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MIPT: BONN SUMMIT: US TRADE POLICY

SUMMARY

1. THE PRIMARY US TRADE POLICY OBJECTIVE AT THE SUMMIT WILL BE TO OBTAIN AGREEMENT TO THE LAUNCHING OF A NEW GATT ROUND IN EARLY 1986. CONFIDENCE THAT THE USA CAN GROW ITS WAY OUT OF ITS TRADE DEFICIT PROBLEM HAS NOW EVAPORATED AND THE BUSINESS COMMUNITY AND CONGRESS ARE DEMANDING EARLY ACTION. IF THE SUMMIT IS SEEN TO FAIL, THE DOMESTIC PROTECTIONIST PRESSURES MAY BECOME IRRESISTIBLE. THE ADMINISTRATION IS NOT WELL-EQUIPPED TO HANDLE THE PROBLEM BUT SHULTZ'S WILLINGNESS TO INTERVENE PUBLICLY AND BAKER'S INFLUENCE WILL BE HELPFUL.

DETAIL

2. IF THE RECENT OUTBURST OF CONGRESSIONAL ANGER OVER US-JAPAN TRADE DID NOTHING ELSE, IT MADE CLEAR THE GROWING FRUSTRATION ON THE HILL AND IN THE US BUSINESS COMMUNITY AT A PERCEIVED LACK OF CONCERN BY THE ADMINISTRATION AT THE SIZE OF THE US TRADE DEFICIT AND THE CONSEQUENCES OF A CONTINUED HIGH VALUE DOLLAR FOR MUCH OF US INDUSTRY

INTELLECTUALLY, MOST CONGRESSMEN AND AMERICAN BUSINESSMEN KNOW THAT THERE IS A CASUAL RELATIONSHIP BETWEEN THE SIZE OF THE BUDGET DEFICIT AND THE RECORD LEVELS OF CURRENT ACCOUNT DEFICIT BUT THIS BRINGS LITTLE CONSOLATION TO EXPORTERS PRICED OUT OF OVERSEAS MARKETS OR DOMESTIC INTERESTS FACING OVERWHELMING IMPORT COMPETITION. THE TRADE DEFICIT IN 1984 WAS DOLLARS 123 BN AND IN 1985 IT IS FORECAST TO REACH DOLLARS 140-150 BN. LAST YEAR 26 PERCENT OF ALL (NON-AUTO) CAPITAL INVESTMENT WAS SUPPLIED BY IMPORTED EQUIPMENT AND THE PROPORTION IS INCREASING.

3. THE ADMINISTRATION HAVE CRIED WOLF ABOUT CONGRESSIONAL PROTECTIONIST PRESSURES MANY TIMES IN THE PAST, BUT THE UNANIMOUS SENATE RESOLUTION, FOLLOWED BY THE SIMILAR ONE IN THE HOUSE CALLING FOR TRADE RETALIATION AGAINST JAPAN, CLEARLY CAME AS A SHOCK TO THEM. THOSE PRESSING FOR PROTECTIONIST MEASURE, PARTICULARLY AGAINST JAPAN, NOW INCLUDE MANY OF THE KEY REPUBLICAN SENATORS WHO HAD BEEN MOST VEHEMENTLY IN FAVOUR OF FREE-MARKET SOLUTIONS IN THE FIRST REAGAN ADMINISTRATION AND HAD ENSURED THAT THE DOMESTIC CONTENT BILL AND

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OTHER TRADE RESTRICTIVE LEGISLATION HAD BEEN BOTTLED UP. THE DEPUTY USTR CONFIDED TO US AT THE TIME THAT HE NO LONGER BELIEVED THAT THERE WERE ENOUGH VOTES IN CONGRESS TO PREVENT OVER-RIDE IF THE PRESIDENT WERE TO VETO PROTECTIONIST TRADE LEGISLATION AGAINST JAPAN. DEALING WITH THE JAPANESE TRADE DEFICIT PROBLEM IS NOW A MAJOR PREOCCUPATION FOR THE ADMINISTRATION, WHICH MUST SHOW SOME PROGRESS IF IT IS TO PREVENT CONGRESS TAKING THE LAW INTO ITS OWN HANDS. IT MUST HANDLE THE PROBLEM DURING A PERIOD OF LOWER ECONOMIC GROWTH AND MORE UNCERTAIN PROSPECTS FOR THE YEAR AHEAD.

4. AGAINST THIS BACKGROUND, THE ADMINISTRATION IS MORE CONCERNED THAT EVER THAT THE BONN ECONOMIC SUMMIT SHOULD NOT ONLY ENDORSE MARKET-OPENING MEASURES BY JAPAN AND GREATER ECONOMIC GROWTH IN EUROPE, BUT SHOULD ALSO SET A TIME FOR THE OPENING OF A NEW GATT ROUND IN EARLY 1986. THEY SEE THE ROUND AS THE BEST WAY OF CONTAINING PROTECTIONIST PRESSURES IN THE MEDIUM-TERM, AND WERE PLEASED WITH THE OUTCOME OF THE OECD MINISTERIAL MEETING WITH ITS PLEDGE TO OPEN PREPARATORY DISCUSSIONS IN THE GATT THIS SUMMER. THERE WAS INTER-AGENCY DISCUSSION LAST WEEK ABOUT WHETHER THE US COULD SETTLE AT BONN FOR THE OECD OUTCOME, BUT THE CLEAR UPSHOT WAS THAT IT SHOULD NOT DO SO, AND AGREEMENT ON A DATE FOR OPENING OF THE TRADE NEGOTIATIONS HAS, PERHAPS UNFORTUNATLY, NOW BECOME FOR THE ADMINISTRATION A LITMUS TEST OF US SUCCESS OR FAILURE AT THE SUMMIT.

5. PARADOXICALLY, THERE IS LITTLE SIGN THAT SIMILAR SIGNIFICANCE IS YET ATTACHED TO THE GATT ROUND ELSEWHERE IN WASHINGTON. KEY CONGRESSIONAL FIGURES ARE DETERMINED THAT QUOTE SOMETHING MUST BE DONE UNQUOTE NOW ABOUT TRADE IMBALANCES. THEY BELIEVE THAT THE GATT PROCESS IS TOO SLOW AND ITS OUTCOME TO INDETERMINATE, AND THEY THEREFORE REMAIN TO BE CONVINCED THAT A NEW ROUND WILL SERIOUSLY HELP, CERTAINLY IN A FORESEEABLE TIME-SCALE. ONLY THE SERVICES SECTOR IN THE BUSINESS COMMUNITY SHOWS ANY REAL ENTHUSIASM FOR THE CONCEPT. TO THE EXTENT THAT THOUGHT HAS BEEN GIVEN TO THE PROPOSAL, THERE IS REAL CONCERN ABOUT THE PRICE THE US WOULD HAVE TO PAY IN ANY NEGOTIATIONS, AND NO WILLINGNESS TO CONSIDER SERIOUSLY THE CONCESSIONS, FOR EXAMPLE ON TEXTILES, WHICH MIGHT NEED TO BE OFFERED UP TO THE LDC'S. THERE REMAINS A PERVASIVE FEELING THAT ONLY THE AMERICANS PLAY BY THE RULES OF THE WORLD TRADING SYSTEM AND THAT THE GATT PROCESS WILL TAKE TOO LONG TO AFFECT THE PRESENT CRISIS OF TRADE IMBALANCES.

6. THERE IS, AT THE MOMENT, AN UNWRITTEN UNDERSTANDING BETWEEN THE WHITE HOUSE AND THE REPUBLICAN LEADERSHIP IN THE SENATE THAT NOTHING WILL BE DONE ON THE TRADE FRONT THIS SIDE OF THE SUMMIT AND PROBABLY FOR SOME WEEKS THEREAFTER. THE RECENT DECLINE IN THE DOLLAR, AND PERHAPS TH US OFFER AT THE OECD MINISTERIAL MEETING TO HOLD A MEETING ON INTERNATIONAL MONETARY REFORM, HAS TEMPORARILY TAKEN SOME OF THE HEAT OUT OF THE FRUSTRATION WHICH WAS EXPRESSED OVER THE US-JAPAN TRADE ISSUE (THOUGH MUCH ATTENTION WILL STILL BE FOCUSED ON THE REAGAN/NAKAONE BILATERAL IN BONN). IT IS ALSO NOTICEABLE, FOR EXAMPLE, THAT THE US CHAMBER OF COMMERCE AND THE NATIONAL ASSOCIATION OF MANUFACTURERS (TWO KEY BUSINESS ORGANISATIONS) HAVE

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BOTH NOW REJECTED THE IMPORT SURCHARGE PROPOSAL AS A SOLUTION TO THE US TRADE PROBLEM. THE PROPOSAL IS FAR FROM DEAD, BUT SO LONG AS THERE ARE SIGNS THAT THE EXCHANGE RATE IS MOVING IN THE RIGHT DIRECTION AND THAT THE ADMINISTRATION IS BECOMING MORE PRAGMATIC AND LESS DOCTRINAIRE IN ITS APPROACH TO INTERNATIONAL ECONOMIC AFFAIRS, THE BENEFIT OF THE DOUBT MAY STILL FOR THE PRESENT BE GIVEN TO THE PRESIDENT.

7. THE ADMINISTRATION'S NEW MORE PRAGMATIC TONE IN RECENT WEEKS WAS BEST EXPRESSED BY SECRETARY SHULTZ IN HIS SPEECH AT PRINCETON, BUT IT HAS MUCH TO DO WITH THE EMERGENCE OF SECRETARY BAKER AS THE KEY PLAYER ON THE STAGE. IN MY VIEW, THE WHITE HOUSE HAVE LOST, AND THE TREASURY GAINED. IN BOTH LEGS OF THE BAKER REGAN SWITCH. THE APPOINTMENT COINCIDED WITH A VIRTUAL VACUUM OF POWER IN THE OTHER DOMESTIC ECONOMIC DEPARTMENTS. SECRETARY BAQDRIDGE LOST OUT OVER THE PRESIDENT'S DECISION NOT TO ENDORSE THE IDEA OF A UNIFIED DEPARTMENT OF INTERNATIONAL TRADE AND INDUSTRY. THE USTR'S OFFICE IS TEMPORARILY HEADLESS, FOLLOWING THE NOMINATION OF BROCK AS LABOUR SECRETARY, AND HIS SUCCESSOR, YEUTTER IS STILL AN UNKNOWN QUANTITY AND UNLIKELY TO BE CONFIRMED BY THE SENATE BEFORE MID-MAY. BOTH DEPARTMENTS HAVE LOST OUT IN THE RECENT REORGANISATION OF THE CABINET COMMITTEE STRUCTURE WHICH CLEARLY PLACES BAKER IN CHARGE OF WIDER ECONOMIC POLICY. HIS FLEXIBILITY COULD CONTRAST WELL WITH THE PERFORMANCE OF HIS PREDECESSOR: PROVIDED THE LATTER'S WHITE HOUSE TEAM DOES NOT OBSTRUCT HIM BY ITS OWN INFLEXIBILITY, AND LESS DEFT TOUCH ON THE HILL.

8. IN THE MEDIUM TERM, HOWEVER, THE DANGERS OF AN UPSURGE OF PROTECTIONIST ACTION REMAIN. EVEN IF THE DOLLAR CONTINUES TO DECLINE, IT WILL TAKE TIME FOR THE EFFECT TO BE REFLECTED IN US TRADE PERFORMANCE. THE IMPORTS FLOODING INTO THE US MARKET NOW WERE ORDERED IN 1984, AND THE DOLLAR WOULD HAVE TO FALL VERY MUCH FURTHER BEFORE FOREIGN GOODS LOST THEIR COMPETITIVE EDGE, NOT LEAST BECAUSE EXPORTERS COULD IN LARGE MEASURE ABSORB THE EXCHANGE RATE LOSS AND STILL MAKE A HEALTHY PROFIT. IN THE PERIOD OF LOWER ECONOMIC GROWTH WHICH IS NOW IN PROSPECT, THE PROCESS OF ADJUSTMENT TO THAT COMPETITION BY US INDUSTRY WILL BE THAT MUCH HARDER AND THE TEMPTATION TO CALL FOR RELIEF AGAINST IMPORTS THAT MUCH GREATER.

CONCLUSION

9. THE ADMINISTRATION WILL GO INTO THE BONN SUMMIT ACUTELY AWARE THAT IT FACES A RECORD TRADE DEFICIT IN 1985 AND GROWING PROTECTIONIST PRESSURES AT HOME. RIGHTLY OR WRONGLY, IT SEEMS CONVINCED THAT THOSE PRESSURES CAN ONLY BE RESISTED BY A FORMAL SUMMIT ENDORSEMENT OF A FIRM DATE IN EARLY 1986 FOR THE OPENING OF A NEW GATT ROUND, AND THE PRESIDENT WILL GO HARD FOR THIS IN BONN. HAVING PINNED ITS COLOURS SO PUBLICLY TO THIS MAST, THE ADMINISTRATION'S CREDIBILITY ON TRADE ISSUES - MUCH QUESTIONED RECENTLY ON THE HILL - WILL LOOK VERY THIN IF THE SUMMIT DOES NOT PRODUCE SOME PROGRESS

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ON THE ISSUE. BUT IN PRACTICE, WHAT HAPPENS IN THE FOREIGN EXCHANGE MARKET, AND WHAT IS DONE BILATERALLY WITH JAPAN WILL PROBABLY HAVE MUCH GREATER IMPACT ON THE HILL IN THE IMMEDIATE FUTURE. IF THE LEADERS OF THE MAJOR INDUSTRIALISED NATIONS ARE SEEN TO BE IN AGREEMENT ON THE BROAD RANGE OF INTERNATIONAL ECONOMIC ISSUES, THIS WILL DO MUCH TO STRENGTHEN THE ADMINISTRATION'S HAND IN REDUCING DOMESTIC TENSIONS. WE CANNOT HOWEVER RULE OUT THE POSSIBILITY OF FURTHER PRECIPITATE US ACTION IN INDIVIDUAL SECTORS AGAINST EC EXPORTS (EG OVER STEEL CONSULTATION PRODUCTS) EVEN IF THE SUMMIT IS A SUCCESS. IT WILL BE RECALLED THAT THE PRESIDENT TOOK ACTION AGAINST STAINLESS STEEL IMPORTS IMMEDIATELY AFTER THE ANTI-PROTECTIONIST PLEDGES OF THE 1983 ECONOMIC SUMMIT.

10. ADVANCE COPIES TO POWELL (NO 10), PPS/S OF S, PPS/CHANCELLOR, HATFIELD (CABINET OFFICE), PS/PUS, LITTLER (TREASURY), HAYES (DTI), BRAITHWAITE (FCO).

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