3. THE ECONOMIC AGENDA

With just over six weeks left before the Toronto summit opens, the leaders of the world's most powerful industrial democracies are already committed, and are slowly preparing, to seriously tackle several critical issues on their unusually long and difficult agenda. Their most obvious challenges lie in the lofty realm of international peace and security, on such issues as superpower strategic arms control, Soviet policy and east-west relations under Gorbachev, Afghanistan, the Persian Gulf, Israeli-Palestinian unrest and the Middle east peace process, Cambodia, Southern Africa, and perhaps even Central America. But in the low, less visible, complex and dismal domain of international and domestic economic policy, the issues are no less difficult or demanding. And it is here that the leaders will ultimately have to produce meaningful, concrete results if the Toronto summit is to be judged a genuine success.

Probably the most pressing economic challenge is exchange rate management. The summit finance ministers continue to boldly declare that they will maintain at its current level a U. S. dollar that respected economists estimate is currently overvalued by 15%. But their efforts to deliver on this promise have already cost their central banks several hundred billion dollars over the past two years, as private investors in the summit countries have ceased to buy steadily depreciating U. S. dollars, and forced governments to assume the burden. Indeed, the ultimate irony of the Reagan revolution is that the U. S. dollar has now lost its magic in the market place and must be propped up by massive government subsidies in a form of hidden foreign aid. With Japan and Germany increasingly reluctant to pay the price of supporting the U. S. dollar, but unwilling to see it go into a tailspin, the pressure is on to take stronger action. To cope with the immediate confidence problem, more organized efforts at exchange rate surveillance and intervention by the summit seven's finance ministers and central bankers are likely.

The key to stable and sustainable exchange rate over the medium term, however, lies in proving to a nervous market that the great U. S. budget and trade deficits can be cured at a faster pace than has been evident thus far. With further reductions in the U. S. budget difficult to secure in a U. S. election year, and with U. S. consumers still addicted to imports, it will be difficult to inspire an inflation-wary Germany and an already booming Japan to take further acts of fiscal stimulus. But the summiteers will want, at a minimum, to exchange vows to maintain their existing movements in the right direction. Moreover with growth rates stalled in Canada and slowing in the United States, and with interest rates and inflation rising in both countries, there are strong incentives to do more, if only because a North American bred recession is so bad for Republican and Conservative re-election fortunes, European and Japanese prosperity, multilateral trade liberalization and third world debt relief. One answer may lie in a strengthened process whereby summit representatives can cross-examine their colleagues, on a detailed, sustained and systematic basis, about whether their countries have lived up to previous, freely-accepted targets, and what remedial moves they will make if they have not.

Reinforcing these moves in macroeconomic policy co-ordination will be initiatives in concerted, market-oriented structural adjustment in the domestic economies of the seven. Because so much of the summit members' budgetary policy is set for next year, and because this is the last chance for President Reagan to entrench his free-market economic philosophy, there will be considerable discussion and confident declarations about the need for such policies as deregulation, privatization, tax reform, competition, financial sector liberalization, foreign investment, and the phase out of industrial and agricultural subsidies.

In the case of agricultural subsidies, exhortation will probably be accompanied by action. As President Reagan sees himself as having come from a farm background, and understands the negative impact of U. S. farm subsidies on his efforts to reduce U. S. government spending and the U. S. federal deficit, this is an area where presidential leadership is likely. Equally engaged will be Prime Minister Mulroney, who introduced the agricultural subsidy issue onto the summit table two years ago in Tokyo, and whose incentives to follow up vigorously in Toronto will be strengthened by his prerogatives as summit host, the Cairns Group of middlepowers Canada has organized to back its case, and the need for seats on the prairies in an election year. Support will come, on grounds of both interest and ideology, from Margaret Thatcher. And the looming threat of an escalation in the already ruinous international trade war in this sector provides pressures for others to co-operate. With such pressure, it may even be possible to reach an meaningful agreement on a moratorium which would eliminate any increase in agricultural subsidies until actual negotiated rollbacks are in reach.

In the area of trade more generally, there is even more valuable work to be done. The leaders will want to inject political energy into the difficult Uruguay round of multilateral trade negotiations, so that by the time the mid term review takes place in Montreal in December, substantial progress will have been made. The summit will also signal several ways in which the functioning of the GATT system might be improved. These include an annual ministerial-level meeting of GATT members to strengthen political oversight and direction of the trade body, stronger co-operation between the GATT and the major international financial institutions, enhanced GATT surveillance of trade policy, an enhanced GATT role in international economic management, a larger role for the International Monetary Fund and World Bank in identifying the costs of trade distortions, and systematic trade policy reviews in developed and developing countries alike.

The plight of the developing countries will command much wider attention, as the leaders seek to identify innovative ways to relieve the crushing and growing burden of third world debt. Amidst the flurry of competing proposals now being shopped around the summit capitals, concrete proposals are likely to emerge in two areas. One is an arrangement for rescheduling the commercial credits of the poorest countries at less than market rates. A second, aimed at the middle income countries, is to have international institutions such as the World bank redesign their lending facilities so that their third world clients have easier access to the funds they require to grow.

Finally, the leaders will want to address the challenges posed by the newly industrializing countries. Countries such as Taiwan and South Korea have acquired enormous trade surpluses and massive foreign reserves from their export-oriented economies, while remaining insulated from the standard set of international rules through their historic position as less developed countries. The time has come for them to accept more of the disciplines of the system, and to contribute more to its orderly operation. How much more remains a matter of dispute between the Europeans, who are calling for a great deal more, and the Japanese, whose summit role as the defender of Asian interests, and large direct investments in the Asian NICs, make them reluctant to cast these small and still vulnerable economies to the international winds. It is only the United States, with its enormous market leverage and larger security concerns, that can define the needed summit compromise in this area.