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TORONTO, CANADA
JUNE 19 - 21, 1988

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BACKGROUND BOOK
THE ECONOMIC SUMMIT
TORONTO, CANADA

JUNE 19 - 21, 1988

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TORONTO ECONOMIC SUMMIT
BACKGROUND BOOK

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I. SUMMIT THEMATIC PAPER

CANADIAN THEMATIC PAPER

(Drafted by Canada as a Result of Sherpa Discussions)

TORONTO ECONOMIC SUMMIT: THEMATIC PAPERINTRODUCTION

1. The Toronto Summit is the fourteenth; the end of the "second cycle". During this period, the world economy and economic policy have undergone profound changes. The information-technology revolution and the globalization of markets have increased economic interdependence, making it essential that governments consider fully the international dimensions of their deliberations.

2. Most striking is the contrast between the 1970s and 1980s. The former was a decade of high and rising inflation, declining productivity growth, commodity and oil-price shocks, policies dominated by short-term considerations, and sporadic and often inadequate international policy cooperation. In the 1980s inflation has been brought under control, laying the basis for sustained strong growth and improved productivity. However, the 1980s also saw the emergence of large external imbalances in the major industrial economies, greater exchange rate volatility, and debt-servicing difficulties in highly-indebted developing countries. Managing the transition to more sustainable economic and financial positions while supporting growth has required more continuous and effective international cooperation, such as the intensified process of policy coordination adopted at the 1986 Tokyo Summit. That process was further strengthened at the Venice Summit.

3. Thus, especially in the 1980s, Summits have motivated and spurred the expanding process of international policy cooperation. They have proven an effective forum to address the issues facing the world economy, promote new ideas and develop a common sense of purpose. They have helped bring about an increasing recognition that the conquest of inflation and of inflationary expectations is fundamental to sustained growth and job creation. That recognition has been fortified by a shift from short-term considerations to a medium-term framework for the development and implementation of economic policies, and a commitment to improve efficiency and adaptability through greater reliance on market forces and structural reform while at the same time confirming the effectiveness of social policies. Leaders have also achieved increasing consensus on the importance of resisting protectionism and strengthening the open, multilateral trading system; an effective strategy to address the challenge of development and alleviate the burden of debt; and recognition of the serious nature of the world agricultural problem.

4. The Toronto Summit provides the opportunity to acknowledge the contribution that Summits have made to international affairs; to strengthen the ties of solidarity that bind the Summit partners; and to express their greater awareness of their responsibilities to the wider community of nations.

5. Since the Venice Summit the industrialized countries have continued to grow strongly and are now in their sixth year of economic expansion. Employment has continued to expand, inflation has been restrained, and progress has been made toward the correction of major external imbalances. The situation of some developing countries was improved by the recovery in their terms of trade and strong growth in world trade.

6. These encouraging economic developments are cause for optimism, but not for complacency. A number of challenges face Summit governments: to continue narrowing large external and internal imbalances, thereby reinforcing the conditions for exchange rate stability; to spur job creation and reduce the high unemployment in a number of countries, particularly in Europe; to forestall any resurgence of inflationary pressures; to foster the process of structural adjustment; to resist protectionist pressures and strengthen the multilateral trading system; and to provide support for developing countries in their efforts to implement effective programs of structural reform and macroeconomic adjustment, which would increase capital formation and ease external debt-servicing difficulties.

To meet these challenges, Summit countries must reinforce their commitment to continued economic cooperation. This will enhance credibility, the key to market confidence.

POLICY COORDINATION

Macroeconomic Policies and Exchange Rates

7. At the Tokyo and Venice Summits and in the Group of Seven forum, the Summit countries have developed and strengthened the coordination of their economic policies. Developments in the wake of the financial strains last October demonstrate the effectiveness and resilience of the arrangements that have emerged. Regular reviews of their policies and performance are taking place in the Group of Seven. Medium term objectives and projections are being discussed for each of their economies and for Summit countries as a group, together with prospects for short term performance, as a basis for assessing current economic trends. The Summit welcomes the progress made in refining the analytical use of indicators, as well as the addition to the existing indicators of a commodity-price indicator.

8. The Summit countries have undertaken a series of fiscal, monetary and structural policies to foster the adjustment of international imbalances which is underway. Efforts in those directions, including continued reduction of budgetary deficits, must continue if the progress to date is to be sustained. To manage the transition over the medium term to more sustainable economic and financial positions in the context of non-inflationary growth, governments will follow, and where feasible strengthen, the agreed strategy of coordinated efforts to reduce spending in countries with large external deficits and sustain the momentum of domestic demand in countries with large external surpluses.

9. The reduction of external imbalances will require the cooperation not only of the Summit countries, but also of some of the smaller European economies and of newly industrializing economies with large external surpluses.

10. The exchange rate changes in the past three years, especially the real depreciation of the U.S. dollar against the Japanese yen and the major European currencies, have played a major role in the adjustment of real trade balances. The Summit should reaffirm that

either excessive fluctuation of exchange rates, a further decline of the dollar, or a rise in the dollar to an extent that becomes destabilizing to the adjustment process, could be counterproductive by damaging growth prospects in the world economy.

Structural Reforms

11. International cooperation involves more than macroeconomic policies. Summit countries have increasingly been concerned with monitoring and promoting structural policies which complement macroeconomic policies, enhance their effectiveness, and provide the basis for more robust growth. In so doing, they facilitate the sectoral adjustments associated with the correction of external imbalances.
12. Summit countries should welcome the further development of the OECD's surveillance of structural reform. Such surveillance would be particularly useful in improving public understanding by increasing transparency. For example, improved analysis and monitoring of government subsidies to industry and agriculture would reveal their impact on government budgets, consumer prices, and international trade.
13. Summit countries should explore other ways of strengthening the momentum for structural reform; for example, by policies which mitigate the social and regional costs which such reform may engender.
14. Agriculture remains one of the most serious structural problems in both developed and developing countries. It is critically important that encouraging policy reform efforts undertaken by a number of parties be reinforced through further positive action by all Summit countries. The primary objective of agriculture in all our countries is to satisfy the demand for food in the most economic way possible. Other important objectives, such as satisfactory levels of farm incomes, the preservation of rural communities, and environmental protection, can be achieved without distorting production or market decisions. The Summit should welcome the OECD's increased emphasis on structural adjustment and development in the rural economy.
15. Financial and technological innovations are rapidly integrating financial markets internationally, contributing to a better allocation of capital but also increasing the speed and extent to which disturbances in one country may be transmitted to other countries. Summit countries should continue to cooperate amongst themselves and with other countries in the examination of the functioning of the global financial system, including securities markets.
16. Summit countries will continue to pursue structural reforms by: removing barriers, controls and regulations; increasing exposure to market competition; removing disincentives to work, save, and invest such as through tax reform; and by improving human resource development through education and training. In this context, the specific priorities that Summit countries have identified have been outlined in the attached Annex.

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MULTILATERAL TRADING SYSTEM/URUGUAY ROUND

17. To realize fully the benefits of structural policies to liberalize markets and enhance competition, it is crucial that an open international trading system be maintained. Thus, a successful Uruguay Round is of critical importance.

18. A successful Uruguay Round will assure the integrity of an open, predictable multilateral trading system based on clear rules of the road, permitting trade expansion to resume its role as the engine of world economic growth and development. At Punta del Este, Ministers committed themselves to further trade liberalization across the wide range of goods and services, including such new areas as trade-related intellectual property and trade-related investment measures, and to strengthen the multilateral trading system. Countries must continue to resist protectionism and the temptation to adopt unilateral measures outside the framework of GATT rules.

19. Summit leaders should welcome the Free Trade Agreement between Canada and the USA, negotiated and concluded under the GATT, which should serve as a catalyst for progress in the Uruguay Round. They should note the steady progress toward the target of the European Community to complete the internal market by 1992. Summit leaders should affirm that these developments, together with other moves toward regional cooperation in which they are involved, would not weaken but rather support the open, multilateral trading system and the liberalizing impact of the Uruguay Round.

20. Accordingly, strengthening the GATT itself, particularly surveillance of trade policies and dispute settlement procedures, is a high priority. These objectives require the GATT to become a more dynamic and policy oriented organization, with greater Ministerial involvement, and strengthened linkages with other international organizations. To ensure that disputes are resolved speedily, effectively and equitably, GATT disciplines must be tightened so that members accept their obligations, and ensure that recommendations on dispute settlement are implemented.

21. The future role of developing and newly industrializing economies (NIEs) in the GATT system should also be a major part of this message. Both developing and developed countries share an appreciation that trade can play a key role in development. The developing countries (especially the NIEs), should be encouraged to undertake increased commitments and obligations and a greater role in the GATT, commensurate with their importance in international trade and the international adjustment process, as well as their respective stages of development. Equally, developed countries should consider what they are prepared to do to meet the legitimate need of developing countries for greater, more secure access for their exports.

22. Nowhere is the need for progress more evident than in agriculture. Reflecting the clear terms of reference provided by the Punta del Este Declaration and the political impetus provided by the 1987 OECD Ministerial and the Venice Economic Summit, good progress was made during 1987 in the Uruguay Round negotiations on agriculture.

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with the tabling of major proposals. Continued political support and impetus is essential to underpin the politically difficult efforts at domestic policy reform and to advance the equally difficult and related process of comprehensive agricultural trade reform.

23. It is necessary to ensure that the Mid-Term Review in Montreal in December, 1988 spurs the negotiating process in this as in other fields. Summit countries should agree on a framework approach, including short as well as long term elements which will promote the reform process as launched last year and relieve current strains in agricultural markets. More precisely, this would be facilitated by agreement on the measures to be included in a device for the measurement of support and protection, such as a modified producer subsidy equivalent, and on the trade liberalization target. Also in this context, ways should be developed to take account of food security and social concerns. Any short term measures would need to be a downpayment on the achievement of long term goals. The objective of the framework would be to make the agricultural sector more responsive to market signals.

24. As the Uruguay Round enters a more difficult phase, it is vital to ensure the momentum of these ambitious negotiations. The Mid-Term Review will provide a unique opportunity to send a credible political signal to the trading world. The greatest possible advance must be made in the months to come, in all areas of the negotiations, so as to reach before the end of the year the stage where tangible progress can be registered. To this end, the Summit countries urge all participants to seek to agree during that period on framework approaches in the negotiations. [These include fundamental reform of GATT rules, market access, agriculture, trade in services, trade related intellectual property and trade related investment measures.] For their part, Summit countries are committed to ensure that the Mid-Term Review establishes a solid base for the full and complete success of the negotiations, in accordance with the Punta del Este Declaration.

25. Summit countries all recognize the critical and expanding role of international investment in the world economy. They share a deep concern that increased protectionism would undermine the benefits of open investment policies. Governments should express their resolve to progressively liberalize international investment policies.

NEWLY INDUSTRIALIZING ECONOMIES

26. Certain newly-industrializing economies (NIEs) in the Asia-Pacific region have become increasingly important in world trade. Although these economies differ in many important respects, they are all characterized by dynamic, export-led growth which has allowed them to treble their share of world trade since 1960. Other outward-oriented Asian countries are also beginning to emerge as rapidly-growing exporters of manufactures. Intra-regional investment and trade are creating greater interdependence among the economies of the region.

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27. With increased economic importance come greater international responsibilities and a strong mutual interest in enhanced cooperation. There is a need for improved constructive dialogue between the industrialized countries and the Asian NIEs, as well as the other outward-oriented countries in the region. The dialogue should centre on cooperative efforts in the near term to achieve the international adjustment necessary for sustained, balanced growth of the world economy. The development of informal processes which would facilitate multilateral discussions of issues of mutual concern such as macroeconomic, trade and structural adjustment policies should be encouraged.

DEVELOPING COUNTRIES AND DEBT

28. The performance of developing countries and their role in world trade have become increasingly important to the world economy. The situation of individual developing countries varies widely; many still face serious economic difficulties. Central to the prospects of all is a global economic environment conducive to strong and sustainable growth, an open trading system, adequate financial flows and, most importantly, a commitment by debtor countries to appropriate economic reform.

Middle-Income Countries

29. The market-oriented, growth-led strategy based on the case-by-case approach for dealing with the debt problems of the highly indebted middle-income countries remains the only viable strategy. This strategy has achieved significant progress in a number of areas:

- many indebted countries have begun the process of macroeconomic adjustment and structural reform necessary for sustained progress, encouraging the return of flight capital and new investment flows;
- lending from official sources has continued to grow at a significant rate;
- the "menu approach" has continued to expand and has facilitated the channelling of commercial bank lending into productive uses; and
- the risk to the international financial system has been greatly lessened as commercial banks have strengthened their financial positions.

30. Progress toward a lasting solution, however, has been slower than earlier expected. High debt ratios persist and the return to creditworthiness for many countries remains distant. The financing situation generally is expected to remain difficult.

31. Official financing and the international financial institutions have played and will continue to play a central role in the debt strategy:

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- through the Paris Club, over US\$73 billion of principal and interest have been consolidated since 1983. Export credit agencies will continue to play a flexible role in promptly resuming or increasing cover for countries which are implementing comprehensive adjustment programs;
- the US\$74.8 billion General Capital Increase (GCI) for the World Bank will substantially increase available resources. Speedy approval and subscription to the GCI by all governments is essential;
- the modified Extended Fund Facility (EFF) of the IMF will support emphasis on medium-term structural adjustment. Also, the incorporation into Fund programs of external contingency mechanisms would assist countries to adhere to their adjustment programs in the face of unexpected adverse external events.

32. Commercial banks hold nearly two-thirds of the external debt of the middle-income countries, and their continued involvement in the debt strategy is essential. In this regard, the World Bank and IMF can play an important catalytic role in mobilizing additional financing from private (and official) sources in support of debtor countries' adjustment programs.

33. In recent years there has been increasing recourse to innovative financing techniques. The important characteristics of these techniques are that they are voluntary, market-oriented, and applied on a case-by-case basis. The "menu approach" has engendered new financial flows and, in some cases, reduced the existing stock of debt. The flexibility of the present strategy would be enhanced by the further broadening of the menu approach and the encouragement of innovative financing techniques to improve the quality of new lending.

34. International direct investment can play an important role in spurring economic growth and alleviating debt problems in developing countries. Accordingly, developing countries, for their part, should welcome and encourage such investment. The positive contribution that the Multilateral Investment Guarantee Agency and the International Finance Corporation are making in stimulating international direct investment should be encouraged.

Debt of the Poorest

35. The debt burden of the poorest developing countries, especially in Sub-Saharan Africa, is part of a broader developmental challenge that requires the developing countries to persist with strong adjustment measures and developed countries to provide adequate concessional assistance. Progress in dealing with the debt burden has been encouraging over the past year:

- the recent enhancement of the IMF's Structural Adjustment Facility by SDR 6 billion will substantially increase funds available on highly concessional terms for low-income countries undertaking structural reform;

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- the World Bank, in conjunction with ODA agencies, has put in place an enhanced program of co-financing aimed at the poorest countries. The donors have announced a total contribution amounting to US\$6.4 billion for the period 1988/90;
- the fifth replenishment of the African Development Fund has reached a total amount of approximately US\$3 billion;
- Paris Club creditors are rescheduling debt at extended grace and repayment periods.

The first three initiatives listed above will mobilize a total of more than US\$18 billion in favour of the poorest and most indebted countries undertaking an adjustment effort over the period 1988/90. Out of this total, US\$15 billion will be channelled to sub-Saharan African countries. The bulk of it will help finance adjustment programs.

36. In cases where it is extremely difficult for countries to meet their debt-service obligations, an increase in concessional resource flows will be necessary to help those countries resume sustained growth. One proposal is to reschedule the commercial debts of the poorest countries at concessional interest rates. An alternative is for official creditors to choose between shorter repayment periods at concessional rates and longer repayment periods at commercial rates. Thus, the adoption of options, as in the menu approach, to allow creditors the choice to offer concessional interest rates with shorter maturity periods would be a positive development. The relief provided would be additional to countries' existing aid programs.

37. Other techniques for reducing the burden of debt service should also be explored, including the provision of grants for countries undertaking adjustments, and further ODA debt cancellation.

FUTURE SUMMITS

38. The challenge for future Summits remains the same as that confronting leaders today: coping effectively with change in an increasingly interdependent world. There is a proven way to achieve this -- through an evolutionary process of improved international cooperation. In particular, we should examine the opportunities for strengthening Summit cooperation in: improving coordination of economic policies; striving for a more open international trading system; intensifying efforts in favour of poor and indebted countries; and extending international cooperation to other issues as they emerge. Based on the lessons learned from past Summits, these will be among the main tasks of future ones.

OTHER ISSUES

In addition to economic matters, the leaders have discussed other issues: --

ENVIRONMENT

1. Protection and enhancement of the environment is essential. The report of the World Commission on Environment and Development has stressed that environmental considerations must be integrated into all areas of economic policy-making if the globe is to continue to support humankind. Summit countries endorse its concept of sustainable development.
2. Threats to the environment recognize no boundaries. Their urgent nature requires strengthened international cooperation, not merely among the industrialized countries, but between East and West, and North and South. Significant progress has been achieved in a number of environmental areas. The Montreal Protocol on Substances that Deplete the Ozone Layer is a milestone. All countries should be encouraged to sign and ratify it. Completion of negotiations on a protocol on emissions of nitrogen oxides within the framework of the Geneva Convention on Long-range Transboundary Air Pollution is important. The efforts of UNEP for an agreement on the transfrontier shipment of hazardous wastes are welcome and encouraged.
3. Further action is needed. Global climate change, air and water pollution, hazardous substances, deforestation, and endangered species require priority attention. A worldwide consciousness must be developed and maintained to counter threats that diminish the heritage of humankind. In this connection, the Summit countries welcome the establishment of an intergovernmental panel on global climate change under the auspices of the UNEP and the WMO. The Summit welcomes the Conference on the Changing Atmosphere to be held in Toronto.

DRUGS

4. Illicit narcotics trafficking poses grave risks to the peoples of Summit countries as well as to the peoples of source and transit countries. There is an urgent need for improved international cooperation in all appropriate fora on programs to counter all facets of the illicit drug problem, in particular, production, trafficking, and financing of the drug trade. The complexity of the problem requires not only reinforcement of present efforts but also additional international approaches. In this respect, we look forward to the successful negotiation in Vienna in November of a United Nations Convention on illicit trafficking.

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5. The Summit also could consider supporting an initiative of the Government of the United States to convene a special task force comprised of senior foreign affairs, enforcement, finance and other appropriate officials from Summit countries concerned with the fight against narcotics. This task force should propose methods of improving cooperation in all areas including national, bilateral and multilateral efforts.

HUMAN FRONTIER SCIENCE PROGRAM

6. We note the successful conclusion of Japan's feasibility study on the Human Frontier Program and are grateful for the opportunities our scientists were given to contribute to the study. We look forward to the Japanese government's proposal for the implementation of the program in the near future.

BIOETHICS

7. We note that, as part of the continuing review of the ethical implications of developments in the life sciences, the Italian government hosted the fifth conference on bioethics in April 1988 and welcome the intention of the European Community to host the sixth conference in the spring of 1989.

French reserve

ANNEX

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- Europe is pursuing structural reforms to complement macroeconomic policies in order to spur job creation, enhance growth potential, and achieve a sustainable pattern of external balances. Structural reform measures are being put into place in the framework of the Community programme for a unified internal market by 1992; including full liberalisation of capital movements; removal of physical, administrative and technical barriers to allow the full mobility of persons, goods and services and an improvement of competition policy. However, full achievement will depend on timely implementation and on associated regional and social policies.
- The main elements of Germany's structural reforms are tax reform and reduction, deregulation and privatization, reform of the postal and telecommunications system, increased flexibility in the labour market, and reform of the social security system.
- In France, the main structural reforms will deal with improving the level of education and professional training and development for workers, the reform of financial markets, and the elaboration of fiscal incentives to innovation and to productive investment.
- Italy will seek to promote training and education, increase the flexibility of the labour market to spur employment, improve the functioning of financial markets, revise the tax system to promote efficiency and eliminate distortions, and enhance public sector efficiency.
- The United Kingdom has been pursuing a substantial program of tax reform, deregulation, the opening up of markets and the privatization of state industries, and will continue the program through further measures to improve the flexibility of the workforce through education, training, and other actions.
- Japan will pursue further structural reforms to support and sustain the greater reliance on domestic demand-led growth which has quickened remarkably over the past year. Japan will promote reform of government regulations in key sectors, including agriculture and land use policies, the distribution system and the tax system.
- For the United States, where recent indications that the declining trend in private savings may have bottomed out are encouraging, it is nonetheless a priority to increase incentives to save. Also the United States will strengthen the international competitiveness of its industrial sector.
- The most promising areas of structural reform in Canada are implementation of the second stage of tax reform, the proposed liberalization of the financial services sector, and, most importantly, the implementation of the Free Trade Agreement with the United States.

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CANADA

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BACKGROUND PAPER
CANADA

Economic Overview: Strong growth, improved employment.

- Canadian economy continues strong 3.5 percent growth; inflation moderate at 4 percent; unemployment at 7.7 percent, lowest since 1981.
- Higher world raw materials prices will favor Canadian resource sector.
- Good fiscal management to reduce deficit, tax reform, and privatization and deregulation of broad sectors -- including aviation and banking -- should lead to improved economic performance.
- Free Trade Agreement ratification process underway; scheduled to enter into force January 1, 1989.

Political Overview: Tories' popularity again on slide.

- After closing gap as result of conclusion of FTA and Meech Lake Constitutional Accord, Tory party support again slipping in public opinion polls.
- Opposition Liberal party leading in polls, although party squabbling makes leader's position uncertain.
- Mulroney looks to Economic Summit to bolster image prior to elections still expected this fall.

Canadian Views on Summit Issues

- Canadians share our desire for less-structured Summit, with more informal sessions among the leaders and communicate reflecting topics actually discussed.
- Canadians keen to discuss agricultural subsidies and Bush initiative on international drug trade.
- Sherpa Sylvia Ostry interested in discussing a proposal that GATT monitor microeconomic factors similar to how IMF oversees macroeconomic policies.
- Mulroney has expressed his interest in having this be a Summit of unity, without divisive issues; thus, he is unlikely to raise South Africa.

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| | <i>Document Description</i> | <i>pages</i> | | <i>tions</i> |
| 244846 | REPORT | 1 | 5/24/1988 | B1 |

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| 244847 | REPORT | 2 | 4/7/1988 | B1 |

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JAPAN

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BACKGROUND PAPER
JAPAN

Economic Overview: Strong domestic growth, low inflation, declining trade surplus.

- Economy has adjusted well to strong yen; robust domestic growth in 2nd half of 1987 expected to continue in 1988; private consumption and investment are expanding briskly; public sector slows; solid growth and continuing external adjustment forecast into 1989.
- Inflation under control: 0.1% in 1987, 0.8% in 1988. Unemployment down to 2.6%, from recent peak of 3.2%.
- Fiscal/monetary policies support domestic demand growth; tax reform under consideration; privatization is proceeding along with gradual financial market liberalization.
- Trade surplus shrinking; in 1987 export volume rose 0.3%, import volume up 9.3%; trend to continue; GOJ estimates JFY88 external surplus will fall to 2.6% of nominal JFY88 GNP against about 3% in JFY87.

Political Overview:

- Ruling LDP enjoys large majority, supports strong U.S.-Japan cooperation, solidly behind Prime Minister Takeshita.
- But Takeshita must deal gingerly with issues affecting LDP interests -- beef and citrus, tax reform.
- Japanese leaders gradually gaining confidence, are pushing Japan to more active international role, including substantially greater economic assistance.

Japanese Views on Summit Issues

- Want a strong statement against protectionism; will support continued progress in the Uruguay Round but with no enthusiasm for accelerated agreement on agriculture reforms.
- Expected to support policy coordination process to stabilize exchange rates; will support call for intensified attention to structural issues as complementary to appropriate macroeconomic policies.
- Will stress growing importance of Asian NICs and need for better dialogue with them; will highlight increased aid commitments and efforts to help LDC debtors.

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-2-

- Support concept of multilateral assistance program for the Philippines.
- May seek Summit endorsement of GOJ's Human Frontiers Research Program.

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| 244848 | REPORT | 2 | 5/23/1988 | B1 |

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| 244849 | REPORT | 2 | 5/25/1988 | B1 |

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| 244850 | REPORT | 1 | 5/25/1988 | B1 |

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| 244851 | REPORT | 1 | 5/25/1988 | B1 |

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