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# WITHDRAWAL SHEET
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| DOCUMENT NO. AND TYPE | SUBJECT/TITLE | DATE | RESTRICTION |
|---|---|---|---|
| 1. Paper | U.S. Trade Objectives at the Versailles Summit, (Tab B), 2 p. | [2/8/82] | P1/F1 |
| 2. Paper | Context of the Energy Security Initiative, (Tab C), 2 p. | n.d. | P1/F1 |
| 3. Paper | Energy Security Theme Paper, 6 p. | 2/18/82 | P1/F1 |
| 4. Paper | Summary of Summit Country Energy Deficiencies (as Reviewed by IEA/SLT), (Annex), 2 p. | n.d. | P1/F1 |
| 5. Paper | East-West Economic Relations at the Versailles Summit, (Tab D), 3 p. | 2/16/82 | P1/F1 |
| 6. Cable | #230114Z Feb 82, (Tab E), 5 p. | 2/23/82 | P1/F1 |
| 7. Memo | Henry Nau to William Clark, re: Report on Summit Preparatory Meeting February 27-28, 1982, 2 p. | 3/2/82 | P1/F1 |
| 8. Notes | Summit Preparatory Meeting, Celle St. Cloud, Sunday, February 28, 1982, 13 p. | n.d. | P1/F1 |
| 9. Memo | Nau to Clark, re: U.S. Foreign Economic Policy and Economic Summit Initiatives..., 3 p. | 3/17/82 | P1/F1 |

**RESTRICTION CODES**

**Presidential Records Act - [44 U.S.C. 2204(a)]**
P-1 National security classified information [(a)(1) of the PRA].
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P-3 Release would violate a Federal statute [(a)(3) of the PRA].
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F-9 Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA].

MEMORANDUM

#1177

NATIONAL SECURITY COUNCIL

February 23, 1982

MEMORANDUM FOR MICHAEL O. WHEELER

FROM: HENRY R. NAU HRN

SUBJECT: Meeting of the Versailles Summit SIG

Before leaving this past weekend, Bob Hormats, the President's Personal Representative for the Versailles Summit, asked that we set up a meeting of the Senior Interdepartmental Group for Versailles Summit preparations. According to NSDD-25, the NSC staff functions as executive secretary of this body. Hence, it is our responsibility to call these meetings. The memo at Tab I from you to the various agencies notifies them of the first such meeting on Thursday, March 4, at 11:00 a.m. in Room 305. I have already reserved the room.

RECOMMENDATION: That you sign the memo at Tab I.

Attachment

Tab I Memo to the Senior Interdepartmental Group with attachments

cc: Norman Bailey
Don Gregg
Jim Rentschler
Charles Tyson

NATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

MEMORANDUM FOR Nancy Bearg Dyke
Assistant to the Vice President
for National Security Affairs

David Pickford
Executive Secretary
Department of the Treasury

Robert P. Meehan
Assistant for Interagency Matters
Office of the Secretary of Defense

Raymond Lett
Executive Assistant to the Secretary
Department of Agriculture

Jean Jones
Director, Executive Secretariat
Department of Commerce

William V. Vitale
Director, Office of the Executive Secretariat
Department of Energy

Thomas B. Cormack
Executive Secretary
Central Intelligence Agency

Dennis Whitfield
Executive Assistant to the USTR

Office of the Chairman
Council of Economic Advisers

SUBJECT: Senior Interdepartmental Group Meeting re the Versailles Summit, March 4, 11:00 a.m.

Pursuant to NSDD-25 on preparations for the Economic and NATO Summits, Robert Hormats, the President's Personal Representative for the Economic Summit, will chair a meeting of the Senior Interdepartmental Group for the Versailles Summit preparations on Thursday, March 4, 1982, at 11:00 a.m., in the Old Executive Office Building, Room 305. He will at that time review the strategy and theme papers that have been prepared thusfar (see attachments) and report on the results of the preparatory meeting in Paris on February 27-28, 1982.

Representatives of the various agencies should be at the Under Secretary level. Please call in the names of the individuals who will be attending to 395-6961.

Michael O. Wheeler
Staff Secretary

Attachments

A Strategy Paper for Versailles Economic Summit
B U.S. Trade Objectives at the Versailles Summit
C Context of the Energy Security Initiative
D East-West Economic Relations at the Versailles Summit
E Initial U.S. Letter to the French with our Suggestions for Theme and Issues at Versailles

# STRATEGY PAPER FOR VERSAILLES ECONOMIC SUMMIT

June4, 5, 6, 1982

The Annual Economic Summit takes place on June 4, 5, 6 in Versailles, France. This Summit is the eighth and the first of a new round of Economic Summits. Each country has now hosted one of these meetings. Versailles takes us back in a sense to Rambouillet, the first Economic Summit. It offers us an opportunity to reconsider the purposes of these annual meetings, which have now become semi-fixed features of the international economic system since the breakdown of the fixed exchange rate system and the oil crises of the 1970s. It also sets up the themes for the following year of economic events and the 1983 Annual Summit which the United States will host. And it occurs this year in connection with a NATO Summit, which takes places two days later on June 9,10, 1982.

If we add to these chronological facts the historic and perhaps unprecedented character of the problems which the West faces (and which the holding of the NATO Summit in past reflects), the Versailles Summit acquires extraordinary significance for US foreign policy.

At Ottawa President Reagan re-established US leadership in the economic sphere by a forceful presentation and defense of his economic program. Despite sharp differences over interest rates, East-West trade, and North-South relations, the communique issued at Ottawa reflected all of the United States' major objectives -- an upbeat tone, no hint of protectionism, unified and a Chairman's Summary on political issues that expressed an extraordinary degree of consensus among the allies on the nature of the Soviet threat and the Western response to it. Much of the "upbeat" tone emanating from Ottawa can be attributed to the President's forecast for vigorous growth in the US, with stable prices and strong dollar. While skeptical, the other participants adopted a "wait-and-see" attitude about the US program. The United States benefitted from an imaginative and attractive economic plan that had not yet been tested.

The follow-up of specific commitments made at Ottawa, both written and unwritten, has proceeded apace, despite some press commentary to the effect that Ottawa concealed real differences with rhetoric (see status report on Ottawa commitments at Annex A). To be sure, Ottawa did not resolve major differences on interest rates, fiscal and monetary policies and trade issues. But resolving issues in some definitive sense is not the appropriate measure of Summits. The agreements registered at Ottawa set the Summit countries on a useful, common course that has produced real progress in a number of areas.

Nevertheless, economic and political events since Ottawa have exacerbated certain alliance issues, particularly in macro-economic, trade and East-West relations. (for a more complete treatment of these events, see Annex B.) These events included:

- onset of recession in the US
- rise of unemployment throughout industrial world (except Japan)

- -- persisting high US interest rates and value of the dollar
- -- projections of massive US budget deficits
- -- growing trade conflicts among US, Europe and Japan
- -- new socialist government in France implementing policies of demand stimulus, protectionism, nationalization of industry, and exchange rate intervention all of which are directly opposed to US economic preferences.
- -- imposition of martial law in Poland and tensions within the alliance over application of economic sanctions, particularly as the latter affect the Western Europe-Soviet Union gas pipeline project.

Issues at Versailles

Given these events, the President's success at Ottawa will not be easy to duplicate. The economic setting in the United States and Europe will not help very much. Even if economic activity is strengthening, unemployment in Europe will be at historic high levels, generating immense pressures for governments to "do" something. The poor macroeconomic setting will color trade, monetary and aid discussions. As importantly, unless the US economy is performing better than now expected by late spring, the skeptics at home and abroad will be lobbying strongly for agreement on policy actions not consistent with our economic program. Economic difficulties will spill over into the more political discussions as well -- coloring the European appraoch to East-West relations, including Poland.

Moreover, the United States has not yet developed an effective and convincing international dimension for its economic program. Persistent discussions of "coordination" and "cooperation" generate expectations of actions we may be willing to take either domestically or in the trade/monetary field, in order to better coordinate with our Summit partners. The Administration's economic philosophy leaves little room for overt coordination of short-term policy actions, but provides considerable opportunity for coordination of longer-range approaches to economic policy. Unfortunately, in the latter sphere, a wide gulf separates us from, for example, the French, with most of the others located on the intervening spectrum.

These factors all suggest that the challenge at Versailles will be greater than that faced at Ottawa. The newness is gone, the economic problems more severe. The preparatory process is under the control of the country (France) least sympathetic to our approach to economic policy.

The dominant issues at Versailles are likely to include, roughly in order of priority:

- macroeconomic issues, particularly massive doubts about US economic policies, which are unlikely to be muted as they were at Ottawa when the US program was still untested.
- trade issues, with the US trade balance and domestic economic circumstances (particularly threatened "reciprocity" type actions in Congress on autos, etc.)

increasing pressure on US officials to beat up on the Europeans and Japanese, at least making it less likely that we can resist European protectionist policies such as those advocated by the Community at Ottawa.

-- East-West trade issues, depending heavily for their devisiveness on how the situation in Poland and the allied response evolve.

-- Monetary issues, with the French government expressing a traditional French interest and a current policy interest, stemming from domestic inflationary policies, in intervention in exchange markets and more fixed exchange rates (as in EMS).

-- Energy and north-South issues, less likely to be burning issues unless the discussions in New York on Global Negotiations polarize or new disruptions of energy supplies occur (e.g. Iranian attacks or subversion against Gulf oil producers).

US Objectives

In these circumstances, US objectives should include:

-- to maintain and enhance the leadership role of the United States and President Reagan emerging from the Ottawa Summit;

-- to focus attention on the broader political consequences of failing to keep economic differences in check;

-- to strengthen Western unity in the face of unprecedented political (Poland) and economic (unemployment)

-- to address immediate issues candidly but also to place them in a context that points to the longer term and the need to define new principles and criteria for Western economic cooperation in the 1980s;

-- to project calm and determination over the US economic recovery effort, stressing that the program deals with fundamentals and will succeed over time.

US Strategy

The difficulty we face in making Versailles a repeat success for President Reagan requires a strategy encompassing the preparation, the procedure and the substance of the meeting. The French have already indicated their preliminary thinking on these three items: they want to minimize the "bureaucratic" element of the preparatory process, to generate in-depth papers on specific issues (the French have suggested instability of markets and management of technological innovation as two such issues) to focus discussion on those issues, and to arrive at concrete policy decisions which can be implemented by all participants. From the US perspective, each element of the French thinking is troublesome: we want a preparatory process which engages all relevant segments of the several governments, discussions which emphasize the long-range and interrelated aspects of policy and a communique which is long on shared principles, etc.... and short on concrete policy actions.

A. Procedures

If we are to be effective, the United States should advocate a preparatory process which engages a have suggested. We have already dispatched a note to the French suggesting that the February meeting of personal representatives and all subsequent meetings should involve full delegations (three members) as has been customary in the past (see Annex C). We have informed other summit personal representatives of this US proposal.

B. <u>Substance</u>

The United States owes the French a letter before the next preparatory meeting on February 27-28 outlining our suggestions on themes and issues at the Summit. A draft of this letter is attached at Annex D.

The general strategy followed in the preparation of this letter and in our current thinking about the Summit involves the following elements:

1. The French and perhaps other Summit partners will undoubtedly stress domestic economic issues -- unemployment, high interest rates, monetary policy -- with particular focus on US economic policy. The United States prefers to stress international issues -- trade, East-West relations, energy cooperation -- and to play out the adverse consequences of ~~adverse~~ domestic policies, such as subsidies, demand stimulus measures, etc. for multilateral trading and financial relations and ultimately for prospects of domestic recovery and growth. Hence, the US

- -- trade in its broadest sense as it relates to domestic adjustment policies, technological innovation and investment;
- -- energy security building on sound domestic market policies (which have been achieved now in most Summit countries) and international cooperation to protect against vulnerability of supplies;
- -- East-West economic relations.

2. In addition to formulating positive themes, the United States may have to undertake various steps to deflect or redirect the focus of other governments on US economic policy. Two possibilities are:

   - -- initiatives to discuss US economic policy outside the Summit preparatory context, as in the case of the US invitation to the EC to hold a seminar on the President's new Economic Report after it is released in mid-February;
   - -- have the traditional macroeconomic paper done by the US drafted jointly with the UK so as to dwell less on US policy and more on how markets in other Summit countries as well as in the US work.

3. The United States may wish to view this Economic Summit together with the NATO Summit, as a critical crossroad for the Western Alliance. In

-- the first of a new round of Economic Summits;

-- the Summit that set in motion the process of shaping a reinvigorated world economic system for the 1980s beginning on the trade area with the GATT Ministerial scheduled for November 1982;

-- The Summit that reaffirmed fundamental Western values of political freedom and economic opportunity in the face of political/military challenge and economic failure on the part of Communist systems.

4. However bold the United States chooses to be, several critical issues must be addressed in our own preparations (a discussion paper at Annex E develops these points in more detail).

-- How do we take the offensive to "internationalize" the Administration's approach to economic policy? The emphasis, especially in Europe, on cooperation and coordination makes it difficult to agree within the Summit Seven on an international system that relies heavily on market decisions which are not overtly coordinated. A first requirement would be for us to give substance to our definition of coordination

-- What are our multilateral trade objectives that go beyond a list of sectors (services, investment, agriculture, etc.) where it is in our specific economic interest to push liberalization? Is there a theme for trade in the 1980s that has the mutually advantageous rationale of tariff reductions in the 1950s, 1960s and 1970s?

-- Can we define a set of actions consistent with market policies to "energize" energy cooperation among the Western allies?

-- How do we sustain the offensive represented by President Reagan's program for development at Cancun while recognizing budget constraints and constraints on US trade policy with the LDCs (which led recently to the Administration's ~~compromise on~~ agreement to a more restrictive textile agreement)?

C. Preparations within the US Government

Preparation for Ottawa involved an elaborate interagency process spanning the bureaucracy horizontally and vertically, involving several Cabinet Councils. The input of this extensive process was disappointing in terms of the material supplied to the White House for eventual use by the President. While the scope of Summitry requires broad participation from the guided, both procedurally and substantively, by a small coherent group which commands the confidence of the White House senior staff. This "Steering Group" should be involved in all aspects of Summit preparations and be granted priority attention when policy decisions are required. A group consisting of the President's Personal Representative (as Chairman) and representatives of the President's office, the Vice President's office, State, Treasury, CEA, NSC and USTR would seem appropriate and has been established under the Assistant Secretary of State for Economic and Business Affairs who is acting as personal representative.

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THE WHITE HOUSE
WASHINGTON

3/23

Bud,

I wanted you to see this before it goes back to Henry Nau.

John

M

Versailles if not already filed

74

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# The White House

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COMMENTS

For Mtg of the NSC with President, Friday, March 19

cy to Bud pls,

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# IS U.S. FOREIGN ECONOMIC POLICY BOLD ENOUGH?

Is there something missing in U.S. foreign economic policy? The principles of this policy are clear enough:

-- emphasis on sound domestic economic policies and greater scope for market forces;

-- maintenance and enhancement of the liberal multilateral trading system;

-- nonintervention in exchange markets;

-- restraint and conditionality in the creation and use of international financial resources;

-- development based on a combination of trade, private investment, and aid directed toward self-sustaining growth;

-- political and strategic limits on economic relations between East and West.

But these principles have been derived largely from domestic economic policy and do not as yet comprise a coherent policy theme that is well suited to the more diverse international system. Nor have they been translated into clear operational policies, (as in the case of tax, expenditure, regulatory and money growth policies on the domestic side), or offer as yet a convincing vision of where the world economy is heading, aside from the general notion that a "rising American tide will lift all boats."

At the forthcoming Economic Summit in Versailles, the United States faces its most difficult challenge in foreign economic policy. Compared to Ottawa (see footnote):

-- the economic circumstances and conflicts (particularly in trade with Japan, EC and Canada) are worse

-- the political situation is strained by Poland

-- the United States no longer has the "bloom" of a new Administration or a new President making his first venture into Summit diplomacy

-- the French government, which symbolizes broad economic differences with the United States and took a back seat at Ottawa, is firmly in control of Versailles.

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See attached analysis "From Montebello to Versailles"

In these circumstances, it is essential that we think a bit harder about the themes, goals and policies of our foreign economic policy. We may need in some instances to complement domestic concepts and to undertake a more activist role in maintaining confidence in the international economic system.

1. <u>Central Theme Underlying U.S. Foreign Economic Policy</u>

What is the guiding theme of U.S. foreign economic policy? In domestic policy, it is quite clear -- reduce the size of government and set the proper conditions for private sector economic revival. In foreign policy, to the extent that we have one, it is the same -- the magic of the marketplace and a desire to redirect the role of international governmental institutions, such as the multilateral banks and IMF, to create incentives for private trade, investment and financial flows.

The latter themes are not only fundamental and unalterable for this Administration but timely. They provide a badly needed corrective to past emphasis on public sector actions and institutions (e.g. proposals of the Brandt Commission or the 1200% expansion of World Bank lending from 1968-1980). And they coincide with a new interest in many places including the World Bank, in the role of the private sector. The United States will miss an historic opportunity if it fails to sustain this focus on the private sector (which even in the developing countries, produces more than 50% of the wealth today) and the need to relate more efficiently public sector efforts to private trade, investment and finance.

But even in domestic policy, the Administration's economic policy does not deny an important role for government. The social safety net reflects government's domestic responsibilities for education, health, agricultural and industrial infrastructure (roads, etc.) and maintenance of decent standards of living for the old, handicapped and unemployed. Is there a comparable concept for government's international economic responsibilities, as understood by this Administration? If there is, we should develop and emphasize this concept more, since the international system is diverse, and the role of government is larger in practically all the economies of our allies than in the United States.

Europe and Japan stress the theme of <u>interdependence</u> to highlight government's role in the organization and management of contemporary international economic relations. Collective action, as they see it, reduced <u>external</u> barriers to postwar trade and other economic relations, and now must be extended to coordinate various <u>internal</u> policies. From their perspective, interdependence calls for a deepening of the Bretton Woods system to include coordination of macroeconomic and sectoral (e.g. French fascination with technology policy) policies as well as trade and other border-related measures.

Interdependence is hardly a new theme, and typically it has become fashionable in Europe and Japan about 5 or 6 years after reaching its peak in U.S. policy. But even in Europe and Japan, the rhetoric of interdependence does not match the reality of policy responses which tend to emphasize national independence. Flexible exchange rates and the recent tendency toward significant and sometimes sudden shifts in political and economic perspectives in individual countries (to wit, Britain three years ago, U.S. and France a year ago, etc.) contribute to more maneuverability and independence in national policies. Resulting divergencies in domestic economic policies complicate interdependent relations, to be sure, but they hardly call for collective responses that can not work as long as such large differences in domestic economic philosophy and direction persist.

Developing countries stress the theme of the new international economic order (NIEO). They call for the restructuring of the rules and institutions of postwar economic management, rather than an extension of this system to domestic policies. Indeed, by emphasizing the international system, developing countries often seek to shield or exclude domestic policies from international supervision. In the U.S. view, NIEO distorts the priorities and real problems of development, which are primarily domestic, and substitutes rhetoric for the proven track record of postwar economic arrangements.

While neither interdependence nor NIEO seems appropriate to modern circumstances, some conceptual glue is needed to restrain the divergencies in economic policy and outlook among countries, to increase the awareness of leaders about the effects of their policies on one another, and to maintain and enhance a sense of community and confidence among the industrialized and more broadly developing countries of the world. The United States can more effectively counter or influence the approach of others by offering ideas of its own. In this effort, we can be eclectic rather than purist:

-- Interdependence does accurately describe the modern world economy. We could embrace it as such, without accepting its prescriptive bias toward collective action.

-- The theme of the international economic system (the original postwar theme, as in the Bretton Woods system) comes closer to U.S. views, as Secretary Regan recently expounded:

"...we view the world economy as a system... And systems have three crucial characteristics... First there can be no event in one part of the system which does not affect the rest of it. The parts are all interconnected and interrelated. Secondly, a true system has self-correcting features built into it. Thirdly, a true system is capable of creating something new... Economic systems have the wonderful capacity to create new wealth where it simply did not exist before."

This theme stresses interrelatedness (one might say interdependence) but does so in terms of effects not responses (i.e. collective action or management). Where responses are concerned, it stresses autonomy and sensitivity (i.e. self-correcting forces), that is independent action that is adapted to a pluralistic world of diverse and diverging economic policies. Finally, the theme stresses an attractive goal -- new wealth not redistribution of existing wealth as in the case of NIEO.

-- Taken by itself, however, the system theme is too mechanistic. Its goals of new wealth may also be too materialistic. The world expects something more from the United States. We should also speak of <u>community</u>. This idea is less precise in economic terms but implies common underlying values and sense of direction. It goes further toward recognizing common human and moral responsibilities at the international level and envisions a more embracing goal of human purpose and fulfillment (stressed by President Reagan at Philadelphia) rather than merely the creation of new wealth. On the other hand, it allows for more pluralism and autonomy than either the dirigist concept of interdependence or the authoritarian concept of a new international economic order.

The themes of system and community imply specific policies, which the United States should encourage to give reality to its rhetoric.

<u>System</u>

-- common analysis and discussion of international economic problems as a means of educating national actors and directing attention to the domestic policies and constraints of other countries (rather than having all of the attention directed at U.S. as at Ottawa)

  -- Is some initiative appropriate here to publicize the growth theme and supply-side economics and to encourage common analysis and discussion of the unemployment problem (e.g. an OECD initiative with its industry and labor committees or an international private sector think tank-type conclave, perhaps embellishing the mock private sector Economic Summit sponsored each year by the German Marshall Fund)?

-- re-emphasis on positive adjustment theme in OECD seeking to better understand impediments to self-correcting features of the international economic system

-- directing more attention to the private sector and market forces through conferences, think-tank sponsored research, and government stimulated voluntarism in the private sector (as in the President's recent New York speech to the U.S. private sector).

<u>Community</u>

-- common action to deal with so-called global problems of poverty, immigration, etc.

  -- Is it possible to complement President's bilateral agricultural initiative at Cancun with a global initiative against world hunger based on private church-sponsored groups with government funds (bilateral, World Bank, etc.) serving as catalyst?

-- exchange programs, especially among youth, to revitalize sense of shared values among Western countries, and to project a better understanding to third world of non-material side of Western life -- freedom, family, faith, etc.

The broad themes of <u>interdependence</u>, <u>system</u> and <u>community</u> require translation into more specific goals and policies for trade, monetary relations, energy and North-South issues.

2. <u>What is the central goal of U.S. trade policy?</u>

U.S. postwar trade policy has pursued the clear, overriding goal of liberalizing multilateral trading relations through reduction of quantifiable barriers at the border, tariffs and quotas. This goal has had such clarity and force that tariffs today are in most most manufacturing goods negligible (weighted average in the OECD countries after implementation of the Tokyo Round will be less than 5%). Compared to the initial postwar period, quotas have also been significantly reduced, although they play a growing role in trade of particular interest to LDCs (textiles, footwear, agriculture, etc.). In the 1970s, the concept of liberalization was extended to nontariff barriers, i.e. non-quantifiable restrictions at the border. The results thusfar are incomplete and mixed.

Has the concept of tariff reductions run its course? Perhaps in manufacturing, some might say, but not in agriculture. Yet is tariff reduction or harmonization of support programs (i.e. coordination of sectoral policies) more appropriate for agriculture?

Is the concept of reduction of nontariff barriers a viable one? Perhaps it is if we limit its definition to non-quantifiable measures at the border (e.g. standards, export tax rebates, etc.). But if we extend its definition to internal domestic policies (fiscal or monetary measures to subsidize depressed industries), does the reduction of nontariff barriers become inconsistent with the tendency toward greater internal autonomy of policy which characterizes the present world economy? How do we expect to eliminate such barriers in countries where government plays a substantial role in manufacturing, banking, etc. without asking for a basic change in the structure of those economies? Is it even consistent to seek to eliminate such policies unless we are ready to coordinate certain internal, macroeconomic and sectoral policies among industrialized and other governments (which we reject as dirigiste)?

These are tough questions to answer but they must be addressed. This Administration's trade policy, from the beginning, has been ambiguous. The Trade Policy Statement released last summer, stressed both open markets and strict reciprocity. Since then the concept of reciprocity has gained ground. According to U.S. officials (WSJ, 1/5/82), this concept "means that the U.S. would penalize countries that don't open their doors to American businesses by limiting those countries' access to the U.S. market." The concept implies the goal of open markets but is ready to impose the opposite. Given this ambivalence, the goal is not entirely convincing. Moreover, it is totally hostage to what the other party does. And it focuses on bilateral trade balances rather than traditional multilateral objectives.

Reciprocity does not define a goal but rather a tactic for implementing goals which remain ambiguous. It is a bargaining tool and a highly useful one since it is appropriate to the more competitive trading world which the U.S. faces today. The United States has to be willing to risk something to gain something. But what are the goals which this bargaining tactic serves? Where do we want to move the multilateral trading system through hard bargaining on the basis of reciprocity? Will opening the Japanese market solve the problems of U.S. or European trade balances? Have we quantified the impact of specific measures to liberalize Japanese markets on U.S. exports? What indeed do we mean by opening markets when we interpret subsidies or trade distorting measures so broadly as to strike at the core of domestic economic policies (if not cultural values) in some countries, particularly those which are sectorally centralized and feature strong government roles?

In the trade area, we have so far failed to define the limits of what can be managed collectively on an international basis, even while in overall foreign economic policy, we stress that areas such as fiscal and monetary policy coordination are outside the sphere of international management. The failure to define limits, combined with the bargaining tactic of reciprocity, contributes to confusion among our partners as to what we want and to irritation among them over our incessant demands.

We may need to ask ourselves a set of additional questions:

-- What do we seek specifically in terms of opening the Japanese market, modifying the EEC's Common Agriculture Policy or revising Canada's FIRA and NEP? Should we prioritize our concerns in terms of those which are compatible with our own view of the limits of international management and are feasible for other countries to meet without changing the political coalition in power? So far we have refrained from doing this out of fear that the partner country may accommodate our highest priority objectives and consider the matter closed. Again this is a useful bargaining tactic. But have we done the analysis on what we want most and what is most feasible? Unless we do so, stepping up pressure on our major economic partners in present economic circumstances of high unemployment, recession, etc. may only lead to U.S.-retaliation. It is assumed that this is not what we want.

-- What are our multilateral trade objectives and how do our bilateral objectives and bargaining relate to the evolution of the broader trading system? We have just begun to formulate U.S. positions for the GATT Ministerial. Do we have an idea of the trading system we seek in the 1980s beyond merely those issues, such as services and investment-related problems, which are primarily in our interest? Leadership is more difficult but also more necessary in today's pluralist world economy. If the U.S. fails to exercise this leadership, who will?

3. <u>What is the central goal of U.S. international monetary policy?</u>

The emphasis on <u>nonintervention</u> in exchange markets is eminently sound as long as domestic economic policies diverge sharply. But what is our longer-term goal? Is it to reduce divergencies in domestic economic policies? If so, it is appropriate to think in terms of some greater effort to discuss and eventually to move domestic economic policies in less diverging directions. The emphasis on non-intervention and the reluctance to discuss and eventually direct domestic policies in less divergent directions are not consistent. Indeed in economic relations with developing countries, we have stressed the close link between international financial flows and domestic economic policies. Is there a need to think this matter through more carefully in relations with industrailized partners?

-- Should we engage in more cooperative analysis of capital and exchange rate consequences of diverging macroeconomic policies?

-- Should we initiate some new international discussions about the domestic economic consequences of moving back to a less flexible exchange rate system (such as Paul Volcker advocated two years ago).

None of this discussion requires a departure from present non-intervention policy. But it could serve to intensify awareness and help define the limits of domestic economic divergencies under a flexible rate system, facilitating self-correcting domestic adjustments.

4. What are consistent policies for U.S. international energy relations?

At the moment, there is a contradiction in U.S. energy security policies. Among Western countries, we have advocated reliance on free market forces, minimizing governmental intervention to deal with short-term emergencies and long-term alternatives. Toward Eastern countries and particularly the Soviet Union, we have advocated government-imposed restrictions on energy relations (e.g. opposition to Western Europe-Soviet pipeline) and offered U.S. cooperation to develop alternatives to Eastern energy resources. Howe can we deliver on the latter in view of our free market philosophy?

Cooperation with Western Europe in long-term energy alternatives would be consistent with the Administration's market philosophy but it is unlikley to be acceptable to our allies (who do not believe the U.S. can sustain R&D commitments -- to wit SRC-II, etc.) and in any case is not timely to meet Europe's requirements for the mid-to-late-1980s (when Soviet gas deliveries are expected). Europe would welcome nuclear R&D cooperation, primarily to counter political resistance to nuclear power. But oil, gas and coal are the only fuels in the near-term that can substitute for Europe's dependence on Soviet gas.

-- Is it sufficient to mediate on Europe's behalf for more Norwegian and Nigerian gas?

-- Does the U.S. government need to take a more active role to develop a meaningful initiative in the coal sector?

-- Can the U.S. assert more vigorous leadership in IEA, emphasizing strategic petroleum reserves and common analysis and discussion of how such reserves may be used in emergency situations? (The more protection the U.S. can offer for Middle East supplies, the less Europe needs to look to the East. Indeed, the occasion for the Soviet gas deal was the collapse of a similar arrangement with Iran when the Shah fell.)

5. Can the United States faithfully implement its development policy laid out at Cancun?

The President's Cancun program offers the first direct challenge in 15 years to NIEO. It is coherent, consistent and already effective in redirecting expectations in the developing world and international development institutions (e.g. see World Bank President Classen's speech in Tokyo, 1/13/82). But it is threatened by backsliding:

-- backsliding on trade as a more important, long-term tool of development than aid.

    -- U.S. acquiesence to a more restrictive textile agreement (MFA) which threatens very little growth if not actual cutbacks (assuming European cutbacks inspire U.S. industry to seek the same) in negotiation of bilateral agreements this year. (Ironically, U.S. acquiesence derived from compromise on Hill to secure passage of aid bill.)

    -- Potential agreement under Hill pressure to an easier standard than 201 treatment for counteracting surges under the Caribbean Basin Free Trade Arrangement, effectively nullifying impact of FTA on investor expectations.

    -- Inability to take initiatives in forthcoming GATT Ministerial sufficient to coopt LDC interest in Global Negotiations as far as trade issues are concerned.

-- backsliding on need to structure more realistic global dialogue

    -- Continuing pressure in the UN to launch Global negotiations on terms inconsistent with U.S. understandings.

    -- Inability to agree on U.S. sponsored initiative (Global Conference on Growth and Development) consistent with our understandings.