

Ref. A083/0838

PRIME MINISTER

See overpage. This is quite different from the basis on which Mr...

- (1) Content with the general approach, especially X below?
- (2) Would you like a small meeting in the next two weeks to take a preliminary look at the main issues for Williamsburg?

A-J.C. 14. 3

I am working and a lot of these briefs in (in my view) of a wide and well rounded nature.

Economic Summit

I seek leave of absence from the Cabinet on Thursday 17 March in order to be present as your Personal Representative at a meeting of the Personal Representatives on 17 and 18 March in San Diego, California.

See my minute to

Sir R. Amstrong.

A-J.C. 16. 3

2. I shall be accompanied by Mr Richard Evans, Foreign and Commonwealth Office, and Mr Geoffrey Littler, Treasury.

3. The agenda for the meeting was in effect set by the message which President Reagan sent to you on 28 January (copy attached).

4. You may like to see the general steering briefs which have been prepared for me for this meeting, and the suggested answers to the questions in President Reagan's message, which will provide me with the framework for my contribution to the discussions.

5. The general aim for Williamsburg must be that the seven major industrialised countries should reach a broad consensus on the general direction which the financial and economic policies of each of them should be given. That general direction must be one of building on the signs of economic recovery now apparent in the United States and elsewhere, seeking positively to promote that recovery, in so far as that can be done without renewed inflation, and seeking to avoid policies (of high interest rates, or of trade protectionism) which would put the recovery at risk. The steering brief mentions the possibility of a framework for a collective strategy, somewhat on the lines of the United Kingdom's own medium-term financial strategy, covering the Summit countries collectively and individually, to be worked out with actual numbers. This seems to me likely to be an over-ambitious and unattainable objective; but a declaration which committed the seven Summit countries collectively to prudent policies which permitted a recovery of economic activity and a measure of growth without putting at risk what has been achieved in recent years in reduced inflation and improved efficiency would be a reasonably satisfactory outcome.

X

The Versailles Commission for 2 d. right-1



6. It may be possible at Williamsburg to take a stage further the general ideas agreed at Versailles for promoting greater stability in exchange rates: the United States Administration is less strongly opposed to intervention in markets than it was two years ago. The San Diego meeting may help to show what prospects there are of this.

7. We shall also be discussing possibilities of strengthening the machinery for international financial and economic co-operation, including possibilities of closer links between the IMF and the GATT. Both the United States and the German Administrations have been showing some interest in this recently, and it will be in our interests to be willing to explore the idea further, and encourage the United States and German Administrations to come forward with specific ideas.

8. Various other matters will no doubt come up, including the effects of the reduction of oil prices, and North-South relations; but the object will be to deal with these not as separate subjects but as part of the general international economic and financial situation and prospects.

RA

ROBERT ARMSTRONG

14 March 1983

I do not like the way that
 is developing. We are not seeking any
 new institutional arrangements or links.
 We are in danger of becoming
 committed to something fundamentally
 wrong just for the sake of saying
 something in a committee

GENERAL ECONOMIC AND FINANCIAL TOPICSBACKGROUND/STEERING BRIEFUK Objectives

A "fireside chat" with the kind of rambling agenda so far suggested will not do. Particularly given the poor command of English of several participants, this could not lead to any clearly agreed comments and ideas on the international economic scene, which the world and its press will expect. Leaving President Reagan as independent rapporteur would be particularly worrying, because some ideas may need considerable pressure on the United States if agreement is to be reached.

2. Therefore the objectives at the 16-18 March meetings should be:

- to identify more clearly some focal points of discussion, which should correspond to what are likely to be the main preoccupations of the leaders and their constituencies in May;
- to prepare the ground for a very few points on which the Summit could publicly agree, launch an idea, or bless some development already taking place.

Background

3. Emergence from recession is bound to be the dominant theme: is it happening? How to encourage it? How to avoid threats to it? How to achieve sustained subsequent recovery without inflation? What about employment prospects?

4. There have recently been a few welcome signs of economic recovery - with a good moral to be drawn from the fact that they appear in the four countries with the best record on inflation: Japan, Germany, the United Kingdom and the United States. Easing (but not a collapse) of oil prices will help. But real interest rates remain very high; the recovery is not yet, and may not be by May, widely spread and robust; and there are potential disruptive threats, particularly of debt problems and trade protectionism, which could cause setbacks.

5. The US economy is dominant, and potential US developments are still a major cause of worry. There is encouragement in recent signs of renewed activity and optimism, and inflation prospects for a year ahead seem very good. But:

- failure to get the Federal Budget under better control is a threat for the future and damages confidence now;
- this is the main reason why US interest rates may be difficult to bring down and hold lower; and temporary success would leave worries about future growth of money supply and inflation;
- the mood of Congress towards other countries is intermittently alarming: probably the GAB and IMF increases of resources will go through, but bilateral aid and contributions to IDA may suffer and bouts of protectionism are all too likely;
- the prospect of a very large US balance of payments deficit will add to tensions.

It is not impossible to envisage a path through all these worries, but it would be dangerous at this stage to overlook them.

6. Germany and Japan are likely to take approaches closely similar to that of the United Kingdom: the same worries about the United States; the same emphasis on prudence and refusal to accept demands for additional and artificial stimulus of economic activity; similar concerns about debt problems, protectionism, etc. France, Italy and Canada are likely to be ready to endorse the need for prudent policies for themselves, but anxious to press the other four countries to expand more rapidly in order to foster a more helpful environment.

Line to Take

7. The sensible focal points for discussion, and for public agreement or comment, go together. It would make sense to concentrate on no more than three or four, very much in descending order as set out below, unless some development between now and the Summit draws one of the special points towards the end into unexpected prominence.

8. First, broad strategy. We have from Versailles, most recently reiterated in the IMF Interim Committee in Washington, the makings of a consensus on desirable economic and financial policies of the Summit countries. It would be an important step forward if we could spell out the vague concept of convergence. It would also present a positive appearance if the policy prescriptions for individual Summit countries could be set in the framework of a collective strategy over the next few years. If we could get that far, something resembling the UK's own medium-term financial strategy, covering the Summit countries collectively and individually, and with invitations to other OECD countries to ally themselves with it, might be worked out with actual numbers (for monetary, public sector deficit and inflation targets).

9. If we are able to pursue the suggestion that the UK should prepare a background paper on progress in the world economy, we would have an excellent basis on which to advance, between March and the last meeting of Sherpas before the Summit, a basic proposition which the Summit could be invited to discuss and endorse. The March meeting could ^{be} the opportunity to manoeuvre the others into acceptance of the need for a general statement on the economies of leading industrial countries and their prospects and intentions. Obviously care will be needed not to push too far at this stage with what the United States in particular might resent as an attempt to over-organise the Summit.

so do I.

10. Secondly, exchange rate stability. Another inheritance from Versailles - and one which owed much to British initiative in prior discussion and speeches at IMF annual meetings, etc - is the study of exchange rate movements and intervention under Jurgensen (French official). The Report will be discussed by financial Sherpas on 16 March. Prospects are that there will be agreement that intervention can play a useful role and should be used where appropriate (an important shift away from United States benign neglect), but that it cannot make much contribution towards stability unless fundamental economic performance, particularly on inflation rates, between countries comes closer than in recent years (some concession here by France). This could provide the basis for a modest agreement to explore, and even begin in practice to operate, ideas of coordinated intervention against the background of (we must hope) a growing convergence of performance.

11. There is an important link between these two first headings: the arrangements also envisaged at Versailles to institute surveillance of the economies and currency movements of the five countries whose currencies make up the SDR (US, UK, Germany, Japan, France). It is the intention to hold another surveillance meeting around the end of April.

12. Thirdly, poorer developing countries. Setting aside those developing countries which have been sufficiently advanced, or have sufficient potential resources, to attract commercial lending, and many of which now present important debt problems, there is some need to look at the position of the poorer developing countries, which have suffered from the recession and from low demand and price for their commodity exports, and have seen a decline in the real value of official aid flows. One of the most important channels of aid for them is the International Development Association, and the unwillingness of the US Congress to ratify amounts offered by the US Administration has not only left prospective IDA flows in great doubt, but now threatens the basis of renewal of future IDA flows. If it were possible to make progress here, which inevitably depends on the US, it would be an important step forward.

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13. One further interesting possibility in the general aid field is that of promoting a new issue of SDR through the IMF, perhaps one in which wealthier countries would refrain from taking up their share. The subject will be discussed further in the IMF between now and the autumn. The question is contentious (and the UK's own attitude still uncertain), because the value of a move of this kind for developing countries has to be weighed against the obvious inflationary dangers of pumping additional liquidity into the world financial system. But the point could at this stage be put down as a marker for further consideration in May.

14. Fourthly, staving off threats. Three points most obviously arise, and treatment of all of them will depend on developments between now and the Summit:

- any measure or statement which can be made to strengthen moves against protectionism;

We must be realistic about this - we all make various statements - we all protect ourselves a bit of protectionism. not

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- further action which might become necessary if the measures already being taken to deal with major debt problems prove to be inadequate;
- oil prices.

Q1 - What are we doing domestically to achieve our common goal of sustained non-inflationary growth? Are we progressing towards our goals? What more do we seek to do?

A1 - The Summit countries agreed at Versailles on the need for prudent monetary policies and for greater control of budgetary deficits if inflation and real interest rates were to be reduced and a durable basis laid for increased growth and employment. The pursuit of these policies over the medium-term still seems to us essential to secure a lasting economic recovery. We need therefore to assess our policies both collectively and individually in this light.

Summit countries have in general continued to try to moderate monetary growth, but rates of increase have varied sharply between countries and in some cases - particularly in the United States - institutional changes and shifts in liquidity preference have made it difficult to interpret monetary movements. Nevertheless, in broad terms a firm but flexible monetary stance, coupled with the sharp slowdown in inflation that we have seen over the past year, is leading to an overall rise in real monetary growth which should in turn be consistent with rising real output. It will be important to ensure that we sustain this prudent stance.

Success in reducing budget deficits has in many cases proved elusive. General government budget deficits in the Summit countries as a whole rose last year to about 4 per cent of GDP on average and seem likely to be similar - if not higher - this year. Part of the increase has been due to the recession.

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Some countries have acted particularly vigorously to offset this effect (Japan, Germany and the UK), but in others, structural factors have added to cyclical factors (the US, France and Canada). It is important to set current budgetary policies in the medium-term framework. Those countries where structural deficits are most stubborn have perhaps the greatest need to set them on a convincing declining path. Those where the structural deficit is being brought under control need perhaps to ensure that adequate attention is paid to cyclical factors.

The reduction in inflation and the depressed level of activity has been accompanied generally by a reduction in nominal interest rates. This has been most marked in the United States. Interest rates have also fallen in other countries. Rates, however, remain historically high relative to inflation levels. Reasons for this are unclear, but the persistence of high budget deficits and uncertainty about future inflation may be important contributory factors. This reinforces the need for prudent policies and lower budget deficits both to improve inflationary expectations and to bring down real interest rates.

The reduction in inflation and fall in nominal interest rates in our countries have helped to create the conditions for recovery - the first signs of which are now appearing. We share the view that a moderate rise in world activity and trade seems likely during the course of this year. Our task

both collectively and individually is to ensure that steady policies both leave enough scope for growth in the short-term while preventing a resurgence of inflation in the medium-term.

The way in which Summit leaders see the prospects and policies for sustained economic recovery must surely be a key feature of what comes out publicly at the end of the meeting. It will be worth considering whether this could be couched in terms which put a collective stamp on the slightly different efforts required from individual countries, and provide a collective context - a kind of medium-term financial and economic strategy for the leading industrial countries collectively.

[We should revert to the idea of a paper by the UK as background for discussion of the progress of the world economy as a whole, which would give the opportunity for spelling out a future strategy in disciplined but reasonably attractive terms]

Q2 - What are the implications of our policies for other countries, particularly developing countries?

A2 - Within the Summit group, policies in individual countries can affect interest rates, inflation and activity in others even under floating exchange rates. In recent years interest rates have fluctuated widely with accompanying volatility in exchange markets. The free movement of capital tends to transmit monetary pressures relatively rapidly between countries. This makes it particularly important that the Summit countries all adhere to their joint purpose of reducing real interest rates. In individual countries this implies that monetary control must be supported by adequate budgetary policies.

Imbalances in domestic policies can also contribute to external payments imbalances. A disturbing feature of most of the forecasts for the period ahead is the prospect of growing current payments imbalances between some of the major countries. The prospect of a significant current deficit in the United States, offset by surplus in Japan and Germany poses the risk of further volatility in exchange markets. We need to consider how the balance of domestic policies affects the balance between domestic and external activity in our economies.

Policies in the major countries as a whole clearly have a marked impact on smaller economies, including developing countries. The determination of the major countries to

reduce inflation necessarily involved a period of sluggish activity in their own economies, and this disinflationary process has been transmitted to the developing countries. The most marked effects have been through the slowdown in their export revenues due to depressed world trade and weak commodity prices and through the rise in their debt service costs due to higher world interest rates.

The reduction in inflation and interest rates in the major economies and the prospect of a recovery in activity and trade should ease the problems of developing countries giving them growing markets, firmer prices for their products and reduced debt costs. It will be important, however, that they themselves continue their own adjustment efforts.

They will require finance from official institutions and commercial banks while they carry out this process. In the case of the least developed countries there will be a continuing need for aid flows.

[Points on which it would be appropriate to focus are: debt problems and the need for (satisfaction with) a major IMF role with enhanced resources - see also Q.5; and increased flows of official aid, where IDA and the willingness of the United States to contribute adequately to it may be the most important single feature.]

Q3 - What actions which other countries might take are compatible or incompatible with our individual efforts?

A3 - The interest of the Summit countries as well as the rest of the world is that the recovery that is now in prospect should be both durable and broadly based. The recovery will only be a lasting one if it is not accompanied by a renewed rise in world inflation and interest rates from which individual countries cannot insulate themselves. This implies that major countries need to avoid excessively expansionary monetary and fiscal policies. The United States by the size of its economy and the importance of the dollar in world financial markets bears a special responsibility both to maintain moderate monetary growth and to ensure that its budget deficit is on a convincing downward path.

All countries need to contribute appropriately to the recovery. The decline in world markets in 1982 - both in Summit partners and in non-oil developing countries - was a particular factor hindering growth in the UK where domestic demand was rising satisfactorily. A broadly-based recovery of world activity and trade is in all our interests. Thus it is important that in these countries where inflation has been brought under control this should result in a rise in domestic activity. This will then contribute to the overall recovery.

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It is important, too that countries should eschew protectionist measures. Liberal trade offers the best prospect for improving efficiency among the major countries, and by offering growing markets to developing countries it should make it easier for them to service their debts and adjust their economies.

[This is probably the best heading under which to press the argument against protectionism and any related proposals (separate Department of Trade brief) and to hold any appropriate discussion of oil prices (separate Department of Energy brief)].

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Q4 - What are the current obstacles to a better inter-relationship among our domestic policies, international trade relationships and world financial requirements?

A4 - Divergent inflation performance as well as different policy emphases continue to make exchange rates volatile and in particular cases have been accompanied by increased protectionist pressures.

A narrowing between Summit countries' inflation rates can only be achieved through greater convergence of policies. In view of the Versailles commitment to seek lower inflation, this implies a particular need for firm policies by those countries with above-average inflation rates. A narrowing of inflation differences should help to reduce exchange rate fluctuations.

At the same time it will be necessary to narrow real interest differentials. This implies at least in part that countries tailor their fiscal policies to take account of the pool of domestic savings available rather than rely excessively on the provision of additional funds from overseas, which may complicate other governments' financial plans and lead to disruptive exchange rate movements.

Differences of performance or inconsistency of policies between countries may lead to payments imbalances or exchange rate movements, but these should not be met by protectionist measures but rather by improved policy coordination.

Q5 - What is the proper role of the various international institutions in dealing with the inter-related problems of domestic policy, expanding trade and an open financial system?

A5 - The IMF has a key role in providing finance to countries undertaking firm adjustment programmes. Many of the major debtor countries now have IMF programmes, but the adjustment process is likely to be slow and we cannot rule out further countries seeking IMF help. The Fund, therefore, must be provided with adequate resources. The enlarged and enhanced GAB, together with the recently agreed quota increase, need to be implemented promptly.

from enough because we are constantly including it. too easy for them to get out of their hands

The Fund also has an important role in surveillance of countries' economies and policies, particularly as regards exchange rate and payments regimes. These regular discussions provide a useful opportunity both to examine individual countries' performance and to promote the open trade and payments system.

The BIS has played a welcome and valuable role recently in providing short-term finance to debtor countries in the interval before an IMF programme can be agreed. The BIS has been particularly well-placed by reason of its expertise and the information at its disposal both to monitor short-term liquidity problems and to mobilise resources quickly. Recent experiences have demonstrated the importance of countries going to the IMF at an early stage but in the event of further short-term problems the BIS may still have an important role.

The higher the resources the freedom the variety of debt countries The dollar is when we are not

The World Bank's major role is to provide long term development finance to its developing member countries. IBRD and IDA loans for economically viable projects and medium term structural adjustment programmes complement the balance of payments assistance available from IMF and BIS. IFC has a useful role in promoting private sector development. Of the three World Bank affiliates IBRD and IFC make few demands on member Governments. However, IDA which lends on near grant terms to the poorest countries has to rely almost exclusively on donor country contributions. It is generally agreed that scarce aid resources should be concentrated on the poorest countries which are unable to borrow commercially and that LDC Governments should be pressed to adopt sound economic policies. IDA is the most effective instrument for pursuing both these aims and it is important that donor countries should continue to provide it with adequate resources on an equitable basis.

N.B. This means that aid should not go to the countries among the 3rd world
 The World Bank Group is also an important source of economic policy advice for its borrowing countries, it analyses development policy issues more generally in its annual World Development Reports and is a useful form for discussing new proposals such as the idea of a multilateral investment insurance agency.

The GATT continues to have a key role in safeguarding the open trading system. It is important that we press ahead with the work agreed at last autumn's Ministerial meeting. It is important, too, that we recognise that maintenance of the open trading system requires consistent response across a wide front involving not only the various international bodies but also bilateral arrangements and domestic policies. The GATT of course deals with the major tariff barriers to trade, but the IMF considers competitive exchange rate manipulation and barter deals, while the OECD considers export credits.

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ECONOMIC SUMMIT: PERSONAL REPRESENTATIVES, 16-18 MARCH

BRIEF NO 3: EAST-WEST ECONOMIC RELATIONS

POINTS TO MAKE

1. President Reagan's questions will play important rôle in focussing discussion by Heads of State and Government at Williamsburg. We have attempted to answer them (Annex A). Entirely right that leaders should have a general, philosophical exchange. But this should be in the context of the follow-up work to which we are all committed in the Summary of Conclusions.

2. Believe that we are, overall, making good progress in this work. The OECD dossier for the Ministerial in May is in hand. The NATO Security Study is underway. Work on the Energy Study is making good progress. COCOM's High Level Meeting next month looks like being a success. Discussion of Other High Technology is beginning. Too early to predict precisely what the overall state of play on this work will be at Williamsburg. But with good will and a constructive spirit there should be a reasonable dossier for Heads of State and Government to examine there.

3. Work in hand is most sustained and comprehensive so far undertaken in this field. Believe it is essential on four grounds :-

- a) Must take proper account of concern expressed about security implications for West of our current policies in this field. Essential to check that there is no conflict;
- b) We should try harder to reach consensus on what economic policy should be towards the East. This may require a measure of compromise from all of us;
- c) By talking and working together we reduce the risk of

unilateral measures which damage Western unity;

- d) Specific problems in this field are more easily soluble if we can create an overall framework, based on the facts.

4. Pipeline dispute showed damage caused by different perceptions and unilateral actions. Also highlighted damage West suffers from extraterritorial legislation. Am sure Summit leaders will want to discuss this at Williamsburg.

ECONOMIC SUMMIT: PERSONAL REPRESENTATIVE'S MEETING 16-18 MARCH

BRIEF NO 3: EAST-WEST ECONOMIC RELATIONS

ANNEXES

- A Responses to President Reagan's questions (his message of 28 January to the Prime Minister)
- B Summary of Conclusions, with manuscript annotations
- C Detailed account of the specific work in hand
- D A note on strategic exports
- E Recent conversation between Mr Pym and Secretary Shultz

ESSENTIAL FACTS

The Work

1. Agreement last November on the text of a Summary of Conclusions (Annex B), which led to lifting of the pipeline sanctions, committed Summit partners (and, later, non-Summit EC and NATO partners minus Greece) to specific bits of work, later allotted as follows :-

- i) An OECD ex-post review of East-West Economic Relations;
- ii) An OECD/IEA Energy Study, including European projected energy requirement and dependence on imports (during the course of which Europe would not sign new contracts for purchasing Siberian gas);
- iii) A NATO Study on the Security Aspects of East-West Economic Relations;
- iv) Furtherwork in COCOM, including a second High Level Meeting next month;
- v) Immediate examination of need for controls on Other (non-COCOM) High Technology, including oil and gas technology;
- vi) 'Work urgently further to harmonise export credit policies'.

2. i) and ii) and iii) may be completed before the Williamsburg Summit which President Reagan sees as the key deadline. The Summit can also take stock on iv). The difficulty lies with v) and vi), which are the most controversial items. The Americans have only just tabled proposals on v). They realise that none of their partners will readily accept controls beyond COCOM, and may eventually settle for agreement to review the position at regular intervals. On vi), no doubt recalling their failure to persuade partners before and at the Versailles Summit, the Americans have so far put forward no specific proposals, although in OECD Consensus negotiations they have proposed a general tightening of export credit terms for all rich markets (including the Soviet Union).

3. In her message of 13 November 1982 to President Reagan, the Prime Minister said :-

'although we cannot be committed in advance to the outcome, I will instruct my officials to contribute wholeheartedly and expeditiously to the agreed programme of work'.

4. Although President Mitterrand initially disowned the Summary of Conclusions, the French are participating fully in the follow-up work. But they, and the Germans, and Italians seem less concerned than us about the importance the Americans attach to a serious and fundamental examination of the subject.

5. The Canadians and Japanese seem likely to agree in general to what other Summit partners can accept. But the Japanese are particularly resistant to the idea of controlling exports of other high technology.

6. It is unclear what the Americans expect to get from this exercise. The President and many other people in Washington want recognition that technology transfer should be tightened (both that with military applications and that which generally enhance Soviet economic power to damage the Alliance), that the subsidy element in exports should be further reduced if not eliminated, and that Europe is in danger of mortgaging its security by buying Siberian gas. As the minimum the Administration expects recognition that American concern over Western economic policy towards the East merits more attention than hitherto, that Western policies may need some fine tuning and more coordination, and that the subject should be kept under regular review. This outcome would suit us well. Anything more radical would probably not be acceptable to our EC partners, or to Japan.

Extraterritoriality

7. Pipeline dispute highlighted problems caused by powers in Export Administration Act, which affected, for 'foreign policy' not security reasons companies outside the United States who were part-owned by Americans or held US licences, products and technology sold by the US to European companies for re-export to the Soviet Union, and jeopardised existing contracts. British (and Canadians) long engaged in dialogue with Americans about extraterritoriality. Other Europeans, and Community, became interested during pipeline dispute.

The Export Administration Act is up for renewal in October. While bearing in mind the risk of linkage between progress in this field and concessions to the Americans on East-West economic relations, it is a good time to press objections to its excessive pretensions. American industry also concerned about its implications. But US Administration wishes to preserve President's existing wide powers.

DRAFT ANSWERS TO PRESIDENT REAGAN'S QUESTIONS

Question 1: What is the strategic and economic importance of East-West trade for each of our countries and economies?

Answer: East-West trade is in itself relatively small. It absorbs only some 2% of UK foreign trade, less for the USA, and only about 4% for the EC as a whole. But it is concentrated in certain sectors where it is of major importance to those concerned, and where business lost cannot be replaced elsewhere. European and Japanese exports to the USSR and East Europe are mainly industrial goods and manufactured products. US exports are primarily of grain. The large size of orders and the profitability of the business make it attractive to Western concerns. In the particular sectors concerned, the employment implications can be major. This is sometimes in depressed areas: for example, some 1,700 Clydeside jobs depended on John Brown Engineering delivering for the Siberian pipeline. Approximately half of total East-West trade is with the Soviet Union, some 75% of whose exports to the West are of hydrocarbons, and only around 5% machinery/manufactured goods.

2. There are two broad strategic questions :-

- (i) Whether we can use trade as a lever to influence Soviet behaviour in other (political and military) fields, by developing or restricting it;
- (ii) Whether a reverse leverage exists, whereby the Soviet Union and Eastern Europeans could exert pressure on the West by threatening restrictions of exports (eg oil and gas), refusing to import as normal (eg American grain), or threatening default (on debt owed to the West).

There are no easy answers to these questions. The two trading systems are so different that it is difficult to compare the benefits

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to either side and assess who derives the greatest advantage.

Past history has shown that the Soviet Union has been relatively impervious to attempts to gain political concessions through economic pressures (eg the Jackson-Vannik amendment on Jewish emigration in return for MFN status). But care obviously needs to be taken to ensure that dependence in individual sectors is kept within reasonable limits.

3. East-West trade has to be seen in the context of the need to maintain our security interests while maintaining a stable and lasting peace. We must create stable relationships, including trading relationships, in which we can pursue our own commercial and industrial interests while safeguarding our security. This means not contributing to the Soviet military effort and maintaining the technological gap in our favour - we all participate in COCOM, and are fully committed to the enforcement of its controls - while pursuing trade which confers an appropriate balance of advantage to both sides (no-one has suggested that we wage economic warfare on the Warsaw Pact nations). Within the limits of commercial and financial prudence we must also define carefully what our security interests really are, and whether trade in certain categories of goods in either direction may affect them. This is why we welcome the studies now underway, and look forward to their results.

Question 2: What are our respective national policies and institutions that affect this trade?

Answer: Outside COCOM goods, British policy towards East-West trade and economic relations is based on the principle of commercial advantage. As a trading nation depending on raw materials, our economy cannot survive, let alone grow, unless world trade expands. It follows that we cannot justify restrictions on trade except for closely defined defence reasons, or in certain limited circumstances, for political reasons. We believe that British companies should be able to trade normally in the Soviet and Eastern European markets. To this end we should to the maximum possible extent promote unrestricted trade. We do not believe in expanding trade with the East solely because it might give the Soviet Union an interest in a more constructive East-West political relationship (although this might be the effect). But by the same token we should not restrict trade in non-strategic goods in normal circumstances simply because of the Soviet Union's ideological and political systems. But we must safeguard our vital interests; hence our commitment to COCOM, and our belief that careful and precise definitions of the limits of its controls, and of the products/technologies to which it should apply, are necessary. These definitions will depend on how we define our strategic interests although it will be detrimental to the interests of all if attempts are made to cast the net too widely for all to agree. We hope the studies will help in this respect, and hope to see some results by Williamsburg.

2. Where our domestic institutions and multilateral institutions are concerned, we believe that the divergent interests of those wishing to expand East-West trade in the interests of unrestricted trade and the generation of employment, and those wishing to
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restrict it out of security considerations, must be represented
in those fora where policy is defined.

Question 3 : How do we perceive our common interests in this area and the goals served by these interests?

Answer: Our immediate interest in East-West trade, as in trade with other parts of the world, is to expand trade leading to commercial and material benefit for our companies and their employees, and thus national (and international) enrichment. However, with East-West trade in particular care must be taken to ensure that pursuit of our commercial interests does not do damage to our overall strategic interests. This is the reason for COCOM.

2. Governments should avoid generating uncertainty; they should enable their companies to trade knowing that their contracts and other (eg licensing) agreements will be respected, and that the guidelines of what they may and may not buy and sell are, and will remain, clearly defined and predictable. Governments should observe, and urge observance on the East Europeans, of the CSCE provisions in the area of trade and commercial relations. One of the lessons of the pipeline affair is that unilateral action, especially when retroactive, without prior consultation, is more damaging to ourselves than it is to the Russians.

3. We also believe that it is also in our political and economic interests to maintain a policy of differentiation between some East Europeans and others. It makes sense to be cooperative with countries whose political/economic policies tend to increase their degree of independence from Moscow. We should not make the mistake of lumping all the East Europeans together in one basket, either with each other, or with the Russians.

4. Commercial credit, both Government backed and unguaranteed, should continue to be extended to Eastern Europe as a normal part

of our efforts to develop trade. But the normal principles of commercial and financial prudence should apply. Two factors should be borne in mind, and they apply particularly to Government backed credit. First, such credit should be applied in accordance with the OECD Export Credit Consensus. Second, the overall debt of Eastern European countries should be kept down to levels which the countries concerned can realistically be expected to service. We must not forget the lesson of Poland: the Soviet Union will not necessarily act as the lender of the last resort to their East European clients.

5. On imports, we meet the question of reverse leverage, of how much of what products we can safely import. With energy, it is important to have secure long-term supplies at reasonable cost. With the largest proven reserves of hydrocarbons in the world, it is natural that the USSR should be a major supplier. In importing from there we must ensure that our strategic concerns are fully met but, provided the safeguards exist, it would not serve our interests to try to shun a plentiful, relatively cheap, and not inaccessible supply.

6. We believe that the Western nations should consult on East-West trade to avoid disharmony in our respective approaches. We should accept that differences of emphasis between us may exist for valid commercial and structural reasons; but we should recognise that areas of consensus can be found. Examples of a broad based consensus already exist in both COCOM and the OECD Export Credit Arrangement. Preservation and extension of this consensus is essential if we are to pursue sensibly the twin goals of realistically protecting our security interests at the same time as pursuing our commercial advantage.

Question 4 : Are we progressing towards our goal? What more do we need to do? What conclusions of the East/West Studies should be adopted for common action?

Answer: We consider that we are progressing - albeit slowly - towards our goals. The pipeline dispute acted as a catalyst. In our view, it is of the greatest importance to establish an overall framework for East/West trade and economic relations which all can abide by. It is especially important not to attempt to make rules which do not command general acceptance, and not to attempt to enforce in existing institutions restrictions which some see as unrealistic or unwarranted. It is essential to assess the security implications of our trade and economic relations with the East, and then agree on our approach.

2. COCOM is already implementing the agreed conclusions of the High Level Meeting in January 1982. We cannot yet say what more we need to do, nor what conclusions of the studies should be adopted for common action. We must wait until the studies are completed: we are committed to them without prejudice to their outcome and so should allow their results to guide us in our deliberations. The facts themselves should point the direction. As far as the UK is concerned we hope that the studies will help all of us to achieve a more unified and less fractured perspective on East-West economic relations. In the wake of the studies, we would also hope that all of us concerned will agree on the principles underlying our economic relations in the East.