
**THE TOKYO SUMMIT
A BACKGROUND PAPER**

APRIL 1986

Each year, in advance of the Prime Minister's departure for the Summit of industrial powers, the Business Council on National Issues releases a paper commenting on some of the issues likely to preoccupy the Summit participants.

This year, the Business Council paper focuses on issues touching the international economy, trade and security. The views expressed in this paper reflect the work of several Council task forces, but in particular the Task Forces on the International Economy and Trade, and Foreign Policy and Defence.

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TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
INTRODUCTION	1
MACROECONOMIC OVERVIEW	1
TRADE POLICY	4
INTERNATIONAL FINANCE AND DEBT	7
INTERNATIONAL POLITICS AND SECURITY	9
FOOTNOTES	13

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EXECUTIVE SUMMARY

The 1986 Summit of major industrialized countries takes place at a time of considerable uncertainty. Although the economic recovery which began in 1983 continues to make progress, its effects are somewhat unbalanced, and several serious international problems have emerged to cloud the prospects for future growth. Exchange rate instability, growing protectionism, and the Third World debt crisis are three such problems, all of which will feature prominently on the agenda to be addressed by Prime Minister Mulroney and his counterparts at Tokyo in May. In addition, international security issues will also merit the attention of the Summit countries at Tokyo.

MACROECONOMIC OVERVIEW

The past year has seen moderately strong economic growth in most of the Summit countries. The prospects for 1986 also appear to be quite good, in part because of the positive effects which declining oil prices will have on many industrialized (and developing) countries. Canada's macroeconomic performance was quite impressive in 1985, and most indicators suggest that 1986 should also be a reasonably good year, both for Canada and its major trading partners. However, in light of continuing high unemployment in several Summit countries and the fragile state of the international financial system, it is important that global economic recovery continue and that growth-oriented policies be followed wherever possible. In the case of some Summit countries such as Japan and West Germany, reflationary economic policies appear to be called for. For other countries, including Canada and the United States, existing large fiscal deficits rule out this kind of strategy, and suggest that medium term growth prospects will be improved through policies designed to lower public sector deficits and the growth of the national debt.

TRADE POLICY

There were several significant developments in the world trading system in 1985. World trade for the first time surpassed \$2 trillion (U.S.) in 1985. More importantly, following protracted discussions a preliminary decision was made in late 1985 to begin a new round of GATT Multilateral Trade Negotiations. This should add momentum to the search for solutions to international trade problems and help to dampen protectionist pressures. With

over 30 percent of its GNP derived from exports, and with a longstanding commitment to more effectively functioning international trade rules and institutions, Canada has a major stake in the success of the next GATT round. In our view, Canada's principal negotiating objectives should include the following: a new safeguards code; expanded coverage and more signatories to the GATT government procurement code; lower foreign barriers to trade in resource-based products; improved international rules to govern the use of subsidies and countervailing duties; new rules to liberalize trade in selected services; progress in bringing agriculture under GATT discipline and scrutiny; and greater participation by developing countries in the GATT system.

The interest recently shown by Canada and the United States in the prospects for freer bilateral trade does not entail any rejection of the multilateral trade system. The Business Council is convinced that bilateral negotiations can lead to an improved Canada-United States trade relationship and can also contribute to the goal of multilateral trade liberalization. However, we recognize that trade liberalization, whether bilateral, multilateral or both, will bring with it increased adjustment pressures. Measures to ease the burden of adjustment, such as the gradual phasing-in of reduced trade barriers, will be essential, as will policies to address the problems caused by interprovincial barriers to trade and commerce

INTERNATIONAL FINANCE AND DEBT

The debt problem facing many developing countries, and the marked exchange rate instability of recent years, have put the international monetary and financial system under great strain. Progress has been made in addressing both of these issues, but more remains to be done. Through the efforts of the International Monetary Fund, Western banks, and the debtor countries themselves, short-term arrangements have been worked out to reschedule loans and provide additional flexibility with respect to repayment of loans. More recently, new proposals to deal with the debt situation were unveiled by United States Secretary of the Treasury James Baker. The United States government has also displayed increased flexibility on the broader question of reform of the international monetary and exchange rate regime.

The need for developing debtor countries to export more and to institute policies supportive of foreign direct capital investment is increasingly recognized. Better access to developed country markets and increased foreign direct investment would help developing countries to grow

more quickly and to service their external debts. Strong economic growth in the OECD countries would also do much to alleviate the Third World's debt problem. In addition, however, new financial arrangements will probably be required as the international community continues to grapple with the debt issue.

The issue of exchange rates will also be a focus of attention at the Tokyo Summit. In principle, exchange rate flexibility is desirable, but the rapid and uncertain currency movements of recent years have had a negative influence on the global economy. A timely initiative was taken in September 1985 to lower the value of the U.S. dollar, and it appears that support is growing for further action to address the problem of exchange rate instability. We welcome this development, and hope that Canada will play a role in devising improved international monetary arrangements.

INTERNATIONAL POLITICS AND SECURITY

Although the Summit is primarily intended to explore international economic issues, the subject of security will also be on the agenda. The advent of the Gorbachev regime in the Soviet Union in 1985 brought an end to the uncertainty characterizing the whole question of the Soviet leadership and has prompted more vigorous Soviet diplomacy in recent months. This trend is likely to continue, and this will demand a careful response from the Summit countries. The Soviets have succeeded over the past decade in achieving either parity or superiority vis-a-vis the NATO alliance across most dimensions of military power. The United States and other NATO countries have responded to the impressive growth of Soviet military capability by upgrading their own forces. These efforts on the part of the NATO nations are essential. They are not incompatible with improved relations between the latter and the Soviet bloc, and need not preclude balanced, verifiable arms control agreements between the two sides.

For its part, Canada should seek to continue to improve its military capabilities in order to strengthen NATO's conventional force posture. This will promote stability because it will raise the nuclear threshold and make NATO's non-nuclear forces more effective and credible in the eyes of a potential aggressor. Along with Canada, Japan is the other Summit country which devotes a relatively small share of its GNP to defence and security. Because it faces special problems in this area, Japan may be able to make a larger contribution to the security of the democratic world by playing a greater role in providing economic and technical assistance to poor developing countries in key parts of the world.

INTRODUCTION

The 1986 Summit of major industrialized countries takes place at a time of considerable uncertainty. The economic recovery which began in 1983 continues to advance, although its future course is unclear and its effects somewhat unbalanced. A measure of progress has been made in seeking to better manage international exchange rates since the September 1985 meeting of the G-5 countries, but currency volatility remains a source of concern in the global economy. The preliminary decision made in late 1985 to proceed with a new round of multilateral trade negotiations under the General Agreement on Tariffs and Trade was a welcome indication that governments are anxious to resist the very powerful protectionist pressures being manifested in many countries. However, it would be wrong to assume that a new GATT round will resolve the serious problems afflicting the global trade system, or that protectionism will suddenly decline. An especially serious international problem that will receive the continuing attention of the Summit countries is the debt situation confronting a number of developing countries. Although positive steps were taken to address this issue in 1985, more remains to be done to develop lasting solutions to the Third World's debt problem, and to lessen the risk of a breakdown in the international financial system. Finally, while the Tokyo Summit will be predominantly concerned with global economic issues, the question of East-West relations and international security developments generally must also be addressed. Because all of the Summit countries share many political values and security interests, and because all except Japan are members of the NATO alliance, the opportunity provided by the Summit to consider international security matters should not be ignored.

In this short background paper, the Business Council on National Issues offers some views of Canada's private sector leaders on these and other key subjects likely to preoccupy Prime Minister Mulroney and his counterparts from the other Summit countries. This paper is also intended to serve as a background document preparatory to the participation of a number of Business Council members in the 1986 Quadrangular Forum in Tokyo.

MACROECONOMIC OVERVIEW

The past year has seen moderately good economic growth internationally, and a somewhat better Canadian performance. Contrary to what many had expected, the economic recovery did not come to a halt in 1985, although there was a marked slowing in the growth rate in the United States through much of the year. More recent indications are that growth in the United States has again picked up and should be in the 3 percent range in 1986. This will help to keep the economic recoveries evident in other

industrial countries on track, and will have a particularly beneficial impact on Canada. Also contributing to faster economic growth in the OECD countries will be the sharply lower oil prices of recent months, although the impact of this trend on Canada will be mixed, particularly in the short term.

Canada's macroeconomic performance in 1985 exceeded most expectations. Real growth was in excess of 4 percent, unemployment by year-end had declined to 10 percent, and inflation remained under control at approximately 4 percent. Deep concern persists over the size of the Canadian federal deficit and the growth of the public debt, but the February 1986 budget, coupled with the measures previously taken by the government to restrain spending growth and raise revenues, indicates that Canada's fiscal problems are gradually being brought under control.

Canada's short-term economic prospects seem to be reasonably favourable when viewed in a wider international context. A recent OECD report, for example, was generally very optimistic about the Canadian economy, although it expressed concern about the unbalanced nature of Canada's fiscal policy.¹ The February federal budget forecasts real GNP growth of 3.7 percent in 1986 and 3.0 percent in 1987. The Department of Finance's "mid-range scenario" projects average annual real growth of 2.75 percent over 1988-91. This projected performance will be surpassed if real interest rates fall to more normal levels.² Job creation in Canada has been impressive over the past three years, with a resulting steady decline in the unemployment rate despite the still rapid growth of the nation's labour force. Compared to the West European Summit countries, Canada's labour market performance has been vigorous. Only the United States has exceeded Canada with respect to employment generation in recent years. Canada has also outperformed Japan in terms of job creation, although the latter's actual unemployment rate is well below our own. The sclerosis characteristic of most Western European labour markets by and large has not been evident in Canada. Even if the economic growth rates of recent years decline somewhat in the future, there is reason for some optimism regarding Canada's employment performance. The February 1986 budget predicts a steady decline in the rate of unemployment from its present level of 9.8 percent to 7.8 percent by 1991. This assumes only moderate real economic growth.³ The growth rate of the Canadian labour force, which was in the range of 3 percent annually in the 1970s, is expected to slow to perhaps 1 percent by the end of the decade, and this will have a definite positive effect on the unemployment statistics.⁴

In light of continuing high unemployment in several Summit countries as well as the fragile state of the international financial system, it is important that global economic recovery continue and that growth-oriented policies be followed wherever possible. The marked decline in world oil prices will clearly provide a significant boost to economic growth in most industrialized countries. In the case of some Summit countries (Japan and West Germany), reflationary macroeconomic policies appear to be called for. For others, however, existing large structural deficits rule out this kind of strategy, and indeed suggest that medium-term growth prospects will be improved through policies designed to reduce the deficit-to-GNP ratio and to slow the growth of public debt. Canada and the United States clearly fall into this latter category. In both countries, but especially in Canada, growth and sound macroeconomic performance are threatened by the existence of a serious fiscal imbalance. The recent budget represents another important step in the direction of a more prudent fiscal policy, but further measures will be required in future budgets. With one of the highest deficit-to-GNP ratios in the industrialized world, it is time Canadians understood that this issue simply cannot be ignored.

At a time of increasing global interdependence, it is clear that economic policies pursued in one country can affect the prospects of others. Moreover, few major economic problems today can be solved or effectively dealt with through unilateral national decisions. Different views on the part of the world's leading industrial countries on the priority to be attached to various macroeconomic issues and objectives can lessen the capacity for successful collective management of the world economy, as witnessed in recent years.⁵ The annual Economic Summits are one vehicle through which the major industrial countries seek to reach a degree of consensus on fundamental economic issues. However, a greater degree of policy coordination and consensus on key macroeconomic issues among the Summit countries would be desirable. A priority for Canadian foreign economic policy should be to pursue this objective wherever possible. Because of their preponderant economic influence and similar values and economic systems, the leading non-communist industrial countries have the responsibility to act as the guarantors and principal managers of the multilateral economic order. To do so more effectively, they must become more prepared to examine the international ramifications of domestic policy decisions, and to undertake actions in concert with their allies for the long-term health of the global economic system. Acceptance of this principle should be a cornerstone of Canada's foreign policy in future years.

TRADE POLICY

The past year witnessed important developments in the global trading system. A landmark was reached in 1985 when the value of world trade for the first time surpassed \$2 trillion (U.S.). The volume of world trade rose by some 3 percent, following an increase of close to 9 percent in 1984. A number of heavily-indebted developing countries were able to increase their exports significantly, thus permitting them to service their debts. Following protracted discussions, a preliminary decision was made in late 1985 to begin a new round of GATT Multilateral Trade Negotiations. Although this alone will not remove the various threats to the stability of the world trading system, it should add momentum to the search for solutions to existing trade problems and to the quest for greater liberalization and transparency in international trade. Canada has a vital stake in the preservation and effective functioning of the GATT multilateral trade order. Close to 30 percent of GNP is derived from exports of goods and services. Up to 3 million Canadian jobs depend on international trade. Canada is thus deeply interested in both foreign market access and the operation of international institutions and arrangements concerned with trade. Moreover, the importance of exports to the Canadian economy has been increasing over the past three decades. In 1965, merchandise exports amounted to 15.6 percent of Canada's GNP; today, the figure exceeds 25 percent.⁶ As the international economy grows more interdependent and Canadian industry seeks to achieve greater efficiencies, Canada's reliance on foreign trade will continue to increase in the years ahead.

Canada has long been a principal supporter of multilateral trade liberalization through the General Agreement on Tariffs and Trade.⁷ Through previous GATT negotiations, Canada has achieved improved access to foreign markets, and has also agreed to lower its own tariff and non-tariff barriers to trade. The seven rounds of GATT trade negotiations that have taken place since the late 1940s have been particularly effective in slashing tariff rates on industrial goods. By January 1, 1987, average tariffs on dutiable industrial imports will have declined to 5-7 percent in the European Community and Japan, to 4 percent in the United States, and to 9-10 percent in Canada.⁸ (Tariffs are considerably higher than this in some sectors.) GATT has also achieved some success in regulating and disciplining the use of non-tariff barriers (NTBs), such as subsidies, quotas, government procurement practices, and many other measures that impede trade. However, NTBs have proven much more difficult than tariffs to address through GATT negotiations, and much remains to be done to achieve more effective and transparent international rules to govern the use of NTBs. Finally, GATT has also provided

a useful mechanism to address and resolve commercial policy disputes among countries.⁹

As a new round of GATT negotiations approaches, the Business Council believes that Canada should continue to attach high priority to the further reduction of foreign trade barriers through the multilateral GATT system. Another GATT round can help to head off the protectionist pressures now growing throughout much of the world and which pose a serious threat to the integrity and effectiveness of the postwar multilateral trade order established in the late 1940s and 1950s. It can also help to strengthen the GATT as an institution vital to the maintenance of a well-functioning trading system. The Business Council strongly supports full Canadian participation in the next round of GATT trade negotiations. In our view, Canada's major objectives should include the following:

1. A safeguards code;
2. Improvements to, and extending the coverage of, the GATT government procurement code, as well as increasing the number of signatories;
3. Lower barriers to trade in resource-based products;
4. Improved rules on subsidies;
5. New rules to govern and liberalize international trade in selected services;
6. Liberalization of agricultural trade; and
7. Improved participation by developing countries in the GATT.

At the Summit, it is to be hoped that a clear commitment will be made to achieve further international trade liberalization and to move the process of the next GATT round forward. This will require limits on new trade restrictions, the application of GATT principles to larger areas of trade (e.g., services and agriculture), and the development of improved rules with respect to fair trade.¹⁰ Summit countries must also realize that the issue of international trade and market access cannot be viewed in isolation from other pressing global questions. In particular, the ability of developing countries to participate meaningfully in the world economy depends in important ways on

their access to the markets of the industrialized world. Unless they can export more, it will prove exceptionally difficult for many of these countries to service their debts and to purchase goods and services from the developed countries. At Tokyo, a strong statement should be offered by the leaders of the Summit participants recognizing the need for the industrialized world to promote Third World development through policies designed to permit developing countries to enjoy gradually better access to Western markets. At the same time, however, the more advanced developing countries should be expected to graduate to a higher level of responsibility within the world trade system as they continue to mature economically.

The interest recently shown by Canada and the United States in exploring the prospects for freer bilateral trade does not entail any rejection of the multilateral trade system. The Business Council welcomes the decision of Prime Minister Mulroney and President Reagan to pursue bilateral trade negotiations in 1986. We are convinced that such negotiations can permit the development of an improved Canada-United States trading relationship, and further the goal of multilateral trade liberalization. The GATT allows for the establishment of free trade areas and other types of regional trade arrangements among its members, provided that certain rules are followed and criteria are met in designing such arrangements.¹¹ Many GATT members have negotiated such regional trade liberalization agreements since the 1950s. Canada and the United States will no doubt wish to ensure that any bilateral accord they may eventually negotiate conforms with GATT rules.

Freer bilateral trade will certainly not solve all of Canada's economic problems, but we believe that it can help to provide an economic environment that encourages investment, growth and job creation in Canada. Freer trade -- whether bilateral, multilateral, or a combination of both -- will bring with it certain adjustment pressures in various regions and industries. Policies will have to be developed to ease the adjustment burden and facilitate adaptation to industrial change. Changes in certain domestic policies and structures that undermine the Canadian common market will be essential if Canada is to compete effectively in an environment of freer trade.¹² Moreover, given that Canada will face stronger adjustment pressures than the United States, it will be necessary to structure a future bilateral trade agreement so as to phase out remaining trade protection gradually, over a period stretching up to a decade.

INTERNATIONAL FINANCE AND DEBT

The global economy has been under great strain in recent years because of the growing debt problem of developing countries, the increasing size and speed of financial transactions, and significant currency and exchange rate volatility. The overvalued United States dollar and larger trade deficits have served to strengthen protectionist pressures. Exchange rate instability has affected trade flows and undermined support for trade liberalization. And the Third World debt crisis has caused a sharp decline in imports by developing countries. These trends clearly testify to the interrelationship between trade and monetary/financial issues in the contemporary global economy.¹³

Enormous foreign borrowings by a number of developing countries, coupled with the unfavourable global economic circumstances of the early 1980s, have created a situation where several Third World states are now laboring under severe debt burdens. The problem has increased dramatically over the past few years. In 1980, for example, the total foreign debt of Asian developing countries stood at about \$135 billion; by 1985 it had reached \$230 billion. In the case of Latin America, foreign debt rose from \$228 billion in 1980 to \$360 billion five years later.¹⁴ Moreover, for many debtor nations this rise in foreign indebtedness coincided with a period of sharply depressed and declining world prices for the commodities upon which they rely heavily to generate export earnings. Through the efforts of the International Monetary Fund, Western banks, and the debtor countries themselves, various short-term arrangements have been worked out to reschedule loans and provide additional flexibility with respect to repayment. Several Third World debtor countries have instituted austerity policies in accordance with IMF guidelines. More recently, new proposals to address the debt crisis were unveiled by United States Secretary of the Treasury James Baker in October, 1985. These steps have led to improvements in the external payments position and balance sheets of quite a few major Third World debtors. The current account deficit of the most highly indebted Third World countries declined from more than \$110 billion in 1981 to less than \$38 billion in 1984. However, this improvement has been at the cost of reduced growth rates in many countries, a sharp fall-off in imports from Western industrialized countries, and rising social tensions. Obviously, the ability of developing countries to service their foreign debts varies considerably. The recent decline in oil prices, for example, is beneficial to many of them, but not to Mexico or Indonesia. The generally weak state of global commodity prices at present and most likely in the near term future constitutes an economic problem for most of these countries (South Korea

would appear to be an exception). The Latin American countries have suffered the most from the debt crisis, and it is in this region that the whole subject has undergone the greatest degree of politicization. It is worrisome, however, that the recent slowdown in growth rates among Asian developing countries may, if it continues, bring their debt situation into sharper relief. This can only increase instability and worsen the crisis atmosphere that has grown up around the Third World debt situation.

Despite the magnitude of the problem, the world has managed the Third World debt crisis reasonably well to date. Institutional cooperation, including the exchange of vital information, has been substantially improved over the pre-crisis situation. The need for developing debtor countries to export more and to institute policies supportive of foreign direct capital investment is increasingly realized. In the past two decades, foreign direct investment as a share of the capital flowing from the developed to the developing world has fallen from 20 percent to 10 percent. Larger direct investment flows into developing countries would benefit these countries by lessening their vulnerability to external economic events, by transferring technological and managerial knowledge to them, and by helping to develop their domestic industries.¹⁵ Initiatives designed to stimulate greater direct investment in the Third World, such as the World Bank's proposed Multilateral Investment Guarantee Agency, thus deserve strong support from the Summit countries.

As the international community seeks to grapple with this difficult problem in the months and years ahead, the flexible and innovative approaches used in past years will have to be continued. But it must also be asked whether a more lasting solution to the problem can be found, to supplement the mainly short-term measures adopted so far. For the fact remains that, despite the balance of payments improvements and the slowdown in the rate of debt accumulation on the part of most Third World debtor countries in recent years, the burdens being imposed on some countries, and the continuing atmosphere of crisis, are unsatisfactory and, probably, unsustainable. Thus new international financial arrangements, underwritten in part by Western governments and international institutions but also requiring commitments from Western banks and the debtor countries themselves, may be needed. However, it is clear that a growing world economy is the most effective way to address the debt problem. If the OECD economies can grow by 3 percent per year in real terms, and provided that interest rates do not spiral upwards again, most heavily indebted developing countries should be able to grow their way out of their debt predicament, perhaps assisted by occasional reschedulings.¹⁶

Another important international economic question likely to preoccupy the Summit countries in Tokyo is exchange rates. In principle, exchange rate flexibility is desirable. However, the excessively rapid and uncertain movements in exchange rates evident in recent years have been a source of instability in the global economy. Such volatility can serve to distort production, investment and trade decisions, and undermine the significant achievements of trade liberalization. The most serious problem has centered on the United States dollar. Its sharp rise in value in the early 1980s has contributed to a marked escalation in protectionist pressure in the United States and is a major reason behind the enormous United States trade deficit. Many experts argue that by early 1985 the United States dollar was overvalued by up to 35 percent on a trade-weighted basis.¹⁷

In the past year, welcome moves have been made by the largest industrial countries to lower the value of the United States dollar. These steps have been quite successful, in that the United States dollar has declined appreciably over the past few months. But there is considerable uncertainty about the future course of exchange rates and the United States dollar specifically. A successful assault on the United States budget deficit, which when combined with the low United States savings rate and the consequent need to import capital is a principal cause of high interest rates, should contribute to greater exchange rate stability. Lower interest rates would also have many other positive consequences, including higher economic growth and an easing of the Third World debt crisis. In the light of this, it is to be hoped that the Summit countries will agree to coordinate their fiscal and monetary policies and priorities so as to achieve more stable exchange rates, lower interest rates and faster growth. It is significant that the United States government has reversed its previous opposition to international monetary reform, and apparently is considering further international initiatives in this vital area.¹⁸

INTERNATIONAL POLITICS AND SECURITY

Although economic issues traditionally dominate Summit agendas, the subject of security will no doubt preoccupy Prime Minister Mulroney and his colleagues. Since the 1985 Summit, a number of important developments have taken place in the sphere of international security. The advent of the Gorbachev regime in the Soviet Union in 1985 brought to an end the uncertainty characterizing the whole issue of the Soviet leadership in recent years. Mr. Gorbachev is now working to consolidate his position internally, and to advance a variety of Soviet political and security initiatives in the

international arena. His rise to power promises to pose new challenges to the United States and the other industrial democracies in the years ahead. Already there are signs that Soviet diplomacy has become more vigorous and better able to exploit with greater sophistication the wishes and fears of public opinion in the democratic world.

For the foreseeable future, the most significant threat to the security of Canada and the community of democracies generally will continue to be the Soviet Union's growing military power and political influence across the globe. A clear underlying strategic trend over the past two decades has seen the steady erosion of the military superiority once enjoyed by the democratic world. Across virtually all dimensions of military capability, the Soviet Union and its allies now equal or surpass the NATO alliance. Moreover, this trend toward increasing Soviet military capability shows little sign of being reversed. In the strategic nuclear sphere, the Soviets have at the very least attained a position of parity with the Western powers. In theatre nuclear forces they enjoy unquestioned superiority in Europe. And in the area of conventional military forces, the Soviet bloc is also stronger than NATO. In short, the priority attached by Soviet leaders to defence and security has led to the development of a powerful, offensively postured constellation of military forces which poses a serious threat to the security interests of the democratic world.¹⁹

However, the simple fact of vastly strengthened Soviet military power does not mean that there is no scope for meaningful arms control negotiations or for improved political relations between East and West. The past year has offered ample evidence that efforts to strengthen the military capability and political resolve of the Western democracies are not incompatible with better relations between the latter and the Soviet bloc. The long-awaited Summit between President Reagan and Mr. Gorbachev yielded positive results in the form of a commitment to intensify the process of arms reduction negotiations. The Soviet Union's previous insistence that the United States totally abandon all activities associated with President Reagan's Strategic Defence Initiative, and that NATO reverse its 1979 decision to deploy cruise and Pershing nuclear missiles in Western Europe, was dropped in 1985. These developments suggest that the maintenance of solidarity within the NATO alliance, coupled with a firm commitment to meet and match improvements in Soviet military capability, can result in positive developments in the area of arms control and East-West relations more generally. It is to be hoped that all of the Summit countries will bear this in mind at Tokyo. A statement in support of the broad thrust of the United States Strategic Defence Initiative -- which despite press

reports is in significant measure a response to Soviet initiatives to develop space-based military capabilities -- would be desirable. In particular, and as noted by Prime Minister Mulroney, the United States decision to proceed with research on space-related military developments is both necessary and prudent.

For its part, Canada can best contribute to a more stable global security situation by maintaining support for the NATO and NORAD arrangements and by improving its defence capabilities so as to strengthen NATO's conventional force posture in Europe. Such a strategy will promote stability because it will raise the nuclear threshold and render NATO's conventional military capability more effective and credible in the eyes of a potential aggressor. In view of its limited military power, Canada cannot realistically expect to have a major influence on the course of any of the East-West arms discussions presently taking place -- the strategic arms talks between the Soviet Union and the United States, the Mutual and Balanced Force Reduction discussions involving a larger group of countries, or the Intermediate Nuclear Force (INF) negotiations. Other than Japan, which faces special problems, all of the other Summit countries are devoting more attention and resources to national defence than is Canada.

NATO countries should be encouraged to further their efforts to improve NATO's conventional capabilities and command and control systems. Despite pressure from the United States, Japan continues to allocate only a small portion of its GNP to defence (about 1 percent), citing its constitutional prohibitions on the development of military forces as well as public opinion. However, perhaps Japan could make a greater contribution to the security of the democratic world if it were to devote substantial additional resources toward assisting poor developing countries through foreign aid and other forms of assistance. At present not only does Japan spend relatively little on defence, but it is also not a leader in terms of official development assistance. It is doubtful that Japan's limited international role will continue to be acceptable to its democratic allies in light of its enormous economic strength and dynamism and the very strong financial and economic pressures being felt among other OECD nations.

Finally, the leaders of the Summit countries no doubt will wish to address the subject of international terrorism at Tokyo. In the past eighteen months, a barrage of serious terrorist incidents have taken place that have cost many innocent lives and generated heightened fear among Western publics. No nation today is immune from the threat of terrorism, but it is

democratic countries that are the most vulnerable because of the very openness and freedom that defines their political and moral character. There is strong evidence that a handful of countries are in large part responsible for the proliferation of terrorist incidents in recent years. It is appropriate that the international community, led by the democratic countries, seek to isolate and to punish those states found to be strongly supportive of terrorist attacks. A firm statement to this effect from the Summit participants would be most welcome.

Footnotes

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