not run.

9. Commercial banks in most industrialised countries, particularly the UK and US have announced increased provisioning against loan losses since May of last year. In the UK the Bank of England has produced a matrix which gives guidance on the appropriate level of provisions in the light of a number of factors which determine the riskiness of the debt of each country. The Governor has recently warned against provisioning which cannot be justified on an analytical basis of this sort.

10. Average level of provisions varies between countries. This is because of differences in exposure and tax regimes and does not necessarily imply different judgements about the quality of the debt or attitudes to the debt strategy.

KEY STATISTICS

	1980	1982	1984	1986	1987
RATIO OF DEBT TO GDP (%)					
Baker 15	32	43	47	49	52
SSA	36	51	57	68	77

RATIO OF DEBT
TO EXPORTS(%)

Baker 15	168	269	273	349	348
SSA	145	213	221	271	302

VALUE OF
OUTSTANDING
DEBT(\$BN)

Baker 15	271	382	412	446	480
SSA	43	54	58	74	86

TORONTO ECONOMIC SUMMIT:

SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 4: TRADE AND AGRICULTURE

Objectives

- 1 To give further impetus to the GATT Uruguay Round as a defence against protectionism, and to promote UK aims for the Mid-Term Review.
- 2 To emphasise the importance of the new areas in the GATT Round, notably agriculture and services, and the need for an improved system of dispute settlement.
- 3 To endorse the need for reform of agricultural policy to remain high on the international agenda.
- 4 To continue to stress the potentially disruptive nature of protectionist proposals in draft US trade legislation and to reject bilateralism.
- 5 To stress the need for improved commercial relations between the EC and Canada notably through the early settlement of outstanding disputes.

Points to make

- 1 GATT system is the best defence against erosion of multilateral system and dangers of protectionism and bilateralism. Must seize opportunity of Uruguay Round not only to reinforce the existing GATT system but to extend disciplines into important new areas (services, intellectual property, investment). Integration of the developing countries and particularly NICs more closely into the GATT system must also be a priority.

- 2 Summit is an opportunity to secure political commitment to substantive progress. Must achieve best outcome possible to Mid-Term Review.

- 3 The Review will be in Montreal in early December. This will allow little time for preparation. MTR must mark significant progress on all main subjects covered at Punta del Este. Should try to reach agreement on specific items where ready (e.g. dispute settlement). Should aim to settle framework for further work on other complex issues (e.g. services).

- 4 Previous Summits have contributed importantly to progress on agriculture. Must prevent back-sliding. Heads of Government must strongly reaffirm their commitment to reform.

- 5 Useful statements of position tabled in Geneva. Must build on these to evolve a negotiation plan.

6 Important now to ensure that the negotiations are pursued energetically and constructively. We should aim to make real progress at the MTR, without deflecting our attention from the long term goals of reform. Too early to forecast what MTR result might be.

7 Uruguay Round alone not sufficient to prevent slide into protectionism. Essential that US Administration continue to resist such pressures in pending trade legislation. World trade has been subject to serious imbalances and heavy shocks in recent years. Some indication that US trade deficit beginning to decline in volume terms, Japanese surplus falling). Not time now to take action which would endanger this progress.

8 Must equally resist temptation to resort to bilateralism either for ostensibly liberal reasons (US/Korean agreement on intellectual property), defensive ones (US/Japan semi-conductors) or as a way of settling disputes.

9 Do not support proposal for a Trade Ministers' meeting linked to Summit. Would overload Summit machinery and risk getting institutionalised. Important of course that Trade Ministers meet and already several chances this year (Konstanz, OECD Ministerial, GATT MTR). Likely to be other opportunities in the future.

10 Welcome proposals for closer surveillance of development of

trade policies in GATT but do not see need for regular Ministerial meetings.

11 Welcome US/Canada FTA Agreement as trade liberalising move. Important that it should not entail new discrimination against trading partners. Concerned at number of current trade disputes between EC and Canada (liquor boards, blocked GATT panels etc.). Need to make a determined effort to resolve these problems within a multilateral framework.

BACKGROUNDGATT Uruguay Round

1 Substantive negotiations in the Uruguay Round got under way in January and the tempo of meetings is quick, with two negotiating groups meeting in each week. The supervising Trade Negotiations Committee agreed on 18 February that the Mid-Term Review should be held in Montreal on 5 December. A major UK (and increasingly a Commission) concern is that preparation for the MTR should not distract effort from the major long-term reforms of GATT structure and specific policies to which the Round is addressed.

2 Clearly the MTR will not be able to register equal progress across the whole of the negotiating field; but it should make progress on the main issues identified at the opening Ministerial meeting at Punta del Este in 1987. At present it seems generally accepted that the best prospects for progress lie in the institutional questions (dispute settlement, functioning of the GATT system); on the more 'difficult' and new issues, such as agricultural reform, the integration of the developing countries in the GATT system and rules on trade in services, it may be necessary to settle for agreement of broad principles to guide further work but we would not wish to settle for less, to prevent these issues slipping down the agenda for action.

3 Canada is vigorously supporting increased ministerial involvement in GATT. We support Ministerial meetings where they

have a role to play, but do not favour calling them for the sake of it. Thus we are against proposals for regular GATT Ministerial meetings but sympathise with Canada's wish to establish a more rigorous mechanism in GATT for surveillance of trade policy developments.

Agriculture in GATT

4 Agricultural policy reform is a major item within the Uruguay Round of multilateral trade negotiations which has now entered its second year. All the major players have submitted proposals, ranging from the US radical proposal for elimination of all support and protection by 2,000 (an objective shared - as an ideal, at least - by the Cairns Group including Canada) to the much more cautious and protectionist proposals of Japan and the Nordics. The EC proposals fall midway, making significant reductions in support the focus of long term reform, but noting the need to maintain the basic elements of the CAP (import protection and export subsidy, but at lower levels).

5 International attention is now focussing on the possibilities for the MTR in December 1988 (very much a US initiative). It remains unclear what of substance can be achieved for an MTR on agriculture. The Canadians will no doubt make proposals e.g. for short-term measures and a negotiating timetable for the rest of the Round. The US has not, however, accepted the need for a short-term package fearing that it could compromise the achievement of further substantial results.

6 Progress towards reform has been considerably helped by the Tokyo Summit, and particularly by the 1987 OECD Ministerial which laid out clear principles to govern this process which were reaffirmed at Venice last year. The GATT negotiation is now the forum in which practical progress must be made, and it is for the Toronto Summit to ensure that Heads of Government maintain the political impetus.

Protectionism

7 Protectionism is still a major danger, though the position has been improved through increased US competitiveness (following decline in the dollar) and the reduction in the Japanese surplus. It is still unclear whether there will be major US trade legislation this year. A strongly protectionist bill which the President would have to veto is less likely than it was, though a bill agreed between the Congress and the Administration could still have unwelcome features, some of which could be inconsistent with GATT (such as a requirement for automatic retaliation by the US in the event of alleged unfair trade actions by other countries).

Bilateralism

8 We deplore the increasing use by the US of bilateral solutions to trade problems so as to bypass agreed multilateral procedures (e.g. the US agreements on copyright protection with Korea and on semiconductors with Japan) and the provisions of the US trade bills which demand a bilateral approach.

Integration

9 Integration - getting the NICs to observe more of their GATT obligations and providing a basis for the LDCs progressively to integrate into the GATT system - remains a major UK priority for the Round.

Japanese proposals for a trade ministers' meeting

10 The Japanese are eager to get in on the act of trade ministers' meetings and had proposed such a meeting on the margins of or linked to the Summit, which we could not endorse. They are also angling for the closing meeting of the Uruguay Round (in 1990) to be held in Tokyo.

11 The latest Japanese proposal is for informal gatherings of G7 Trade Ministers in the margins of a wider Trade Ministers' meeting to be held at Konstanz (March 18-20) and of the OECD Ministerial (May). This proposal is being put to DTI Ministers, but our preliminary view is that it would be acceptable, provided that such meetings do not become institutionalised or linked in any way to the Summit.

12 Some representatives of the Commission are disputing Tokyo's claim to host the final meeting of the Round, arguing that at Punta del Este there was a gentlemen's agreement (of which we know nothing) that it should be in Brussels. We see no particular case against Tokyo, and holding the meeting there would give Japan a bigger political stake in observing agreements reached during the Round.

Canada

13 Canada is a vigorous participant in GATT and supporter of the GATT Round, particularly on agriculture.

14 The Canada/US Free Trade Area (FTA) Agreement is not comprehensive - certain topics like intellectual property have just been shelved as too difficult. But it is an important market-opening move. We are looking at it carefully to ensure that it does not entail unjustified discrimination against other trading partners. GATT provides for the conclusion of FTA agreements on customs unions, subject to the condition that overall levels of protection are not increased.

15 EC/Canada trade relations are often fairly tense and following an improvement last year are so again. Canada is currently blocking the adoption of four GATT Panels, three of which are cases where the panels found for the EC against Canada (discriminatory mark-ups of provincial liquor boards; beef; pasta). Attempts to negotiate a bilateral settlement with Canada to the liquor board problem have failed. An approach by Sir Geoffrey Howe to Joe Clark at the end of the UK Presidency in 1986 about ways of improving overall EC/Canadian trade relations met with a very sharp rebuff.

16 The total volume of EC/Canadian trade was US\$17 bn in the year ended September 1987. Against this the issues in dispute

are minor irritants, but persistent. The Article 113 Committee recently concluded that the Canadians should be pressed hard to behave better on these specific points.

Department of Trade and Industry

19 February 1988

TORONTO ECONOMIC SUMMIT:

SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 5. FINANCIAL MARKET MECHANISMS

OBJECTIVES

- ①
- 1 To respond positively to the Canadian proposal but insist that further preparation needs to be done in advance of the Summit if there is to be any prospect of a useful discussion or follow-up.
 - 2 To offer to help the Canadians work up a proposal.
 - 3 To acknowledge the need for improved international co-ordination between those responsible for the supervision of banks and securities firms. There are currently no institutional arrangements for doing this.
 - 4 To ensure that the follow-up involves the countries and institutions most directly involved: G10 cover the right countries and the Cooke Committee covers banking but there is need for a parallel committee covering securities, with links into the Cooke Committee and IOSCO. (The OECD coverage is too broad and academic in its approach; G7 is too narrow.)
- ✓

BACKGROUND

- not included
- 5 The Canadian proposal has not been properly thought through: it apparently stems from a personal interest of Mrs Ostry. Nonetheless, it coincides with the feelings of the SEC in the USA and others in the G7 countries. There will be an opportunity before the summit to make informal soundings of those others to see what institutional framework is thought desirable.
 - 6 Work is already going on in a number of fora. The OECD is conducting studies. The Cooke Committee is considering banks' securities business. It is regulators who are best placed to develop these initiatives.
 - 7 On market structure - Each member country of G7 suffered to a greater or lesser extent from the crash in share prices in October 1987. The reports emanating from the USA are of interest to everyone but their recommendations (even when they are in accord with each other) are not always relevant or apposite to other countries. Different conditions, sizes, techniques and requirements all need different structures and mechanisms.
- 1/5

BRIEF NO 5. FINANCIAL MARKET MECHANISMS

OBJECTIVES

1. To respond positively to the Canadian interest in this subject and informally encourage them and others to pursue it with us, while expressing doubts over whether the Summit is the right forum for it.

POINTS TO MAKE

2. Clear need for increased cooperation between securities regulators has been widely recognised since the October crash.

3. Worth distinguishing three aspects of the problem, while recognising that they are to some extent inter-related:

- safeguards against systemic financial risks: these must be primarily for central banks, who have well established fora for policy coordination;
- market structure questions (such as some of the points raised in recent US reports): an area in which securities supervisors should lead and recognise the need for international cooperation; and
- investor protection: an area for securities supervisors in their own markets, but with a keen interest in the standards of other markets also.

4. Work is already going on in a number of fora. The OECD is conducting some fact-finding studies. The Cooke Committee is considering securities business of banks. But regulators have an important role to play, and there is at present no convenient and authoritative international forum for them.

5. We want to encourage further contacts between regulators in different countries, and the development of a forum covering regulators of the major markets between whom cooperation could be of particular value. Must go wider than the G7 Summit group. Not clear ourselves of the best answer, and conscious of problems in the different status of regulators in different countries.

6. On market structures. [As previously drafted]

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BRIEF NO 5. FINANCIAL MARKET MECHANISMS

OBJECTIVES

1. To discourage Canadians from raising this subject in the Summit. There is no message that the Summit can usefully deliver, and the Summit is in any case too narrow a forum for this issue.
2. To distinguish the various aspects of this issue
 - prudential/systemic concerns, primarily matters for central banks who have well established fora for policy co-ordination.
 - market structure questions, such as those discussed in various US reports, an area in which securities supervisors should lead and are aware of need for international co-operation.
 - investor protection, again, a matter for securities regulators.
3. To encourage further contacts between regulators, who are in best position to establish right framework, while accepting that we do not currently see an appropriate forum of securities regulators for taking this forward.

POINTS TO MAKE

4. Clear need for increased co-operation between securities regulators, widely recognised since the crash. Must clarify distinction between systemic issues, which are for financial authorities, and market structure/investor protection issues which are for securities regulators. We should support direct contact between securities regulators, to improve co-ordination. But immediate role for Governments is to deal with the macro-economic imbalances that contributed to the loss of confidence in October.
5. Work is already going on in a number of fora. The OECD is

conducting studies. The Cooke Committee is considering banks' securities business. It is regulators who are best placed to develop these initiatives.

6. [(If raised) We would not object to extending the scope and functions of the "Wilton Park Group" if it was the wish of other G7 countries. (Its current membership covers the world's 11 leading securities markets.)]

7. On market structure - Each member country of G7 suffered to a greater or lesser extent from the crash in share prices in October 1987. The reports emanating from the USA are of interest to everyone but their recommendations (even when they are in accord with each other) are not always relevant or apposite to other countries. Different conditions, sizes, techniques and requirements all need different structures and mechanisms.

CONFIDENTIAL**BACKGROUND**

1. The Canadians are keen to discuss recent proposals for changes in financial market mechanisms following the October crash and the various US studies (see para below). This is clearly not material suitable for the Summit, rather, it is for discussion amongst securities market (and banking) supervisors.

2. But there is a problem here, in that there is no tradition of co-operation between securities market supervisors, and none of the current fora are well suited for taking this forward. There are signs that the existence of this gap is now generally realised by the relevant supervisors, but the widely differing approach to securities regulation in different countries means that it may take some time to establish effective co-operation. The best strategy, at this stage, is to allow the regulators to establish co-operation mechanisms.

Stock Market Crash:

3. It is now generally accepted that the immediate cause of the stock market crash was the perception by investors world-wide that equities were overvalued. Uncertainty about governmental policies stemming from the budget and trade deficits of the US and the trade surpluses of Japan and Germany triggered the crash in prices.

4. The nature of the crash in prices has been the main area for examination in the studies which have been undertaken. The bulk of these (both in number and weight) have emanated from the USA. (None have emerged from Japan!) The speed with which prices fell was the unique element which tested market mechanisms. The areas under closest scrutiny are:

- i. globalisation, the way markets influence one another, with possible spiral effect,
- ii. new market technology and techniques; programme trading, index arbitrage, portfolio insurance,

- iii. the relationship between stock index futures and options markets and the market in the underlying securities,
- iv. the effectiveness of the national regulatory arrangements.

5. DTI is preparing a "study of the studies" for the Secretary of State, which is to be completed by end March. Other reports have been published (see Annex).

International Co-Operation

6. The "Wilton Park" group is an informal gathering of international securities regulators who have so far met three times since December 1986 (most recently February 1987). It meets at UK invitation and under UK chairmanship. Eleven countries took part in the February 1988 meeting; Australia, Canada, France, FRG, Hong Kong, Italy, Japan, Netherlands, Switzerland, UK and USA. It considers matters relating to the enforcement of regulations including the nature and operation of bilateral agreements and the exchange of information.

7. The International Organisation of Securities Commissions and Similar Agencies (IOSCO) and its committees meets primarily in order to examine technical problems. Participants include securities commissions and stock exchanges from a wide range of countries (including third world). The Canadians are heavily involved in this which is based in Montréal. Support is from a central secretariat. There are some doubts as to its effectiveness not least due to difficulties in funding and the wide range of participants. We would not consider this the right forum for major initiatives on securities co-operation.

8. The Cooke Committee of Banking supervisors is also looking at how to harmonise treatment of banks' securities business.

9. **CONFIDENTIAL**: There have been recent important bilateral initiatives: the Bank of England and the Securities and Investments Board held a meeting in February with the US Federal Reserve Board and Securities and Exchange Commission on co-operation in the area of the financial integrity of British and American markets and the firms operating in both. It is hoped that Japan will

join this initiative in due course. No publicity is being given to the real objective because of (i) possible adverse reaction of non-participating countries and (ii) European Community competence in the area of banking supervision. Multi-lateral co-operation should not be allowed to slow down these bilateral initiatives but the bilateral (or trilateral) discussions will need to be widened as soon as there is an appropriate multilateral forum to take this forward.

ANNEX : SUMMARY OF REPORTS SO FAR PUBLISHED

- i. The International Stock Exchange report was the first formal UK study to be published. It concludes that the decision to keep the market open was correct because the cost of closure on users would outweigh the cost of adjustments which market makers can make to protect their position. It pointed out that the old pre Big Bang system, in the UK, could not have absorbed the £250m of stock which was absorbed during 19 October. In that week turnover in foreign equities and American Depository Receipts rose sharply, suggesting that foreign investors found London to be a relatively liquid and accessible market. It recommends the development of faster execution services with increased capacity to handle higher volumes. It also proposes the development of arbitrage techniques to prevent UK futures and cash markets getting out of step.

- ii. The New York Stock Exchange commissioned a report on programme trading from Mr Katzenbach, a former Attorney General. He found that futures serve a legitimate hedging function but they can have an undesirable impact on equities when the two are linked through trading. His main recommendation is to merge the SEC and CFTC. His study made proposals about how stock index futures should be traded and recommends a new type of contract and increases in margins and capital requirements.

- iii. The Brady Commission, appointed by the US President, has compiled a very lengthy report. It calls for action to protect the market from violent shifts. It recommends one "super regulator", preferably the Federal Reserve Board, to co-ordinate the financial system. The Brady Commission argued for changes to the clearing systems and for information to monitor transactions in related markets. Its other two main recommendations are that margins should be harmonised to control speculation and financial leverage, and that "circuit breaker mechanisms" (eg price limits and trading halts) should be formulated and implemented.

iv. The Commodities and Futures Trading Commission has published a three part report. This argues that futures connected trading did not constitute a major part of NYSE volume on or after 19 October. It suggests that many institutional investors used the futures market as a safety valve and that this lessened the decline in prices on the stock market. Recommendations include changes to the clearing system to improve capacity and information exchange, improved surveillance by self regulating organisations through increased central computerised data and the routine use of intra day margin calls.

v. The Securities and Exchange Commission has published a detailed analysis of the market break and its Chairman, David Ruder, presented a set of recommendations in testimony to the Senate Committee on Banking. The two fundamental conclusions were that the three markets (stocks, stock index futures, stock index options) are unified and that new trading mechanisms can cause peak volume and volatility, sufficient to overwhelm the capacity of markets. The recommendations include three types of operational reform; changes to increase the capacity of each of the individual markets to respond to new market structures and trading strategies; changes to improve co-ordination among the markets; changes to retard, at least during crisis periods, the increased velocity and volume of intermarket and intramarket trading. The SEC also recommends a temporary increase in margin requirements for stock index futures so that more permanent reforms may be studied. It argues that all equity related products should be regulated through mandated co-ordinated regulation, if not by one agency. It recommends improvements in specialist and market maker performance, capital adequacy and clearing and settlement. It acknowledges that the market for US equities includes the major foreign markets.

vi. The Chairman of the Federal Reserve Board, Alan Greenspan, gave evidence to the Senate Banking Committee. He argued that price limits and other circuit breakers may be inherently destabilising but may also be the "least bad" solution. Oversight should be the responsibility of a merged or joint authority but not solely that of the Federal Reserve. He agreed with

Brady that improvements are needed in the clearing system.
He agreed to prepare a specific list of recommendations by
4 March 1988.



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27-29 FEBRUARY 1988
BRIEF NO 6 SCIENCE

OBJECTIVES

1. To support any moves by other Summit countries to raise broad issues of international co-operation in science at the Toronto Economic Summit and to stress that international co-operation rather than competition avoids duplication of effort (e.g. the Americans should increase their support for CERN rather than start their own ambitious SSC).

LINE TO TAKE (If raised)

International co-operation.

1. The costs of large scale scientific endeavours are becoming increasingly prohibitive. We all face hard choices. One answer is to collaborate internationally rather than to compete and duplicate. (The stimulus of intellectual competition will continue.) Cost pressures put a premium on improved management of international projects too.

No
2. It should not be necessary for Summit leaders to consider international scientific co-operation in any detail. But they could endorse this underlying philosophy, and ask the Chief Scientists of Summit countries to study the issues.

3. The US ideas on a framework of common principles for international co-operation in science and technology could merit some acknowledgement by Summit leaders if the continuing discussions on them in OECD make sufficient progress.

Human Frontier Science Programme (HFSP).

4. There are no issues here which need to be put to leaders at the Summit. Good progress has been made, under Japanese leadership, in narrowing down the scientific scope. But the practical administration is still unclear and needs to be discussed much more thoroughly. (If pressed) It is premature to speak of financial commitments but, as their initiative, we assume the Japanese will be showing the way.

BACKGROUND

1. Budgetary pressures have prompted the UK to make a rigorous re-assessment of its priorities and we have, for example, not increased our space funding and are pressing for lower contributions to CERN and to the new European Synchrotron Radiation Facility, ESRF. Our partners are not yet in similar difficulties although there are, for example, rumblings of doubt among the German scientific community about the scale of commitment to prestige projects such as space and the Americans want to share the huge costs of their superconducting super-collider, SSC, and research on fusion. The Toronto Summit could help push discussion in a direction helpful to us, especially if the European participants there gave a clear message to the Americans that they should increase their contribution to CERN.

2. We should not, however, wish to give the Japanese the pretext to seek promises of financial contributions to their **Human Frontier Science Programme, HFSP**, for the joint study inter alia of molecular biology and brain function. They raised this at the Venice Summit in 1987. Officials and scientists are conducting a feasibility study which is due to be concluded in March 1988 when the Japanese Government is expected to consider its recommendations. Most Summit countries share our view that finance for the first three to five years should be provided by Japan as an earnest of their good intent but that our own related research efforts could complement the HFSP.

3. The **US Framework of Common Principles for International Co-operation in Science and Technology** follows an initiative by President Reagan's Science Adviser, Dr William Graham, at the OECD. Conceived as a blunt instrument to attack Japanese under-funding of basic science, it may provide a means for improving understanding on the importance of international co-operation and countering the "technology protectionists". But much work is still needed before it can be decided that a text is ready even for the OECD Ministerial in May.

4. High Energy Particle Physics, HEPP, is a prime example of expensive science. **CERN** has the leading experiments. Huge costs are against the Americans futuristic superconducting super-collider, **SSC**, but President Reagan has backed it in principle and US scientists want to take the lead back from

At the same time as we are using a bit in the Budget Report.

Europe. The Japanese too have their own major facility, Tristan.

5. The commercial application of **fusion** technology for power generation remains distant and the research is costly. JET at Culham financed by the EC is the leading experiment. The way forward may be to build on wider international collaboration, e.g. the ITER studies between EC, US, Japan and the Soviet Union instituted following the Reagan/Gorbachov Summit in Washington last year.

6. Another candidate for wider international collaboration is **sequencing the human genome** i.e. the human genetic blueprint. There is no proposal at present to bring together separate national work on this huge task. However, the Italians may mention that they will be hosting this year's conference on bioethical issues for Summit Seven countries. It will be held in Rome on 11-15 April on the subject of "Human Genome Sequencing : The Ethical Issues". We understand that the Americans may be ready to host the next conference in 1989. Thereafter only the UK among Summit countries will not have hosted such a conference.

7. The Working Group on **Technology Growth and Employment**, which was set up on French initiative at the Versailles Summit in 1982, reported to successive Summits until Tokyo in 1986. It then disbanded in accordance with the principle that permanent machinery should be avoided. It could equally easily be reconvened if Summit leaders agreed that international science and technology issues again required study.

International Group
Science and Technology Secretariat
Cabinet Office

19 February 1988



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TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES

27 - 29 FEBRUARY 1988

BRIEF NO 7. Environment

OBJECTIVES

1. To resist proposals for taking environmental issues as a substantive agenda item.
2. To support any proposals for a general statement of welcome for the report of the World Commission on Environment and Development, while resisting detailed discussion of the report.

POINTS TO MAKE (IF NECESSARY)

1. Environmental issues were fully aired at the 1985 Bonn Summit, following the 1984 meeting of the Environment Ministers of Summit countries in London. Since then Summit leaders have twice reaffirmed their commitment to cooperation on the environment. No issues have arisen which merit their renewed attention.
2. General statement of welcome for the report of the World Commission on Environment and Development would be appropriate. UK supports the report's basic message of "sustainable development". But not an appropriate subject for detailed examination by Summit.

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BACKGROUND

1. Since the 1985 Summit the Germans have continually pressed for renewed prominence for environmental issues in the Summit context. They have had instead to be contented with references to "attaching importance to cooperation", "encouraging efforts to tackle problems" etc. in the 1986 and 1987 communiques.
2. They and possibly the Canadians may try again in 1988, but nothing new has occurred to justify this.
3. There is also a chance that the Canadians will want to give attention to the report of the World Commission on Environment and Development (WCED), published in April 1987. Other Summit countries have so far reacted less enthusiastically to WCED than the Canadians, but the UK has gained credit by its generally supportive stance, which we aim to build upon.
4. The detailed recommendations of the report (some of which cause us difficulty) are not appropriate for the Summit to involve itself with but the UK would support a suitable, general statement of welcome.

Department of the Environment
15 February 1988

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TORONTO ECONOMIC SUMMIT:
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27-29 FEBRUARY 1988

BRIEF NO 8: AIDS

OBJECTIVES

1. Secure brief reference in Summit communique to AIDS problem.

POINTS TO MAKE [if raised]

2. Important to maintain momentum gained over last few months in international cooperative efforts to control spread of HIV infection.
3. Though separate statement along lines of that issued at Venice perhaps not justified this year, valuable if communique referred briefly to:

continuing importance of international cooperation;

leading role of WHO's Global Programme on AIDS in directing international cooperation;

role of public education as the major element in national AIDS programmes;

success of World Summit of Ministers of Health on Programmes for AIDS Prevention, London, January 1988, in highlighting both points;

commitment of the Seven to the London Declaration on AIDS Prevention.

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BRIEF NO 8: AIDS

BACKGROUND

- A 1. The Chairman issued a statement on AIDS at the Venice Economic Summit underlining the importance of international cooperation and the role of the World Health Organisation. The statement also highlighted the need for AIDS public education programmes and welcomed the convening of the World Summit of Ministers of Health on Programmes for AIDS Prevention, held in London on 26-28 January and jointly organised by HMG and the WHO.
- B 2. The Director-General sent a telegram of appreciation to the Prime Minister (and the other Heads of State and Government), who, in her reply, expressed the hope that the statement would help to strengthen international commitment to the WHO and referred to the World Summit of Ministers of Health.
- C 3. It is important to keep up momentum in the wake of the highly successful World Summit, at which 148 countries were represented, which provided an effective forum for the discussion of information and public education campaigns and which adopted a London Declaration on AIDS Prevention. Given the progress over the last few months in the strengthening of international cooperation on AIDS, a distinct statement at the Toronto Summit is probably unnecessary - though we would not oppose one in principle if others suggested it. On the other hand, it is important that the communique should confirm the continuing concern of the Seven and allude to the contribution of the World Summit of Ministers of Health.
- D

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4. The statement on AIDS issued at Venice also welcomed a proposal that President Mitterrand made at Venice - to general surprise - that there should be a committee on the ethical issues raised by AIDS. President Mitterrand subsequently invited the Twelve, the US, Canada and Japan each to nominate three experts to serve on the committee, which was to have had a first meeting in the autumn. The Prime Minister nominated the Government's Chief Medical Officer, Sir Donald Acheson, Rev Prof Gordon Dunstan and Sir Raymond Hoffenberg. We have heard nothing since. We are not convinced of the usefulness of a committee of this sort, but, if the idea is taken forward, are ready to play our part in its work.

NARCOTICS CONTROL & AIDS DEPARTMENT

18 February 1988

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On the basis of the concern already shown in the past for health problems (London Chairman's oral statement on cancer and Bonn Chairman's oral statement on drugs), the Heads of State or Government and the representatives of the European Community affirm that AIDS is one of the biggest potential health problems in the world. National efforts need to be intensified and made more effective by international cooperation and concerted campaigns to prevent AIDS from spreading further, and will have to ensure that the measures taken are in accordance with the principles of human rights. In this connection, they agree that:

- international cooperation will not be improved by duplication of effort. Priority will have to be given to strengthening existing organizations by giving them full political support and by providing them with the necessary financial, personnel and administrative resources. The World Health Organization (WHO) is the best forum for drawing together international efforts on a worldwide level to combat AIDS, and all countries should be encouraged fully to cooperate with the WHO and support its special programme of AIDS-related activities;
- in the absence of a vaccine or cure, the best hope for the combat and prevention of AIDS rests on a strategy based on educating the public about the seriousness of the AIDS epidemic, the ways the AIDS virus is transmitted and the practical steps each person can take to avoid acquiring or spreading it. Appropriate opportunities should be used for exchanging information about national education campaigns and domestic policies. The Heads of State or Government and the representatives of the European Community welcome the proposal by the United Kingdom Government to co-sponsor, with the WHO, an international conference at ministerial level on public education about AIDS;
- further cooperation should be promoted for basic and clinical studies on prevention, treatment and the exchange of information (as in the case of the E.C. programme). The Heads of State or Government and the representatives of the European Community welcome and support joint action by researchers in the Seven countries (as in the case of the joint programme of French and American researchers, which is being enlarged, and similar programmes) and all over the world for the cure of the disease, clinical testing on components of the virus, and the development of a successful vaccine. The Heads of State or Government and the representatives of the European Community welcome the proposal by the President of the French Republic aiming at the creation of an International Committee on the ethical issues raised by AIDS.

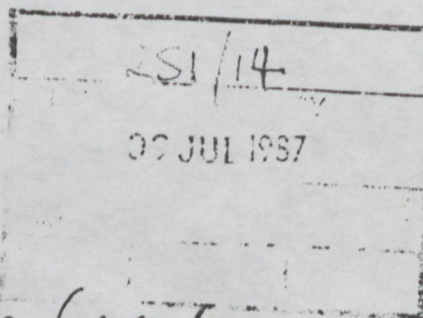
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10 DOWNING STREET

THE PRIME MINISTER

24 June 1987



35

Dear Director-General

Thank you for your message of 11 June.

The British Government hope that the Declaration on AIDS issued at the Venice Economic Summit will contribute to the strengthening of international commitment - both political and financial - to the work of the World Health Organisation in combating the spread of AIDS. We have every confidence that you and your staff will provide the leadership essential if international efforts are to be effectively co-ordinated, and we are particularly pleased to be co-sponsoring with the World Health Organisation the World Summit of Ministers of Health on AIDS in London from 26 to 28 January next year.

I should like to take this opportunity of assuring you of the British Government's continued support in this important task.

Yours sincerely
Margaret Thatcher

Dr. H. Mahler

Handwritten notes and signatures: J.B. Mrs Kelly, H.P., UKMI Geneva, J.B. Mrs Moxer, R.H., S.S.

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WORLD SUMMIT OF MINISTERS OF HEALTH ON PROGRAMMES FOR AIDS PREVENTION

LONDON 26-28 JANUARY 1988

JOINTLY ORGANISED BY THE WORLD HEALTH ORGANIZATION AND THE UNITED KINGDOM GOVERNMENT

WORLD SUMMIT OF MINISTERS OF HEALTH

LONDON DECLARATION ON AIDS PREVENTION

28 January 1988

The World Summit of Ministers of Health on Programmes for AIDS Prevention, involving delegates from 148 countries representing the vast majority of the people of the world, makes the following declaration:

1. Since AIDS is a global problem that poses a serious threat to humanity, urgent action by all governments and people the world over is needed to implement WHO's Global AIDS Strategy as defined by the Fortieth World Health Assembly and supported by the United Nations General Assembly.
2. We shall do all in our power to ensure that our governments do indeed undertake such urgent action.
3. We undertake to devise national programmes to prevent and contain the spread of human immunodeficiency virus (HIV) infection as part of our countries' health systems. We commend to all governments the value of a high level coordinating committee to bring together all government sectors, and we shall involve to the fullest extent possible all governmental sectors and relevant nongovernmental organizations in the planning and implementation of such programmes in conformity with the Global AIDS Strategy.
4. We recognize that, particularly in the absence at present of a vaccine or cure for AIDS, the single most important component of national AIDS programmes is information and education because HIV transmission can be prevented through informed and responsible behaviour. In this respect, individuals, governments, the media and other sectors all have major roles to play in preventing the spread of HIV infection.
5. We consider that information and education programmes should be aimed at the general public and should take full account of social and cultural patterns, different lifestyles, and human and spiritual values. The same principles should apply equally to programmes directed towards specific groups, involving these groups as appropriate. These include groups such as:
 - policy makers;
 - health and social service workers at all levels;
 - international travellers;
 - persons whose practices may place them at increased risk of infection;
 - the media;
 - youth and those that work with them, especially teachers;
 - community and religious leaders;
 - potential blood donors; and
 - those with HIV infections, their relatives and others concerned with their care, all of whom need appropriate counselling.

6. Emphasize the need in AIDS prevention programmes to protect human rights and human dignity. Discrimination against, and stigmatization of, HIV-infected people and people with AIDS and population groups undermine public health and must be avoided.

7. We urge the media to fulfil their important social responsibility to provide factual and balanced information to the general public on AIDS and on ways of preventing its spread.

8. We shall seek the involvement of all relevant governmental sectors and nongovernmental organizations in creating the supportive social environment needed to ensure the effective implementation of AIDS prevention programmes and humane care of affected individuals.

9. We shall impress on our governments the importance for national health of ensuring the availability of the human and financial resources, including health and social services with well-trained personnel, needed to carry out our national AIDS programmes, and in order to support informed and responsible behaviour.

10. In the spirit of United Nations General Assembly Resolution A/42/8, we appeal:

- to all appropriate organizations of the United Nations system, including the specialized agencies;
- to bilateral and multilateral agencies; and
- to nongovernmental and voluntary organizations

to support the worldwide struggle against AIDS in conformity with WHO's global strategy.

11. We appeal in particular to these bodies to provide well-coordinated support to developing countries in setting up and carrying out national AIDS programmes in the light of their needs. We recognize that these needs vary from country to country in the light of their epidemiological situation.

12. We also appeal to those involved in dealing with drug abuse to intensify their efforts in the spirit of the International Conference on Drug Abuse and Illicit Trafficking (Vienna, June 1987) with a view to contributing to the reduction in the spread of HIV infection.

13. We call on the World Health Organization, through its Global Programme on AIDS, to continue to:

- (i) exercise its mandate to direct and coordinate the worldwide effort against AIDS;

- (ii) promote, encourage and support the worldwide collection and dissemination of accurate information on AIDS;
- (iii) develop and issue guidelines on the planning, implementation, monitoring and evaluation of information and education programmes, including the related research and development, and ensure that these guidelines are updated and revised in the light of evolving experiences;
- (iv) support countries in monitoring and evaluating preventive programmes, including information and education activities, and encourage wide dissemination of the findings in order to help countries to learn from the experiences of others;
- (v) support and strengthen national programmes for the prevention and control of AIDS.

14. Following from this Summit, 1988 shall be a Year of Communication and Cooperation about AIDS in which we shall:

- open fully the channels of communication in each society so as to inform and educate more widely, broadly and intensively;
- strengthen the exchange of information and experience among all countries; and
- forge, through information and education and social leadership, a spirit of social tolerance.

15. We are convinced that, by promoting responsible behaviour and through international cooperation, we can and will begin now to slow the spread of HIV infection.



CONFIDENTIAL

TORONTO ECONOMIC SUMMIT: SECOND MEETING OF PERSONAL
REPRESENTATIVES 27-29 FEBRUARY 1988

Brief No. 9 Terrorism

Objectives

To secure crisp, new wording on terrorism in the main political
declaration.

(if raised)

Points to Make

- i) Believe terrorism may well arise during discussion. Do not
expect heads of government to spend much time on it.
- ii) If we are to say something on terrorism needs to be crisp and
new. Do not want to see tired reiteration of previous
wording.
- iii) If partners have suggestions for solid new elements for a
separate declaration on terrorism we are happy to consider
them. But believe it would be more realistic to include
language on terrorism in main declaration.

CONFIDENTIAL

BACKGROUND

- i) The first meeting of the Summit Seven Counter Terrorism Experts under Canadian chairmanship is due to take place on 21/22 March.

- ii) We have spoken informally to the Canadians about their intentions for a declaration on terrorism. Our view is that baring a major terrorist incident we should aim to include few terse sentences on standing firm against terrorism in a wider political statement.

- iii) Separate statements on terrorism were made at previous summits (texts below) but there is a danger of making statements just for the sake of it. Anything which we do say must be relevant, new and convincing.

- iv) Against a background of persistent rumours of French and German and even Italian deals on the release of hostages, it is hard to see what a new declaration might include without sounding hollow.

Security Coordination Department

19 February 1988



TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 10: TECHNOLOGY AND FOREIGN POLICY

OBJECTIVES

1. (If raised by others): To welcome further discussion by Foreign Ministers in September on assumption this will not appear on Toronto agenda.

POINTS TO MAKE

1. Sir G Howe sorry he was unable to manage March dates proposed by FRG for Foreign Ministers' meeting: unbreakable Cabinet and Parliamentary commitments. In principle discussion in New York over weekend before UNGA looks good.

2. Subject an intriguing one. Agree should not be handled bureaucratically. Discussion so far has drawn attention to several trends which need watching. But not clear what specific policy conclusions should be drawn.

3. Now that Foreign Ministers' meeting postponed to September, assume subject will not appear in its own right on Toronto agenda. (But would not want to exclude longer term analysis, eg evolution of East/West relations, in discussion of the normal range of foreign policy subjects).

BACKGROUND

1. At the Venice Summit, Shultz initiated a discussion of the implications of technological change for foreign policy. This was pursued at the Seven Foreign Ministers' dinner in New York in September at which it was agreed that the Germans would host an informal meeting in 1988 to take discussion forward. It has proved impossible to settle on mutually convenient dates in the Spring. The only ones convenient to Shultz (30-31 March) proved impossible for Sir G Howe, and the French and Japanese Foreign Ministers. Genscher has therefore proposed an informal meeting in or just outside New York over the weekend before the UNGA in September. The Americans are looking into this.

2. If this meeting does take place, it may not deal exclusively with the technology and foreign policy ideas. Genscher has suggested an even larger theme: "global trends" or "global imponderables". There is an obvious danger that discussion will move from the practical to the ethereal.

3. The key elements in the Shultz thesis, which have since been advanced in public in a speech in December 1987 (attached), are as follows:-

- a) We are in the "information age" in which knowledge and the methods of communicating it are the key to progress. Human talent (not geographical size, possession of raw materials etc) becomes the key to economic prosperity: "the ability to use information is the cutting edge of modernisation";
- b) The ever-accelerating pace of change in industrial etc processes;
- c) The technological backwardness of the socialist world;
- d) The steady erosion of the nation state as markets and productive processes are internationalised;
- e) The emergence and development of regional and functional groupings, fragmenting the bipolar post-war framework;
- f) The growth of terrorism and of Third World sources of weapons;

- g) The possibility of countries dividing into three basic categories:
- i) the technologically innovative and effective;
 - ii) the imitators, coping with but unable to influence the pace of change;
 - iii) the "lumpen proletariat" of those left behind.
- (The Americans privately put the US, Western Europe and Japan in the first category, but think the Soviet Union is slipping from the first to the second).

4. The Americans have drawn the following conclusions:

- a) The need to avoid protectionism and dismantle agricultural subsidies;
- b) The need to cultivate regional organisations;
- c) The need to be alert to Soviet attempts to exploit Third World disadvantage;
- d) The need to deal with Soviet efforts to use the UN to compensate for their relative lack of influence on regional grouping such as ASEAN.

5. These conclusions, and the analysis underlying it, are not in dispute. Although further discussion might be illuminating, it is not clear that much more can be said; or that it will be possible to translate conclusions into specific policy options for the Seven.

Policy Planning Staff
18 February 1988

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REMARKS BY

THE HONORABLE GEORGE P. SHULTZ

SECRETARY OF STATE

BEFORE

THE WORLD AFFAIRS COUNCIL OF WASHINGTON

WASHINGTON, D.C.

FRIDAY, DECEMBER 4, 1987

AS PREPARED FOR DELIVERY

National Success and International Stability
in A Time of Change

Americans, and people just about everywhere, now know that big changes are underway in the world -- changes in virtually every subject from science to superpower relations.

So understanding and managing change is crucial. The United States has been trying to do that in recent years. And we have had some success in doing so, because our society thrives on change. We are open to it and we are ready for it.

The summit which starts next week is one mark of our success. Arms control gets most of the attention, but this summit will reflect hard work on human rights, in coping with conflicts around the world, in trying for a more stable relation between the two superpowers.

We have been doing pretty well. But we cannot be satisfied to rest on our accomplishments. This is a time to try to deepen our understanding of the changes taking place, to look ahead, and to assess what needs to be done if we are to keep control of our own future.

Now at this point in a speech about the world ahead an audience can expect to be inundated with a tide of vague generalities -- words like "interdependence," exhortations like "the challenge of global change," and recitations of the "gee whiz" variety about artificial intelligence, genetic engineering, and robotics.

Maybe it's impossible, but we have to try to talk about the world ahead without getting bogged down in this stultifying vocabulary. In ancient China, when familiar words and ways of thinking no longer accurately described the realities of the day, philosophers spoke of the need to "rectify names" so that concepts would correspond to the new order of things.

This is one of those times. Developments in science and social organization are altering the world profoundly -- too profoundly for conventional habits of thinking to grasp.

History suggests that mankind rarely understands revolutionary change at the time it is coming about. When concepts eventually catch up with the pace of change, new definitions and descriptions are applied: the Agricultural Age, the Bronze Age, the Industrial Revolution were named long after the fact.

So if we are in such a time of transformation, what kind of age is it that we are entering? What do we need to know and do about it?

I am not here to offer a definitive analysis of the global trends now underway, but to try to survey the present scene -- in Emerson's words -- from "an original relation to the universe." In this time of profound change, one of the hardest adjustments to make is intellectual adjustment. We must discard outdated habits of thinking and make room for new possibilities.

First of all, just how different is this era we have entered?

From one point of view, it was the 19th century's radical intellectual, ideological, spiritual, moral, and social revolutions that shattered the "eternal verities." In a way, we have not fully adjusted yet to those epic events.

Today's -- and tomorrow's -- revolutionary changes are of a different nature. They are characterized by greater size and speed; they are both centrifugal and centripetal in their impact, dispersing yet concentrating activities, influences, and decisions.

-- First, the very material substances that surround us in everyday life are being transformed. Physically, synthetic materials make objects lighter, stronger, more durable. But they are changing societies and economies too, because their emergence affects supply and demand for natural raw materials. One new material substance -- ceramics -- has led researchers around the world to superconductivity which in turn may profoundly alter one foundation-stone of all human activity: energy. Another such foundation -- food -- no longer limits by its production the possibility of world population growth. Biotechnology in agriculture has stood Malthus on his head.

The same scientific progress that has altered the nature of these basic substances has also accelerated the speed of human transactions. Time and space are calculated in ever-smaller units. Success in every field depends increasingly upon how quickly ideas can be transformed into reality. The speed at which information flows has already created a global financial market. Markets are no longer places, but electronic networks.

Along with these alterations in substance and speed have come changes in magnitude. Scientific, economic, political matters are global in dimension and enormous in extent. They are outstripping the traditional means by which governments dealt with them. The amount of money that changes hands in the global financial market in one day exceeds \$1 trillion -- more than the entire budget of the U.S. government for a year. Such flows transcend national boundaries and can overwhelm rigid economic policies. Manufacturing processes similarly are becoming global in scale. I recently saw a snapshot of a shipping label for some integrated circuits produced by an American firm. It said, "Made in one or more of the following countries: Korea, Hong Kong, Malaysia, Singapore, Taiwan, Mauritius, Thailand, Indonesia, Mexico, Philippines. The exact country of origin is unknown." That label says a lot about where current trends are taking us.

The thread that runs through all these things is knowledge: its discovery, its rapid transmission as information, and the education needed to use it. Access to ideas, no matter where they are developed, becomes the key to scientific and economic progress.

For example, the growth sector for employment is the "service sector", particularly in finance, data processing, software, engineering and management consultation. "Services" is a misleading designation. These activities are centered on ideas, but have all the characteristics of the production of what we traditionally call "goods." So it is time, as the ancient Chinese would have recognized, for "a rectification of names".

Changes in materials, magnitudes, knowledge and the speed of its dissemination -- the opportunities offered by these changes are immense -- and America and other open societies are beautifully situated to make the most of this era ahead.

But there are troubling implications of change to consider as well. Emerson would put it down to his principle of "compensation" -- no aspect of progress comes free of some drawback.

For many nations, the emerging era means new problems. Countries which cannot or will not compete in the global marketplace and interact with ideas from other societies will find themselves falling behind the advanced innovators and producers.

Some of those countries may be able to absorb what the innovators develop and may register moderate growth. But the quality and technological content of that growth will remain limited by the inability of such countries to adjust to rapid change.

Other nations -- single commodity countries and agricultural and industrial subsistence economies -- are in danger of becoming marginal participants in the "Information Age" economy, living as in eras past. Some lack the human and physical infrastructure to create and exploit economic opportunities. Others are held back by the inflexible nature of their political and social systems.

Yet even those who fall further behind economically can partake of some of the fruits of the new age -- fruits that unfortunately are not sufficiently forbidden. Wars in the Third World are being fought with increasing sophistication and firepower. The spread of modern technical skill coincides with the modern resurgence of age-old ethnic, religious, and communal conflict. Beyond the Iran-Iraq war, we see fighting in Sri Lanka, ethnic conflict in Fiji, the devastation of Lebanon, Sino-Indian border tensions, the New Caledonia and Cyprus disputes, the continuing Arab-Israeli conflict.

Such tensions have always been part of human history. What is new is the heightened possibility that they will become wider and more deadly conflagrations through the misuse of relatively sophisticated weaponry. In the Iran-Iraq war, we see how readily available on the world arms market are missiles such as the EXOCET, the SCUD, and the SILKWORM. And many developing countries are becoming not just purchasers and users -- but adept manufacturers -- of military hardware considered highly advanced only a few years ago.

We have long feared the dangers of nuclear proliferation. Now we face a worldwide diffusion and use of chemical weapons -- thus breaching the international moral consensus of more than half a century. But this growing capacity to acquire or produce and employ such weapons unfortunately is not the whole story. Violence itself is undergoing a qualitative change, as terrorists and narcotics traffickers spread new forms of destruction around the world. We now recognize the long, tough battle we are fighting with these modern day barbarians, equipped with effective weaponry and uninhibited by traditional norms of civilized conduct.

In centuries past, advances in science and technology and warfare often far outstripped the abilities of statesmen and politicians. Today, political, economic, and social arrangements must be more closely harmonized with change.

Drawing from the example of science, we must create a more just and decent social order from the elements of our understanding. Human society has no unique or preordained social pattern. Our God-given goal is to fulfill ourselves through the social and cultural institutions that we ourselves create, and to leave this world a better place than when we entered.

As we face this phalanx of changing conditions, what principles stand out for us? I see three clear guidelines for dealing with the size, speed, and complexity of events today:

1. A society must be open to this new age of knowledge and information; to resist it deadens hope of progress. Today's transformations are products of our own system of openness and creativity. What we face are not vast impersonal "forces" or "trends" that sway us against our will, they are challenges created by our own past achievements. They offer opportunities for a better future, but only if they can be exploited.

- o The eighteenth century idea of democracy, with its qualities of openness, freedom, individual initiative and innovation remains the best way to deal with the stress and the opportunities of change.

2. For decision-makers, the margins for error are diminishing as the consequences of error increase in scope and gravity. Over-centralized plans and decisions increasingly will be inept. Thus the free operation of the marketplace -- for goods and ideas -- is the far more efficient arbiter of decisions.
 - o Entrepreneurial initiative in a market environment is the engine of development and change. Global economic problems will keep coming at us in waves; we must remain open as we face them or be swept away.
3. The global nature of changes in science, in economics, in communication must be matched by political developments, particularly the strengthening and closer association of like-minded nations. To a greater degree than in revolutionary eras of the past, there is a synergistic interaction between scientific and technological advances and political, economic and social developments, with each element enhancing and accelerating the effect of change on the others.

- o Today, regional associations of nations are fast becoming an important and effective new milieu for political and economic interaction in the world.

How do things stand in applying these principles? Not bad.

The Drive Toward Democracy

The most stirring political response to the new temper of our time has been the resurgence of democracy and the demand for political openness and participation.

Not so many years ago, democratic nations were thought to be a dwindling and embattled minority; today the idea of democracy is among the most important political forces of our time. Elites in the East and West recognize that advanced economic power comes from a high level of education, an openness to the world, a rational distribution of decision-making power, emphasis on individual initiative, decentralization of authority, greater freedom of information and association, and the right of the people to have a say in their own affairs and destiny.

Around the globe we see a powerful impulse toward democratic institutions and values. This recent phenomenon was first evident in Spain and Portugal a decade ago. Now, in Latin America, this drive has changed the complexion of the entire continent, from Argentina to El Salvador. In the Philippines, despite serious challenges, we see how tenaciously people are seeking to effect a transition to a new democratic way. In South Korea, there is a dramatic struggle to create new political institutions and achieve the peaceful transition of national leadership through open elections. And the Haitian people will not abide a return to the tyranny they so recently rejected.

Elsewhere the struggle continues, as in South Africa where the structure of apartheid is under increasing siege; and in Afghanistan, Angola, Nicaragua and Cambodia, where communist oppression has spawned resistance movements fighting for the rights denied them.

For the United States, these trends must be seen not only as an affirmation of the values we hold so firmly, but also as a test. The transition to democracy is a difficult and fragile process. And, it can be reversed.

Confronted by daunting internal and external challenges, new democracies will look to us for ideas, assistance and understanding. In response, we cannot shut our eyes or close our doors. If we do, the lamp of democracy will go out in many lands.

Freedom - Turning to the Market

With the new surge of democratic feeling, others have come to recognize what we have known all along - that democracy and free markets go together. As our free political system looks out for basic justice and opportunity and provides a safety net in case of adversity, our free markets ensure that our economy will function effectively.

- Free markets cannot function in an environment of stifling political regulation or interference. Measures that would isolate an economy from the world or disengage it from the global community do enormous harm. The disintegration of the trade and financial structures during the 1930's provides ample evidence on this score.

- All nations share a common responsibility, and must work together, to promote market forces and to ensure the maintenance of an open international economic system. The objective of cooperation is not to achieve a fixed, predetermined result, but to ensure that the free market is allowed to function.

There is real progress on all fronts here. The nations of Southeast and Northeast Asia were in the vanguard, but now with every passing year we see formerly socialist or command economies, in Africa, Latin America, and Asia, shucking off those rigid and limiting policies and relying more and more on open market practices and individual incentives.

There is progress as well in overcoming the lingering sentiment that governments can get together and somehow dictate economic results. In today's world that simply cannot be done. Markets, not governments determine economic results and there is no way to overrule the market more than momentarily -- especially given the vast quantities of goods, services, capital, information and technology flowing across national boundaries today.

However, governments can work together to promote procedures which allow markets to work more freely and efficiently -- that's what we are doing, for example, in the GATT trade talks in Geneva, in the annual economic summits, in the structural adjustment program of the OECD, and through the International Monetary Fund, the World Bank, and other international financial institutions.

The record of economic growth over the past four decades is one of amazing success. But at the same time there are plenty of problems and challenges facing the world's free enterprise, market economies. Just to name a few:

-- the size of government, whether measured by spending, or taxation, or regulatory influence, or income redistribution, or price distortions, has become a real burden to the efficient functioning of the market. There are many stories to be told, from the unconscionably expensive and distorting farm programs to the detailed regulation of opening and closing hours of retail stores. But our own recent experience in trying to trim the budget deficit may bring it home most clearly to this audience. Once established, government programs are virtually impossible to eliminate -- they spawn their own interest groups and become entrenched. Unless government is to grow without limits, we must find a way to make it shrink.

-- The trading imbalances in the global economy are most likely a symptom of more fundamental imbalances that need to be corrected. I suspect that we are farther along in facing up to our trade deficit than are many other countries whose economic growth has become all too dependent on an export surplus generally related to our deficit. Our challenge is to adopt policies at home that engender confidence in the strength of the U.S. economy, and promote policies overseas that will strengthen the economies of our major trading partners. If we fail, the process of correction is likely to be acute and painful.

-- The extraordinary cycle of inflation and disinflation over the past two decades has left a legacy of inflated debt, depressed commodity prices and stagnation in much of the developing world, especially in several countries close to home. The unpalatable mix of seeming political necessities and economic realities has made a debt workout hard slogging. Progress toward efficient, market-oriented solutions to the debt problem has been demonstrated in some key developing countries. But the problem remains a serious one, calling for unusual political resolve in debtor countries and genuine ingenuity in the international community.

Each country must pursue market-oriented policies and get its own house in order if the international economic system is to thrive. This is especially true for the United States as we are the largest player by far. The fact is that our size relative to that of other economies makes getting our house in order far more important for them than their housekeeping is for us. But we are not the only important player, and so others -- Japan, Germany, the other OECD countries, the newly industrialized countries, indeed all trading nations -- must contribute to a stronger international system by strengthening their own economies.

New Political Groupings

A third emerging reality on the world scene is that political, technological, and economic power and influence have been dispersing horizontally. Ours is no longer a bi-polar world -- the U.S. and Soviet share of world economic output is decreasing as the growth rates of other countries have been more rapid.

In the future, more nations will have the economic and human resources to contend for political, technological and commercial influence.

Already Brazil, Korea, China, India, Israel and the countries of ASEAN, for example, have become movers and shakers in one or more commercial or technological areas. The increasing number of students from developing countries in advanced training programs -- India alone has about 10 per cent of the world's total enrollment in higher educational institutions -- will put these countries in a position to create and take advantage of technological change.

In this new environment, the importance of regional country and functional groupings has been heightened.

Regional, political and religious blocs of nations -- such as the Organization of American States, the Organization of African Unity, South Asian Association Regional Cooperation, the Non-Aligned Movement, and the Islamic Conference -- now provide platforms for a number of countries to exercise influence in global affairs.

Other regional organizations are taking on growing economic and political importance -- from the Eastern Caribbean to Southern Africa, from the Americas to South Asia, from the Persian Gulf to the South Pacific. For example, the Pacific Basin, a region of phenomenal economic growth, is developing a web of cooperative realities.

ASEAN is showing the way to regional cooperation and is taking on more and more of a political dimension beyond its initial focus on economic affairs.

Just as with the new trends toward democratization and open economies, these developments in political cooperation are outgrowths of our efforts and aspirations for a better world.

The United States led the way after World War II in advocating the importance of the regional approach to the recovery of a devastated Europe.

Today, the institutions that resulted are thriving:

- o regional organizations such as the NATO alliance, the OECD, the European Economic Community and the Western European Union;
- o and functional organizations such as GATT, IMF, the World Bank and regional development banks, and the effective functional organizations of the UN, such as those dealing with nuclear energy, health, and civil aviation.

This cooperation, which began in large measure by focussing on post-World War II reconstruction needs in Western Europe, is an inspiration and a model for regional and functional approaches to challenges around the world. It is vital to recall that these groupings originated in efforts to reduce barriers. New associations must stay true to that purpose rather than evolve with protectionist enclaves which would spark devastating economic warfare.

Based on the clear success of the regional approach in advancing Western security and economic well-being, we are intensifying our efforts to strengthen regional cooperative efforts everywhere in meeting the common challenges we will face in the Information Age.

The East-West Dimension

What I have sketched out here is a picture of immense dynamism: of the creative energies of free peoples generating challenges which they -- and increasing numbers of those who would emulate them -- are meeting with considerable success. The West has no monopoly on clever people, and the world's centers of scientific creativity and economic power are proliferating.

Where in this picture do we find the nations of the communist world?

The Soviet Union will remain our central security concern for the foreseeable future. The United States' military strength, our framework of alliances and our other security ties, remain central to peace in the world. But there is also emerging a new dynamism in the East-West relationship.

In this respect, the current ferment in the communist world is a remarkable political development. Perhaps nowhere is this more evident than in China, which can be seen to be undergoing a new era of "rectifying names." The opening of a long-closed society to market forces, trade, technology and ideas is bringing significant benefits for the Chinese people.

Certainly, China and Western democracies are still divided over critical ideological issues. However, China has realized that the future belongs to those who open themselves up to global trends in the dissemination of knowledge, in the international economy, and in popular political participation.

Similar rethinking of old concepts and ways of doing things seems now to be underway in the Soviet Union and Eastern Europe. While the ultimate dimensions of this process remain to be seen, its potential importance is great.

Despite the constraints of a rigidly centralized society and economy, the Soviet Union is a leading scientific force in space science, in various fields of medical research, and in theoretical disciplines. Its massive economy, for all its inefficiency, generates a per capita GNP of about \$8000.

But now Soviet leaders are telling their people that that is not enough -- that the system they inherited essentially unchanged from Stalin must be restructured. As General Secretary Gorbachev stated in his June Party Plenum speech, "command forms of managing society put a brake on our movement." Whatever "perestroika" may finally come to mean, the terms in which it has been defined thus far suggest that Mr. Gorbachev and his colleagues understand that a closed society is a dead-end for advanced development. And implicit in the parallel concept of "glasnost" may be a recognition that the free flow of ideas and information which will fuel growth in the future requires greater intellectual and political freedom.

The most telling indicator will be the Soviet human rights situation. The world is looking for results that bear out the rhetoric -- not only for the sake of the individuals and families involved, but because human rights as practiced at home ultimately are related to international security. For a government that does not respect the rights it has guaranteed to its own people will not respect its international obligations and the general norms of the world community.

There is nothing in the "new political thinking" to date which suggests that the end of the adversarial struggle is at hand. What will "new thinking" mean for the people of Eastern Europe, who continue to strive for greater autonomy in dealing with their daunting socio-economic agenda? And what about Afghanistan? Will Soviet leaders withdraw their troops and allow the Afghan people to decide by political means what kind of government, economy and political system they desire? Will the Soviet Union play a constructive role in Cambodia, Korea, southern Africa, and the Persian Gulf?

The winds of change blowing from Moscow may prove as revolutionary as Mr. Gorbachev has declared. But in determining their ultimate impact, historians will look to the answers to questions such as these.

But as for us today, the continuing reality before us means that American political resolve must remain constant, our defense robust. With those parameters, the challenge to us is to be sensitive to any opportunities which the changes now underway in the Soviet Union and other communist countries may hold.

In this time of global challenge and change, nations of the world look intensively and searchingly at the relationship between the U.S. and the U.S.S.R. That relationship today is meaty and substantial. A major reason for this is that we Americans stand up for our principles and our interests while remaining ready to test and to deal with changing realities in international life. This approach gets results, and we're going to stick with it.

Conclusion

In a world of blurring national boundaries, dispersed power and new players vying for influence in international affairs, there will be a continuing need for U.S. engagement and leadership.

Our alliances and our friends, and the growing number of regional associations around the world, provide a foundation for problem solving on the scale demanded by the world ahead.

We must not falter on the economic front. We can take great satisfaction knowing that the message of economic freedom is at last being heard and acted upon in country after country around the world. If we ourselves yield to the temptation to return to isolation, protection and structural rigidities we betray this movement -- and general prosperity in the era ahead will be a lost cause.

Economic progress and freedom go hand in hand. New democracies will require continuous support and encouragement.

The United States has an immense stake in seeing that the democratic idea works. And those who resist totalitarian governments must be able to know without doubt that they will be able to look to America to back their legitimate pursuit of liberty and justice.

And finally, in this period of profound historical change, both the United States and the Soviet Union must make the most of opportunities to transform the adversarial character of the U.S.-Soviet relationship to one that is better for both our peoples, and for the world at large.

We will leave it to future historians to give our age a name. Our task is to try to throw off outmoded concepts of the past as well as cloudy generalities about the future. What we need to see is the dynamism in the size, speed, and scope of global change.

And most of all we need to see that this change is of our doing. We can manage it better than anyone. We have to have the courage to stand fast to our own principles: democracy, free enterprise, the cooperative association of responsible nations.

With this as our vision and guide, we face a bright future indeed.



TORONTO ECONOMIC SUMMIT: SECOND MEETING OF PERSONAL REPRESENTATIVES

27-29 FEBRUARY 1988

BRIEF NO 11 : SOUTH AFRICA

OBJECTIVES

1. To resist any pressure for major discussion, or for a declaration.

POINTS TO MAKE - IF RAISED

1. South Africa not an appropriate subject for this primarily economic forum.
2. Time is not right for making a new statement or launching an initiative. Neither side in South Africa in a position to respond constructively: P W Botha preoccupied with beating off serious right wing (Conservative Party) challenge; Black opposition divided.
3. Time may come for further international activity: but not now.

ESSENTIAL FACTS

1. In the run up to last year's Economic Summit at Venice there was considerable pressure from some of the seven to bring South Africa to a prime place on the agenda. The Americans first proposed that the Summit should issue a declaration of principles governing an eventual settlement in South Africa. As American enthusiasm waned (mainly because we made clear to them our opposition to a declaration), the Canadians took up the running. They argued for a declaration and suggested a new mediating/contact group of seven Foreign Ministers.

2. In the event, the Canadians received no support at Venice. There was no separate formal declaration on South Africa, but one paragraph of the Chairman's closing Summary on Political Issues was devoted to South Africa.

3. The absence of a formal statement received some press attention. A Financial Times article claimed that 'full-scale criticism of South Africa' at the Summit was blocked by Britain. Press speculation had been fuelled well in advance. The indications are that Mr Mulroney will be much less keen this year. But we should attempt to head off (as early as possible, preferably in company with others) any suggestion of discussion of South Africa.

HD3ACS

*Re*

TORONTO ECONOMIC SUMMIT:
SECOND MEETING OF PERSONAL REPRESENTATIVES, 27-29 FEBRUARY

AGENDA: CANADIAN ISSUES FOR DISCUSSION PAPER: TEXT PLUS
COMMENTARY

1. This brief offers short, page by page comments on the Canadian paper; the text appears on each left hand page, the commentary on the right.
2. Each section of the text starts with description and analysis followed, in the case of sections III-VIII B, by questions for discussion (which have been sidlined in red for ease of reference).

General Comment

3. A worthy paper, if rather long and detailed. Provides a useful starting point for discussions. Addresses the right questions but poses them in a very general way. Real Summit preparations need to go further and identify a positive message and/or programme of action.

ECONOMIC RELATIONS DEPARTMENT
FCO
FEBRUARY 1988

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February 15, 1988

ISSUES FOR DISCUSSION PAPER
SECOND SHERPA MEETING

I INTRODUCTION: Commitment, Credibility, Confidence

Since the Venice Summit, the world economy has been rendered vulnerable to turbulence in financial markets which could lead to a slowdown in growth. Concern centres on the sustainability of current account positions and the external debt problems of the developing countries. To minimize the risk of a downturn in world economic activity and defuse tension in the international trade and payments systems, governments must demonstrate commitment to the goals of sustainable economic performance and external positions. Government policies must be seen as credible in addressing those goals. Commitment and credibility will restore market confidence.

II DEVELOPMENTS SINCE VENICE SUMMIT

Economic activity in the Summit countries was stronger in 1987 than expected at the time of the Venice Summit, but unemployment rates declined only in North America and the United Kingdom. Inflation, which troughed in 1986 (or early 1987), remains moderate. The differential between real total domestic demand growth in the United States and the other countries as a group turned significantly negative in 1987, mostly on account of weaker US domestic demand growth. Real net exports made a positive contribution to output growth in the United States -- the first year since 1980 -- but a negative contribution in all other Summit countries except the United Kingdom.

In volume terms, trade flows adjusted considerably toward more sustainable positions, although in nominal terms the imbalances of the three major economies remained persistently large. The further realignment of exchange rates in 1987 will contribute to the ongoing international adjustment process. (The recent economic performance of the Summit countries and the latest OECD and IMF projections are summarized in the appended tables.)



I INTRODUCTION

'Commitment, credibility, confidence' - possibly the basis of a Summit theme.

Over-emphasis on 'the risk of a downturn in world economic activity', ie recession, and in general too much concentration on effects of stock market crash.

II DEVELOPMENTS SINCE VENICE SUMMIT

Descriptive section. It balances good against bad points - economic activity in 1987 stronger than expected in the Summit countries (see first paragraph) but weaker in developing countries (see sixth paragraph). No attempt at overall assessment.

Our view: evidence that we are now clearly moving in the right direction is becoming more visible; need commitment to continue right policies.

Specific criticisms: no mention of the failure of Germany to grow sufficiently fast since Venice; a contrast of Japanese and German performance would have brought this out

: Louvre accord of February 1987 barely acknowledged, and insufficient emphasis on the importance of exchange rate stability.

: unwelcome hint in Section III of wanting more dollar depreciation (fourth paragraph, page 7 of text).

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On the basis of unchanged policies and exchange rates (as of the end of 1987), no further large disturbances in financial markets, and stable terms of trade, the medium term outlook is one of moderate, but lower growth in the major industrial countries, a modest increase in inflation, and continuing large external imbalances among the three largest industrial economies. There is a high degree of uncertainty about the outlook, however, and the risks are on the downside.

The fiscal stance of the Summit countries as a group, as measured by changes in general government structural balances, moved toward restriction in 1987 and is projected to move further toward restriction in 1988 and 1989. Fiscal consolidation was particularly marked in the United States, though the federal deficit remains high in absolute terms. In Japan and Germany fiscal policy was moderately expansionary. The fiscal stance of the United States and Japan is expected to be approximately neutral in 1988 before once again turning restrictive in 1989. Fiscal policy in Germany is projected to remain mildly expansionary in 1988 and approximately neutral in 1989.

In the wake of the October stock-market decline interest rates fell in all major industrial countries, albeit unevenly, as central banks injected liquidity to support the financial system. US interest rates declined more than German and Japanese rates, leading to downward pressure on the dollar. In turn, the upward pressure on the Deutschmark created tensions within the EMS which were defused by reductions in German interest rates. Since October 1987, a number of coordinated interest rate reductions in Europe have largely reversed the increases earlier in the year. From about mid-November, short-term interest rates in the United States, Canada, and Japan have edged upwards as central banks withdrew much of the liquidity injected previously. Over the past year, interest rate developments, especially in the major surplus countries, have also been affected by the "trade-off" between exchange rate stabilization and domestic monetary objectives. This potential conflict remains.

Economic activity in the developing countries in 1987 was weaker than expected at the time of the Venice Summit. Moreover, the outlook for the next year has deteriorated. On a regional basis there are wide divergences, however. The Asian economies are continuing to grow strongly, whereas the Latin American economies have weakened considerably. Growth in Africa is weak.



- last sentence, third paragraph : clumsy treatment of "conflict" between domestic monetary and exchange rate objectives.

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The debt situation remains a matter of serious concern in many developing countries. Even barring unfavourable developments such as a further terms-of-trade deterioration or world interest rate increases, debt-export ratios are expected to show only modest reductions.

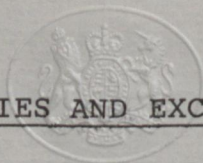
III MACROECONOMIC POLICIES AND EXCHANGE RATES

Two crucial factors impinging on the outlook are investor and consumer confidence, and the willingness of markets to continue financing the fiscal and current account deficits at prevailing interest rates and exchange rates. A further shock in equity markets could undermine confidence, thereby reducing business and consumer spending and making a recession more likely. As well, a strongly increasing reluctance by investors to absorb dollar-denominated assets would tend to raise US interest rates and dampen economic activity in the United States and abroad. Though these potential developments cloud the economic outlook, they should be considered in light of the progress that has been made in reducing underlying international imbalances. In particular, the favourable effects of past policy actions and exchange rate changes have begun to materialize, as witnessed, for instance, by the considerable adjustment of trade volumes over the past year. Nor should it be overlooked that in recent weeks a substantial degree of calmness has been restored to foreign exchange and equity markets. The challenge is to manage the transition to a more sustainable, that is, less vulnerable, position so as to reduce the downside risks.

The main issue is the adoption of macroeconomic policies that will facilitate the smooth adjustment of international current account imbalances while maintaining growth and avoiding a resurgence of excessive inflationary pressures.

On the basis of projections by the IMF and the OECD of the US current account balance over the next couple of years, the United States at the end of 1989 will have an external debt of about \$700 billion, for which annual servicing payment will be in the range of \$30 to \$40 billion. Under current exchange rates and policy settings, many observers project large US current account deficits for some years to come, resulting in a rapid cumulation of US external debt. For instance, the latest IMF World Economic Outlook implies a US current account

III MACROECONOMIC POLICIES AND EXCHANGE RATES



pp 3-6:

a good discussion of the imbalances problem, bringing out in particular the potential problems of cumulating US debt.

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deficit of about \$130-140 billion in 1992. Of concern is whether the projected rate of debt accumulation is sustainable, i.e., whether the current account deficits would be financed by private capital flows at prevailing interest rates and exchange rates. Official flows are not a viable long-run alternative.

Concerns by market participants about the implications of rapid accumulation of US net external debt for future exchange rates, inflation and growth, could result in a drying-up of foreign lending and, consequently, strong downward pressure on the dollar and upward pressure on US interest rates. Furthermore, there is the risk that these pressures could erupt in a sudden loss of investor confidence with ensuing turmoil in financial markets.

At some point the US trade deficit will have to shrink significantly, as will, correspondingly, the trade surpluses of other countries. What is of concern is the manner and the speed with which these changes will come about and the economies' ability to shift resources across sectors smoothly. Specifically, what will be the roles of relative prices, expenditures, and structural flexibility in bringing about the adjustment? Before turning to the issues raised by these factors, one point needs to be underlined. Evidence from a range of multicountry models¹ indicates that the rise in the US current account deficit can be broadly explained by differences in policy stance between the United States and the other major industrial countries. The deficit took several years to accumulate and will likely take several years to reverse.

¹ This evidence is from the Brookings Institution conference of March 1986 and workshop of January 1987, as well as other research. Some of this evidence may be found in R. Bryant, G. Holtham, and P. Hooper, eds., External Deficits and the Dollar: The Pit and the Pendulum, Washington, D.C., Brookings Inst. 1987, and R. Bryant, D. Henderson, G. Holtham, P. Hooper, and S. Symansky, eds., Empirical Macroeconomics for Interdependent Economies, forthcoming.

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That the narrowing of international imbalances will be a slow process enhances the importance of cooperation amongst countries to ensure the adoption of policies which foster that process. The alternatives, including the prospect of an even longer period of adjustment and uncertainty, would be a disturbing signal to markets.

The Role of Expenditures and Exchange Rates in the Adjustment of International Imbalances

Expenditures

In the past five years the cumulative growth of real total domestic demand in the United States has exceeded considerably that of other industrial countries. The respective rates for the Summit countries are: United States, 25 1/2 percent; Canada, 23 3/4; Japan, 19 percent; and the four major European countries, 14 percent. This cumulative differential in domestic spending accounts for a considerable portion of the US current account deficit. Reduction of the external imbalances would require a reversal of this differential in domestic spending. US fiscal policy would have to be tightened to permit the transfer of resources from domestic absorption to net exports, whereas domestic demand in the other industrial countries (especially the external surplus countries) would have to grow more rapidly. This process is now underway and is projected to continue over the next couple of years, but, in view of the slow adjustment of external imbalances, the question remains as to whether further policy actions are necessary.

Exchange Rates

The other major proximate cause of the external imbalances of the three major economies was the large real appreciation of the US dollar between 1981 and March 1985 which eroded US international competitiveness. However, notwithstanding the sharp depreciation of the US dollar against other major currencies since March 1985, which has restored US competitiveness to 1979-1980 levels, the US current account deficit has continued to grow.

These persistently large external imbalances mask two important developments, however. First, US export volumes have risen sharply in the past year, whereas those of the two principal surplus countries have declined. Secondly, the current account imbalances in US dollar

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terms reflect the use of a depreciating currency as the basis of measurement. Expressed as a proportion of GNP/GDP, the current account surpluses of Japan and the Federal Republic of Germany peaked in 1986.

A number of explanations for the persistence of the US trade deficit, and the surpluses elsewhere, have been offered. In addition to the traditional J-curve phenomenon and the fact that in 1985 the value of US imports was more than double that of exports, explanations include a number of microeconomic developments and special factors which have affected exports and imports asymmetrically:

- weak prices for agricultural products have depressed a usually strong US export sector;
- credit-constrained LDCs have reduced their demand for US products;
- US price competitiveness has not followed in step with the evolution of the exchange rate. Changes in bilateral exchange rates have not been completely reflected in changes in US import prices. Exporters to the United States have absorbed part of the appreciation of their national currency by maintaining their export prices in US dollar terms and reducing their profit margins in an effort to maintain their market share. In contrast, US export prices have been determined mostly by movements in internal markets and only to a limited extent by external events;
- adjustment costs make the recapture of lost market shares by US firms a slow process; and
- new competitors have entered world markets for manufactures, in particular the Asian NICs, which have experienced large increases in competitiveness in the past two-and-one-half years. (The U.S. dollar has depreciated little against the currencies of these countries.)

The above, and perhaps other, factors help explain the persistence of the US trade deficit, but in the final analysis a reduction of the deficit requires that US output grow faster than final spending. And conversely for the countries with trade surpluses. Inasmuch as the US economy is operating near capacity -- the unemployment rate and capacity utilization in manufacturing are at their lowest and highest levels, respectively, since the end of 1979 -- further improvement in the external balance will require a reduction of US

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domestic absorption (either by reducing the fiscal deficit or through a drop in investment and consumption), thereby freeing resources for the export sector. Faster domestic demand growth in Europe and sustained growth in Japan would contribute to a narrowing of the imbalances and support world demand.

The Asian NICs also should play a role in the international adjustment process by further liberalizing trade, reorienting more of their savings toward domestic investment, and correcting exchange rate misalignments.

Conclusion and Issues for Discussion

If international payments imbalances are to be significantly reduced from present levels, the US current account balance would have to improve substantially, whereas the surpluses of Japan, Europe (largely the Federal Republic of Germany), and the NICs would have to shrink by a similar amount. The policy challenge is to correct the imbalances while avoiding a decline in world demand.

To maintain world demand any reduction in US expenditure should be offset by increases in other countries. Expenditure changes alone will likely not be sufficient to bring about the required adjustment. Even if the reduction in US expenditure is matched by an increase in spending in other countries of the same amount, the effect on trade balances would be only a small fraction of the changes in expenditures (since propensities to spend on domestic goods are much higher than propensities to spend on foreign goods.) Thus, changes in expenditures will have to be accompanied by a switch in expenditure toward US goods and services. Given the large real depreciation of the US dollar that has already occurred, any further depreciation necessary to induce the switch in expenditure is likely to be comparatively small.

| What rate of reduction of international imbalances would be viewed as necessary to manage the transition to a sustainable outcome?



- page 7, fourth paragraph: muddled discussion on the maintenance of world demand. It seems to miss the point that there have already been large exchange rate shifts: now we need the accompanying demand changes. The discussion of import propensities seems to confuse "average" with "marginal": Therefore, doubt if it is true that demand changes will have a small impact on net imports. That then must cast doubt on the argument that further depreciation of the dollar is necessary (final sentence of this paragraph).

Questions for discussion

- ✓ - asking about the 'rate of reduction' puts the question too much in the frame of econometric models; the real question is: given that we are in a long process of correction, which will need sustained and enhanced policy action, do we need to do more to secure financing over the transitional period?

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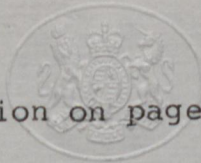
- 8 -

- | Are the differences in the projected rates of growth of domestic demand in the Summit countries concordant with the desired narrowing of international imbalances?
- | In view of the large cumulative domestic demand gap between Europe and the rest of the Summit countries, are there special factors which have to be considered in Europe?
- | What specific further fiscal and monetary policy measures by individual countries are necessary to bring about the desired adjustment of international imbalances?
- | How best can the NICs be integrated in the coordination process?

IV STRUCTURAL POLICIES

As trade imbalances narrow, the macroeconomic adjustments will be accompanied by structural adaptation. Regardless of how the gap between production and absorption in the deficit and surplus countries is achieved, it will involve large sectoral adjustments -- between tradables and non-tradables and within tradables -- which displace labour. The longer the trade imbalances persist, the greater will be the subsequent sectoral adjustments.

As the trade deficit and surpluses are reduced, producers in surplus countries have to shift from producing for the US market to producing for their domestic market, whereas US producers have to orient more of their production towards foreign markets. Given the structure of trade, much of the adjustment will fall on manufacturing. Agriculture might make some contribution to the improvement in the US trade balance, but in view of the excess supply of many agricultural products in world markets, any such contribution is likely to be small. Service exports cannot expand sufficiently to make a significant contribution -- the net investment income category will be in deficit, while the remaining categories are too small to make a sizeable contribution. Hence, manufacturing trade must bear the brunt of the adjustment. In this regard, the declining trend in the growth of world trade in manufactures is of concern, since adjustment is likely to be more difficult, and protectionist pressures more intense, in a climate of uncertainty and slow growth.



- Answer to first question on page 8, Yes (but see answer to next question).
- Intra-European imbalances are emerging as a major problem. France and Italy are likely to attack Germany, with the US cheering them on; we are concerned about the structure of the German economy.
- This question more suitable for OECD.
- Is this reference to 'integration' of the NICs really referring to how to get Taiwan and South Korea to drop their trade restrictions and raise their exchange rates? (The other two Asian NICs, Singapore and Hong Kong already have liberal trade regimes; latter special case for us of course).

IV STRUCTURAL POLICIES

Sir Geoffrey Littler comments on this section as follows: "this passage gets the balance wrong on timing. The really damaging structural changes arose from the effect of the high dollar in the US. As this is reversed, there may well be some problems for countries which excessively exploited the high US dollar, but of lesser order.

The worry about decline in the rate of growth of trade in manufactures is overdone. The distortion of the high US dollar included as one major effect the substitution of huge US imports for previous US domestic production - and contributed to a rapid growth of world trade in manufactures. Unwinding this will need to have the opposite effects (and the US must surely as part of their adjustment regain some of their lost domestic market share)."

In general, too little in the paper on structural policies and too much on macro demand management.

- last paragraph : The gloom on US agricultural exports seems overdone. They are already 30% up on 1985 (when the dollar was at its peak). Market shares are being regained.

In view of the large adjustments required to correct existing international imbalances, and in view of the resistance that may be encountered from affected groups, there is a need for the encouragement of policies that will facilitate sectoral adjustments. This need is underlined by the fact that in the major European countries employment in manufacturing has declined throughout the 1980s despite strong exports of manufactures. Moreover, the growth of service-sector employment has not been sufficient to offset employment losses in manufacturing and absorb new entrants to the labour force. In contrast, in North America the decline in manufacturing employment in the first three years of the 1980s has since been reversed, and strong growth in service-sector employment has permitted a reduction of unemployment rates to 1979-80 levels. In Japan, employment has risen somewhat in manufacturing and more rapidly in the services sector, but not sufficiently to prevent some increase in unemployment.

What policies can countries implement or modify -- for instance, with regard to subsidies, government regulations, and taxation -- that would facilitate sectoral adjustments while contributing to demand growth?

In particular, are labour markets sufficiently flexible to allow the required sectoral adjustments to come about without undue frictions??

V MULTILATERAL SURVEILLANCE AND POLICY COORDINATION

The two major issues in this area concern the management of the transition to sustainable economic policies and performance for the Summit countries, and, once sustainability is achieved, ensuring that it is maintained. Multi-lateral surveillance and coordination of policies should facilitate the attainment of both these objectives.

Over the past two years the Summit countries, in conjunction with the IMF, have been formulating a surveillance mechanism based on a set of economic indicators proposed at the Tokyo Summit. Countries have also agreed to provide medium-term objectives and



It might have been helpful if the proposals on micro policy surveillance had been discussed here rather than in Section V.

Questions for discussion

The questions on structural policies are very general. In particular, no sign of Japan/Germany being picked out for special mention. OECD work in hand: some sign that German Finance and Economic Ministries would welcome focus on structural adjustment at OECD Ministerial, as way of putting pressure on German spending Ministries.

V MULTILATERAL SURVEILLANCE AND POLICY CO-ORDINATION

As Sir G Littler comments, this section gives useful backing for the Chancellor's proposals on indicators at the 1987 annual meetings (though is hardly the stuff of Summits). We strongly agree on the importance of global indicators, but should avoid detailed and quantitative questions about them.

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projections for their economies. These are now being assessed regularly in conjunction with the IMF's World Economic Outlook in order to highlight possible tensions.

At the IMF/World Bank Annual Meetings in September 1987, US Treasury Secretary Baker and UK Chancellor of the Exchequer Lawson proposed possible extensions to the use of indicators in the surveillance process. Both suggested the use of a commodity price index as a leading indicator of inflationary trends. More generally, the question is whether there is a need for global indicators to aid in monitoring the performance of the Summit countries as a group.

Work underway at the IMF, the OECD, and elsewhere suggests that a commodity price index could play a role as an indicator of inflation pressures in the Summit countries, individually and globally, complementary to that of other indicators. But given the relatively small contribution of commodity prices to the inflation forecast, their volatility and their high susceptibility to speculative forces that role would be limited. A commodity price index, however, is only one possible global indicator.

|| Is there a need for global indicators as:

- an aid to discussion amongst countries on the appropriate policy stance?, and/or
- a guide to the policy that individual countries should adopt (i.e., who does what)?

The rapid trend towards the global integration of securities markets and the recent turbulence of equities markets have raised the question of whether greater international cooperation in the supervision of securities markets is called for.

|| Is there scope for Summit consideration of how to catalyze the ongoing discussion in this area?

The scope for policy surveillance also extends to other areas. In an increasingly integrated world economy, the "spillover" of domestic microeconomic or structural policies cannot be neglected; especially as these have often been the motive force of protectionism. In the future, latent protectionist pressures may be exacerbated by the turnaround of current account positions and the



Fifth paragraph and question: Sir G Littler comments that "We must distinguish in discussion of securities markets two levels of problems:

- systemic financial threats, which certainly need some international co-ordination (of a kind which will also tend to help towards more level playing-fields);
- customer protection needs, where we can probably learn from each other, but where the need for international co-ordination arises in more limited senses.

In any case I am very doubtful about the aptness of this subject for Summit discussion, or even for handling by G7/8 (i.e. Summit groups)." It is certainly a highly technical subject and advice would have to be sought from the Bank of England. (See also DTI/HMT brief on Financial Market Mechanisms).

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ongoing force of structural change stemming from technological developments and shifting patterns of comparative advantage.

|| How can a method of domestic surveillance of micro or structural policies be developed?

VI MULTILATERAL TRADING SYSTEM


The international trading and monetary systems, national economic policies, international imbalances and developing countries' debt problems are all inter-related. Difficulties in resolving external imbalances exacerbate protectionist pressures. Also, to the extent that these difficulties adversely affect growth and the smooth functioning of financial and foreign exchange markets, they affect the ability of LDCs to service their international debt. On the other hand, further trade liberalization will contribute to international well being generally and assist in the adjustment of international imbalances and debt servicing problems of the developing countries.

Recent events - e.g. the October stock market shock - may have momentarily helped stem the forces of protectionism, but exchange rate and trade adjustments may well renew protectionist pressures.

A key issue is a credible and continuing fight against protectionism. A successful MTN, with its commitment to standstill and rollback, to improved market access, to improved rules of trade and to an expanded role for GATT, is essential.

Further, unless the GATT System itself is fundamentally strengthened, gradual erosion may over time render it obsolete. More effective multilateral surveillance of the full range of trade-related policies is imperative. At the very least, the system needs a strong vote of confidence. Substantive early progress toward a successful MTN thus remains a major goal.

|| How can the Summit best help prevent continuing erosion of the trading system and provide the momentum to maintain and improve the functioning of the GATT System?



On micro surveillance, this might be an opportunity to point to the OECD as the main forum for examining countries' structural policies. The monitoring of agricultural policies is a first step in this direction. The negotiations in the GATT on surveillance of trade policies also offers the beginnings of such a process.

VI MULTILATERAL TRADING SYSTEM

There is little new in the analysis in this section. A number of difficult questions are set but no answers are offered.

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|| In particular, how can an effective system of multilateral surveillance be implemented to facilitate the adjustment process?

A major political and institutional consideration is the future role of developing countries in the GATT System. On the one hand, some developing countries - the NICs - are able to take on greater GATT responsibilities and to be less dependent on special treatment. On the other hand, a number of developing countries should play a larger GATT role - in their own developmental interests - but lack the resources to participate fully.

The developing countries and especially the NICs should be encouraged to undertake increased commitments and obligations and a greater role in the GATT, commensurate with their place in international trade and their respective stages of development. Moreover, developed countries must consider in this context what they are prepared to do to meet the legitimate need of developing countries for greater, more secure access for their exports into developed countries.

|| How should the NICs be encouraged to undertake increased commitments and obligations and a greater role in the GATT?

At the Venice Summit leaders reaffirmed the OECD Ministerial Agreement on agriculture, including the principles for policy reform and undertook to refrain from adverse practices which would exacerbate market imbalances and the trade environment. They agreed on the early tabling of negotiating proposals in the MTN (which has been done by Canada, the United States and the European Community) and committed themselves to review progress in the MTN at the 1988 Summit and consider the tasks that remain. Provisional results of OECD studies suggest little progress, however.

|| Assuming discussions in Geneva can be sufficiently advanced, what could be the elements of a framework agreement for the negotiation of long term reform of agricultural trade and trade-distorting domestic policies? What specific commitments on such a framework could Summit leaders make?



On the NICs, recent G7 statements about the need for them to correct their ways (through import liberalisation, appreciating exchange rates) are probably yielding diminishing returns. Task is to persuade them to change their policies in their own interests, with judicious mix of sticks and carrots (work in hand in Whitehall).

There is an element of circularity in the discussion of what might be agreed on agriculture and the role and purpose of the MTR. If the MTR is to be no more than a political round-up at the end of the Reagan administration, then there may not be much need for a substantive discussion on agriculture. If, on the other hand, the intention is to have a meeting to announce the fruits of a substantive negotiation than there may, indeed, be a need for Summit negotiation. It is too soon to tell at the moment.

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|| What undertakings could leaders make on short term measures which would: (a) lead to immediate improvements in the trade situation? (b) be consistent with longer term reform?

Ministers have also in more general terms committed themselves to further trade liberalization and the success of the MTN. It will be important to reaffirm this broad commitment particularly at a time of possible slower economic growth. The 1988 Summit will undertake the same kind of overall review of the state of play in the MTN, as in agriculture. The key issue will be to ensure that the MTN momentum is maintained. In this context the Ministerial level Mid-Term Review Conference is most important. The question of when (December) and where (Canada) has basically been settled. For the Toronto Summit the outstanding issue will be:

|| What is to be achieved at the Mid Term Review?

VII DEVELOPING COUNTRIES AND DEST

A. MIDDLE INCOME COUNTRIES

The situation of indebted developing countries is characterised by uncertainty. There has been progress in strengthening the international financial system and commercial banks against the risks posed by the debt situation, and many indebted countries have implemented programs of macroeconomic adjustment, complemented in some cases by structural reforms. However, a generalized return of these countries to sustained economic growth and creditworthiness is proving elusive. There is a growing sense that recent developments may have marked a turning point in the international debt strategy, as the focus on "growing out of debt" begins to be complemented by techniques which actually reduce the stock of debt.

Perceptions of the middle-income debtors tend to be dominated by the three largest debtors: Brazil, Mexico and Argentina. The financial system has withstood Brazil's moratorium of 1987, and negotiations may result in a comprehensive agreement and a resumption of debt service. Mexico's situation is also encouraging, particularly since a sizeable increase in non-oil exports and a return of some flight capital have occurred. However, in Argentina's case there is a serious prospect the country will once again fall out of compliance with the IMF Standby Arrangement, possibly leading to a debt



Too early to say what Mid Term Review could achieve. We must avoid an argument on dates. Commission (in Geneva) has accepted MTR, but French still objecting.

VII DEVELOPING COUNTRIES AND DEBT

A good discussion but the key question of adjustment fatigue is not explicitly addressed on page 16 though set out on page 14. Also too much on middle income debtors and not enough on Africa (see brief).

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service moratorium. While that action would be a matter of deep concern, the international financial system and the debt strategy have already demonstrated their capacity to withstand the non-participation of one of the major debtors. While the situations of other middle-income debtors vary considerably, none can be characterized as on the brink of financial collapse. There are therefore grounds for assuming the international debt situation can be managed over the next period within the framework of the current strategy.

In addition to economic risks relating to interest rates and growth of world output and trade, there are intimately connected political and financial risks. Debtor commitment to adjustment, and new financial flows from commercial and official sources, are essential components of the strategy. The Acapulco summit, while eschewing confrontation and unilateral measures, demonstrated that regional leaders are under domestic political pressure to take action on the external front as well as on domestic policy. The pressure can only grow, as most of the countries in the region will be putting their recently recovered democracy to the test in elections in the next 12 to 18 months. Their dilemma is worsened since necessary declines in consumption have not been accompanied by the increases in investment required for an eventual growing out of the debt: recent small increases have still not made up for the precipitous declines of 1982/83, and the average growth rate of investment for the World Bank's Seventeen Highly Indebted Countries for the period 1980-87 is still -4.8 percent.

A disruption consisting of unilateral action by a debtor or debtors; therefore, cannot be ruled out in coming months. As noted above, a debt service moratorium by Argentina could be withstood by the international financial system. Were Brazil's negotiations, however, to falter badly or break down at roughly the same time, the situation could become a good deal more ominous. A coherent response could be impeded by the different levels of financial strength of various creditor banks.

The growing difficulties in assembling concerted lending packages attest to the differentiation in financial positions of creditor banks, and even more to the reluctance of private sector lenders to put up any more resources, even for countries whose adjustment records are fairly good.

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Progress in developing and implementing the "menu of options" has been mixed, both because unrealistic expectations by debtors of what lenders will find attractive, and because some of the options are less ways of mobilising new resources than they are means to allow both debtors and creditors to exit from a financial relationship that both find constraining. The recent Mexico-Morgan Guaranty bond scheme may be a successful example of the latter, with the important new element that the debtor will now capture at least some of the benefit of an effective asset write down. While the Mexican scheme is not immediately applicable to other debtors (because, inter alia, of Mexico's strong reserves and relatively good debt service record), new and similar "options" may begin to appear for other debtors. Finally, debt-equity swap programs have been successful where debtors have a good macroeconomic policy record, and a welcoming legislative and regulatory regime for foreign investment. Chile, for instance, has retired well over \$2 billion in this manner, some 12 to 14 per cent of its total debt burden.

The Mexico-Morgan Guaranty scheme can also be seen as a significant step in the process of developing a second track to the debt strategy, namely that of actually reducing the stock of debt. The process has its roots in the growth of secondary markets for LDC debt, and notably in the large discounts at which these assets are traded, as well as in last year's well publicized increase in commercial banks' loan loss provisions. The latter development in particular may have had the result of increasing expectations among debtors that banks' ability to withstand losses could readily be transformed into willingness to do so.

Burden-sharing amongst creditors could come under increasing pressure in the coming months. This would seem to pose questions to creditor governments, since different bank supervisory practices and regulations have clearly played a role in promoting different levels of financial strength among national groups of banks. Even more delicate is the question of official credits: the Paris Club would be ill-placed to reject burden-sharing as new approaches and techniques are developed, after having firmly insisted on it in earlier phases.

The role of official financing is likely to grow, particularly by the World Bank. Prospects for a substantial increase in available resources are good, as

progress toward a GCI has been encouraging. An early conclusion to these negotiations, accompanied by a suitable clarification of the Bank's role in assisting the major problem debtors, is essential to achieving a significant strengthening of the debt strategy. This contribution will be particularly welcome, given that net transfers from the World Bank to LDCs in FY 1987 were only some \$2.6 billion, of which only \$776 million were to major debtors. The IMF's role as a source of financing seems set to diminish. This may be inevitable given the nature of the institution as compared to the fundamentally long-term, structural problems of the debtors. On the other hand, its policy role seems more necessary than ever, given the vital link between commitment to adjustment and prospects for an eventual return to creditworthiness. Official sources of financing, especially the Paris Club, will continue to require an IMF role. Thus it is important that the current review of conditionality, with an emphasis on greater flexibility, help debtors to overcome their reluctance to seek Fund assistance.

What scope for further progress does the "menu of options" provide? Can it be expanded further, through action by creditor governments or the international financial institutions? Are there "options" which creditor governments can adopt in the Paris Club vis-à-vis their own credits in heavily indebted countries?

What are the prospects for financial flows to debtors from commercial banks, official sources (including ODA and export credits), and private sector investors (both direct investment and purchases of LDC securities)?

How likely is a disruption to the current situation and strategy in coming months? Are creditor governments and banks positioned to cope with it, or is further preparation required?

How likely is the second track to complement the current strategy in coming months? What should be the role of international financial institutions and creditor governments, and especially their bank supervisors, if its development accelerates? How could equitable burden-sharing among different creditors be maintained? Would there be a role for conditionality under such a scenario?



The drafting here on the role of the Fund is rather odd. It could be read as suggesting that there is a need for weaker conditionality. The problem is not whether Fund programmes can be made more attractive by weakening conditionality. Rather the question is whether conditionality can be made more attractive by improving Fund facilities.

Last sentence
Questions

: "Greater flexibility" means longer term Fund programmes, not conditionality which will remain vital. Caution on first two sentences: negotiations are between debtor countries and commercial banks. Africa different because governments and IFIs hold much of the debt. Therefore agree with question in last sentence (Chancellor's initiative).

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B. DEBT OF THE POOREST

The Venice Summit made a commitment to address the debt problems of the poorest indebted countries, mainly in sub-Saharan Africa. Progress has been encouraging:

- the Paris Club has adopted extended rescheduling terms of 15 to 20 years for these countries;
- the World Bank, in conjunction with ODA agencies, has put in place an enhanced program of co-financing aimed at the region;
- the IMF Managing Director has announced the establishment of the Enhanced Structural Adjustment Facility, at close to the target level of SDR 6 billion on highly concessional terms.

While the proposal for concessional interest rates in the Paris Club has not been implemented, it can nevertheless be argued that the Venice commitment to greater action has been met.

What is less clear is whether the action taken is sufficient to allow these countries to overcome their debt burden and resume sustained development, hopefully with the aid of market-oriented adjustment programs. A variety of analyses have shown that most of these countries must be considered insolvent, and that only a substantial increase in concessional resources, either through increased ODA or concessional debt rescheduling, will allow them to break out of their current situation

However, despite the eighth replenishment of IDA, there are still shortfalls in meeting these countries' needs for concessional resources. Notwithstanding undertakings in international meetings, the strong adjustment programs which many of these countries are at last undertaking risk failure if concessional flows are not increased from their current levels.

Only a few years ago our populations were deeply concerned over the obvious failure of development effort in Africa. What actions can we take to ensure that this episode is not repeated? How can we ensure that strong adjustment programs in the region are successful?



We do not agree that Paris Club action is no longer
required.

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OECD Projections

IMF Projections

	OECD Projections				IMF Projections			
	1986	1987	1988	1989	1987	1988	1989	1992
	US \$ Billion				Percent of GNP/GDP			
<u>Current Balance</u>								
United States	-141.3	-156.0	-134.0	-105.0	-3.5	-3.0	-2.7	-2.3
Japan	85.8	86.0	81.0	79.0	3.6	2.7	2.5	2.2
Germany	37.1	44.0	41.0	32.0	3.8	3.3	3.1	3.0
France	2.9	-3.0	-5.0	-6.0	-0.2	-0.2	-0.3	-0.2
United Kingdom	-1.5	-3.0	-6.0	-9.0	-0.6	-0.7	-1.1	-1.0
Italy	4.0	-2.0	-4.0	-4.0	--	-0.1	-0.3	-0.6
Canada	-6.7	-7.0	-7.0	-7.0	-1.7	-1.8	-1.7	-2.5
Summit Countries	-19.7	-41.0	-35.0	-21.0	-0.4	-0.4	-0.4	-0.4
<u>Unemployment</u>								
	Percent of labour force							
United States	7.0	6.25	6.00	6.50	6.2	6.1	6.1	
Japan	2.8	3.00	3.00	3.25	2.8	2.8	2.8	
Germany	8.0	8.00	8.25	8.50	7.9	8.1	8.2	
France	10.5	10.75	10.75	11.75	10.8	11.4	11.9	
United Kingdom	11.8	10.75	10.25	10.50	10.4	9.5	9.3	
Italy	10.1	10.75	11.25	11.50	11.6	11.8	12.0	
Canada	9.6	9.00	8.75	9.00	8.9	8.4	8.4	
Summit Countries	7.3	7.00	7.00	7.25	7.0	6.9	7.0	

Source: OECD Economic Outlook 42, December 1987
World Economic Outlook - Preliminary Assessment of Prospects and Policy Issues,
EBS/88/1, January 6, 1988.

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	OECD Projections				IMF Projections			Average 1990-92
	1986	1987	1988	1989	1987	1988	1989	
	Percentage changes from previous period							
<u>Real GNP</u>								
United States	2.90	2.75	2.50	1.75	2.8	2.6	2.8	2.8
Japan	2.40	3.50	3.50	3.00	3.8	3.7	3.6	3.6
Germany	2.50	1.50	1.50	1.25	1.6	1.6	1.7	2.3
France	2.00	1.50	1.50	1.25	2.0	1.8	1.8	2.2
United Kingdom	3.30	3.75	2.75	1.75	4.0	2.6	2.0	2.3
Italy	2.70	2.75	2.00	1.75	3.0	2.3	2.3	2.3
Canada	3.30	3.75	2.75	2.25	3.7	2.7	3.1	3.0
Summit Countries	2.80	2.75	2.50	1.75	3.0	2.6	2.7	2.8
<u>Real Total Domestic Demand</u>								
United States	3.90	2.00	1.00	1.00	2.3	1.6	2.2	
Japan	4.00	4.25	4.00	3.25	4.7	5.3	4.4	
Germany	3.70	2.50	2.25	2.00	2.8	2.6	2.0	
France	3.70	3.00	1.50	1.25	3.0	1.9	2.0	
United Kingdom	3.80	3.50	3.75	2.25	3.7	3.6	2.5	
Italy	3.20	4.50	2.50	2.25	4.5	2.8	2.7	
Canada	3.90	4.00	2.75	2.00	4.3	3.1	3.1	
Summit Countries	3.80	3.00	2.00	1.50	3.1	2.7	2.7	
<u>Inflation (GNP/GDP deflator)</u>								
United States	2.60	3.00	3.50	3.75	3.1	3.6	3.7	
Japan	1.80	-.25	1.00	1.50	-0.1	1.8	1.6	
Germany	3.10	2.50	1.75	1.75	2.1	2.0	2.0	
France	4.70	2.75	2.75	2.50	3.3	2.4	2.4	
United Kingdom	3.50	4.00	5.25	5.00	4.4	4.8	4.2	
Italy	8.00	5.75	5.00	4.25	5.4	4.8	4.6	
Canada	2.90	4.75	4.25	3.50	4.4	3.6	3.5	
Summit Countries	3.10	2.75	3.25	3.25	2.7	3.2	3.0	

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