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REAGAN'S MESSAGE FOR THE TOKYO SUMMIT

INTRODUCTION

The annual economic summit of the seven leading democratic industrial powers convenes in Tokyo on May 4. The leaders of the United States, Japan, West Germany, France, the United Kingdom, Italy, and Canada will meet for two days. At past summits, during the recession of the early 1980s, Ronald Reagan's supply-side economic policies were roundly criticized by the allies. Reagan was urged, for example, to raise taxes to deal with budget deficits. Reagan not only held his ground but also took the offensive and promoted free market, growth-oriented policies. The result: not only has the U.S. economy recovered and grown rapidly since the 1982 recession, but the West European countries, by reducing economic controls and stimulating enterprise, have begun to recover and grow. Generally lower interest rates, brought about in part by falling U.S. rates, and collapsing oil prices, resulting from disarray in OPEC and Reagan's deregulation of U.S. oil prices, bode well for the industrial democracies' economic future.

Reagan also goes to the summit with a record of political successes. For example, at his meeting with Soviet leader Mikhail Gorbachev, the President held out the possibility of more peaceful East-West relations if the Soviets would alter their aggressive military and geopolitical policies. Further, he has dealt firmly with the terrorist activities of Libya. The allies were generally critical of Reagan's actions, but now they themselves are taking the first tentative, albeit much belated steps to face the situation.

Problems, however, remain. They include trade protectionism and Third World debt and terrorism as an economic as well as a political threat. To deal with these problems, Reagan at the Tokyo Summit should urge the allies to:

1) <u>Attempt to cool the trade protectionist fever that has spread to Europe</u>.

Over the last year, trade protectionist sentiments in the U.S. Congress have been as strong as at any time since World War II. While some legislative proposals have sought to open foreign markets to U.S. exports, many others have contained the same import-restricting policies for which the U.S. criticizes other countries. Reagan has stood against the protectionist tide, last year vetoing the one major trade act of Congress to reach his desk, a bill to limit textile and apparel imports into the U.S. market. While he blocked that effort, his Administration nonetheless is seeking to restrict further textile imports through a tougher Multi-Fiber Arrangement, the international agreement governing such trade, which must be renegotiated before it expires in July. The U.S. also is pressing its trading partners to restrict their exports of steel to the U.S. And in Congress, more protectionist legislation is brewing.

The situation is worse in Western Europe, which systematically impedes the import of U.S. goods. Just recently, for example, the European Community (EC) announced plans to raise tariffs and quotas on as much as $1 billion in U.S. grain imports. As a result, U.S. farmers could lose $600 million in sales. When Washington responded by warning that it would curb European imports by a similar amount, the EC threatened to retaliate against another $2 billion worth of U.S. goods.

The only signs of trade liberalization have come from Japan and Canada. Though it still restricts far too many U.S. imports, Tokyo at least has liberalized trade in electronics and several other products. Canada, whose general tariff levels are higher than most other industrialized countries, is seeking a complete free trade area with the U.S. In 1984, Congress granted the President authority to enter negotiations for such an agreement unless overruled by either the Senate Finance Committee or the House Ways and Means Committee. An attempt by the Finance Committee to head off such negotiations was defeated on April 23 by a tie vote. Therefore, the process of liberalizing U.S.-Canada trade will proceed. Congress will have to approve the final agreement.

Protectionism helps neither the "protected" nation nor the nation whose trade is restricted. Consumers pay more for goods. Productivity is lowered. New product development is hindered. Unemployment or underemployment grows. Everyone loses. Among the seven summiteers, none is without fault.

Reagan should use his widely acknowledged diplomatic skills to mute the protectionist rhetoric and urge steps to restore momentum toward freer trade. He should emphasize the benefits of open markets, just as in the past he has emphasized to the allies the positive aspects of other free market policies, but he also should make it clear to his fellow leaders, that their countries court economic distress if they close their markets to U.S. goods.

2) Discuss specific agenda topics for the next GATT round.

Last year the industrialized countries agreed in principle to convene a new round of trade liberalization talks under the General Agreement on Tariffs and Trade (GATT). Preliminary work on this by trade officials of the various governments has been underway. Reagan should press the allies to include in this new round of talks such topics as trade in services (for example, banking and data processing), other nontariff barriers, and the problem of government export subsidies.

Although it is a sensitive topic in all the countries to be represented in Tokyo, Reagan should tell them that agriculture, too, should be addressed in future trade negotiations. The agricultural policies of most countries are particularly protectionistic. The world's worst offender may well be the European Community's Common Agricultural Policy (CAP). Yet Canadian and U.S. agricultural subsidies are also undesirable.

3) Seek strong support for a market solution for the Third World debt problem.

The mounting debt burden among the less developed countries (LDCs) since 1982 has been mainly the result of their own flawed economic policies. Reliance on socialist economic models, state-run cooperatives, and huge bureaucracies has stunted growth. The crisis has not only harmed the LDCs but has imposed an economic drag on the world economy, harming the U.S. in particular. Example: U.S. exports to Latin America fell from $41.9 billion in 1981 to only $25.2 billion in 1983. Western attempts to solve the debt problem have often done more harm than good: austerity requirements attached to International Monetary Fund (IMF) loans, for instance, generally have damaged recipient nations by forcing ever higher taxes on the productive private sector.

Positive steps have been taken by some debtor countries. Argentina's monetary reforms have helped curb its 2,000 percent inflation. Lower U.S. interest rates have aided such actions, and some debtor nations have benefited from falling oil prices. Yet there is still much to be done. The entire world would benefit from a growing, economically dynamic Third World. The LDCs would have more goods to offer the West and could better afford to purchase products from the industrialized world.

The new debt strategy announced last year by U.S. Treasury Secretary James Baker seeks to promote economic growth by encouraging debtor nations to reduce the state's role in the economy, to sell off state-owned enterprises, to provide tax incentives for private investments, to liberalize trade and direct foreign investment, and to follow other proved growth policies. The Baker Plan envisions the World Bank as a primary agent to promote these policies.

Reagan's newly nominated World Bank President, former New York Congressman Barber Conable, will face much resistance to such reform from the debtor governments pressured by their entrenched bureaucrats and from many officials inside the World Bank.

An agreement to contribute more funds to the World Bank and International Monetary Fund is not what the U.S. should be seeking from its industrialized allies. Enough money already has been wasted. Needed instead is strong backing for the Baker Plan. The money already available must be spent more creatively to promote growth policies. Reagan also should point out that trade protectionism on the part of the developed countries is very damaging to debtor nations struggling to sell more goods overseas for hard currency.

4) <u>Encourage continued market-oriented reforms among the allies</u>.

While America's summit allies are the world's richest countries, they still could gain greatly from more consistent practice of market principles. Most are moving in this direction. Inflation induced by money-printing presses and public sector spending has been slowed. Taxes have not been increased--and tax cuts are envisioned by some. Perhaps most important, Japan at last (under much pressure from the U.S.) is considering basic changes to its economic strategy. Tokyo plans to move away from its excessive dependence on exports for economic growth and toward more consumer-led expansion. This could do much to defuse balance of trade tensions.

Reagan should take pride in his key role in prompting such positive developments. During his early economic summits, his supply-side policies were met with scorn. Now the "American Miracle", as the West Europeans describe the Reagan expansion, has led to Reaganite policies being imitated widely. The President should continue to remind the allies of the value of such free market policies, congratulating them on their successes and encouraging them to do more.

5) <u>Consider, but with great care, ways to stabilize or reform exchange rates</u>.

The exchange rates between various currencies are not themselves a major problem. They simply reflect the strength or weakness of each economy and the particular domestic economic policies being undertaken.

Yet the current system of floating exchange rates creates some economic distortions. Trade flows, for example, always lag behind exchange rate fluctuations, leading to serious trade imbalances.

The best solution to international monetary problems and trade instability would be a return to a gold or other commodity standard for international currency exchange rates. This would provide a standard of exchange not easily manipulated by governments. Few countries, regrettably, seem willing to move in that direction.

Returning to a system of artificially and arbitrarily fixed exchange rates, on the other hand, would simply replace one set of problems with another. There are some advantages to be gained through the enforced coordination of monetary policies by the major countries. But the experience with fixed rates during the 1960s suggests that the most likely outcome would be intense currency regulation and frequent international financial crises.

Thus Reagan should be extremely cautious about schemes to move back to fixed exchange rates, unless they are linked to gold. He should be receptive, however, to reasonable suggestions about how to overcome some of the marginal inefficiencies of floating rates. And he should urge continued cooperative efforts among the allies to bring down interest rates in an orderly manner.

6) <u>Urge the allies, for their own good, to stand with the U.S. against international terrorism</u>.

Reagan's bold and overdue military action against Libya demonstrates that states supporting international terrorism can be made to pay for the actions. Curiously, with the exception of Britain and Canada, America's allies opposed this action. They were also reluctant to cooperate in nonmilitary sanctions. Before and after the fact they have offered no constructive alternatives to military action.

European leaders who try not to offend Libya have seen their security undermined. Increasingly damaged too are their economies. American and other tourists are beginning to avoid Western Europe because of the threat of terrorism. And this may be the tip of the iceberg. If Western Europe is perceived as a dangerous place, and if foreign businesses fear for their personnel, they will begin to take their investments and staffs elsewhere. The losers will be the West European economies.

CONCLUSION

The world economic situation continues to improve, mainly because of the move by many countries toward market-oriented policies. Even so, trade protectionism threatens the coming Tokyo summit. The U.S. and Europe are no longer simply talking about restricting their markets. They are taking action to undo 40 years of progress in trade liberalization.

Reagan must do all he can to defuse this dangerous situation. As a positive step toward this goal, he should emphasize the need for the next GATT round to deal with trade in services, export subsidies, and agricultural policies. Further, Reagan should continue to promote growth-oriented policies among the allies and to seek their backing for a market-oriented solution to the Third World debt crisis. He should consider, though with caution, addressing the problems of fluctuating exchange rates. Finally, Reagan should stress the economic as well as the political consequences of terrorism and seek strong allied support in dealing with it.

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