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Sir Geoffrey Littler KCB  
Second Permanent Secretary

1 March 1988

*Dear Nigel*

VAL DAVID MEETING

I attach my detailed notes of the main financial parts of the meeting last weekend - probably much more detailed than you will need now, but some of it will be helpful to us later, and also more immediately to some of my staff in forthcoming meetings. I am copying all or part to a limited number of colleagues here and to Anthony Loehnis at the Bank of England.

I think I should also send Robin Mountfield the passage on securities markets. Would you be content for me to do so with a letter on the lines of the attached draft.

It proved not only an enjoyable occasion, but at a number of points rather more useful operationally than I had feared at the outset.

I am copying this to Rod Braithwaite.

*Yours,*  
*Geoffrey*

Nigel Wicks Esq CBE  
No 10 Downing Street  
LONDON SW1.

**DRAFT LETTER TO:**

Robin Mountfield Esq  
DTI.

**SECURITIES MARKETS AND THE SUMMIT**

I am sorry that we boxed and coxed so that I could not give Nigel Wicks an agreed text of a brief for the weekend. Instead I gave him your draft and explained my reservations and the area on which we had agreed.

I now attach my record of the short discussion we had in Val David on Sunday. (In case the names mystify you: Sylvia Ostry is Canadian, Mulford US Treasury, Sarcinelli Italian Treasury, Trichet French Treasury and Attali the Elysee).

It came out at this stage fairly encouraging for your ideas but with reservations: Trichet's point that we need to know what to say before we can agree to say it was greeted with nods all round; nobody offered any new and encouraging thought about a forum; and I judged Germany and Japan pretty hostile in general, with the US very cautious, as regards international cooperation at any early date. And I have to say that Nigel Wicks (to whom I am copying this) shares my doubts whether the Summit will want to 'father' a special exercise, as distinct from blessing a good one already in hand.

Apart from some very minor gossip one evening, nothing else happened on this subject in the margins, but I shall try gently to probe further in the margins of my WP3 meeting next week.

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Note for the Record

SUMMIT PREPARATION MEETING: 27-29 FEBRUARY 1988

Main Financial Issues

The first plenary summit preparation meeting for the Toronto Summit was held at La Sapiniere, Val David, Quebec Province, from Saturday evening 27 February until noon on Monday 29 February. These notes cover the discussions of the world economy, securities markets and debt. Discussion of trade and agriculture, political subjects and logistics are being recorded by others.

Attendance

2. Sylvia Ostry (Canada) took the chair. The eight teams (of Sherpa, Foreign Affairs Sous-Sherpa and Financial Sous-Sherpa) were as follows:

Canada: Sylvia Ostry, John Paynter, Wendy Brown  
France: Jacques Attali, J.B.Ouvrieu, Jean-Claude Trichet  
Germany: Hans Tietmeyer, A.Jelonek, Lorenz Schomerus  
Italy: Mario Sarcinelli, N.Cambiaso, Antonio Pedone  
Japan: Hiroshi Kitamura, Kazuo Ogura, Toyoo Gyohten  
U.K.: Nigel Wicks, Rod Braithwaite, Geoffrey Littler  
U.S.A.: Allen Wallis, Stephen Danzansky, David Mulford  
E.C.: Pascal Lamy, Horst Krenzler, Antonio Costa.

World Economy

3. Sylvia Ostry invited general comments, in the light of the paper she had circulated in advance (copy attached for ease of reference). She emphasised that this paper was in no sense a preliminary summit text, but was intended simply to review the scene and elicit comments, in the light of which the Canadian team would aim to draft a 'thematic paper' in time for the next (May) meeting of the preparation group. She drew attention to the main issue proposed, on page 3: "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".

4. Gyohten broadly welcomed the analysis in the paper (as did nearly all subsequent speakers), but felt that the tone should be a little less pessimistic. Tietmeyer also thought the paper under-estimated the progress which had been made. In particular, growth last year had been better than foreseen at the time of the Venice Summit; fears expressed in the immediate aftermath of the October stock markets crash had been falsified; risks remained but there were many positive developments.

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5. Sarcinelli thought it very important that the risks be fully recognised. Why, for instance, had there been such financial unrest in October and could it happen again? And the paper should have given more attention to unemployment problems.

6. Wallis thought the paper too pessimistic and too short range in its perspective. Many possible developments should be treated as challenges and opportunities rather than as risks. He wondered whether the fact that this would be the last of the second round of Summit meetings might suggest a review of the enormously important progress made since seven years earlier.

7. Attali did not think the paper too pessimistic by any means. He was worried over: the prospect of the US deficit remaining indefinitely at over \$100bn per year; the lack of international coordination of markets; the persistence of debt problems; continued unemployment. He agreed with Wallis that larger perspectives should be sought for Heads of Government, who might want to discuss for example education, future East/West economic relations, etc. One such subject he would want to suggest would be international monetary reform, which was overdue. Trichet added that he thought there had been useful progress in the past year in the field of international cooperation, but it needed to be carried further.

8. Tietmeyer wondered whether concentration on the larger perspectives might seem to the public audience rather like a way of dodging difficult immediate issues. On specific parts of the paper's analysis: he disliked the heavy focus on 3 economies (Germany, Japan, US) to the exclusion of problems elsewhere; he warned against speculation on exchange rate movements; he did not like the treatment of fiscal deficits; and he thought that the explanation given of exchange rate developments was poor.

9. Littler joined those who thought the paper could have been more positive on progress in the last year. The problems of confidence and credibility were underlined at the beginning, and were indeed important. The message should be: that the strategy being pursued was clearly right; evidence of progress was becoming stronger and more visible; what was needed was consistent and determined pursuit of the agreed policies.

10. Mulford wanted more confidence shown in the strengthening of international cooperation. The Louvre accord was only just one year old. It had proved largely workable and indeed credible: there had been a hiccup in October, but this had been followed by a workmanlike response, with good action in the US and Germany and good cooperation on interest rates. There remained a short-term confidence problem, and a need to keep a close eye on markets and try to educate them. But October 19 was now behind us and had evidently had far less impact than at one time feared.

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11. He agreed that concentration on 3 countries was a mistake: it simply fed the press appetite for the drama of a "3-country shoot-out". There should be references to US/Canada agreements, to the NIC problems, to positive aspects of the debt situation. It would be wrong to focus on exchange rates and interest rates, which were the major 1987 problems: in 1988 we might have to tackle others, such as capacity constraints. On international monetary reform, he noted that recent French comments had posed some important questions, but not given satisfactory answers: in his view it would be premature to press too rapidly on this front while imbalances still remained very large.

12. Trichet said that cooperation was very important - it was a break in cooperation that had largely precipitated the crash in October and the paper should have acknowledged this and the fact that it had been repaired by the 23 December agreement. The aims of the Louvre and 23 December agreements, which he summarised as convergence and stability, were still valid and essential: what was needed was not to rebuild, but to ensure full implementation of the agreed policies.

13. He also felt that something should be said about savings. There was a world-wide phenomenon of diminution of household savings and a consequent imbalance of world savings. (Mulford interjected that US figures had recently shown some recovery). Finally he disagreed over the 3-country point: in his view the 3 countries in question should be put on the spot, because it was their imbalances which had to be resolved.

14. Kitamura said that the paper did not sufficiently acknowledge the huge and successful scale of Japanese action to stimulate domestic demand. He also thought it should have made more of the dangers of further substantial exchange rate changes which must be avoided. Gyohten added that since Venice there had been a clear improvement in the patterns of growth of total and domestic demand in most countries: this needed now to be sustained and reinforced.

15. Tietmeyer had doubts about Trichet's thesis on savings, but was worried about a related problem: the reluctance of private investors to commit themselves to investments in productive capital development. Sarcinelli and others agreed with this. Trichet took the opportunity to challenge Tietmeyer on why with an excess of savings over investment demand German long-term real interest rates were so high.

16. Costa warned that if there was no room for manoeuvre on monetary policy or on fiscal policy, one might be driven to look again at the need for further dollar depreciation to secure an adequate pace of adjustment. He also claimed that there was some parallelism generally between securities and foreign exchange markets (but left his audience a bit baffled!).

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17. After some contentious exchanges about the 3-country point Mulford said that the possibility of further disruptions by June could not be ruled out - that would force the Summit to focus on short-term responses. But if the more positive prospect remained the Summit should play on strength and success.

18. Wallis challenged the theory that fiscal stance affects economic performance, although conceding that Govt expenditures do so. He also reminded the meeting of the helpful effects of the US trade deficit on the rest of the world. He thought the question why the October crash had happened should be replaced by why the previous price-boom had taken place. Finally he poured scorn on statistics of total external debt of the US and on any statistics of savings ("the garbage-heap of US statistics"), because of the well-known problems of identification and valuation.

19. After a slightly ragged but generally acceptable summary by Sylvia Ostry, there were some more direct answers to particular questions posed on pages 7 and 8 of the paper.

20. Littler commented on the question "what rate of reduction of international imbalances would be viewed as necessary to manage the transition to a sustainable outcome?". He suggested that the answer raised another question. We all believed that measures to achieve a very rapid adjustment would have high costs (in slow growth and or higher inflation). We would like therefore a more gradual and longer process of adjustment. The problem was whether the market would go on providing compensating capital flows for a longer adjustment period, and this was precisely where the key questions of credibility and confidence came in. This was widely agreed, and only Lamy offered an alternative assessment: that reduction of the major imbalances (3 countries) to 1% of gdp by 1990 should be the target. Tietmeyer took the opportunity of underlining the importance for confidence of avoiding public disputes between G7 countries.

21. The question about the "cumulative domestic demand gap between Europe and other Summit countries" was challenged as to its factual justification. That there had been sluggish growth in Europe recently was accepted by all, but Trichet and others pointed out that Europe as a whole was pretty close to balance, although there were some internal disequilibria within Europe.

22. On the NICs, Kitamura said the lack of effective fora would have to be tackled through current OECD studies, but meanwhile it would be useful to cultivate any other available fora, such as the Pacific group. Mulford urged the importance of agreed and parallel bilateral pressures. Wallis threw in a reminder that the NICs story was one of success, not failure: it was important that our attack on them should be a demand for more open markets, not a demand for them to restrict their exports. Braithwaite emphasised that we should first determine what action we wanted, and then seek the fora in which to press for it.

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Securities Markets

23. Sylvia Ostry invited comments, having made it clear that inclusion of this subject in the Canadian paper did not imply any particular proposal, but simply the reflection that the October crash was an important event since the last Summit and might be worth some discussion at the next Summit.
24. Gyohten said that in his view this was not an appropriate subject for Heads of Government to discuss. He recalled that some study was being made by OECD, and that Working Party No 3 would at some point discuss it: we should wait for further progress there.
25. Wicks said this was a complicated matter, with different aspects - risks of systematic financial breakdown, problems of regulation, investor protection. It was undoubtedly important, but he doubted whether it was an appropriate Summit subject yet. The prior need was for more work elsewhere.
26. Mulford agreed: in his view there was need for domestic authorities to tackle first the conditions in their own markets; premature international action could do damage. Tietmeyer took much the same view, with the gloss that internationally any first stage should be confined to exchange of information; he also expressed doubts whether central banks had any role to play.
27. Sarcinelli agreed that more analysis of the October events was needed, but he would not oppose reference to the subject at the Summit, indeed it would be a mistake to drop it.
28. Sylvia Ostry noted that there was no clear forum for discussion of the subject as a whole and wondered whether the Summit might in some way harness future efforts.
29. Wicks and Tietmeyer said that they would have no objection to some brief encouraging reference at the Summit to the subject. Trichet thought this would be wise, but the fact was that nobody knew what could best be said - he hoped that the OECD work might point the way.
30. Attali said emphatically that we must keep the subject on the agenda - it could be the main outcome of the 1988 Summit. [This was a characteristic Attali burst of enthusiasm, leaving his audience unsure whether he meant anything, or was merely bored!]

Structural Adjustment

31. Sylvia Ostry suggested that lack of room for manoeuvre on macro-economic policy meant that more attention must be focussed on micro-economics. She wondered whether anything might be developed on the notion of 'transparency', as a route to better public understanding of the process and need of adjustment.

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32. Tietmeyer and others felt that domestic idiosyncracies made it difficult to attempt detailed general commentaries or any form of international surveillance of structural reforms; and that many of the main areas had been identified - what was now needed was for individual governments to pursue them more vigorously.

33. Lamy reported that the European Commission had been conducting a sector-by-sector study of effects of removal of a variety of constraints. The broad indicated results were scope for adding 1% gdp per year to growth rates. The material should be available around mid-April.

34. Wicks agreed with some earlier comments and added that bureaucrats were probably not the best-qualified people to tackle this area. The primary need was political will. Bureaucratic approaches would not help; nor would indicators or analytical techniques generally. To which Wallis added that political skill was also needed.

Debt: Middle-Income Countries

35. Discussion resumed at 9 a.m. on Monday and followed the paper in treating middle-income countries and the poorest countries separately, beginning with the former.

36. Gyohten thought the paper too pessimistic, contrasting with the more hopeful recent report of the Chairman of the OECD Development Assistance Committee. But he acknowledged that there was a troublesome air of public impatience to contend with.

37. Mulford insisted that the basic strategy being followed was right, and that there had been important signs of improvement in the last year - in growth rates of debtor countries, in their attitudes towards necessary reforms of policy, and in containing the scale of debt. The widening of the menu of options in relation to debt to commercial bank, was encouraging; but it was wrong to speak of this as an alternative approach ('second track') and we must all beware of accepting official responsibility for it. He agreed with Gyohten however that political perceptions were suffering from debt fatigue.

38. Littler suggested that for the coming Summit there could be both need and opportunity to demonstrate progress. The need stemmed from the impatience and wrong perceptions which had been mentioned already. He saw opportunity on four key fronts: the adjustment of policies by debtors remained critically important, but there were some good cases of acceptance of this by debtors; as far as commercial banks were concerned, the wider menu was a good concept and the Mexico operation could be an important addition to the options available; settlement of the World Bank capital increase could help relaunch their part in the strategy and the same point might arise from prospective reviews of IMF facilities; and the Paris Club record was an excellent one which could with advantage be better publicised.



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39. Sarcinelli said he was less optimistic, but he did not dissent from the views just expressed.

40. Trichet agreed that the strategy was right, was active, was being implemented and was making progress. There was even a world consensus to this effect, as had unusually been seen at the 1987 UNCTAD. We were of course not yet out of the wood.

41. He supported Littler's remarks about the Paris Club, and was inclined to agree that its operations had been kept a little too quiet, for good reasons at the time. In retrospect, there had been in 1987 some \$26bn rescheduled in 17 countries, and in the period since early 1983 some \$73bn. These figures bore very well any comparison with the roles of IMF/IBRD and of commercial banks. He said that menus of options should be encouraged: commercial banks should be induced to choose between exit bonds at a discount and agreeing to lend new money. He mentioned a prospective 3-year IMF programme for Argentina, which he thought an excellent idea provided the programme itself was strong.

42. Tietmeyer warmly agreed that there had been much more progress than publicly recognised: the Summit should try to get the record straight. (He then digressed in argument with Trichet about cooperation versus sovereignty on new export credits).

43. Sylvia Ostry took note and added, to general agreement, that emphasis must continue to be placed on the role of private direct and portfolio investment.

Poorest Countries

44. Sarcinelli briefly commented that the Summit would want to take a continuing interest in this problem and note both that much progress had been made in accordance with Venice Summit agreements and that most ODA was concentrated on these countries.

45. While agreeing that progress had been made, Littler said that there was still an important unresolved problem which he was sure the British team at the Summit would want to pursue. Unlike the position on middle-income countries, it could be argued that official creditors must take a bigger responsibility and were not quite doing so. What was needed was the concession on interest rates to official creditors proposed by the UK nearly a year ago.

46. Trichet said that the biggest obstacle to the British proposal, which had been discussed in the Paris Club, was worry about concessions spreading to middle-income countries. If a satisfactory ring-fence could be established, agreement might be forthcoming. It would be highly desirable to coordinate views before the Summit, in order to avoid embarrassing argument there. Littler agreed and said that he was confident that a ring-fence could be devised which would hold.

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47. Gyohten said he was not happy with the UK argument that some of the poorest countries were basically 'insolvent', and that this distinguished them from other countries. He felt that other approaches should be tried and completed first, and in this connection took credit for Japan's prompt endorsement of IDA8 and hoped others would follow suit quickly.

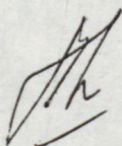
48. Sarcinelli said that Italy had offered unilaterally some interest rate concessions, but they would be very happy to proceed in a multilateral agreement.

49. Sylvia Ostry expressed deep concern over the risk of this becoming a bone of contention at the Summit. The Canadian press and others would latch on to it. One could just imagine contrast pictures of starving Ethiopians alongside Summiteers at their dining-tables! We therefore must work hard for prior agreement. Wendy Dobson confirmed that Canada was sympathetic, but remained worried by the ring-fence problem.

50. Tietmeyer asked when the Paris Club would discuss this again, and was told that no agenda space was planned but space could be provided at an early meeting. Tietmeyer then asked if Littler could provide a short paper on how to limit the proposal, to exclude trade credit, contain the amount of the concession and ring-fence the countries. Littler said (and Trichet confirmed) that debts arising from export credit were envisaged as being included, indeed could not be excluded. [It may be that there is a confusion here between the bulk of export credit debt and the very-short-term trade credit which all would agree to exclude, but the point was not challenged or clarified at the meeting]. After some further exchanges Littler promised a paper within 10 days.

51. Trichet said that in Paris Club discussions all had been sympathetic except the US, Germany and Japan. In response to the chair: Mulford said that the US had legal, budgetary and domestic political problems; Gyohten said Japan had legal and budgetary problems; Tietmeyer managed to avoid comment.

52. Trichet took the opportunity, as this part of the meeting closed, to recall the French interest at the Venice Summit in the performance of donor countries in relation to aid targets, and said that France would want to pursue this again, bearing in mind that it would surely be wrong to retreat from the Venice position.



(Geoffrey Littler)  
H.M. Treasury  
1 March 1988.