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TO IMMEDIATE FCO

TELEGRAM NUMBER 520 OF 3 JULY

INFO ROUTINE OTTAWA UKREP BRUSSELS WASHINGTON PARIS TOKYO ROME

YOUR TELNO 200 TO OTTAWA: ECONOMIC SUMMIT: OBJECTIVES OF PARTICIPANTS

1. RECENT CONTACTS WITH OFFICIALS IN THE CHANCELLOR'S OFFICE AND ELSEWHERE SUGGEST THAT HERR SCHMIDT ATTACHES GREAT IMPORTANCE TO THE SUMMIT BUT HAS RELATIVELY LOW EXPECTATIONS OF IT. HE SEEMS TO BE INFLUENCED BY HIS OWN DEEP ANXIETIES ABOUT PRESENT TRENDS IN THE WORLD ECONOMY, HARASSED BY THE PROBLEMS OF MANAGING THE GERMAN ECONOMY AND DISAPPOINTED THAT THE EUROPEAN COUNCIL DID NOT PRODUCE A SOLID COMMUNITY IDENTITY OF VIEW ON ECONOMIC POLICY. HE FEELS FORCED TO ACCEPT THAT THERE IS NOT A GREAT DEAL THAT CAN BE DONE IN THE SHORT TERM TO IMPROVE MATTERS, BUT CONVINCED OF THE NEED TO PRESERVE IF WE CAN WHAT REMAINS OF THE CONSENSUS.

2. SCHMIDT PROBABLY JUDGES THE WORLD ECONOMIC SITUATION TO BE THE SINGLE MOST IMPORTANT ISSUE FOR DISCUSSION AT OTTAWA. BUT HIS OFFICIALS TELL US THAT HE FEELS THE DIFFERENCES BETWEEN THE ECONOMIC APPROACHES OF THE U.S. AND NEW FRENCH GOVERNMENTS ARE AT PRESENT SO GREAT THAT THEY CANNOT BE EXPECTED TO REACH SUBSTANTIVE AGREEMENT ON POLICY. THEY SAY THAT HE THEREFORE WANTS INSTEAD TO FOCUS ATTENTION ON WORLD TRADE AND THE FIGHT AGAINST PROTECTIONISM (THIS LAST THE SINGLE POINT OF SUBSTANCE HE PICKED OUT WHEN INTERVIEWED ON TELEVISION AFTER LUXEMBOURG ABOUT HIS HOPES FOR OTTAWA).

3. THESE TACTICAL INTENTIONS WILL PROBABLY NOT STOP SCHMIDT STRESSING THE NEED TO GIVE TOP PRIORITY TO THE FIGHT AGAINST INFLATION, THE NEED TO AVOID LARGE SCALE DEFICIT FINANCING AND THE DIFFICULTIES CAUSED FOR THE GERMANS AND OTHERS BY HIGH AND VOLATILE AMERICAN INTEREST RATES. IF WHAT WE HAVE BEEN TOLD ABOUT HIS TACTICS IS RIGHT HE WILL BE TALKING HERE MOSTLY FOR THE RECORD. BUT HE WILL HOPE ALSO FOR A GENERAL REAFFIRMATION OF PRINCIPLES COMPATIBLE WITH HIS ECONOMIC POLICY TO HELP HIM, IF ONLY PRESENTATIONALLY, IN THE DIFFICULTIES HE WILL FACE ON HIS RETURN IN DEALING WITH GERMAN ECONOMIC PROBLEMS, MOST PRESSINGLY THE 1982 BUDGET AND THE NEED TO CUT PUBLIC EXPENDITURE IF TAXES ARE TO BE HELD DOWN AND THE DEFICIT IS TO BE COVERED.

4. IN TALKING ABOUT WORLD TRADE, HIS OFFICIALS SAY, SCHMIDT WILL BE LOOKING FOR AGREEMENTS, NOT CONFRONTATIONS. BUT HE IS SERIOUSLY CONCERNED BY THE GROWING THREAT OF PROTECTIONISM: THE PRACTICAL KNOCK-ON EFFECTS OF NEO-PROTECTIONIST MEASURES SUCH AS SELF-RESTRAINT; DIFFERENCES OF OUTLOOK BETWEEN JAPAN, THE COMMUNITY AND THE UNITED STATES; CONTINUING SERIOUS PROBLEMS IN THE EUROPEAN AND WORLD STEEL MARKETS; AND THE MULTI-FIBRE AGREEMENT. HE FEELS STRONGLY THAT PROTECTIONISM IN WORLD TRADE HAS A DAMAGING EFFECT ON ECONOMIC POLICY TOO, E.G. BY WEAKENING THE CAMPAIGN AGAINST INFLATION.

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5. ON NORTH/SOUTH ISSUES SCHMIDT WILL WANT TO TRY TO CONVINCE THE HARD LINERS OF THE NEED TO KEEP EFFECTIVE LINES OF COMMUNICATION WITH THE DEVELOPING COUNTRIES OPEN BUT TO REMAIN ROBUST ON SUBSTANCE - THE IMPORTANCE OF TRADE, PRIVATE INVESTMENT FLOWS ETC. HE WILL, HOWEVER, WANT TO AVOID HAVING THE FEDERAL REPUBLIC IDENTIFIED AS A LEADER AMONG THE HARD LINERS. IN A RECENT CONTRIBUTION TO QUOTE FOREIGN AFFAIRS UNQUOTE (VOL 59 NO 4 SPRING 1981) HE LAID EMPHASIS ON:

- I) THE NEED FOR ALL COUNTRIES TO BE REMINDED OF THEIR RESPONSIBILITIES FOR WORLD DEVELOPMENT:
- II) THE OVERWHELMING IMPORTANCE OF SOLVING ENERGY PROBLEMS AND THE NEED FOR OPEC TO MAKE A MAJOR CONTRIBUTION:
- III) POPULATION CONTROL:
- IV) SUSTAINING FINANCIAL AND TRADE FLOWS: AND
- V) A REAL WILLINGNESS ON THE PART OF THE DEVELOPING COUNTRIES TO COOPERATE.

OFFICIALS TELL US THAT THESE ARE THE THEMES IN NORTH/SOUTH ISSUES REALLY CLOSE TO HIS HEART.

6. FOLLOWING TRUDEAU'S RECENT VISIT WE UNDERSTAND FROM THE CANADIANS THAT THE GERMANS WILL RAISE UNLOSC TAKING THE LINE THAT THE U.S. DECISION TO RECONSIDER SHOULD BE TAKEN BY THE REST OF THE WEST AS AN OPPORTUNITY TO CONSIDER WHETHER, COLLECTIVELY, THEY ARE NOT GOING DOWN THE WRONG STREET.

TAYLOR

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