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FOIA
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ID	Doc Type	Document Description	No of Pages	Doc Date	Restrictions
162374	PAPER	THE ECONOMIC CONDITIONS IN SUMIT COUNTRIES	2	ND	B1
162375	PAPER	MACROECONOMIC AND STRUCTURAL ISSUES IN OTHER SUMMIT COUNTRIES	3	ND	B1
162376	PAPER	EAST-WEST ECONOMIC RELATONS	1	ND	B1
162377	PAPER	TALKING POINTS- RE: EAST-WEST RELATIONS	2	ND	B1

The above documents were not referred for declassification review at time of processing

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UNDER SECRETARY OF STATE
FOR ECONOMIC AFFAIRS
WASHINGTON

CONFIDENTIAL

April 2, 1986

MEMORANDUM FOR THE PRESIDENT

FROM: Allen Wallis

SUBJECT: Initial Briefing Package on the Tokyo Economic Summit

With your departure for Bali and the Tokyo Economic Summit now just three weeks away, this memorandum (prepared in consultation with my "Sherpa" colleagues, Assistant Secretary David Mulford of the Treasury and Stephen Danzansky of NSC) will describe how the Summit fits into your overall Asian trip, and outline events in Tokyo. In addition, I have attached background papers on the economic situation in the Summit countries and international monetary issues. These last two issues will be updated for your final briefing book in light of discussions at the IMF Interim Committee meeting next week and the OECD Ministerial the week after. I also understand that Beryl Sprinkel will be briefing you on the U.S. economy in late April, and will coordinate that briefing with other pre-Summit meetings.

The Asian Trip

On April 26 you depart on Air Force 1 for Bali, with stopovers in Honolulu and Guam. While in Bali, you will meet with Indonesian President Soeharto, and you will also participate in a meeting with Foreign Ministers of the six ASEAN countries -- Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Your discussions in Bali will focus on regional political issues, and will take place mainly on May 1.

You will travel to Tokyo for the Economic Summit on May 2, while Mrs. Reagan departs for separate meetings on narcotics in Malaysia and Thailand. Your working schedule in Tokyo begins on May 3, with bilateral meetings with other Summit leaders and a proposed afternoon speech before the American Chamber of Commerce in Japan.

The Summit itself will follow the pattern of the last few years. It will begin on Sunday, May 4 with an afternoon arrival ceremony, reception, and working dinner. The first meeting on May 5 will be a morning session for Heads of State and Government, followed by a working luncheon with Foreign Ministers. (To accommodate Dutch Prime Minister Lubbers' participation in the Summit as President of the EC Council, there will be nine participants in Heads-only meetings instead of the usual eight.) In the afternoon, there will be a plenary session including both Foreign and Finance Ministers. That evening, Heads will again have a working dinner, after which their Personal Representatives will begin their all-night drafting session on the Summit Communique. Negotiation of the Political Declaration will be handled by Assistant Secretary of State for European Affairs Roz Ridgway.

The next morning, May 6, Heads of Government will meet briefly to finish their private discussions and consider the Communique; they will be joined for the rest of the morning and at luncheon by Foreign and Finance Ministers. That afternoon the Summit will conclude with a joint press conference at which Prime Minister Nakasone will read the Communique and Political Declaration. In the evening the Emperor and his wife will host a banquet at the Imperial Palace.

Tokyo Summit Issues

Economic and political issues for the Tokyo Summit will be outlined in your meeting with the Summit White House Group next Monday. In brief, the Summit will cover all the usual economic topics: domestic economic policies, exchange rate issues, international trade, and LDC debt problems. In addition, there will be some "specialized" issues, such as a review of the manned space station project, cooperation in high-technology and education. Prime Minister Nakasone is personally interested in the last two areas.

When we met with you in January, you agreed that we should request that time be set aside for a "free-form" discussion during the morning meeting on May 5. The original idea behind this proposal was to leave room for unstructured and personal discussions, and to fight the tendency for bureaucracies to try to program every word in advance. While the other countries accepted our proposal, their Personal Representatives are uneasy about the idea of a discussion whose contents are not prearranged, and they have asked us repeatedly what you might want to discuss during that hour. Neither we nor any other country has volunteered a topic yet; however, this would be a reasonable time for Prime Minister Nakasone to raise his ideas about education, or for Prime Minister Thatcher to discuss problems posed by an aging society. As you know, we have suggested two issues which you might wish to raise: the future of the Soviet economy, and the need for fundamental reform of agricultural policies. Briefing sessions have been arranged for you to meet with outside experts, should you decide to pursue either (or both) of these topics.

Background Papers

I have attached two short papers for you on the economic situation in Summit countries and on the international monetary system. The paper on Summit economies outlines the economic environment in which the Tokyo Summit will occur and suggests our main objectives for the discussions of economic performance and policies. The paper on the international monetary system provides background on issues which will be discussed at the April 9-10 meeting of the IMF Interim Committee. The outcome of those discussions will influence Summit treatment of monetary issues. Secretary Baker will update you on that meeting before you leave for Asia, and we will incorporate the results in your final briefing material.

Attachments:

Tab 1 - The Economic Situation in Summit Countries
Tab 2 - International Monetary System

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TOKYO SUMMIT

PRESIDENT'S BRIEFING BOOK

I. Scope Paper - Sections on the President's objectives, the setting, and a general discussion of the main economic and political issues to be addressed at the Summit.

Length: 5 pages Drafter: State (E and EUR)

First Version Due: April 7

Final Version Due: April 22

II. Background Papers

A. Key Summit Economic Themes

This paper will consist of expanded treatment of the main economic themes for the Summit as they finally emerge from the last meeting of Personal Representatives in late April. At this time, we anticipate four main categories: macroeconomic and structural policies in Summit countries; relations with developing countries (with emphasis on the U.S. initiatives proposed by Secretary Baker at Seoul); improving the functioning of the international monetary system; strengthening the trading system. There may also be some review of issues in technology cooperation and energy policy. The substantive content of this paper will be drawn from the issue papers listed below.

Length: 6 pages Drafter: Treasury

First Version Due: April 7

Final Version Due: April 22

B. Key Summit Political Themes

This paper will expand on the main political themes for the Summit as developed by the Political Directors and Personal Representatives at their final meeting in April.

Length: 5 pages Drafter: State (EUR)

First Version Due: April 4

Final Version Due: April 22

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DECL:OADR

C. Country Papers

These papers will briefly describe the current political and economic situations in each Summit country and summarize each leader's main Summit objectives and attitudes toward issues important to us. (Example attached. Follow format as explained under D below.)

Length: 1 page

Drafter: Treasury (Economic)
State (Political)
(Regional Bureaus)

D. Individual Issue Papers

These papers will discuss in more detail certain specific issues which we expect to arise under the broad thematic headings identified in the "Key Themes" papers. Subjects, drafting agency and due dates are as follows. Each paper should contain one page of discussion of the issue (or initiative, as appropriate) and up to one page of talking points (on a separate page). A sample issue paper is attached. Drafting offices should clear their papers with other agencies with whom they would usually coordinate on the issue. Other agencies would have further opportunity to comment when the entire set of papers is assembled. (Note: It is essential that these papers conform to the format used in the attached sample: use courier type, 10 pitch, with paragraphs set one inch in from the left hand margin. These papers may not exceed one page. Use of smaller type or margins to squeeze material on to a single page will only require us to edit texts submitted to us to conform to the necessary standard. Better that the drafting and clearing agencies do such editing, rather than us.)

Issue Papers	Drafter	Due
Macroeconomic & Structural Issues:		
Other Summit Countries	Treasury	4/4
US	CEA	4/4
Exchange Rates and External Imbalances	Treasury	4/11
Intenational Monetary System	Treasury	4/11

LDC Debt Situation	Treasury	3/30
Aid to the Poorest LDC's	Treasury	3/30
New Trade Round	USTR	3/30
Environmental Issues	EPA	3/30
Space Station	NASA	3/30
Energy Issues	DOE	3/30
Technology Cooperation	OSTP	3/30
Education	Education	3/30

E. Selected Economic Statistics

Treasury will prepare tables, charts and graphs of economic statistics as it deems useful.

Due: April 11

III. Summit Thematic Paper

As drafted by the Personal Representatives.

IV. Annotated Schedule (sample attached)

Length: 3-4 pages Drafter: State, (E, EAP, EUR)

First Version Due: March 28

Final Version Due: April 22

V. Settings/Talking Points by Event

These papers will consits of a one or two page description of each day's events on the Summit schedule and 3x5 cards with summary talking points for the President's use at the events during that day.

Due: April 14 Drafter: State, Treasury, NSC

Washington, D.C.

April 2, 1986

NLRR 7/22/13

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MEMORANDUM

TO: EPC Working Group

FROM: E - Scott Brown CBB

SUBJECT: Papers for the President's Tokyo Economic Summit Briefing Book: 1st Installment

Attached are the papers already received for the President's Tokyo Economic Summit briefing book. If your Department has any further questions or comments on these papers, I would appreciate having them directed to the drafters (list attached) by c.o.b. Friday, April 4.

Attachments: As stated.

~~CONFIDENTIAL~~ Dept. of BY dh 21, 1997 7/4/13

Papers for President's Tokyo Economic Summit Briefing Book

PAPER	Drafter
Macroeconomic & Structural Issues in Other Summit Countries	Treasury Christine Cannon 566-2064
International Monetary System	Treasury Mark Sobel 566-5112
U.S. Debt Initiative	Treasury Max Hudgins 566-8532
Aid to the Poorest Countries	Treasury Rick Zechter 566-2776
Energy Issues	DoE John Brodman 252-5893
East-West Economic Relations	DoD William George 694-5074
Technology Cooperation	OSTP Barbara Moore 395-6190

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ID	*Document Type* *Document Description*	*No of pages*	*Doc Date*	*Restrictions*
162375	PAPER MACROECONOMIC AND STRUCTURAL ISSUES IN OTHER SUMMIT COUNTRIES	3	ND	B1

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U.S. Debt Initiative

Secretary Baker outlined last fall at the IMF/World Bank annual meeting in Seoul a "Program for Sustained Growth" to build upon and strengthen the debt strategy. This program contains three essential and mutually reinforcing elements:

-- First, adoption of growth-oriented economic reforms by the debtor countries;

-- second, a continued central role for the IMF in conjunction with enhanced and more effective lending by the MDBs; and

-- third, $20 billion in net new lending by the commercial banks.

If each of the participants does its part, and the demand for quality lending by the World Bank increases, we indicated that we would also be prepared to look seriously at the timing and scope of a general capital increase for the World Bank.

The U.S. debt initiative has been endorsed by the international financial institutions, the IMF, and commercial banks in all of the major creditor countries. The principal debtors have also welcomed the proposal, particularly the emphasis on growth, and recognize the need to undertake fundamental structural reforms for growth.

The initiative is already being implemented through individual debtors' negotiations with the IMF and World Bank. Some countries, such as Mexico and Argentina, will need to draw on all elements of the initiative. Others, which already have IMF programs and recent commercial bank reschedulings in place, may focus primarily on securing additional World Bank resources. Following the adoption of credible reforms, additional commercial bank lending should also be made available.

Implementation of the debt strategy, therefore, will occur on a case-by-case basis, depending on the individual situation in each debtor country, and each country's decision to implement the additional growth-oriented measures which are needed.

The sharp decline in oil prices, a significant decline in interest rates, and stronger growth in industrial countries will help to ease debt problems for most debtor nations. While the financing needs of the oil exporting debtor nations will increase, we believe these requirements can be managed within the overall framework of the debt initiative.

AID TO THE POOREST COUNTRIES

Your Objectives

-- Endorsement of the use of IMF Trust Fund reflows in conjunction with World Bank resources (primarily IDA) to promote comprehensive economic policy reform in the poorest countries.

-- Seek a commitment to improve coordination of bilateral aid programs.

-- Endorse an adequate IDA VIII replenishment which plays a more effective role in supporting policy reform, with particular emphasis on Africa, in the context of IMF/IBRD comprehensive economic policy frameworks.

-- Welcome measures identified in the Africa Famine Report to improve economic prospects for the poorest countries.

-- Defuse potential criticism of U.S. aid levels.

Note: The IMF and World Bank Boards voted recently to approve the U.S. proposal to use IMF Trust Fund reflows together with World Bank resources to promote comprehensive economic policy reform in the poorest countries. Negotiations are underway on the Eighth Replenishment of the International Development Association, IDA, the soft loan window of the World Bank.

Watch Out For

-- Arguments for an IDA VIII size which does not conform to U.S. budgetary realities. We are considering an IDA VIII of $9-12 billion; other summit donors favor at least $12 billion.

-- Arguments by the French and others that an endorsement of of the Trust Fund arrangement should be linked to U.S. support for an unreasonably ambitious IDA replenishment.

Talking Points

-- The United States is the single largest provider of official development assistance with about $8.3 billion budgeted for FY 86.

-- We also provide valuable concessions to developing countries through preferential trade access for a large array of developing country exports.

-- We believe that aid can be most effective when used in a sound economic policy environment. A primary objective of our bilateral assistance programs is to encourage policy reform.

-- We are directing more of our aid to the poorest countries, particularly Sub-Saharan Africa. We responded generously to the African food emergency and are coordinating our bilateral policy reform efforts with multilateral initiatives such as the World Bank Special Facility for Sub-Saharan Africa.

-- The experts' report on African famine, commissioned at the Bonn Summit, identified many specific cooperative measures to meet both immediate food needs and the longer term problem of agricultural self-sufficiency. These measures are being implemented in appropriate fora.

-- With respect to IDA VIII, we are operating in a constrained budgetary environment. It is clear that over the life of the IDA VIII replenishment, the competition for available resources will be intense.

-- We support a substantial IDA VIII replenishment, in the $9-12 billion range, a significant proportion of which would go to Sub-Saharan Africa, provided there is an adjustment of lending terms and an agreed framework for IDA VIII which supports policy reform.

-- We were extremely pleased by the IMF and World Bank Boards' approval of the Trust Fund proposal providing for an IMF/IBRD comprehensive policy framework for economic growth in the poorest countries,

-- An endorsement of the Trust Fund framework by this group and a commitment to use our bilateral programs in support of this program would be an important contribution.

ENERGY ISSUES

The issue of the impact of declining oil prices should not overshadow the fundamental message that free market policies have succeeded in providing an adequate supply of energy at a reasonable cost. We want to remind our Summit partners that the best way to attain energy stability, security, and strength is to reduce further unnecessary government intervention, maintain diversification of energy supply sources, improve energy efficiency, enhance R&D collaboration, and to continue to rely on strategic oil stocks and early coordinated stock draw in the event of a disruption.

The current oil price decline allows Summit partners to step forward, not backwards, to the goal of an even freer energy market. This means having the confidence that our energy industries will adjust and that energy policy objectives already in place provide the means of achieving long-term market stability and energy supply security. The most appropriate action for Summit partners to take is to monitor, analyze and discuss the challenges that change imposes.

Rather than shackle ourselves with new price, allocation, and import controls in the name of stability, we must reinvigorate our existing energy security policies and programs. Namely, Summit partners should take this opportunity to reaffirm our commitment to:

- Monitor and analyze long-term oil market developments to detect the emergence of trends which might compromise our energy security.

- Maintain appropriate levels of strategic stocks. Countries with low stock levels should take advantage of lower oil prices and exchange rate declines to buy additional protection now.

- Resist the temptation to prop up prices in the name of support for energy security or stability. Policies should continue to be based on market prices to guide consumers' and producers' decisions; remaining barriers to energy production should be removed.

- Further liberalize trade, particularly with respect to oil products trade, to allow markets to function more freely, and to diversify supply sources, with emphasis on more trade among members of the Organization for Economic Cooperation and Development (OECD).

- Promote a balanced and mixed energy system of energy resources through diversification to coal, nuclear, and new technologies.

- Enhance international energy R&D coordination through early, joint program planning.

Talking Points

-- The current world oil market situation, in which supply is abundant and prices are declining, gives testimony to the importance and efficiency of market forces as an allocator.

-- Lower oil prices offer the opportunity to use their short term effect--lower inflation, higher real incomes in oil importing countries, and general stimulation to economic growth--to further reduce government intervention in energy markets and to encourage appropriate R&D investment to bring about the scientific and engineering breakthroughs that will provide the competitive energy technologies of the future.

-- At the same time, let us continue to monitor, analyze and discuss the impact of lower prices to ensure that consumers and producers have timely information with which to form expectations and make decisions. The monitoring process will also be of use in keeping alert to any energy security impact.

-- Let us use this forum to reaffirm the commitments many of our energy ministers made at the 1985 IEA Ministerial:

° to press for open markets, particularly in international trade;

° to maintain adequate stock levels and coordinate through early use in the event of an emergency;

° to continue to implement the 1983 IEA Ministerial Conclusion on natural gas supply seucrity;

° to pay continued attention to increased utilization of coal and nuclear energy; and

° to enhance collaboration for our R&D effort.

-- Let us use this opportunity to move forward not backward, to continue to learn from the decade of the 70's and achieve the commitments that we have made so that even if for a period we may become more import dependent because of lower prices, we do not become more vulnerable.

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TOKYO ECONOMIC SUMMIT
ISSUE PAPER ON
TECHNOLOGY COOPERATION

I. Technology, Growth and Employment (TG&E) Working Group

The TG&E Working Group was formed at the Versailles Summit in 1982 to 1) identify the contribution of research and technology to economic growth and employment, and 2) stimulate international collaboration in 18 specific technical project areas. The Working Group has decided that they have largely completed their work: this conclusion is reflected in the final report to be submitted to the Tokyo Summit. Consequences are that the TG&E Working Group will discontinue formal meetings, but maintain their network of contacts on an informal basis, being prepared to reconvene if Heads of State should request their advice in the future. With respect to international collaboration on the 18 technical projects, some have been completed, most of the others will continue outside the Summit purview.

II. Japanese Proposal for "Human Frontier Program"

The Japanese may raise, either formally or informally, a proposal for a major new research program entitled "Human Frontiers." Specific objectives for the program are not yet well defined nor has it received consensus within the Japanese government. At this time, the proposal is being reviewed by the Prime Minister's Council on Science and Technology. From preliminary details, the Japanese intention is to pursue this program internationally to strengthen Japanese research in the biosciences and to coordinate and share costs with the world research community. The U.S. scientific community is quite active in most of the proposed areas. While the U.S. could benefit from cooperation in some areas, particularly in the long-term basic research aspects, others, with a more applied thrust in biotechnology, could negatively impact our future industrial competitiveness. Japanese proposals for funding the program are significant ($5B over 20 years), with most of that commitment coming directly from Japan. At this point, the Japanese are seeking expressions of interest and, hopefully, additional funding support from other Summit countries.

We believe that the nature and content of the Human Frontier Program are much too diffuse at this time to allow the United States to make commitments to its support. However, we should applaud the emerging consensus in Japan to devote significant domestic resources to long-term fundamental research programs and to facilitate more open access to their research establishment. The Human Frontier Program, in addressing the science needs of the future, appears to reflect a significant change in Japan's traditional science and technology strategy that heretofore targeted short-term applied and developmental research of immediate relevance to Japan's industrial priorities and trade objectives. Moreover, it underscores Japan's growing acceptance of her role and attendant responsibilities as a world economic power.

TALKING POINTS

I. TG&E Working Group

1. We accept the final report of the TG&E Working Group with thanks and welcome their final recommendations. We believe the group has done a commendable job in completing the tasks assigned to them at the Versailles Economic Summit.

II. Human Frontier Program

1. We have followed the developments in the "Human Frontier" Program with interest. We applaud Japan's foresight in expanding her long-term commitment to basic research and in welcoming the participation of the world's leading specialists in this important endeavor.

2. We will be particularly interested in the specific research projects that will be included in the program and how the activities will be managed in Japan as well as in the multilateral setting you have suggested.

3. At this time, we feel it is premature to commit U.S. government support or funds to this program. When we receive more detailed proposals, we will be better able to judge our interests. I suggest, however, that we ask our scientific experts to continue this dialogue and to work together to further define the substance and format for any future initiative.

Tokyo Summit file

Document No. ____________

WHITE HOUSE STAFFING MEMORANDUM

DATE: 5/2/86 ACTION/CONCURRENCE/COMMENT DUE BY: -----

SUBJECT: PRESIDENTIAL RADIO TALK: TOKYO SUMMIT

	ACTION	FYI		ACTION	FYI
VICE PRESIDENT	☐	☐	LACY	☐	☐
REGAN	☐	☐	POINDEXTER	☐	✓
MILLER	☐	✓	RYAN	☐	☐
BALL	☐	✓	SPEAKES	☐	✓
BUCHANAN	☐	☐	SPRINKEL	☐	✓
CHAVEZ	☐	✓	SVAHN	☐	✓
CHEW	☐P	☐SS	THOMAS	☐	☐
DANIELS	☐	✓	TUTTLE	☐	☐
HENKEL	☐	☐	WALLISON	☐	✓
HICKS	☐	☐	ELLIOTT	☐	✓
KING	☐	☐	______	☐	☐
KINGON	☐	✓	______	☐	☐

REMARKS: The attached is being forwarded to the President.

RESPONSE:

David L. Chew
Staff Secretary
Ext. 2702

May 2, 1986
2:00 p.m. (Bali)

PRESIDENTIAL RADIO TALK: TOKYO SUMMIT
TOKYO, JAPAN
SATURDAY, MAY 3, 1986

Greetings from Tokyo. I am here for the 12th annual meeting of seven major industrialized democracies. I flew here last night after meeting in Indonesia with some of America's close friends and energetic trading partners. During my stay there I conferred with President Soeharto of Indonesia on a number of issues of common interest to our countries.

President Soeharto has led his country during a period of impressive economic growth. Over the last 15 years, the annual increase in Indonesia's gross national product has averaged 6.8 percent. The Indonesian people have reaped the rewards of a higher standard of living.

While in Indonesia, I also met with the foreign ministers of six countries which make up the Association of South East Asian Nations, or ASEAN. Indonesia, Malaysia, Singapore, the Philippines, Thailand, and Brunei have joined together in one of the most successful and admirable regional groupings in the developing world. Our relations with these ASEAN countries exemplify the mutual benefits that can be derived from close and open relations among free and enterprising peoples.

Over the last two decades, ASEAN countries, committed to free trade and open markets, have had some of the highest growth rates in the world. Commerce between us has created a host of jobs on both sides of the Pacific. The sound management of their economic affairs enabled the ASEAN countries to weather much of the turbulance experienced in other parts of the world. On the eve of the economic summit, here in Tokyo, there was much to talk over with our ASEAN friends.

One of the issues of concern to us all, and a subject I expect to discuss in detail at the economic summit, is the growing pressure for protectionism to shut world markets. Unfettered commerce has been a mighty force for growth and prosperity since the close of the Second World War. Our open trading system has kept America efficient and on the cutting edge of technology. While free trade means change and progress, protectionism invariably leads to stagnation and decline. Well, Americans aren't going to be left behind by anyone.

But, like our friends in ASEAN, we want to make certain that free trade is not a one-way proposition, that markets are open in all countries, and that other governments do not unfairly subsidize their exports. I assured our ASEAN friends that the United States will continue to fight trade-killing protectionism and aggressively pursue open markets and trade that is free and fair. There is no reason to doubt America's ability to compete, no reason to lack confidence in our working men and women or our corporate leaders. When everyone plays by the same rules, our people have what it takes -- the ingenuity, the hard work, and the integrity -- to compete with anyone, anytime, anywhere.

Economic challenges remain. At the summit we will discuss interrelated problems of growth, debt, trade, and finance. The fundamental strength of the economies of our summit partners will be a major focus of our discussions. At the same time, however, we will address the situation of debtor countries. Growth-oriented structural reforms in developing countries and the opening of their economies to international trade and investment is the path to progress. It's up to the Industrialized Democracies to lead the way.

The summit will also serve as a forum for discussion of critical non-economic issues; the environment and terrorism, for example.

Poet John Donne once wrote that no man is an island. When it comes to terrorism, no country is a fortress. The death of innocent people at the hands of terrorists, then, is everybody's business, a threat to the liberty and well being of all free people.

Here in Tokyo, I will be talking with the leaders of the other industrialized democracies about what must be done in response to terrorism, especially state-sponsored terrorism. We must and will stand as one against the enemies of civilization.

Seldom has the interdependence of modern industrial states been more evident than this past week. All Americans -- indeed the entire world -- sympathize with those affected by the tragedy at Chernobyl. We stand ready -- as do many nations -- to assist in any way we can.

But, the contrast between the leaders of free nations, meeting at the Summit to deal openly with common concerns -- and the Soviet government, with its secrecy and stubborn refusal to inform the international community of the common danger from this disaster is stark and clear. The Soviet's handling of this incident manifests a disregard for the legitimate concerns of people everywhere. A nuclear accident -- that results in contaminating a number of countries with radioactive material -- is <u>not</u> simply an internal matter. The Soviets owe the world an explanation. A full accounting of what happened at Chernobyl -- and what is happening now -- is the least the world community has a right to expect.

Until next week, thanks for listening and God bless you.

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

May 22, 1986

Dear Beryl:

As a follow-up to the Tokyo Economic Summit, enclosed is a copy of my remarks on the international debt situation which I presented at the Annual Meeting of the Bankers' Association for Foreign Trade.

I hope you find it of interest and welcome any comments you may have.

Sincerely,

David C. Mulford
Assistant Secretary
International Affairs

Enclosure

The Honorable Beryl Sprinkel
Chairman, Council of Economic
Advisors
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TREASURY NEWS

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FOR RELEASE
MAY 16, 1986

STATEMENT BY THE HONORABLE DAVID C. MULFORD
ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS
U.S. TREASURY DEPARTMENT

BEFORE THE
BANKERS' ASSOCIATION FOR FOREIGN TRADE
ANNUAL MEETING
PHOENIX, ARIZONA

MAY 16, 1986

Strengthening the Global Economy

I welcome this opportunity to discuss the international debt situation, which continues to pose a serious challenge for the global economy. Fortunately, our efforts to manage and resolve the debt crisis are improving, thanks in large part to the Program for Sustained Growth launched by Secretary Baker last fall in Korea. We still read and hear lots of doom and gloom in the media, in the Congress, and among some of the debtor nations, but to those of us on the firing line, important changes are visible.

First, it is becoming increasingly accepted by all parties that the debt crisis can only be resolved by improving growth prospects in the debtor nations. This means improving their ability to accumulate foreign exchange at a faster pace than they accumulate debt. The key point here is that sustained, lower-inflation growth can only be accomplished through fundamental economic reforms in the debtor countries' economies. Unless credible reforms are put in place, these countries will not be able to command the necessary capital for their development. Acceptance of these facts represents an important and basic recognition of reality from which a new beginning can be made.

Second, and very fortunate from a timing standpoint, improvements presently taking place in the global economic environment will have an enormous impact on the ability of debtor nations to service their debt and finance imports needed for growth.

-- Industrial country growth will be approximately one percent higher than projected at the end of 1985, and inflation will be about two percent lower. We estimate that in 1986 this will add nearly $5 billion to developing nations' non-oil exports and reduce their non-oil import costs by approximately $4 billion.

-- The sharp decline in interest rates -- nearly 3 percentage points since early 1985 -- will reduce annual debt service payments for all LDCs by about $12 billion, freeing up these resources for productive use elsewhere in the debtors' economies. For the major debtors alone, the savings will be nearly $8 billion, or 20 percent of their annual interest payments on outstanding debt. If we compare current 6-month LIBOR rates to the average for 1984, and focus on debt owed to the commercial banks, the savings are even more dramatic -- a decline of nearly 5 percentage points and a 45% savings in annual interest payments to commercial banks.

These developments will provide significant relief for debtor economies which is only now beginning to be more broadly recognized internationally.

There are other foreign exchange savings as well. Declining oil prices will save oil-importing developing nations some $14 billion annually. While it is true that several major oil-exporting debtor nations will suffer from falling oil export revenues, they <u>will</u> benefit from lower interest rates and stronger world growth.

In fact, we are seeing the most favorable economic environment since the early 1970s, and we should bear in mind that these broad economic changes could be more important to a resolution of the debt problem than the provision of marginal amounts of financing by the banks or the much-touted World Bank general capital increase.

Admittedly, positive changes in the global economic environment must be supplemented by economic reforms in the debtor nations themselves to have a lasting effect. Without such reforms, no amount of international lending or external economic improvements can assure sustained growth for the longer term.

I often hear criticism that the creditor nations are not called upon to do anything under the Baker plan. This usually refers to the provision of more aid or a general capital increase for the World Bank. This criticism, in my view, entirely misses the point. The major industrial countries have a broader responsibility, which in a sense serves as the foundation for the debt initiative -- namely, the provision of a sound world economic environment. Viewed in this light, the contribution since last fall has been substantial.

I want to dwell on this for a moment, because I have just returned from the Tokyo Summit, and it is possible now to bring a greater sense of perspective to the important question of international economic policy coordination. Last September's Plaza agreement and the Program for Sustained Growth in October were mutually supportive initiatives to improve the prospects for growth and stability in the global economy. It is widely agreed that the results of the Plaza agreement have been impressive. Major exchange rate adjustments have taken place which will substantially improve the U.S. trade deficit, and there has been better coordination of policy actions among the Group of Five industrial nations, particularly with regard to interest rates.

The recent Summit agreement constitutes another important step forward in strengthening the system of international economic policy coordination among the key industrial nations. A new Group of Seven Finance Ministers, including Canada and Italy, was formed in recognition of the importance of their economies. The Group of Five will continue its multilateral surveillance activities, but important improvements in the process for international economic policy coordination have been agreed. This process will now involve the following steps:

First, countries will develop individual country economic forecasts.

Second, these forecasts will then be reviewed for internal consistency and external compatibility, using a range of economic indicators. These indicators would include growth rates, inflation rates, unemployment rates, fiscal deficits, current account and trade balances, interest rates, monetary growth rates, reserves, and exchange rates. Exchange rates and current account and trade balances would be particularly useful in assessing the mutual compatibility of country forecasts.

Third, modifications in forecasts and underlying policies would be considered as necessary to promote consistency. Whenever there are significant deviations from an intended course, best efforts will be made to reach an understanding on appropriate remedial measures, focusing first and foremost on underlying policy fundamentals. Intervention in exchange markets could also occur when to do so would be helpful.

The IMF, through Managing Director de Larosiere, will play an important role in this process. We intend to implement this agreement with the same degree of commitment and cooperation that made reaching this agreement possible. With such implementation, we believe the prospects are significantly enhanced for greater exchange rate stability, more balanced growth, and more sustainable patterns of international trade.

The Debt Initiative

The Tokyo Summit also endorsed the U.S. debt initiative and recognized that its priorities are right. In particular, the Summit communique emphasized the importance of effective structural adjustment policies within the debtor nations, coupled with measures to mobilize domestic savings, encourage the repatriation of capital, improve the environment for foreign investment, and promote more open trading policies.

Providing a more favorable climate for foreign direct investment is particularly important to help reverse recent declines in net direct investment flows. This is the exclusive responsibility of the debtor nations themselves. If they choose to ignore the growing competition for attracting capital, they will face further declines in investment flows. The U.S. stock of investment in Mexico, for example, was down 7% in 1984 compared with the average U.S. investment level for the years 1980-84.

Similarly, a rationalization and liberalization of debtors' trade regimes can contribute to improved efficiency and productivity for the economy as a whole. Policy improvements in the areas of both direct investment and trade should be part of broader efforts by the debtor nations to improve the prospects for growth. Neither, alone, can do the whole job.

These aren't impractical objectives, despite the political sensitivity of some of these reforms. It is also important to emphasize that we are not advocating austerity measures here but policies with real potential to make an immediate and lasting contribution to growth. There already has been, I believe, some significant change in attitudes within some of the debtor nations. Brazil and Argentina, for example, have undertaken substantial domestic economic reform programs to reduce inflation. A number of countries, including Chile, Mexico, and Argentina, are moving to privatize public enterprises, while Ecuador and Colombia have taken steps to significantly increase the market-orientation of their economies.

Taken as a whole, I am optimistic that many of the Latin debtors -- with a few exceptions -- are working to improve the efficiency of their economies at a time when growth prospects are improving. The IMF and the World Bank are assisting in this process. The IMF has existing or pending arrangements with 11 of the 15 major debtor nations, while the World Bank has structural or sector loan negotiations underway with 13 of these nations and has recently extended loans to Ecuador, Argentina, and Colombia to support adjustment efforts in some of their key sectors.

In addition, several of the major debtors have discussions underway with the World Bank on the development of medium-term adjustment programs, focusing on efforts to increase growth and export capabilities, mobilize domestic savings, encourage increased investment, and liberalize trade. These medium-term programs will provide the framework for future World Bank sector or structural adjustment loans and IMF programs or arrangements.

The Role of the Commercial Banks

Once debtor governments have committed to undertake viable economic reform programs which have World Bank and IMF support, commercial banks should be ready to implement their earlier pledges of support in short order. I recognize that the commercial banks are cautious about seeing the precise conditions for IMF and World Bank lending before committing to increase their own lending. This is understandable, and will undoubtedly mean that pledges by the commercial banks will come later in the process than was true in the 1982-1985 period. However, once reforms are agreed upon, commercial banks must be ready to lend without delay.

Yet I am concerned that not enough has been done by commercial banks to assure that when the time comes, they will in fact be ready to lend. Have the modalities for additional lending within current lending syndicates been agreed? Have the differences between the larger and smaller banks been resolved? I doubt it. And I would caution again, as I did when I spoke to a large group of banks in London in February, that continued efforts by banks to obtain government guarantees or to secure for themselves the preferred creditor status of the multilateral development banks, will not be supported by the Administration. The Administration is firmly on record as opposing government or World Bank guarantees for new commercial bank lending.

Coordination among commercial banks -- domestically and internationally -- is a vital part of this exercise. Smaller banks must be able to count on the willingness of the major banks heading bank advisory groups to keep them informed at an early stage of country and other developments affecting bank lending. Similarly, the large U.S. banks need some assurance that regional and foreign banks will continue to participate in reschedulings and new money packages. Resolving these problems is fundamental to continued concerted lending.

In Washington, we frequently hear that smaller banks "want out", despite the pledges of support for the debt initiative from U.S. banks with 98 percent of U.S. commercial bank exposure to the major debtor nations. We have accepted these pledges of support and the subsequent endorsement from BAFT membership as representing the serious intentions of U.S. and foreign banks, and we are grateful for them. Nevertheless, there seems to be an inconsistency between previous pledges and the alleged desire of smaller banks to cut and run.

We do not intend to twist the arms of U.S. banks. They will lend if they perceive it to be in their interest to do so. Taken as a whole, the banks know that without growth in the debtor nations -- and an improved ability to earn foreign exchange -- they cannot expect to be repaid, nor, to put it bluntly, can they expect to continue favorable earnings on assets of declining quality. The banks also know that growth must be financed in large part from private capital resources. The banking community, therefore, should concern itself with helping both the debtor nations and the international financial institutions to develop the necessary reforms and procedures for implementing the debt strategy. Traditionally, banks have worked with troubled clients, because they have believed it to be in their own self-interest. The present international debt situation is no different. Indeed, there is more at stake for the participating banks in all the creditor nations, because they share the same international and interdependent financial system.

I would urge you to continue to consider innovative means to keep banks with less exposure involved and at the same time simplify the lending/negotiating process. That is a major challenge.

When senior financial officials of debtor countries have to travel throughout the United States to sell their program to virtually every potential lender right down to those with a few tens of thousands of dollars of exposure, one must seriously question the wisdom of syndicate members, both large and small. Those officials should be home developing and implementing the policies to improve their economies. The syndicates should centralize their efforts more effectively and improve the cohesion of their groups by making all members feel they have a stake in the progress of the debtor nations. I would add to that the need to plan ahead so that the valuable time you have now to prepare for the major negotiations which are nearly at hand will not have been wasted.

<u>Debt/Equity Swaps</u>

I would like to comment on debt/equity swaps.

Coming as I do from an investment banking background, I am intrigued by recent developments in the area of debt/equity swaps and the securitization of commercial bank loans. Debt equity swaps, in particular, can help to reduce outstanding debt obligations, thereby also reducing the annual debt service burden. They can also provide an attractive means of encouraging the return of flight capital.

Chile has recently adopted modifications in its foreign exchange regulations which permit nationals and foreigners to make debt/equity conversions. At least $300 million in such conversions have already occurred since last August, including foreign equity positions in financial institutions in Chile. We understand there are hopes that considerable further sums will be converted this year.

Part of the attraction in Chile, of course, is its open, market-oriented investment regime, which is likely to attract foreign direct investment in Chile, quite apart from debt/equity swaps.

I would encourage other debtor nations to follow Chile's example and in liberalizing their direct investment regime to permit financial institutions to establish financial subsidiaries that would be active in the host country's domestic markets. I understand that some commercial banks might be interested in moving in this direction.

In your other discussions here, you may want to review the possibility for other innovative mechanisms to securitize debt. I have long believed it must be possible to establish a consortia-type development bank in certain debtor countries, owned partly by the commercial banks, partly by the host government concerned, and perhaps partly owned by the public, which could use existing debt to purchase the shares of domestic corporations, privatized parastatals, as well as existing private company shares. I believe this to be worth exploring.

I don't want to overstate the potential benefits nor minimize the complexities we are dealing with. I assume that as debt is shifted to equity, or as loans are swapped or sold off, the syndicate or exposure bases for new lending would also shift or change. But I can't believe this is an insoluble problem.

There are a fair number of regulatory and accounting rules, guidelines and standards that would be involved. My understanding is that within the existing framework, there already may be a degree of flexibility to deal with the kinds of innovations that I would like to encourage. Situations will vary country by country and bank by bank; the existing markets are thin; spreads between bids and offers are wide; and some creative possibilities for improvement are only in a nascent stage of development. Given the long tradition of BAFT's, technical expertise perhaps some of your own committees might have suggestions to put forward in this regard.

Finally, in discussing these issues, let me stress the continued need for the CEOs and boards of directors of your institutions to take a direct interest and longer term view of the potential benefits of the Program for Sustained Growth, both to your banks and your domestic clients, as well as to the borrowers. Banks and exporters are interdependent. So, as I have emphasized earlier, is the banking community as a whole.

To the extent that the Program for Sustained Growth succeeds, all the participants -- including the banks and the regions they serve -- will be better off.

You know your markets, your clients and peers -- larger and smaller -- better than we do in Washington. Now is the time to exercise your ingenuity, to have the information and syndicates in place and be ready to act. We must have your vigorous leadership and active cooperation if the Program is to succeed.