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THE WHITE HOUSE

WASHINGTON

July 2, 1994

INFORMATION

MEMORANDUM FOR THE PRESIDENT

FROM: ANTHONY LAKE *AL*

SUBJECT: Your Trip to Germany, July 10-12

OVERVIEW

Your visit to Germany for bilateral meetings and a U.S.-EU Summit is the first trip by a U.S. President since the fall of the Berlin Wall and the last before the Berlin Brigade departs in September. It also comes in the run-up to October 16 national elections, and you will have to take some care not to be showcased by Helmut Kohl for his partisan political benefit. Germany's role as our most important European partner is clear, reinforced by your relationship with Kohl. Bonn and particularly Berlin are fitting sites to repeat your message about the unfinished business of Europe's liberation -- and to reassure Germans about their critical role and U.S.-German ties. Overall, the trip will help put in perspective Germany's exclusion from D-Day events.

Unified Germany is once again becoming the European continental power, giving some pause to France, the UK and eastern neighbors as they eye Germany's return to pre-eminence. This evolution has increased the importance of Kohl's and Mitterrand's commitment to close Franco-German ties -- bilaterally and within the EU -- and raised the cost to the UK of its ambivalence toward Europe. Germany's strength and self-confidence are essential to many of our most important goals, such as global economic growth, reform in Russia, the NIS and CEE, and adjusting Western institutions (especially NATO and the EU) to welcome Europe's new democracies. Germans know what they stand to benefit -- or lose -- most from success or failure of democratic transitions in Europe's east and have been willing to invest more there both politically and economically than other West Europeans.

Our continued role as Germany's strongest friend is an essential element of European stability. Germany cannot cast off the burdens of its history, but can -- if encouraged by the U.S. and firmly embedded in the EU and NATO to reassure all its neighbors -- take on greater responsibilities. This is the direction Kohl has been cautiously but definitively moving.

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Vice President
Chief of Staff

The U.S.-EU Summit is the first major event of the 6-month German presidency that began July 1. Greece's embarrassing tenure, the EU's Bosnian failure and public skepticism toward the Union demonstrated in June's European Parliamentary election all have depressed hopes raised by the 1993 Maastricht Treaty. In the plus column, Germany's leadership will increase the EU's focus on CEE and, we hope, set the CEE countries on a course toward eventual EU membership. At the same time, Austria's June vote for joining the EU may help the publics in Finland, Sweden and (more problematic) Norway decide similarly.

YOUR OBJECTIVES

- o Affirm unequivocally the German-American partnership and friendship.
- o Present from the heartland of Europe -- where East and West once met in confrontation -- your vision of an expanding, peaceful and prosperous trans-Atlantic order.
- o Highlight Germany's vital role and contributions to date in helping adapt Europe's institutions and reach out to the new democracies in the East.
- o Further the bilateral dialogue on Russia and the NIS, CEE and NATO and stress the need for follow up.
- o Launch at the U.S.-EU Summit working groups to coordinate aid to CEE and to strengthen U.S.-EU consultations.

BACKGROUND

German Politics. In power since 1982, Kohl is in a tough re-election fight with vigorous but inexperienced Rudolf Scharping, the fourth Social Democratic Party (SPD) leader to challenge him. Scharping has done much to unify his fractious party on the issues of unemployment and the economy and, while mostly avoiding Kohl's foreign policy strength, has travelled abroad (Washington included) to show competence and continuity if he wins. Recession, new budget deficits resulting from roughly \$90 billion a year in transfers to eastern Germany, and post-unification dislocations helped Scharping until recently. But Kohl has bounced back with the election of his presidential candidate and a big Christian Democratic Union/Christian Social Union (CDU/CSU) win in June's Euro-elections. Foreign Minister Kinkel's Free Democratic Party (FDP) is the coalition's weak link and must work to clear the 5% hurdle for Bundestag representation. Any new government formed in October will be a coalition. Possibilities include reelection of the current Kohl-Kinkel (CDU-FDP) coalition; a "grand" CDU/SPD coalition, with either CDU or SPD on top; and an SPD/Greens alliance. The grand coalition could be a recipe for deadlock. A governing arrangement Scharping might work out with the Greens (who have called for abolishing NATO and the German Army) would keep foreign and security policy in his hands but still complicate bilateral cooperation.

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German Economy. Germany was in sharp recession from the second half of 1992 through 1993. Unemployment, at over 9% nationally and 15% in the east (where massive industrial re-structuring has been underway) reached the highest level since WWII. Growth of 1.5% in 1994 is forecast. Unification costs have restricted Bonn's ability to deal with the recession. The Bundesbank kept credit tight during the recession to combat inflation, which dropped below 3% in April for the first time since mid-1992. Labor costs are among the world's highest. The recession increased concerns about Germany's long-term industrial competitiveness. The SPD has based much of its campaign on alternative economic strategies focusing on training and high-tech research to promote employment. SPD tax proposals aimed at a more equitable distribution of the costs of unification (now largely financed through payroll taxes) appear to have backfired, however, and Kohl is profiting from returning confidence in the growing but still sluggish economy.

German Foreign/Defense Policy. Germany has been the biggest European troop contributor to NATO and the most active of the Allies in advancing NATO's opening to the East. Bonn does not, however, see Russia, Ukraine and the NIS as potential members. Germany shares our view that Russia should have no veto over NATO decision-making and supports rapid PFP implementation, including a not-yet-finalized "command estimate" on German soil this year. Major bilateral and multilateral economic and technical assistance to Russia, NIS and CEE is part of Germany's policy of promoting stability and prosperity to the East. The German military's helpful participation in "out-of-NATO-area" missions mandated by the UN and/or NATO (in Cambodia, Somalia, Bosnia and the Adriatic) is the subject of political debate and legal challenge, as the country weighs its post-unification international role. On Bosnia, for instance, German assets help enforce sanctions in the Adriatic and the No-Fly Zone. The German Constitutional Court plans to issue a ruling on such activities during your visit on July 12. Germany seeks a permanent seat with a veto on the UN Security Council and has proposed Bonn as the site of the new World Trade Organization. Kohl has usefully told Germans that they cannot expect a permanent Security Council seat until they participate in UN peacekeeping.

The European Union. On July 1 Germany assumed the 6-month rotating EU Presidency. Kohl wants to give the slumping Union -- suffering from members' sluggish economies, weak governments and disgruntled publics -- new impetus by demonstrating its relevance on issues that touch citizens like job creation and crime and by giving it a new sense of mission to its east. He favors both deepening integration among current members and bringing at least Poland, Hungary and the Czech Republic into the EU by 2000. He wants successful coordination of the German and subsequent French presidencies to solidify the Franco-German partnership at the heart of the EU and gain French support for a more active EU role in east. But elections will distract Bonn from its European policies, and Paris sees expansion eastward as a threat to "deepening" European integration, while worrying more about

instability in Algeria than in CEE. Meanwhile, EU enlargement is proceeding apace. Britain slowed EU agreement on a successor to Commission President Delors at the June 22-24 Corfu Summit.

EVENTS

Official Meetings. In Bonn you will meet with President Herzog, Chancellor Kohl, and party leaders Kinkel and Scharping. The U.S.-EU Summit will take place in Berlin the next day and you will also have a photo op with Finance Minister Waigel.

Media. You will give speeches to the citizens of Berlin at the Brandenburg Gate and to the departing U.S. Berlin Brigade. Press availabilities will follow both your bilateral meeting with Kohl and your summit with him and EU Commission President Delors.

Other. Capping the first full day is a trip to Ludwigshafen, where Kohl will host you for dinner at his private home in the suburb of Oggersheim. In Berlin you will also visit the Oranienburg Synagogue.

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MEETING WITH PRESIDENT HERZOG

CONTEXT OF MEETING

Roman Herzog took office for a five-year term July 1, succeeding the respected Richard von Weizsacker -- who used the largely ceremonial post as a bully pulpit for tolerance, social responsibility and national unity. Until winning electoral college balloting as Kohl's candidate May 23, Herzog was head of Germany's Constitutional (Supreme) Court. A legal scholar, he has shown interest in the presidency's little-used power to review the constitutionality of bills after passage.

Not well known to the public, Herzog is at this point perceived as stolidly conservative, lacking in charisma and ignorant of eastern Germany. He reached out to Easterners in his acceptance speech, calling them a national asset, but was criticized for not making a similar gesture to foreigners in Germany. Prior to election, he criticized the extension of dual citizenship to foreign permanent residents. He has since condemned extremist violence and warned against a new German nationalism.

The Constitutional Court will rule on Germany's participation in "out-of-(NATO)-area" military missions (Somalia, the Adriatic, Bosnia) July 12. Most expect a decision in favor of the government (approving such missions) but perhaps introducing a requirement for Bundestag approval of each mission. Germany's evolving international role brings new responsibilities. A related trend is the shift of our bilateral relations from the Cold War's security focus to deepening economic and cultural ties. Herzog noted America's contribution to postwar Germany in his acceptance speech May 23.

YOUR OBJECTIVES

- o Establish a relationship with Germany's new head of state.
- o Discuss his domestic role, Germany's international role, and bilateral relations.

CORE POINTS

Herzog's Presidency

- o Grateful for your acceptance speech reference to America's contributions in building postwar Germany.
- o Domestic issues of intra-German solidarity, right-wing extremism and intolerance concern many Germans, including your predecessor. What will be your approach as President?

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Germany's Role

- o Unified Germany's new status brings new responsibilities. Pleased to be working together during Germany's EU Presidency to give new boost to reform in CEE.
- o Support of/participation in NATO and UN peacekeeping will also be very important.
- o What are likely implications of tomorrow's court ruling on out-of-area military missions? How do you assess domestic political debate on Germany's role in world?

U.S.-German Relations

- o Bilateral relationship crucial now and in future to European and American security and prosperity.
- o U.S. security presence being balanced by enhanced economic and cultural ties. Welcome your support for this evolution.

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MEETING WITH CHANCELLOR KOHL

CONTEXT OF MEETING

May's win by Roman Herzog (Kohl's candidate for President) and the CDU/CSU's victory in June's European Parliament election suggest Kohl could win a fourth term in October's national elections. Germans bucked a Europe-wide, anti-incumbent trend to support the CDU/CSU over Rudolf Scharping's SPD 38.8% to 32.2%. Kohl drew some discontented voters from right-wing parties, while increasing confidence in the still-sluggish economy (expected to grow 1.5% in 1994) neutralized the SPD's central campaign theme. Foreign Minister Kinkel's Free Democrats (FDP) fell below the 5% hurdle for representation in EU Parliamentary and Saxony-Anhalt state elections to take fourth place behind the Greens. While the FDP will likely clear the Bundestag's 5% hurdle in October, its margin may not put Kohl's current coalition over the top.

Our military drawdown in Germany and the September departure of U.S. troops from Berlin signal a new relationship. Economic and cultural ties are deepening, including our creation of U.S. Business Information Centers throughout Germany, the opening of a commercially-oriented Consulate General in Dusseldorf, expanding academic and artistic exchanges, and a conference of top German and American CEOs whom Kohl will address in Berlin in September. These steps come as Germany's importance in promoting global economic growth and reform in the East grows.

Germany has since the mid-80s provided the most assistance -- over \$75 billion -- to Russia, the NIS and CEE, and sees the need to consolidate post-1989 gains. But Germany balks at giving major new bilateral aid to Russia and Ukraine and is alarmed by developments in both countries. As the last Russian forces prepare to leave eastern Germany in August, Russian "mafias" that have sprung up there are a growing concern.

Germany sees Poland as key to creating a zone of stability and prosperity to the East, favors its NATO membership and was instrumental in securing WEU associate status for CEE states. Germany's EU Presidency will focus on ways to encourage reform in CEE and eventual EU membership. In spite of support for PFP and bilateral military cooperation with eastern neighbors, Bonn has not yet finalized a promised 1994 PFP event on German soil. On Bosnia, Germany participates in international relief deliveries, sanctions monitoring, and NATO AWACS patrols and encouraged Croatia to support the Muslim-Croat Federation in Bosnia.

Your conversation with Kohl will continue over an official lunch and private dinner, where you can discuss further Germany's EU presidency, "out-of-area" military missions, bilateral compensation claims and Iran.

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YOUR OBJECTIVES

- o Affirm the U.S.-German partnership and its new dimensions.
- o Continue engaging Kohl in pursuit of critical shared objectives on Russia, Ukraine, CEE and Bosnia.
- o Encourage preparations for a PFP activity on German soil this year.

CORE POINTS

Bilateral Relations

- o Want to stress importance of multi-dimensional partnership with Germany, even as U.S. military presence declines.
- o Pleased to see security focus of postwar relations shifting to deeper economic and cultural ties.

Russia

- o First-ever visit by U.S. President to Baltics sends clear message we support their sovereignty, reject Russian "sphere of influence."
- o Hope you'll join me in pressing Russia and Estonia to settle final differences and conclude troop withdrawal deal. Together with pullout from Germany, will be first time since 1945 Russian forces fully within pre-war borders.
- o Relations with Russia on track. Reforms continue despite pessimism after December elections. Pleased Yeltsin responded to urging to sign up to PFP before Naples. Will host him for Summit in September.
- o Concerned about spreading crime; undermines support for reform, scares away investors. FBI Director Freeh visited Moscow after his visit to Berlin to help expand cooperation in combatting organized crime.

Ukraine

- o Need to continue pushing Kiev to adopt an economic reform strategy; no alternative. U.S. and Germany will appoint private economists as advisers; they'll visit Kiev later this month.
- o Naples signal of substantial support for reform important.
- o Ukraine a major priority for us. Want to work with you to bolster its independence.

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Central and Eastern Europe

- o West must focus efforts to consolidate CEE gains of 1989. Need to show that path to integration with West is open.
- o Economy is key. Despite signs of recovery, social stresses pushing voters in anti-reform direction.
- o Two-track response: continued support for free market transformation and efforts to help societies cope with dislocations, like unemployment.
- o Want to work much more closely to coordinate assistance. See Germany, U.S., EU as core, working with IBRD, EBRD.
- o Beyond assistance -- which must be temporary -- trade and investment essential. Must avoid protectionism, keep EU enlargement on track.
- o Transforming societies need to be secure and feel secure. CEE need to know that they won't be left in a "grey zone" of instability, that Russia will not have veto over NATO membership or special rights in CEE.

NATO

- o Need to make PFP work, think about way forward on NATO's expansion.
- o Welcome German offer to host a PFP event this year; hope planning can go forward.

Bosnia

- o Must maintain resolve in supporting Bosnian territorial compromise and in following through on the incentives/disincentives package if map rejected.

BACKGROUND

The Federal Chancellery (Bundeskanzleramt) where you will meet is an ultra-modern building housing about 420 of the Chancellor's staff, located between his official residence (Palais Schaumburg) and the parliament. Kohl's predecessor, Helmut Schmidt, had a Henry Moore sculpture placed in the garden.

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LUNCHEON HOSTED BY CHANCELLOR KOHL

CONTEXT OF EVENT

This event occurs one day before the U.S.-EU Summit in Berlin and a court ruling on German "out-of-area" military activities.

Germany, after a weak Greek presidency, hopes to re-energize the EU in close coordination with France, which follows Germany in what some have dubbed a year-long "megapresidency" of the EU's "heart and soul." Germany plans to focus on: job creation and growth; external relations, including as a first priority the countries of Central and Eastern Europe; justice and home affairs; and decision-making procedures. Kohl insists Germany not be the eastern edge of the EU. Even before CEE states gain full membership, Bonn seeks to enhance their market access and sense of participation -- for instance, with an annual summit of EU heads of government with CEE counterparts. Domestic unemployment and the financial support new (poorer) members would require constrain Germany's agenda.

Kohl has gradually sent Bundeswehr units on out-of-area missions in Cambodia (medical unit), Somalia (logistics troops), Bosnia (crews for AWACS No-Fly Zone enforcement) and the Adriatic (a ship to assist sanctions enforcement). Opponents have challenged the constitutionality of these deployments, which for some are painful reminders of the Nazi past. The Constitutional Court will announce its ruling July 12, just before your speech at the Brandenburg Gate. Future deployment decisions will depend on the specifics of the case. The SPD, for instance, accepts military participation in humanitarian and peacekeeping missions, but not in combat -- i.e., no Gulf Wars or "peace enforcement."

YOUR OBJECTIVES

- o Get Kohl's view of Germany's goals within and for the EU.
- o Encourage participation in "out-of-NATO-area" missions.

CORE POINTS

- o U.S. increasing its support for CEE reform; welcome Germany's decision to focus on this during EU Presidency.
- o Want to see CEE join EU. What's a reasonable timeframe? Can Germany persuade current EU partners concerned about diluting effect and budgetary drain?
- o On tomorrow's court ruling on out-of-area: know of domestic and regional sensitivities to German military; but unified Germany's support of/participation in NATO and UN peacekeeping very important, as shown in Cambodia, Somalia, Adriatic and over Bosnia.

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PRIVATE DINNER WITH CHANCELLOR KOHL

CONTEXT OF EVENT

Kohl sets great store on personal relations. A gracious host, he is not above calculating the domestic political benefit of entertaining you at home in an election year in the state SPD Leader Scharping governs. The intimate setting may afford a good opportunity to raise two sensitive bilateral issues: U.S. citizen claims cases from the Nazi and GDR eras and Iran.

Interest in the Holocaust compensation claim of Hugo Princz -- which you mentioned to Kohl in January -- persists in Congress and among Jewish groups. A federal appeals court is considering a district court ruling that Princz's suit against Germany may proceed. This decision could ease Germany's fear of the precedent an ex gratia payment to Princz would set. Members of Congress have just written you again to take up the matter with Kohl. Separately, a number of U.S. citizens who seek restitution of property in the former GDR risk being treated unfairly under a 1992 property claims settlement agreement -- due both to Treasury's late notification to claimants to choose compensation now or pursuit of restitution in German channels and Germany's insistence on the missed deadline.

Germany's policy of engagement with Iran is a concern, though Bonn shares our objective of changing Iran's behavior. In June Kohl received Iranian Foreign Minister Velayati, who announced Tehran's pardon of a German businessman under death sentence for espionage. Such solicitous behavior at the highest level and Germany's rescheduling of Iran's official debt make it difficult for us to convince Iran that its unacceptable behavior has a price.

YOUR OBJECTIVES

- o Follow up earlier discussion during the day.
- o Alert Kohl to continuing need for help on Holocaust and property claims and Iran.

CORE POINTS

- o A significant ex gratia payment would resolve the deserving claim of Holocaust survivor Hugo Princz, especially now that the U.S. appeals court has ruled in Germany's favor.
- o A problem under our 1992 property claim agreement: a number of U.S. citizens risk having valuable claims in German channels cut off.

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- o Iran continues to act unacceptably, especially in supporting violence against Middle East peace process. Need Germany to refrain from extending new official credits or guarantees.

BACKGROUND

Oggersheim is a quiet residential village outside Ludwigshafen, a medium-sized industrial city on the Rhine where Kohl grew up and saw the destruction of World War II. The countryside is flat, known for asparagus and sugar beet production. Ludwigshafen is home of the large BASF chemical company; Kohl began his career in environmental affairs. Oggersheim/Ludwigshafen are within striking distance of some of Germany's best wine country. Nearby Worms has one of the most famous Rhineland cathedrals and was the site of diets of the Holy Roman Empire, including the famous confrontation between Martin Luther and Emperor Charles V. The neighboring city of Speyer also hosts an important cathedral. Kohl's house in Oggersheim is medium to large by American standards, situated on a small street with two-way traffic. His favorite dish, often served to guests, is saumagen, a hash of meat, potatoes and vegetables baked in the skin of a pig's stomach.

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EU SUMMIT MEETING

CONTEXT OF MEETING

The EU is in a slump. Sluggish economies contribute to weak governments and low popular enthusiasm for political engagement, including in Europe's new democracies. The EU's Bosnia policy is widely regarded as a failure and Greece's January-June 1994 Presidency unsatisfactory. June elections to the EU Parliament showed dissatisfaction with national leaders (German and Italian notably excepted) and apathy toward the Union itself.

On July 1 Germany assumed the six-month rotating presidency of the European Union. Kohl wants Germany's Council Presidency to give the EU new impetus by demonstrating its relevance on issues that touch citizens like job creation and crime, and by giving it a new sense of mission to its east. He favors both deepening integration among current members and bringing at least Poland, Hungary and the Czech Republic into the Union, ideally by 2000. He understands that Germany would suffer most from instability to its east, but also that "widening" without "deepening" could wreck the fledgling Union. He hopes close coordination of the German and subsequent French Presidencies will both solidify the Franco-German partnership at the heart of the Union and gain French support for a more active EU role in Europe's east.

But domestic pressures in this German "super-election" year will distract Bonn from its European policies. Moreover, Paris views expansion eastward as threatening the "deepening" of European integration and is increasingly preoccupied with security issues in the Mediterranean/Maghreb, specifically Algeria, which could have devastating effects on migration to and ethnic relations within France.

On June 12, an Austrian referendum approved EU membership. Similar referenda are scheduled later this year for Sweden, Finland and Norway (only Norway appears still skeptical on joining). Existing EU institutions are set for review during the scheduled 1996 Inter-Governmental Conference, which will be forced to deal with the issue of strengthening the institutions while balancing member state concerns. The 1996 conference will come under the tenure of Delors' successor -- perhaps the reason Britain's John Major blocked consensus on Belgium's Dehaene, a "deepening" proponent, at the EU Summit in Corfu June 22-24. Kohl has called another summit for July 15 to try again.

You will meet with Chancellor Kohl and President Delors in a photo-op before the ten-on-ten meeting. A press availability concludes the Summit. The major initiative you will undertake is to establish two ad hoc study groups. One group will recommend steps to coordinate and rationalize U.S. and EU policies on Central and Eastern Europe. The second group will outline options to improve U.S.-EU cooperation, including on home and

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justice affairs (the "Third Pillar" of Maastricht) which the EU has only recently undertaken. Both groups would offer recommendations at the next U.S.-EU Summit (under French Presidency), then disband. Also on the agenda are Uruguay Round ratification and growth and employment, the Middle East and Bosnia.

YOUR OBJECTIVES

- o Reaffirm our commitment to close ties and cooperation with the European Union.
- o Encourage practical steps on U.S.-EU cooperation in CEE.
- o Move U.S.-EU consultations beyond information exchanges to real policy cooperation.
- o Establish two limited-duration, ad hoc study groups on coordinating U.S./EU support for CEE reform and improving U.S.-EU consultations.
- o Exchange views on the Uruguay Round ratification, growth and employment, the Middle East and Bosnia.

CORE POINTS

Commitment to the European Union

- o Eager to expand practical U.S.-EU cooperation as the Union takes on new responsibilities.

Cooperation on CEE

- o The EU was never just a rich man's club/common market. Putting key war-making sectors under supranational control, making borders over which nations had fought less important in daily lives, always made it important to members' own security.
- o Major potential now to extend stability/prosperity eastward, contribute to integrating Europe with security based on cooperation not confrontation.
- o Despite tremendous strides, CEE's reforms remain at risk, as the election trends in Poland and Hungary show. Cannot take success for granted.
- o Admire EU and its members' role as chief trade partners/investors/aid donors in the new democracies with over \$20 billion in aid and 50% of CEE trade. Want to help Stability Pact project use CEE desire for membership to influence how they deal with minority, other problems.

- o American efforts already complement EU's. In January in Prague, I announced a series of measures to deepen our political/economic engagement. Included more support for grassroots democracy and a social safety net; support for intraregional cooperation; and various ways of encouraging trade and investment.
- o Building on these, e.g., Housing Investment Guarantee Program we launched in Poland to support market-based mortgages and construction, also will help with the human dimension of reform.
- o Must continue opening markets to new democracies. Politically hard for all of us. Any more you can do on expand access for agriculture would help immensely. [I have developed a proposal for treating economies in transition differently under our anti-dumping laws. I hope to secure Congress's support.]
- o Interested in your plans for involving CEEs in foreign and other policy coordination even before full membership is possible. With PFP, can give them sense of inclusion and promote habits of cooperation.

Ad Hoc Study Groups

- o The CEE Study Group we create today can move us beyond joint declarations to concrete cooperation. Doing practical work together also will strengthen U.S.-EU ties.
- o The second group can provide other recommendations, particularly for cooperation on Third Pillar issues.

Consultations

- o Need to move beyond just consultations to cooperation, as we seek to do on CEE. (FYI: The EU prefers "cooperation" to "coordination.")
- o Cabinet-level consultations called for in the 1990 Declaration are not useful; sub-cabinet and expert-level meetings which have grown up are effective. Need more input from our EU partners in meetings between our diplomats in third countries.
- o Perhaps we can participate as EUROPOL establishes its data links and information-sharing policies.
- o Our study group should also explore U.S.-EU cooperation on anti-crime assistance to CEE.

Middle East

- o Appreciate EU participation and support for the Middle East peace process and the over \$600 million the Union has provided for Palestinian economic development, social programs and police force; EU cooperation is key.
- o Also must focus our dialogue on potential instability in the Maghreb, which might spread to destabilize the whole region.
- o Committed to the U.S.-EU-Canada Working Group on Iran. Concerned that Germany, France, Belgium and Spain have proceeded with debt rescheduling agreements with Iran.
- o Trust the EU will uphold its international commitments, despite exigencies of member-state domestic politics.

Bosnia

- o Contact Group agreement on territorial proposal, package of incentives/consequences, holds best hope yet for a negotiated settlement.
- o Must also give higher priority to planning for reconstruction. U.S. will do its part, but EU contribution is critical.
- o Prospect of Western help to restore normal economic life can encourage Bosnians, even Bosnian Serbs, to accept peace and help make any agreement stick.

Uruguay Round Ratification

- o Tough, but will do. Have asked Congress to pass implementing legislation before August recess.
- o Almost every major business group supports passage. Means \$100-200 billion per year for the economy. Passage key to growth and employment.
- o All significant signatories should strive for ratification in 1994 so Agreement can take effect January 1995.
- o If EU delays Uruguay Round agricultural tariff reductions until July 1, 1995, as planned, I will have problems with our agricultural interests, since our tariff reductions begin in January. Changing your plans could aid passage in Congress.
- o Must move immediately thereafter to tackle other issues, e.g., agreements on financial services, telecommunications. Also to continue productive dialogue on relationship of trade with the environment and international labor standards.

Growth and Employment

- o Jobs Conference helped focus attention of governments and businesses on ways to make our economies more adaptable and productive. Labor mobility as well as growth key to job creation.
- o Ratifying NAFTA and the Uruguay Round, and passing welfare and healthcare reform are all key components to secure U.S. growth.
- o We expect to grow at 4% this year; should provide stimulus for your exports. U.S. unemployment down to 6%, but still too high. Must not let concerns for inflation strangle the recovery.
- o How have you fared with implementing the White Paper recommendations? Will the projected 1.9% EU growth make it easier to build trans-European infrastructure? Will the member states agree to financing?

Russia/NIS (if raised)

- o Congratulations on Partnership/Cooperation Agreements with Russia and Ukraine. Reaffirms West's support for NIS reform and shared commitment to independent, non-nuclear Ukraine.
- o Understand you are close to signing Partnership and Cooperation Agreements with other NIS.

BACKGROUND

Since its completion in 1894 as the parliament building for the new German empire, this neo-renaissance palace has been at the center of German history. The Nazis used a fire in 1933 as a pretext to suspend basic rights and help consolidate power. The Reichstag suffered damage still visible today from bombing missions in World War II. The Soviets raised the red flag over the building on April 30, 1945. After the war, the Reichstag stood just inside West Berlin. Reconstruction, minus dome and most ornamentation, was completed in 1970. The celebration of unification took place on its steps on October 3, 1990 and the all-German parliament (Bundestag) held its first meeting in the plenary chamber on October 4, 1990. The building is now used for both national and international conferences and occasional meetings of Bundestag party caucuses. It will become the permanent venue of the Bundestag when the federal government moves to Berlin. Presidents Harry Truman and Ronald Reagan have visited the building; the latter peered into the former East Berlin from a balcony.

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GERMANY, NATO AND THE EAST

Germany has been the most active of the Allies in advancing NATO's opening to the East, but German officials make a clear distinction between the Central and Eastern European (CEE) states on the one hand and Russia, Ukraine and the other New Independent States (NIS) on the other. Bonn sees the former as potential NATO members and the PFP as a step toward membership for them. It does not see Russia, Ukraine and the other NIS as potential members. Instead, German leaders call for a close relationship between NATO, Russia and Ukraine, in part to reconcile them to their permanent exclusion from NATO.

While we have emphasized the equal status of PFP Partners, German leaders, particularly Defense Minister Ruehe, prefer to state openly that some partners will become NATO members and others, like Russia, will not. Despite these differences, Bonn firmly shares our view that Russia should have no veto right over NATO decision-making. Germany strongly supports rapid PFP implementation and has agreed to host a "command estimate" as a PFP activity during 1994. We are working to get this event and a field exercise scheduled as soon as possible.

Bonn always has been sympathetic to our concerns that the development of European defense capabilities not undermine NATO and was an early supporter of the Combined Joint Task Force initiative. Since the NATO Summit, the FRG has been helpful in working out arrangements to implement this effort. Nonetheless, the German Defense Ministry is concerned about dilution of NATO's traditional role (in which it is a key player) through greater emphasis on peacekeeping (in which it is relatively a minor player).

We work closely with Germany on nonproliferation matters, and German support was important in establishing the NATO nonproliferation initiative at the Summit. The Germans have expressed concern that this initiative not undercut other political-diplomatic efforts and that it not be seen as an effort to "militarize" the West's nonproliferation efforts.

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GERMAN ASSISTANCE TO RUSSIA AND THE EAST

Germany has a great stake in promoting economic reform in the East, and Chancellor Kohl has electoral points riding on regional stability. Germany is the East's most important trading partner, the second leading investor and the most vocal European Union member supporting a further reduction of import barriers and Visegrad accession. Nevertheless, Kohl believes that Germany, the largest aid donor with over \$75 billion to Russia, the New Independent States (NIS) and Central and Eastern Europe, has reached the bottom of its purse. Germany balks at providing major new bilateral aid to Russia or Ukraine, preferring international financial institutions and other donors to make greater commitments.

German assistance is weighted toward spurring private investment and fostering small and medium-sized firms by developing modern credit, private sector and legal structures in Russia, Ukraine, Belarus, Romania and Bulgaria. Bonn believes, however, that assistance cannot "reform" large economies unless aid recipients carry out reforms. Bonn is increasingly focused on trade and investment rather than direct aid. While German exports to Russia and the NIS stagnate due to financing difficulties, several East European countries are emerging as growth markets.

Bonn's aid to Russia and the NIS -- some two-thirds of the G-7 total \$75 billion pledged since 1990 -- is largely related to German unification and the scheduled August 31 departure of Russian forces from eastern Germany. A major portion of this aid involves export credit guarantees, assumption of "transfer ruble" debts, humanitarian and technical grants, investment projects and a \$5 billion housing construction program for withdrawn Russian soldiers. Bonn's support for the G-7 Special Privatization and Restructuring Program translates into German intent to set up two (of ten) regional enterprise funds assisting investment in privatized state enterprises.

Bonn supported the approach among Paris Club creditors leading to a June 4 agreement to reschedule \$7 billion of \$10 billion owed by Russia to official creditors this year. Germany agreed to reschedule \$2.6 billion of \$3.3 billion due in 1994, while the U.S. agreed to reschedule \$1 billion of \$1.8 billion. German banks and suppliers also hold the bulk of private Russian debt.

Bonn has given special attention to the economic situation in Ukraine. It is interested in a G-7 assistance package similar to the one adopted for Russia, pending evidence of a Ukrainian commitment to implement comprehensive economic reforms. Bonn (and Paris) also want the G-7 to help Ukraine construct two nuclear energy plants to replace Chernobyl.

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GERMANY'S ROLE IN THE FORMER YUGOSLAVIA

Germany participates in international relief deliveries, sanctions monitoring, and NATO AWACS patrols to help enforce the Bosnian, and supports U.S. activities conducted from Rhein-Main AFB. It has accepted more refugees from ex-Yugoslavia than any other West European country and offered civilian personnel for an EU transitional administration of Mostar.

Because of constitutional limitations and the bitter legacy of Germany's World War II occupation of Yugoslavia, Germany has no troops on the ground and does not participate in operations that could involve combat. It has, however, strongly supported NATO military actions. It has expressed support for lifting the arms embargo on Bosnia but, with no troops at risk, has not pushed the issue.

The Germans participate actively in the Bosnia Contact Group and helped to convince the Croatian Government to accept the Federation agreement between the Bosnian Muslims and Croats. Chancellor Kohl and others have also used their influence to encourage Russia to play a constructive role. Throughout the search for peace, German views have been close to our own, but with some differences of emphasis. For example, German officials have joined other Europeans in arguing that outside powers should define what would constitute an acceptable settlement package for Bosnia. The Germans have also advocated a more front-loaded lifting of sanctions against Serbia than we, in exchange for Serbian implementation of a peace agreement.

The German Government has shared our impatience with Greece's policy of isolating the Former Yugoslav Republic of Macedonia. German and French officials hope to use Germany's EU presidency to improve EU-Macedonia relations.

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INTERNATIONAL PEACEKEEPING AND OTHER OUT-OF-AREA OPERATIONS

Whether Germany's constitution permits the German military to operate outside the NATO area is ambiguous. Perhaps more important is the psychological burden of the Nazi legacy. Chancellor Kohl has gradually been moving the Bundeswehr into out-of-area deployments, leaving opponents to challenge his actions in the Constitutional Court. Steps include: a Bundeswehr medical unit to join UN forces in Cambodia in 1991; a German ship to participate in NATO monitoring of "Yugoslav" sanctions in the Adriatic Sea in 1992; German crews aboard NATO AWACS planes monitoring the Bosnia No-Fly Zone, even when the operation turned into an enforcement action in 1993; and 1700 logistics troops that supported UNOSOM II in Somalia.

The Constitutional Court is expected to rule July 12 that these missions are constitutional. Then any decision to deploy will depend heavily on the specifics of a mission. The current policy of the opposition Social Democratic Party, for example, is to accept German military participation in humanitarian and peacekeeping operations, but not in actions involving combat -- i.e., no Gulf Wars or "peace enforcement."

While we understand the sensitivity of this issue, especially during a difficult election year, we make clear our hope that a unified Germany will assume the responsibilities and burdens appropriate to its new status in the international system.

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GERMANY'S ROLE IN INTERNATIONAL ORGANIZATIONS

German Bid for Permanent UN Security Council Membership

The U.S. supports a permanent German seat on the United Nations Security Council. We want to ensure, however, that the status of the current permanent members remains unaltered and that the Council's effectiveness is preserved. We have not taken a position on whether new members should have the veto.

The German government has become more active in campaigning for a permanent seat, although Bonn's effort remains low-key to avoid offense to its European partners. German officials have floated the idea of expanding the Council to 23, including Germany and Japan as permanent members, with two additional non-permanent members from each of the Third World regional groups. Germany would expect the same status (i.e., veto power) as other permanent members. German officials assert that "Germany is prepared to assume the responsibilities which permanent membership of the Security Council entails." Indeed, Kohl has told his countrymen that Germany cannot expect a permanent seat until it is ready to play such a role. Nevertheless, German participation in UN military operations remains controversial domestically. Meanwhile, Germany is seeking the rotating European seat on the Security Council for 1995-97. Germany is the UN's third-largest financial contributor, and the escalation in UN peacekeeping bills reinforces its wish for a seat on the Security Council.

Bonn's Bid to Host the World Trade Organization

The German government has proposed Bonn as the site of the new World Trade Organization (WTO). With most German government institutions moving from Bonn to Berlin by the year 2000, Bonn is offering an attractive package of inducements. German officials also argue that the Federal Republic is under-represented as a host nation for international organizations. USTR and the State Department are weighing Bonn's candidacy against that of Geneva. (The Swiss have also made an attractive offer to keep the WTO in Geneva, the current home of the GATT Secretariat.)

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GERMAN-IRANIAN RELATIONS

Germany agrees with us that Iran's actions -- including financial and military support for groups which oppose the Middle East peace process by violent means, support for international terrorism, violations of human rights, and efforts to acquire nuclear weapons -- are reprehensible, but disagrees on how to change Iran's behavior. German-American cooperation has been good on export controls and non-proliferation issues, but Bonn favors engagement to strengthen moderation in Iran. We also object to German official contacts with Iranian intelligence.

Chancellor Kohl is personally involved in Germany's Iran policy. Ultimately, any significant change would have to come from him. Kohl would be very sensitive, however, to public disagreement with the U.S. during his difficult re-election campaign.

Germany is the most important advocate within the EU for its policy of "critical dialogue" with Iran. Germany, along with Greece, France and Italy, also opposes concrete steps to press Iran. Though they rescheduled Iranian official debt despite American objections, Germany, Japan and other creditors have refrained from giving Iran new official credits for the moment because of Iran's fiscal disarray. We are pressing Germany and Iran's other major creditors to turn this temporary economic decision into a political commitment to restrict Iran's credit at the G-7. We do not oppose trade with Iran in non-sensitive items (in fact the Germans point to statistics that assert that the U.S. is Iran's largest trading partner), but we oppose trade subsidies.

Kohl may argue that his engagement with Iran is working -- Iran's rhetoric on the peace process has cooled down, and the frequency of violent acts abroad may have tapered off temporarily. One argument is that if Iran is exercising restraint, it is due to effective pressure and Iran's desire to be seen as an acceptable member of the international community. We do not want to reward Iran prematurely and believe the hard-line behavior remains official policy in Tehran. We do not want to be deceived by rhetoric or allow Iran to divide the Western allies.

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RESIDUAL VALUE AND BURDENSARING

The sore points in the otherwise excellent U.S.-German defense relationship revolve around German financial payments for the U.S. military presence. Both are of intense interest to Congress.

Residual Value

Germany is obligated to pay the "residual value," if any, of U.S. military facilities returned to it. Significant sums are at stake as we return over 400 facilities. Negotiations on reimbursement have proven difficult, primarily since the Germans focus on current market value while we want actual cost (adjusted for inflation, depreciation and damages). Several members of Congress, pointing to estimates as high as \$3 billion in potential reimbursements, have expressed concern. An amendment to the 1994 DOD Authorization bill linked future construction of a U.S. embassy in Berlin to progress on this issue before the end of 1994. EUCOM Deputy CINC General Boyd and Ambassador Holbrooke recently presented a broad framework proposal to the German Finance Ministry that would spread out German reimbursements over several years and direct them toward critical U.S. military construction and maintenance priorities. Bonn is willing to consider this, but significant movement before the October election is unlikely.

Burdensaring

The size of the U.S. military presence makes Germany a natural target of Congressional pressure to reduce overseas stationing costs. The House has passed an amendment calling for NATO allies to pay 75% of the cost of stationing U.S. troops by 1996. We have proposed that Germany forgo approximately \$240 million in taxes and fees annually that the U.S. military now pays, but Bonn is unlikely to consider it seriously until after the October elections. We are trying to broaden the debate beyond the contentious focus on stationing costs to one of "responsibility sharing," in which the emphasis is on the totality of our Allies' contributions to Alliance security. Not surprisingly, German officials support this approach, citing German contributions that include payments to hasten the withdrawal of Russian troops from eastern Germany and assistance to Eastern Europe and Russia.

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GERMANY AND THE EUROPEAN UNION (EU) PRESIDENCY

Germany has four priorities for its EU presidency: (1) job creation and economic growth, (2) external relations, including enlargement, (3) justice and home affairs and (4) decision-making in the run-up to the 1996 inter-governmental conference on institutional reform.

On the eve of its presidency, Germany exhibited a new assertiveness, for example in overcoming Spanish hesitancy in hammering out EU accession packages for Austria, Sweden, Finland and Norway. Last year, Germany won the European Monetary Institute for Frankfurt. Kohl has also called for a review of German contributions to the EU budget, asserting that Germany has reached its financial limit.

Bonn champions the "subsidiarity" principle limiting EU competency to areas in which national decision-making is not better-suited. In recognition of the limits of national policy, however, Bonn favors increased coordination on "third-pillar" issues such as anti-crime measures and asylum policy. Germany has taken in more refugees and asylum seekers than all other EU countries combined and seeks more equitable distribution of the burden. While Bonn generally wants to deepen and broaden European integration, Kohl has enunciated broad public dissatisfaction with too much European bureaucracy and has underscored the need for deregulation.

During the 63rd Franco-German Summit on May 30-31, Kohl and French President Mitterrand discussed priorities for Germany's EU presidency and the subsequent French term, but no formal joint program was set. Kohl has said that Germany cannot be the eastern edge of the EU. With French acquiescence, if not enthusiasm, Germany wants to develop the EU's relations with the Baltics and Central and Eastern Europe (CEE). Bonn seeks to provide the CEE countries a sense of participation in EU decision-making and greater market access, even before they become full members. Kohl, for example, advocates an annual summit of EU heads of government with CEE counterparts. Domestic political constraints narrow the scope for German action on further trade liberalization, however. Although Kohl would like to hold out the prospect of full EU membership for four Eastern European countries by 2000, Bonn is not in a position to push too fast, in part because Germany cannot afford anticipated additional EU agricultural subsidies, structural adjustment transfers, or cohesion funds that would be due them as new members.

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BILATERAL U.S.-EU ECONOMIC ISSUES

Agricultural Tariff Reductions: The European Union (EU) has scheduled its Uruguay Round (UR) agricultural tariff reductions to begin on July 1, 1995, though the overall UR implementation date is January 1. Our agricultural interests oppose this six-month delay, since our tariff reductions begin in January. The EU claims marketing year considerations require the delay, even though the marketing years differ by commodity.

Industrial Tariffs: The EU is refusing to implement permanently eight industrial tariff and plywood quota concessions which were made pursuant to GATT Article XXIV:6, as a result of the Spanish and Portuguese accession into the European Community. The EU's refusal to include these items, despite assurances made during the Uruguay Round negotiations, could actually result in unacceptable UR tariff increases.

EU Enlargement: While the United States fully supports EU enlargement and integration, we will seek full compensation from the EU (under GATT Article XXIV:6) for the breach of the tariff bindings in Austria, Sweden, Norway and Sweden, which will occur as a result of their January 1, 1995 EU accession.

GATT Aircraft Code: The EU has charged that the U.S. is not living up to its December 1993 commitment to negotiate a new GATT Aircraft Code. The EU still seeks subsidy disciplines on all aircraft products (particularly engines), tight disciplines on indirect supports, exemptions from certain provisions of the Subsidy Text (1995) and "grandfathering" of past subsidies. The U.S. is opposed to extending disciplines to non-Large Civil Aircraft and has resumed efforts to multilateralize the Bilateral disciplines on LCAs to cover new competitors.

Audio-Visual: The United States remains committed to constructive efforts to resolve U.S.-EU disputes in the audio-visual sector. Technological advances are rapidly leading to the convergence of the telecommunications, informatics and audio-visual industries. We seek to develop rules for the future in this important complex of industries that avoid restrictions like mirror reciprocity.

Spanish Film Dubbing: Spain recently passed a new Film Law that contains discriminatory restrictions on the ability of U.S. film producers to distribute a dubbed version of their films in Spain. The U.S. Government is now reviewing the law in light of Spain's GATT national treatment obligations. In the meanwhile, the U.S. and Spanish film industries are attempting to negotiate an elimination of the restrictions.

Conditional National Treatment: Our position is that the definitions applicable to the eligibility of companies have generally allowed foreign subsidiaries to participate in these programs. The U.S. administration also strongly opposes the Manton Amendment (which would tighten the eligibility criteria).

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URUGUAY ROUND IMPLEMENTATION AND UNRESOLVED ISSUES

Uruguay Round Implementation: You reaffirmed to the leadership in Congress your commitment to securing passage of the Uruguay Round (UR) implementing legislation by the August congressional recess, in order for the agreement to enter into force, as scheduled, on January 1, 1995. We are discussing draft implementing legislation with Congressional committees and staff. While there has been some opposition to the agreement, virtually every major business group in the United States recognizes that the economic benefits are enormous (adding \$100-200 billion annually to U.S. GDP).

All significant trading partners need to ratify the UR by late fall 1994, if we are to achieve entry into force on January 1, 1995. The EU's process is complicated by unresolved questions concerning the prospective authority of the EU Commission and its member states over trade policy in the WTO.

Financial Services: The UR parties have until December 1995 to revise their final commitments and MFN exemptions. Greater market access for U.S. firms remains the key USG objective. We will seek an MFN exemption, i.e., not extend MFN treatment to other GATS parties financial services sectors, unless a critical mass of commitments develops. The U.S. wants significant progress on financial services from Japan, the ASEANS, and major developing countries. The EU, particularly France, has been sympathetic to our concerns about free riders.

Basic Telecommunications: The UR final act established a basic telecom negotiating group which has until April 30, 1996 to complete its work. The group has begun meeting to define the scope of its work. If negotiations are unsuccessful, the USG will consider MFN exemptions in this sector.

Maritime Services: Maritime negotiations are extended until June 1, 1996. The negotiations seek commitments in all maritime service sectors including international shipping, auxiliary services and port facilities. The U.S. will take an MFN exemption in this sector unless a critical mass of shipping countries improve their commitments. We are concerned that Japan is threatening to be an observer rather than a full participant.

Movement of Personnel: Negotiations to further liberalize movement of personnel must conclude within six months after the WTO enters into force. Country comparisons show the U.S. offer is one of the most liberal, but India, among others, remains unsatisfied. The USG is pushing other countries to bring their offers up to the U.S. level of commitments.

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U.S.-EU RELATIONS: REQUIREMENTS, STATUS, IMPLEMENTATION OF
THE 1990 TRANSATLANTIC DECLARATION

The framework of the partnership as currently defined was laid out in 1990 and is limited to consultation. The Declaration on U.S.-European Community Relations, issued on November 23, 1990, formally set out common goals and principles of U.S.-EC partnership. Common goals included support for democracy and human rights; helping developing countries and support reforms in Central and Eastern Europe; promotion of prosperity and market principles; and the pursuit of policies aimed at achieving a sound world economy marked by sustained economic growth. The Declaration commits the U.S. and the EC (and its member states) to inform and consult on important matters of common interest -- political and economic -- with a view to bringing their positions as close as possible. Further specific goals were also enunciated for economic cooperation; education, scientific and cultural cooperation; and transnational challenges.

In more concrete terms, the Declaration set out an institutional framework for "regular and intensive" consultation:

- semi-annual Summit meetings between the Presidents of the European Council and Commission and the President of the U.S.

These Summit meetings have been valuable, especially in lending momentum to the consultative process and focusing the day-to-day dialogue on particular priority areas.

- semi-annual consultations between the EC foreign ministers, including the Commission, and the Secretary of State.

Productivity of these meetings has depended on the format. When ministers were accompanied by individual delegations and the number of attendees swelled, the meetings stuck to scripted talking points and prepared interventions. When the ministers met alone (as at the 1993 UNGA in New York), the more informal atmosphere allowed for a freer and more substantive exchange.

- ad hoc consultations between the Presidency Foreign Minister or the Troika and the U.S. Secretary of State.

This format generally has been very effective. Meetings have occurred with some frequency of late, on the margins of the September 13, 1993 Israeli-Palestinian signing, the October 1, 1993 Washington Donors' Conference and the March 18 Bosnia-Croat Signing Ceremony. These relatively informal meetings often are more useful because they allow the principals to focus on a particular and immediate issue at hand.

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- semi-annual consultations between the Commission and the U.S. Government at Cabinet level.

These meetings have never occurred, as it is impractical to assemble the Cabinet. The substance of Cabinet-level meetings with the Commission is, as a practical matter, fulfilled in the semi-annual "sub-cabinet" meetings attended by deputy or under secretaries -- an effective forum resurrected in mid-1993.

- briefings by the EU Presidency to the U.S. on European Political Cooperation (EPC) meetings at the Ministerial level.

Although the EPC process has now given way to "Common Foreign and Security Policy" (CFSP) under the Maastricht Treaty, these briefings continue in substantially the same format. They can be very useful, although the quality depends on the resources, conscientiousness and commitment of the presidency country.

Other regular forums of U.S.-EU consultation exist outside the 1990 Declaration framework. They include:

- third-country consultations in which U.S. and EU-member state diplomats posted in third countries discuss local and regional issues. These meetings generally occur two or three times a year in 12-15 countries, not counting informal U.S.-EU member contacts.

Secretary Christopher gave impetus to these consultations in early 1993, as a way of fully using the transatlantic partnership and effectively sharing resources. Unfortunately, consultations are generally one-sided, with the U.S. providing the bulk of the information. While this is not the kind of consultation the Secretary intended, it does provide useful opportunities to support U.S. views.

- semi-annual CFSP-U.S. regional and functional consultations at the expert level.

These are scheduled around EU internal working group meetings on specific regions or topics. While useful, they need to move beyond mere consultation and information exchange toward policy cooperation.

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EUROPEAN UNION-POLISH RELATIONS

European Union membership is at the very top of Polish foreign policy objectives for political and security as well as economic reasons. EU-Polish relations have remained good, despite changes in Polish governments.

Poland's Association Agreement (AA) addresses a broad range of trade and political relations and envisions but does not guarantee eventual EU membership. In April, Poland formally applied for EU membership; the GOP understands that the EU will not begin serious consideration of its application before 1997. The biggest obstacles to Polish membership are the relative weakness of its economic development and its large agricultural sector. If Poland were admitted, it would be entitled to huge subsidies under the EU's Common Agricultural Policy and economic development funds. Nevertheless, the Germans have been strong advocates of Polish membership.

EU-Polish contacts at high levels are frequent. The EU has been Poland's greatest source of economic assistance; from 1990 through June 1993, the EU and member states had committed over \$8.5 billion to Poland, including debt forgiveness (U.S. figure for the period was \$3.9 billion).

Trade and Market Access: Poland has complained about access to EU markets, usually following the imposition of an EU trade restriction on Polish exports, notably on steel and agricultural products. These should become more rare as the AA is fully implemented. Under the AA, most Polish industrial goods will enter the EU duty- and quota-free beginning on January 1, 1995; restrictions on steel and textiles will be lifted later. The EU and Poland will have free trade in all non-agricultural sectors by January 1, 1997. Thanks in part to the AA, Polish exports to the EU rose over 40% from 1990 to 1993, despite the European recession; however, imports from the EU more than doubled, thanks to increased consumer demand in Poland and the appreciation of the zloty in real terms. As a result, Poland's billion dollar-plus trade surplus with the EU in 1990 became a \$2.5 billion deficit in 1993.

European Stability Pact ("Balladur Pact"): The GOP remains unhappy with the European Stability Pact; it does not consider itself to be an "object" of the Pact as it argues Poland has no border or minority problems. The Poles did not participate in bilateral meetings with the EU on the Pact, and maintain that at a minimum the Pact's focus needs to be diverted to "good neighborly" relations including, in particular, economic cooperation, in order to make it possible for them to participate. It would also like its agreement with Germany to be included in the Pact. Germany is not enthused.

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EU MACROECONOMIC COORDINATION

The 1979 European Monetary System committed member states (excluding Greece) to maintain currencies within a narrow band of fluctuation (1.125% on either side of the central ECU rate). Since the August 1993 exchange rate crisis the band was widened to 15%, and U.K. and Italy interrupted participation indefinitely.

The Maastricht Treaty on European Union of 1993 commits members (except the UK) that meet "convergence criteria" on inflation, interest rates and budget deficits to monetary union, including a common currency and central bank, by 1999. The Council sets broad guidelines to promote convergence and a "cohesion fund" helps members with per capita GNP under 90% of the EU average if their economic policies are deemed conducive to meeting the criteria. Few if any are likely to qualify as initial monetary union members. Over the last ten years most EU members have reined in inflation but budget deficits have swelled and unemployment is likely to continue growing into next year.

On June 6, the EcoFin (Council of EU Economic and Finance Ministers) approved the latest revision of the economic guidelines which focus on four main points: (i) sustaining economic recovery by creating conditions to allow central banks to reduce short-term interest rates further, thereby reversing the recent increases in long-term rates; (ii) keeping inflation at 2- 3% per year; (iii) reducing budget deficits to within 3% of GDP EU-wide and increasing national savings; (iv) structural reform measures (improved training, education programs, labor market flexibility, and privatization) to improve employment growth.

The EU and the G-7

The European Union Commission participates in the G-7 process in two ways. First, the President of the European Commission attends the annual Economic Summit meeting as a full participant. The Commission plays a full role in the sherpa process as well.

Second, the EU participates on an ad hoc basis with the G-7 Finance Ministers and Deputies. This arose because of the EU's primacy in Europe on issues relating to assistance to Russia. The EU representative has attended several recent G-7 Finance Deputies meetings, but only for the relevant portions. The U.S. has traditionally resisted EU efforts to expand their participation, partly on the reasoning that this would "over-represent" Europe in the group's discussions.

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PRAGUE INITIATIVES CHECKLIST

Sustained High Level of Engagement: Since your Prague trip there has been sustained high level engagement with Central and Eastern European (CEE) countries. Cabinet members and senior level travellers include: UN Amb. Albright and Gen. Shalikashvili (throughout the region), Commerce Sec. Brown (Warsaw), Atty. Gen. Reno (planned - Budapest), Deputy Sec. Talbott (Warsaw and Bratislava), Under Sec. Tarnoff (Warsaw, Budapest and Prague), Under Sec. Davis (Budapest, Bratislava, Sofia and Skopje) and NSC Senior Director Schifter (Bucharest, Sofia, Warsaw, Bratislava and Budapest).

Democracy Network: USAID expects to start awarding grants for the "Democracy Network" this summer. We will provide about \$30 million in grants to U.S. NGOs over the next 3-5 years. In turn, the selected U.S. NGOs will cooperate with and support CEE counterparts involved in public policy.

Improved Market Access: We have agreed with the EU to avoid megaphone diplomacy on this sensitive matter. We can do little more to expand CEE access to our markets; the EU cites "domestic political realities" as preventing its further concessions. The U.S. is interested in working with CEE states to address their own sizeable barriers to exports and could work with the EU.

U.S. Trade Remedy Laws: NEC Deputies agreed to explore Congressional receptivity to a proposal to establish an inquiry-based trade remedy for CEE/NIS "economies in transition." The new remedy would apply in lieu of current market surge and anti-dumping provisions applied to non-market economies.

U.S.-sponsored Conference on CEE Investment and Trade: This proposal has sparked great interest in the CEE. It will probably take place in Cleveland in September or October. We are arranging for U.S. private sector cooperation in hosting the conference. The conference will focus not only on both trade and investment opportunities in the region, but also on what measures these countries should take to make their business climate more attractive. Key CEE ministers -- but not heads of government -- will be invited to attend and learn.

Early OECD Membership for Visegrad Countries: With strong U.S. leadership the OECD Ministerial Communique stated our intention to begin negotiation with the V-4 on membership as soon as possible. Eventual OECD membership will depend largely on how quickly Poland, Hungary, the Czech Republic and Slovakia can bring their laws, regulations and practices into conformity with OECD guidelines on trade, investment and the environment.

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Regional Infrastructure Improvements: At a February 1994 meeting in Vienna, the USG and CSCE partners developed a regional road infrastructure plan for short-term projects in the southern CEE countries. The EU has been slow to provide its share of the funding necessary to implement these projects. TDA is working on a series of special infrastructure programs; it has been funded to the level of \$3 million for regional programs. State and Customs continue to lead an effort to develop a transport corridor around Serbia for perishable agricultural commodities from the southern Balkans. We are trying to identify possible sources of funding for the "Highways for Peace" proposal.

Regional Civil/Military Airspace Management: DoD has provided \$500,000 toward the cost of a preliminary study of a regional integrated civil air traffic control system/military air sovereignty regime. The Visegrad states other than the Czech Republic have endorsed this initiative. The target date for completion of the preliminary study is the end of FY94.

Social Sector Restructuring Assistance: Using primarily existing assistance resources, and coordinating with other international donors, we have launched an initiative to help Poland in this area. Our focus is the financing and provision of retirement and disability pensions, poverty relief, health care, housing and job generation. We will draw on our experience in Poland to assist other CEE countries.

Post-privatization Assistance: Treasury has developed a proposal for an equity fund to assist newly privatized companies in Poland, but no interagency agreement has been reached. We are working out details.

Bilateral Working Groups on Security: So far this year alone, we have held BWGs -- consultations on regional security, defense relations and bilateral assistance -- with ten CEE non-combatants (all except Hungary, with whom we will meet in the fall and the Former Yugoslav Republic of Macedonia).

Peacekeeping Units: With our support, the Baltic states have launched a joint peacekeeping battalion initiative. We have requested \$10 million for FY95 to support CEE peacekeeping, including the Baltic Battalion.

Removing Cold War-era Restrictions: We have finished removing all CEE states (except those subject to the Yugoslav arms embargo) from the International Traffic in Arms proscribed destination list. In addition, we and our allies removed Hungary, the Czech Republic, Slovakia and Poland -- but not Romania or Bulgaria -- from the COCOM proscribed destination list before the termination of COCOM on March 31. Finally, this year you signed Presidential Determinations (PDs) for all CEE states not already covered by PDs and not subject to the Yugoslav arms embargo. These PDs make these states eligible to participate in the Foreign Military Sales (FMS) program.

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MEETING WITH PRIME MINISTER CHRETIEN OF CANADA

CONTEXT OF MEETING

Though trade disputes on wheat/poultry/dairy and Pacific salmon persist, the past nine months with the Chretien government have been productive. Canada agreed to NAFTA, showed fortitude on Bosnia, renewed participation in the space station project and made progress with us to perpetuate defense cooperation through NORAD. The trade issues impact the economies and powerful domestic interests on both sides of the border. When Chretien raised them with you in April, you agreed to seek negotiated solutions. The talks on wheat have made some progress, but we are unlikely to reach an agreement until after the ITC issues its decision on wheat on July 8 -- later on the day of your meeting with Chretien. On Salmon, the Canadians have agreed to lift the transit fee on U.S. fishing vessels, which we considered illegal and discriminatory. Negotiations resume this week. We consider Canada's imposition of an illegal, discriminatory transit fee on U.S. fishing vessels to be an unjustifiable obstacle to resolving differences by negotiation.

Chretien may raise concerns about Congressional proposals, in the context of Uruguay Round implementing legislation, which would make it easier for the U.S. lumber industry to bring successful subsidies cases against Canadian lumber imports. Chretien would like these issues kicked over to the subsidies working group we established to secure Chretien's support for NAFTA. We recommend you express a willingness to consult with Canada during the legislative process, but indicate we need some flexibility in working with Congress.

One of the "Friends of Haiti," Canada has been a reluctant supporter of our efforts to broaden the UN military and police mission mandate and size. They are concerned about Aristide's reaction and the possibility of intervention and have gone slow in UN consultations. (Pro-Aristide Haitian voters in Quebec have made Chretien very attentive to Aristide's views.) Canada has offered police trainers for UNMIH -- as they did last year -- but not military personnel or police for civic order functions.

Growing Canadian activism in Latin America could work at cross-purposes to U.S. objectives. While Chretien enthusiastically supports the Summit of the Americas, his recent letter to you suggested that Canada host a meeting to define the agenda. Canada has also pushed for a greater OAS role. The Vice President will visit Ottawa later this month for Summit consultations. Canada has also decided to resume humanitarian assistance to Cuba.

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On Bosnia, Chretien made clear after a June visit to Canadian peacekeeping troops in Sarajevo that he would withdraw them if the arms embargo is lifted -- and linked their continuing presence to seeing some progress. He praised the relatively stable situation on the ground now, but noted that Canadians are "peacekeepers, not peacemakers."

The U.S. has been actively supporting Canada's candidate, Don Johnston, for Secretary General of the OECD. Chretien may be concerned that, with Salinas' entry into the race for the head of the World Trade Organization (WTO), U.S. support for Johnston might waver. (Europeans will be reluctant to allow North Americans to hold both positions and may try to press us to support one or the other.) We recommend you reiterate U.S. support for Johnston but ask for his support for a strong WTO candidate.

The issue of Quebec separatism is heating up for Chretien and likely to be a growing distraction. The separatist Parti Quebecois (PQ) is now predicted to come to power in September elections -- and committed to holding a referendum on the province's future within ten months of taking office.

YOUR OBJECTIVES

- o Assure Chretien of your desire to see the wheat and salmon disputes settled -- but not under pressure of unjustifiable acts such as the transit fee.
- o Urge Chretien to support rapid UNSC approval of a new, broader mandate for the UN Mission in Haiti and to consider contributing military as well as police.
- o Stress U.S. interest in working closely on Latin America.
- o Praise continuing Canadian fortitude on Bosnia.
- o Observe the rising temperature of Quebec separatism and the U.S. posture of non-interference.

CORE POINTS

Wheat/Poultry/Dairy

- o Strong domestic interests and equities on both sides.
- o Have asked Kantor and Espy to make every effort. Urge you to encourage your trade and agriculture ministers to resolve quickly.

Salmon

- o Want to see the discriminatory and illegal transit fee on U.S. vessels lifted. Encourages affected interests and their representatives in Congress to press for retaliation to hurt Canada. Options naturally under review so long as fee stands.
- o Believe preferable course, as Vice President told your Ambassador, to return now to negotiating table, where with recommitment can find accommodation for 1994 catch and work on longer-term regime.
- o Important to both sides -- which both have significant equities -- to achieve mutually-acceptable agreement.

Uruguay Round

- o Understand your concerns about some of the provisions of the Uruguay Round legislation, and will be conscious of them as we work with Congress on the bill. Will resist all amendments that are inconsistent with our Uruguay Round obligations.
- o Need some flexibility in working with Congress to get the Uruguay Round passed and lock in the benefits of the Uruguay Round. Will consult fully as legislation proceeds.

Haiti

- o Tensions building fast in Haiti due to the sanctions, as the increased migrant outflow shows. Need to be ready should the military leaders go quickly.
- o Have to get UNSC approval for the revamped UN Mission without delay. New mandate essential to meet the challenges we'll face and stabilize restored democracy. Hope Canada can provide a military as well as police contribution.

Latin America

- o Appreciate Canada's active interest in Summit of the Americas. Delighted Vice President will have opportunity for consultations with you later this month.
- o Want to work closely together on Summit and other priorities in the hemisphere, such as promoting democracy in Haiti and democratic transition in Cuba.

Bosnia

- o Appreciate Canada's steadfast presence in Bosnia. Your views from visiting troops on the ground in Sarajevo?

OECD

- o Have supported Don Johnston for the OECD job and will continue to do so. Understand he's doing well in the race.
- o Important that we work together to support a strong candidate to start the WTO, someone who can help bridge the gap between industrialized and developing countries and manage the new issues on the global trade agenda.

Quebec

- o Americans following with interest and variety of emotions issue of Quebec separatism.
- o Our posture to make two points: U.S. has long enjoyed excellent relations with a strong, united Canada; how Canadians craft constitutional changes is a matter for them to decide.

MEETING WITH
RUSSIAN PRESIDENT YELTSIN

OVERVIEW

This will be your fourth meeting with Yeltsin since you took office. The 90-minute session and 30-minute press conference will follow directly the G-7 lunch with him on July 10 and is the last event on your schedule in Naples.

Your primary aim in this meeting is to chart with Yeltsin objectives for your two-day summit meeting with him in September and for U.S.-Russian relations over the long term. After a year and a half of intensive engagement with the Russians in defining a new relationship, the Naples meeting presents you with a good opportunity to step back with Yeltsin and focus on a big-picture view of the future.

We have just weathered during the last six months the most difficult period in U.S.-Russian relations since the fall of the Soviet Union in December 1991. Several important events combined at the turn of the year to cast a cloud over our relationship: the strong anti-reform vote in the December elections; the resignations of Gaydar and Federov; the Ames spy case; a resurgence of Russian military activity and influence in its neighborhood; and difficulties with Moscow on Bosnia, North Korea and other foreign policy issues.

You made the right decision in January to stick with a policy of engagement and support for reform despite the many problems we encountered. Nevertheless, this unleashed a wave of criticism from the press and prominent observers that the Administration was unrealistically optimistic about Yeltsin's ability to sustain reform and naive about Russia's intentions in the "near abroad." During the intervening months, however, the sky did not fall on our Russia policy as the critics predicted. Yeltsin and Chernomyrdin kept the economy on a strict reform regimen. Yeltsin, together with Ukrainian President Kravchuk, acted to restrain the Crimean and Black Sea fleet crises. He also committed to a complete withdrawal of troops from the Baltics by this summer's end. The Gore-Chernomyrdin process produced significant results on the Space Station, energy investments and control of nuclear weapons and materials. While we had some problems on the economic assistance program and in dealing with Russian adventurism in Georgia and Nagorno-Karabakh, our Russia policy has been on the right track all along as the New York Times, Zbig Brzezinski and Jim Hoagland have recently affirmed.

Yeltsin comes to Naples anxious to put the problems of the past months behind us. His overriding foreign policy objective is to convince you and Chancellor Kohl to integrate Russia with the West. While wishing to retain independence in foreign policy,

Yeltsin wants very much to link Russia economically westward and to participate as an equal as we design a new framework for the future security of Europe. He believes that is already happening with Russia's new membership in the Partnership for Peace, its new Economic Treaty with the EU and its enhanced role with the G-7 at Naples.

The core points that follow are designed to have you suggest to Yeltsin concrete steps that we can take between Naples and the September Summit to continue progress in some areas and resolve problems in others.

Yeltsin sent you a letter last week proposing an active G-7 plus Russia process on political issues. You can assure him we favor a close G-7 relationship with Russia modeled on the Naples Summit. While Yeltsin probably won't ask, we should continue to approve Russia's full membership in G-7.

On economics, you will want to congratulate Yeltsin on Russia's recent positive performance in meeting IMF targets and the international community's strong support for reforms as they continue. In addition, you should urge a continued, strong emphasis on the Gore-Chernomyrdin process, now the heart of our bilateral cooperation. Finally, you can suggest that you and Yeltsin agree in September on a "strategic economic agreement" that will trade action by us on Jackson-Vanik and Market Access for Russian reductions on tariff items important to us.

On security issues, we want to continue our good work together on nonproliferation and arms control, in particular by cooperating to bring about Ukraine's accession to the Non-Proliferation Treaty (NPT), START I entry into force and Duma ratification of START II. You should also applaud our joint work on nuclear materials control and accounting. You should highlight our concerns on biological and chemical weapons. You and Yeltsin should discuss Russia's recent decision to join the PFP and our wish for enhanced military-to-military ties, while making clear that Russian cannot veto NATO's relations with the CEE states.

Foreign policy cooperation remains the most difficult part of our relationship with Russia. We have succeeded in improving communications and joint work on Bosnia and North Korea. We have worked well with Russia on Ukraine issues and on troop withdrawals from the Baltics. We have had differences on Georgia and Nagorno-Karabakh. (Russia has threatened to block the broader UN Mission in Haiti unless we are more supportive of CIS peacekeeping in Georgia.) These issues received scant attention during your January trip. We need to put a bigger spotlight on them now and have a frank exchange with the Russians on how we can work more effectively together.

YOUR OBJECTIVES

- o To chart with Yeltsin the agenda for your September Summit and objectives for U.S.-Russian relations over the long term.
- o Underscore the importance we attach to Russia's continued economic and political integration with the West.
- o Push for continued economic reform in Russia and new ideas to expand our trade and investment.
- o Highlight our interest in advancing security cooperation on arms control, nonproliferation and on PFP.
- o Suggest ways to improve our foreign policy cooperation.

EVENTS

Bilateral Meeting. You will host Yeltsin for a ninety-minute meeting at your hotel directly following the G-7 lunch on July 10.

Joint Press Conference. You and Yeltsin will make statements and will then respond to questions from the press corps.

Points to be made are attached.

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POINTS TO BE MADE
BILATERAL MEETING WITH PRESIDENT YELTSIN

SEPTEMBER SUMMIT

- o Looking forward to our September 28-29 Summit in Washington. Will be State visit with official ceremonies and several meetings.
- o You should spend time with Congress and our business community to emphasize trade and investment. We can help to arrange.
- o I want to move beyond our declaration of partnership in Vancouver and make concrete advances in economics, security and foreign policy cooperation.
- o Suggest you and I agree today on broad objectives for September and ask our Ministers to work on them.
- o We've had active and sometimes difficult six months since the Moscow Summit. Let's discuss today problem areas and also successes like the Gore-Chernomyrdin process.
- o Suggest we focus now on three broad areas of cooperation: economics, security and foreign policy.

ECONOMIC COOPERATION

Economic Reform

- o Congratulations on your impressive reforms since January. You've earned the IMF's support. As you heard today, the G-7 fully supports you.
- o Hope you can intensify the pace of reforms and bring inflation down further, because that will help you gain the confidence of the Russian people and foreign investors.
- o We expect our G-7 initiative for increased access to IMF resources to permit a much higher level of support for Russia.
- o We want to see an intensified reform effort trigger an IMF standby loan this year with significant IMF funding and permit us to discuss a more comprehensive debt rescheduling.
- o Concerned about recent decisions that delay U.S. banks' entry into the Russian market, but allow some European banks to enter.

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- o We think our banks can contribute to Russia's economic transformation.

Gore-Chernomyrdin Process

- o Gore-Chernomyrdin more successful than we imagined in Vancouver when we created it.
 - Recent meeting produced significant, concrete results that will benefit us both -- Space Station; Sakhalin Island oil agreement; agreement to shut down plutonium production reactors and stop production of military plutonium.
 - VP Gore will continue to treat as top priority.

U.S. Economic Assistance

- o I'm determined to make our aid program effective to support your reforms.
 - Privatization and exchange programs succeeding. Housing helpful to you on Baltic withdrawals.
- o I want to improve speed of implementation and want to focus our efforts more on few, key areas.
- o Will name a new Aid Tsar soon to produce better results.

Market Access and Jackson-Vanik

- o You asked in Moscow for my cooperation on removing Jackson-Vanik from relationship and improving market access for Russian exports to the U.S.
- o VP Gore and I discussed with Chernomyrdin a Strategic Economic Partnership agreement at September Summit to spur trade and investment.
 - We will support your early accession to GATT.
 - Will work with Congress to recognize Russia (and other CEE/NIS countries embarked on reform) as "economy in transition." This will help soften effect of our dumping laws. Will be very difficult to convince Congress but I think important to try.
- o At same time, I will state publicly in September that Russian emigration policies are in compliance with Jackson-Vanik.
 - Will remove need for annual Jackson-Vanik waiver and set you apart from China and other countries.
 - Chernomyrdin's meeting with Jewish community in U.S. helped to build support for this.

- o As part of this Strategic Economic Agreement, understand you are prepared to seek ratification of Bilateral Investment Treaty by Duma and reduce tariff barriers in key sectors (aviation, autos and confectionary sugar).

Private Trade and Investment

- o I still believe this is most important of all economic issues.
 - Gore and Chernomyrdin making progress in identifying barriers to trade.
 - Suggest you and I meet U.S. executives together in September and that we announce completion of Texaco's Timon Pechora oil project. Can we make such progress?

Crime and Corruption

- o Know this is big concern for you. Important domestic issue in U.S., too.
 - FBI Director Louis Freeh is back from Moscow. I've asked him to work closely to help you fight organized crime.

SECURITY COOPERATION

Partnership for Peace

- o Applaud your decision to join. Know some in Russia oppose.
 - Historic step in European history that establishes basis for our common goal -- promoting Europe's unity in next century.
- o We must now make it work for closer Russian relations with NATO and other members. Also want to work with you to increase understanding in Russia of the stabilizing role NATO plays in Europe.
 - We want more active military ties with Russia inside PFP.
- o Also determined to promote activities beyond PFP such as our bilateral military exercises now set for Totskoye in September just before our summit.

Trilateral Agreement

- o Very pleased with progress--way ahead of schedule with some 300 warheads shipped from Ukraine to Russia.

START I and II/NPT

- o We should set as goal for September cooperating to achieve Ukraine's NPT accession and START I entry into force.
- Also want action on START II. Will the Duma ratify it?

Non-proliferation

- o Want to make as priority area for September controls on plutonium and safety, security and accountability of nuclear weapons stocks.
- o Also have continued concern about biological weapons activities in Russia.
 - VP raised with Chernomyrdin who insisted all programs have stopped. We need to continue to monitor problem closely since we continue to receive reports of activity.
- o On chemical weapons, want to resolve issues of bilateral data exchange and conversion of former CW production facilities, to ease ratification of the Chemical Weapons Convention.

ABM/TMD Demarcation

- o Secretary Christopher recently outlined for Minister Kozyrev our new U.S. position on the demarcation between theater missile defenses (TMD) and anti-ballistic missile (ABM) defenses.
- o I believe this new U.S. offer is very responsive to Russian concerns and hope your side can show similar flexibility.
- o In particular, I hope our experts can agree on a solution to this issue during their next round at the Standing Consultative Commission (SCC).

COCOM SUCCESSOR REGIME (If asked):

- o We agreed at Vancouver to end COCOM and establish new successor regime with Russia as member.
 - Have had difficult negotiations. Gore and Chernomyrdin had a good discussion of statement to resolve our differences. It should be finished by September so you and I can sign it.
 - This is a key test of our ability to cooperate. We must succeed. Let's ask our experts to arrange by September.

START III (If asked):

- o Following our discussions in Moscow, our experts have held some preliminary discussions of a concept for START III. This process should continue.
- o At the same time, I believe we must be careful not to let a START III process get too far ahead of the immediate business at hand -- ratification and formal entry into force of START I and START II.

FOREIGN POLICY COOPERATION**Overview Points**

- o Foreign policy area of greatest challenge and where you and I can make an active difference.
 - We should continue frequent phone conversations and letters so that we avoid miscommunications/misunderstandings.
 - I start with belief that Russia is great power and essential partner to resolve most serious conflicts around world.

Bosnia/North Korea

- o Pleased our cooperation/communication on Bosnia and North Korea is good now.
 - On Bosnia, Contact Group working well. Once we have agreement on the map and package of incentives, we can move to get the parties to end the war.
 - We need to be prepared to follow through with our threat if one or the other party rejects the plan.
 - On North Korea, Christopher and Kozyrev have worked effectively together on key elements of a sanctions resolution. Will keep you closely informed on results of our talks with North Koreans.

Baltics and Russian Troop Withdrawals

- o Had good meeting with three Baltic Presidents in Riga.
 - All want good relations with Russia. I stressed importance of their giving ethnic Russians chance to participate in political life, have access to citizenship.
- o On Latvia: President Ulmanis did right thing in returning the bad citizenship law to Parliament. We will continue to push for more equitable treatment.

- Very pleased your troops will withdraw in August.
- o On Estonia: Understand negotiations on troop withdrawal are tough and complicated.
 - I feel very strongly that you should complete negotiations and withdraw troops by August. If you fail to meet deadline, will hurt Russia's image internationally.
 - I talked with President Meri. I am carrying a letter from him to you with proposals to resolve the toughest issues.
 - I think you should take a personal role in finishing these talks. Have given same advice to Meri.
 - I am ready to help behind the scenes if you find useful.

Ukraine

- o Congratulations for keeping relations with Ukraine on track.
 - Ukraine major priority for us all. Need to act together to help stabilize.
 - Would be interested in your assessment of elections in Ukraine, both presidential and local levels.
 - We will push new government to begin economic reforms. If it does, G-7 will mobilize substantial support.
- o Hope you can continue to work effectively with Ukraine on Black Sea Fleet and Crimea.
 - I am willing to help quietly if you believe useful.

Georgia and Nagorno-Karabakh

- o As I mentioned in my recent letter, we need to work more effectively on these two problems.
 - Christopher and Kozyrev discuss frequently.
- o On Georgia, understand your concerns with stability and its effect on your North Caucasus.
 - We are supporting expanded UN presence to monitor the CIS force. Best we can do for now. If your force acts consistent with international standards, could possibly lead to UN endorsement and voluntary fund to help defray your expenses.

- Important thing is to support Shevardnadze and keep Georgia together.
- No valid linkage between Georgia and a broader UN Mission in Haiti. Urge you to support UNSC authorization of the revised UNMIH mandate when the Secretary General submits his report.
- o On Nagorno-Karabakh, we are disappointed that we've been unable to work together effectively.
 - Neither Russia nor the CSCE can produce a solution on its own. We should merge our efforts and try to use our combined influence to produce negotiations.
 - If that is to happen, we will need to give strict instructions to our people. Let's have Christopher and Kozyrev work on this.

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CONTINGENCY BRIEFING PAPER: EU COMMISSION PRESIDENT DELORS

BACKGROUND

Jacques Delors is in the last six months of his ten years as Commission President. He may run for the French Presidency in 1995. Credited as one of the great visionaries of European integration, Delors was the architect of the EC's 1992 Single Market program and a guiding force in shaping the Maastricht Treaty. However, the EU Commission is now on the defensive as the member states seek to assert their dominance in shaping EU policy and public skepticism about the Union grows.

Delors will concentrate on a few key projects: the White Paper on economic competitiveness and unemployment that you and he discussed in January; improving EU relations with CEE and Russia; overseeing successful EU enlargement; and laying the foundation for reforming the EU's institutions. Delors wants evidence of strong U.S. support for European integration and commitment to partnership with the EU.

CORE POINTS

- o U.S.-EU partnership essential to confront European and global problems. Must strengthen mechanisms for developing transatlantic foreign and economic policy consensus.
- o Want to ratify the Uruguay Round agreement so it can take effect January 1, 1995. Also need to tackle the relationships between trade and the environment and trade and international labor standards.
- o Need to work together on combatting unemployment. What came out of the Corfu summit on that?
- o How was your meeting with President Yeltsin last month? Congratulations on signing your partnership and cooperation agreement. We must coordinate more on our approaches to Russia and to Central and Eastern Europe to improve our effectiveness and avoid disputes.

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CONTINGENCY BRIEFING PAPER: UK PRIME MINISTER MAJOR

BACKGROUND

The Major government is curiously relieved after the Conservative Party polled only 27% of the national vote in the June European parliamentary elections. Although the party had its worst performance ever -- never before dipping below 30% at the national level -- the result was not as catastrophic as some had feared. Major has promised a cabinet reshuffle, but Foreign Secretary Hurd, Defense Secretary Rifkind and Major's putative rivals (Clarke, Heseltine and Portillo) will likely remain. Ironically, Major's position is more secure now since Conservatives realize their problems go deeper than the Prime Minister. At the same time, the Labour Party has justifiably trumpeted its best national showing (45%) in 30 years. Tony Blair is set to be picked as Opposition Leader in July. Major has until 1997 to call a general election. With the British economy in steady recovery, he and the Tories cannot be counted out.

On Bosnia, Major will reiterate his deeply-felt view that lifting the arms embargo would force the withdrawal of British and other UNPROFOR troops. The British believe that no more than two months are left to prevent a return to a full-scale conflict in Bosnia and beyond. They are generally more inclined than we to offer carrots to the Serbs, notably sanctions relief. On North Korea, UK has been generally supportive though it pressed for a more aggressive sanctions strategy at the UN. On Haiti, it has decided against accepting refugees for resettlement and not yet responded definitively to our request for support for UNMIH. On Russian peacekeeping, it argues for keeping up a persistent dialogue with the Russians on the standards and norms for any operation. On fissile materials, British coolness threatens to undermine your proposal of an international ban on fissile materials for nuclear explosive purposes.

CORE POINTS

- o Must maintain resolve in supporting Bosnia territorial compromise and in following through on the incentives/disincentives package if map rejected.
- o Goal to have North Korea continue its freeze and address the past. Meeting of Kims important.
- o Appreciate your help in getting Turks and Caicos agreement to a migrant processing facility for Haitians. Hope you decide to participate in UNMIH.

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- o Need to firm up a realistic and constructive approach to Russian peacekeeping before November CSCE Summit in Budapest.
- o Need your help to move on a fissile material convention, which is important to our efforts in the South Asia and on extending the NPT in 1995.

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CONTINGENCY BRIEFING PAPER: FRENCH PRESIDENT MITTERRAND

BACKGROUND

The June European Parliament elections shuffled the French political deck as campaigning for the April 1995 presidential vote begins. The Socialists' poor showing (15%) forced the resignation of their presumptive nominee, Michel Rocard. Many Socialists including Mitterrand would like Jacques Delors to take up the mantle. On the center-right, a strong "anti-Brussels" vote has put more pressure on Balladur to prove his nationalist mettle if he is to win the nomination over Chirac.

The French economy is picking up, in response to U.S. growth and lower short-term interest rates. Forecasts for French growth have been revised upward to 2.8% for 1995. Unemployment (12%) is unlikely to fall soon. Uruguay Round implementation would stimulate the economy further, but there remains a dispute over competence between the EU Commission and member states which threatens to delay its ratification.

Mitterrand hopes his approval of Eurocorps (including German) participation in this year's Bastille Day parade will put to rest the flap over Germany's absence from the D-Day commemorations. France is concerned that EU expansion will create a "Germanic bloc" of Nordic/CEE states, reducing French influence and puts great stock in coordinating the back-to-back German-French EU presidencies beginning in July. Mitterrand and Kohl are likely to stress cooperation in Naples. The two wrote you recently to request help in shutting down Chernobyl. You will want to review the bidding on North Korea, Bosnia and Haiti. Mitterrand may say France's new peacekeeping role in Rwanda precludes military participation in UNMIH, though France is willing to provide police.

CORE POINTS

- o Goal to have North Korea continue its freeze and address the past. Meeting of Kims important.
- o Must maintain resolve in supporting Bosnian territorial compromise and in following through on the incentives package if map rejected.
- o Understand new demands in Rwanda; but hope you can provide military as well as police to reconfigured UN Haiti mission. French participation highly desirable.
- o U.S. prepared to help replenish the EBRD Nuclear Safety Account to close Chernobyl as soon as possible.

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CLINTON LIBRARY PHOTOCOPY

- o U.S. pushing to implement Uruguay Round by January 1. Hope EU able to join us.
- o Need your help to move on a fissile material convention, which is important to our efforts in the South Asia and on extending the NPT in 1995.

JAPAN: ECONOMIC OUTLOOK

Overview

- o Worst of economic slowdown is over, but weak and protracted recovery ahead led by private demand; very limited external adjustment.
- o Substantial, sustained fiscal stimulus needed on both tax and expenditure sides to boost domestic demand and facilitate external adjustment; further monetary easing would be helpful too.
- o Japan has the capacity for such policy action: although the general government budget will remain in deficit this year and next due to cyclically-related factors, Japan's fiscal profile is still very strong compared with the rest of the G-7.

Economic Prospects

Although several more months of data will be needed to make a definitive pronouncement, the Japanese economy does appear to have reached the bottom of the current cycle. The most telling improvements are found in measures of business confidence and corporate conditions (confirmed by the BOJ's May Tankan), measures of consumer sentiment, leading employment indicators (overtime hours and part-time hires), housing investment, personal consumption, money supply growth, and industrial production. Some analysts are quick to point out that straight-line improvement is not necessarily implied by these positive developments, and that a mixed picture still presents in terms of an uncertain longer term employment outlook, continued stock adjustment in the corporate sector, private capital spending, and a continued decline in wholesale prices. To be sure, the recovery at best will be a weak and protracted one, and the economy remains at risk from such factors as renewed appreciation of the yen and heightened political turmoil.

Real GDP is expected to grow by 0.5% in calendar 1994, but by 1.0% in the fiscal year beginning last April 1 and 1.6% in calendar 1995, attesting to the expectation of stronger activity later in the current fiscal year. Growth will be led by private demand, spreading from housing investment to personal consumption and finally to business investment. Consumer price inflation will edge down from 1993's 1.3% to the 1% range. The general government budget deficit will rise, from 0.2% of GDP in 1993 to 1.4% this year, but will recover to 0.2% in 1995. About one-half of this deterioration reflects discretionary policy action (tax cuts and public investment); a cyclically-related strain on

revenues is another contributing factor. Some external adjustment is expected, with the current account falling slightly in 1994 (\$128 billion) and more so in 1995 (\$123 billion), but relative to GDP, (2.8% and 2.6%, respectively), it will remain substantial.

Policy Stance

With the exception of the FY1994 tax rebate enacted in March, Japan's fiscal policy could be characterized as passive in recent months, with funds from earlier stimulus packages supporting demand in the current fiscal year. The FY1994 regular budget had been held hostage to political wrangling in the Diet, but managed to clear the Lower House on June 8, 1994; thus, it will become law in 30 days, regardless of action in the Upper House.

With respect to overall tax reform, the Government Tax Council, an advisory body to the Prime Minister, is expected to submit recommendations in late June, probably only laying out the basic direction of overall tax reform -- entailing a permanent extension of the present ¥5.5 trillion cut in individual income taxes and an offsetting increase in the consumption tax at some later date -- but leaving the key decisions about specifics in the political arena. Focus is also building on the deregulation and administrative reform package to be announced in late June, as lists of possible measures and improvements from a variety of institutions begin to surface.

Monetary policy appears to be reaching the bottom of the current cycle of easing, with the official discount rate (ODR) at an historic low of 1.75% and short-term market rates around 2%. Some weeks ago, Governor Mieno had publicly hinted that the central bank's recent efforts to prop up the U.S. dollar (via concerted intervention) had the primary objective of propping what he perceived to be a still-fragile Japanese economy. The BOJ has been guiding the key overnight call rate to record lows through ample funding operations in recent weeks. Most recently, however, Mieno's comments have taken on a more hopeful and positive tenor, suggesting that there is no immediate prospect of another cut in the ODR. Such a reduction is probably seen as an option only if the recovery does not take firm root by the latter half of the current fiscal year.

Policy Judgment

The Japanese have not gone far enough to stimulate their economy in a way which will bring about a meaningful reduction of the current account surplus, despite a relatively strong fiscal position. It is true that the series of fiscal stimulus packages has helped to offset weak private demand, but the level of

spending has not been sufficient to restore strong growth in overall domestic demand, and a withdrawal of stimulus from public demand is expected after the current fiscal year. As a result, Japan's economy will still be operating well below potential in 1995, with continued high current account surpluses.

Consequently, in the area of fiscal policy, the overall stance should be to provide more substantial and sustained stimulus, on both the tax and expenditure sides. This would include an income tax cut large enough to provide, and structured to ensure, a substantial boost to real after-tax incomes and consumption. Implemented in the larger context of tax reform, this reduction should not be offset or removed until strong growth in domestic demand has been convincingly restored. While an increase in the 10-year public investment plan's target, expected to be announced at the end of this month, would be welcome, this too would have to be substantial. Given the relatively rapid growth in annual public investment spending during the initial years of the plan, the total target would have to be increased by a very large margin for there to be meaningful annual investment growth for the remainder of the plan -- specifically, an increase to at least ¥580 trillion would be needed to keep the ratio of public investment to GNP from falling.

In the area of monetary policy, another reduction in the ODR and continued reductions in the major interbank interest rates would further encourage a recovery, as well as help address the problem of illiquidity in the financial sector. Nevertheless, substantial and sustained fiscal stimulus would be of more overall benefit to the economy.

Continued and more drastic deregulation will be needed to allow the positive aspects of the stronger yen to benefit the consumer and the economy, to improve domestic absorption of savings, and to open the Japanese market to cheaper imports.

Treasury/IMI: Kathleen M.P. Byrne
6/20/94

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JAPAN
KEY ECONOMIC INDICATORS

	<u>1991</u>		<u>1992</u>		<u>1993¹</u>		<u>1994²</u>		<u>1995³</u>	
	<u>y/y</u>	<u>4/4</u>	<u>y/y</u>	<u>4/4</u>	<u>y/y</u>	<u>4/4</u>	<u>y/y</u>	<u>4/4</u>	<u>y/y</u>	<u>4/4</u>
<u>REAL GDP</u>										
CY	4.3	3.5	1.1	-0.3	0.1	0.0	0.5	1.4	1.6	2.1
<u>Unemployment Rate (%)</u>	2.1		2.2		2.5		2.9		2.8	
<u>CPI (%Change)</u>	3.3	2.8	1.6	1.0	1.3	1.1	1.0	1.3	1.2	1.3
<u>BOP (\$BIL.)</u>										
Cur. Acct. Bal.	72.9		117.6		131.4		128.1		122.8	
Cur. Acct. %/GDP	2.2		3.2		3.1		2.8		2.6	
<u>EXCHANGE RATE</u>										
Yen/\$ Nominal	134.6		126.8		111.75		101.94(6/20)		N.A.	
Real Trade-weighted	4.2%		2.5%		11.9%		N.A.		N.A.	
<u>FISCAL BAL %/GDP⁴</u>										
Gen. Govt.	2.9		1.8		-0.2		-1.4		-0.2	
Structural Balance	2.5		0.9		0.8		1.0		1.2	
<u>MONETARY</u>										
M1 (% chg)	5.2		4.5		3.0		4.9		5.4	
M2+CDs (% chg)	3.6		0.6		1.1		2.1		3.0	
<u>INTEREST RATES (end/yr)</u>										
90-day Gensaki	6.1		3.7		1.7		1.84 (6/15)		N.A.	
10 yr JGB	5.8		4.7		3.2		4.23 (6/15)		N.A.	
Real 90 day Rate	3.3		2.7		0.7		0.84 (6/15)		N.A.	
Real 10 year Rate	3.1		3.7		2.2		3.23 (6/15)		N.A.	

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¹ Treasury Estimates

² Treasury Forecasts

³ Treasury Forecasts

⁴ All levels of government plus social security balances (Financial Attache), and estimates of cyclically-adjusted general government balances (OECD)

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GERMANY: ECONOMIC OUTLOOK

Overview

- o Latest projections are for a weak 1994 recovery, with growth in 1.5% to 2% range for all Germany, and up to 2.7% next year. This expansion will be too small to lower unemployment in 1994 (8.3% rate (west) in May). Uncertainties are whether strong export growth can continue and whether saving rate will decline further to sustain consumption.
- o 1Q94 western growth came in at +2.2% saar, regarded as unsustainable by most forecasters. Exports and construction were main positive factors, the latter helped by good weather. Real consumption was stable, by virtue of a substantial (and probably aberrant) fall in the saving rate.
- o Inflation continues to fall, while monetary growth (M3) continues to be well above target levels.
- o Bundesbank continues to cut its primary money market guidance rate (the "repo" rate). There remains the possibility that it will cut discount/Lombard rates again before the late August recess (far enough ahead of the mid-October elections to avoid being seen as acting politically). However, Bundesbank Council hardliners may succeed in deferring any action until after the July Economic Summit, when more 2Q94 data will be available.
- o Long rates have been rising since early January low; less than in US but still +160 basis points to June 17, on 10 year government bond. Yield curve now positive.

Economic Prospects

In 1994 we see all-German GDP rising 1.6% (1.2% in the west). The German research institutes jointly forecast 1.5% growth, while the OECD's recent forecast expects 1.8%. Two major German banks, Deutsche and Dresdner, also have turned more bullish on the 1994 outlook. Both expect around 2% growth for all-Germany this year. In mid-June the Bundesbank said that "the recessionary tendencies in the west German economy appear to have been overcome", a view also expressed by IFO, a leading research institute, which now agrees with the government's early expressed

optimism that all-German growth would be 1-1.5% growth in 1994 year. In the west, increased output, largely for exports, is the expected main component of growth, together with slight increases in investment in both construction and equipment. Despite the strength of private consumption recorded in 1Q94 -- attributed to a reduction in the savings rate -- declining real wages and fiscal stringency are expected to keep private and public consumption weak for the year as a whole. East German GDP is forecast to grow 7.5% in 1994. While this growth has resulted in greatly improved public infrastructure, housing and new productive investment, it has been financed largely by official financial flows and investment incentives, rather than from internally generated funds.

Reflecting both the weak economy and ongoing industrial restructuring, west German unemployment rose sharply last year, and is forecast to rise further to an 8.5% average rate in 1994. In the east, 1994 recorded unemployment is forecast to average 15.7%. Including hidden unemployment, the rate is expected to remain about 30%, as job losses due to economic restructuring continue to exceed the employment opportunities created by new investment. This year Treasury sees an average all-German inflation rate of 2.8%. In the east inflation has declined sharply (3.4% rate yr/yr in May), as price levels converge.

Policy Stance

The Government is expected to release shortly its draft FY95 budget. Even though the momentum in this election year has shifted towards Chancellor Kohl in his campaign to be reelected for the third time on October 16, the budget is not expected to relax the current restrictive fiscal policy stance. Despite the economic recession, the government has initiated and proposes to continue its policy of expenditure reduction and revenue increases, including a 7.5% income tax increase in January 1995, all aimed at reducing the public sector deficit, which under the burden of reunification's immense financial costs leaped from nil in 1989 to over 6% of GDP in 1994. While this fiscal policy stance has been pro-cyclical, it is generally accepted that the government has no alternative. The Bundesbank had clearly enunciated its view that fiscal "consolidation" was one of its key requirements for monetary easing. Also, the government feels that it has to move towards meeting Maastricht requirements in order to maintain its credibility as the primary proponent of "sound" policies within the EU.

The Bundesbank, motivated as much by exchange rate concerns as purely domestic considerations, accelerated the pace of monetary relaxation during 2Q94. With lower inflation and low wage increases this year, the Bundesbank has, for the moment at

least, set aside its concerns about above target monetary growth. Since peaking in mid-July 1992, official interest rates have been cut (eleven times) to the lowest levels since 1989. This will boost business sentiment and encourage industrial investment.

Germany's small current account deficit (about 1% of GDP), is forecast to decline in 1994. Over time, Germany's competitive position, which has been eroded by large increases in already high labor costs, excessive government regulation and other structural rigidities that inhibit efficient utilization of labor, will improve through industry and government initiatives to lower labor costs and remove these impediments. This will contribute to the health of Germany's export industries and improve Germany's investment climate, compared to that in other countries. This improvement is crucial both to industrial restructuring and to future growth, particularly in east Germany.

Policy Judgment

In its latest assessment, the OECD is very circumspect in stating the case for further relaxation of German monetary policy. Calling for a "pragmatic approach to monetary targeting, taking into account a wide range of indicators", the OECD is saying, correctly, don't pay too much attention to M3 at least for the present. However, the OECD is too cautious in its hedged recommendation of further interest rate reductions.

There is a danger that strong 1994 GDP growth will cause German monetary policy makers to declare victory and to assert that economic growth in 1994-95 will be satisfactory without further interest rate reductions. In fact, conservatives on the Bundesbank Council have already publicly espoused this view, arguing that while M3 growth remains above target, further easing only sets the stage for reigniting inflation at a future date. With German capacity utilization barely above its cyclical low, unemployment continuing at very high levels and inflation continuing to fall, the case for further monetary easing continues to be strong.

Treasury/IMI:Oscar M. MACKOUR 6/20/94

GERMANY
KEY ECONOMIC INDICATORS

	<u>1992</u>		<u>1993</u>		<u>1994F</u>		<u>1995F</u>	
	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>
<u>REAL GDP</u>								
West	1.6%	0.0%	-1.9%	-0.8%	1.2%	2.1%	2.2%	2.8%
East	9.7%		7.1%		7.5%		8.5%	
All	2.1%		-1.2%		1.6%		2.7%	
Savings/GDP	21.9% ¹		20.7% ¹		21.8% ¹		22.0% ¹	
Investment/GDP	23.2%		22.7% ¹		23.1% ¹		23.4% ¹	
Unemployment Rate	7.7%		8.9%		9.9%		10.0%	
<u>CPI</u>								
West	4.0%	3.7%	4.2%	3.7%	2.8%	2.5%	2.5%	2.6%
East	11.2%		8.8%		3.9%		3.2%	
All	4.5%		4.6%		2.9%		2.6%	
<u>BOP (\$ bils)</u>								
Current Acct	-22.0		-21.3		-14.9		-7.8	
Current Acct/GDP	-1.1%		-1.1%		-0.8%		-0.4%	
<u>EXCHANGE RATE</u>								
DM/\$ Nominal	1.56		1.65		1.63 ²		N.A.	
Real Trade-Weighted	2.8%		0.5%		N.A.		N.A.	
<u>FISCAL BALANCE(%GDP)</u>								
Central gov't	-1.7%		-2.2%		-2.3%		-2.5%	
General gov't ³	-2.6%		-3.3%		-3.4%		-3.0%	
Structural bal. ⁴	-4.5%		-3.7%		-2.3%		-1.4%	
<u>MONETARY GROWTH (yr. end)</u>								
M1	10.8%		8.4%		N.A.		N.A.	
M3	7.6%		8.8%		N.A.		N.A.	
<u>INTEREST RATES (Dec avg)</u>								
90-day	7.8%		6.0%		5.0% ²		N.A.	
10 yr. gov't bond	7.1%		5.6%		7.2% ²		N.A.	
Real 90-day	4.1%		2.4%		2.1% ²		N.A.	
Real 10 yr.	3.4%		2.0%		4.3% ²		N.A.	

F is Treasury forecast 6/94.

¹IMF Forecast, 12/93 and 4/94.

²As of June 17, 1994

³Nat'l Income Accts. basis -- includes Social Security

⁴OECD estimate of general gov't balance with output at trend level.

FRANCE: ECONOMIC OUTLOOK

Overview

- o The two major problems currently facing the GOF are high unemployment and the budget deficit. Facing a presidential election in May 1994 after only one year in power, the Balladur government's fiscal strategy is clear -- reduce the budget deficit in the long run primarily by increasing taxes and reducing spending, but offset the immediate restrictive effect with temporary stimulus measures.
- o The initiatives to relieve unemployment and increase household spending are unlikely to increase the deficit in 1994, but only because the GOF expects to reap about FF20 billion from privatization revenues (which lower the deficit but do not represent fiscal tightening). However, meeting its target of a central gov't. deficit of 3.5% of GDP in 1995 will be difficult, despite stronger growth forecasts for 1994 and 1995.

Economic Prospects

Treasury estimates that GDP will increase 1.8% this year, following France's worst economic performance in 30 years in 1993 when the economy contracted 0.9%. Increased industrial production, buoyant export demand from the recovering U.S. and UK economies, and strong household consumption contribute to the upgraded forecast.

Despite higher growth, the inflation rate (1.7% in May y/y) will remain subdued. An increasing rate of unemployment (12.3% rate in April) will continue to limit wage increases, which currently measure less than 1% per year.

The focus on the "franc fort" policy of ERM stability has contributed to the worsening of the GOF's fiscal position and further departure from the Maastricht conversion criteria. However, now that the worst seems to be over for the French economy, any change in monetary policy in the near future is unlikely. Monetary policy will continue to be made in Frankfurt, as the newly independent monetary policy council of the Bank of France continues to shadow the Bundesbank's rate reductions, as demonstrated most recently by the 10 basis point cut in the official short-term call rate to 5.2% on June 16, the ninth cut since January.

PM Balladur has promised reduction in the budget deficit, now estimated to measure 5.3% of GDP in 1994, down from 5.8% in 1993. A weak economy and numerous retreats in the form of

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subsidies to fishermen, private schools, and businesses who employ graduating youth workers have not boosted decisive deficit-fighting measures. However, the government has promised progressive deficit reduction starting this year through increased social security taxes, spending cuts, and privatization revenues, the latter conveniently reducing deficits without withdrawing fiscal stimulus. In the meantime, a modest stimulus package of tax cuts and stimulus measures announced in January has been extended. The package aims to boost household consumption and the automobile and construction industries. These growth initiatives are unlikely to provide significant boost to the economy.

Policy Judgment

Much remains to be done on the structural side to combat unemployment. The high costs of labor (because of high social insurance charges and high minimum wages), generous unemployment benefits, and the mismatch of job skills to the education system limit improvement in this area of reform. While the government has promised to reduce unemployment through public spending, job training, and by reducing the cost to employers of hiring first-time workers through subsidies, recent policy retreats in this area are not encouraging for prospects for further reform.

GOF policymakers may see the highest costs of FF/DM linkage as having already been paid. Unless the franc is forced out of the ERM, the GOF will have little freedom to use monetary policy to stimulate growth. Meanwhile, the GOF remains cautious about too much deliberate fiscal action to stimulate its economy. Any expenditure growth will be kept at moderate levels.

France would welcome collective actions to strengthen and accelerate the easing of interest rates, but will resist any unilateral easing of its monetary policy.

Of the largest economies in Europe excluding Germany (France, Italy, UK, and Spain), only France remains pegged to the DM. France stands to gain the most from a joint reduction in European interest rates. Furthermore, stimulus actions could be undertaken with little risk of a resurgence in inflation. Although somewhat stronger growth seems on the horizon, the GOF's current monetary policy continues to restrain rather than bolster the current trend.

OASIA/IMI/Susan Rzemien 6/20/94

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FRANCE

KEY ECONOMIC INDICATORS

	<u>1992</u>		<u>1993F</u>		<u>1994F</u>		<u>1995F</u>	
	<u>y/y</u>	<u>4/4</u>	<u>y/y</u>	<u>4/4</u>	<u>y/y</u>	<u>4/4</u>	<u>y/y</u>	<u>4/4</u>
<u>Real GDP (% Change)</u>	1.2	0.2	-0.9	-0.3	1.8	2.6	2.8	2.8
Savings/GDP (%)	20.9		20.7		20.8			
Investment/GDP (%)	21.8		21.4		21.6			
Unemployment Rate (%)	10.4		11.7		12.2		11.9	
<u>CPI (% Change)</u>	2.3	1.8	2.1	2.2	1.7	1.7	1.9	2.0
<u>BOP (\$BIL.)</u>								
Cur. Acct. bal.	4.0		10.5		13.2		10.0	
Cur. Acct. %/GDP	0.3		0.8		1.0		0.7	
<u>Exchange Rate</u>								
Franc/\$ Nominal	5.3		5.7		5.7		5.7	
Real Trade Weighted	+4.1%							
<u>FISCAL BAL/GDP</u>								
Cent. Govt.	-3.2		-4.5		-4.2		-3.9	
Gen. Govt.	-3.9		-5.8		-5.3		-4.5	
Structural Balance ¹ (cyclically adjusted)	-2.8		-3.2		-2.4		-2.3	
<u>MONETARY²</u>								
M1 (%Chg)	-0.1		1.3		N.A.		N.A.	
M3 (%Chg)	5.5		-1.6		N.A.		N.A.	
<u>Interest Rates</u>								
Interbank (3 month)	10.42		6.56		5.6 ³		4.4	
Govt Bond (7-10 yr.)	8.63		5.70		6.7 ⁴			
Real Interbank	8.02		4.36					
Real Govt. Bond	6.23		3.50					

F = U.S. Treasury Forecast 1994-1995

Treasury/IME: Susan Rasmussen
6/17/94

¹OECD estimate of general gov't. balance with output at potential level.

² 1993 is December y/y rate

³As of June 4, 1994.

⁴As of June 4, 1994.

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ITALY: ECONOMIC OUTLOOK

Overview

- o Now that Italy is emerging from recession, the key economic question for the country is whether the new government will continue the process of fiscal consolidation begun over the past two years under Prime Ministers Ciampi and Amato.
- o Prime Minister Berlusconi has pledged to continue the fiscal austerity program. His campaign rhetoric and some of the measures his government has proposed call his commitment to fiscal restraint into question, however.
- o The other key issues for the new government are unemployment and privatization.

Economic Prospects

The Italian economy is emerging from recession as domestic demand has begun to recover and the lira's depreciation following the 1992 ERM crisis has boosted net exports. Treasury forecasts economic growth of 1.4% this year and 2.4% next year, in line with most other forecasts. The elimination of wage indexation has helped to restrain inflation, which fell to a 4.2% rate last year, its lowest level in more than 20 years, despite the lira's 20% decline against the DM. Treasury forecasts a further decline in inflation to 3.9% this year and to 3.4% in 1995. The unemployment rate is expected to level off over the next two years at 11%, about where it was in Q4-93. The 11% national rate masks sharp differences between northern Italy, where unemployment is in the 6-8% range, and southern Italy, where the average rate is about 18-20% and even higher in some regions. Italy's improved competitiveness following the lira's decline leaves the country positioned for a period of sustained growth, if the Berlusconi Government and its successors continue the Ciampi reforms.

Policy Stance

Fiscal Policy: Although the government sector budget deficit declined only from 10.2% of GDP to 9.9% of GDP between 1991 and 1993, the recession masked a significant strengthening of Italy's underlying public finances. The OECD estimates that, abstracting from cyclical factors, the structural budget deficit declined by 2½% of GDP over the two-year period, and is projected to fall by another 1¼% of GDP this year.

Berlusconi promises to continue the Ciampi and Amato Governments' fiscal austerity, although his campaign's economic program consisted primarily of tax cuts and fiscal incentives. His recent policy actions have mirrored his campaign rhetoric on fiscal policy. His government's program calls for social security tax rebates for firms hiring new workers and additional tax incentives

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for youth hires in an effort to reduce unemployment. He also proposes investment tax credits targeted at small and medium sized firms and unfreezing public work programs put on hold by the anti-corruption investigations. Berlusconi has often pledged that these tax incentives and increased public works expenditures would be balanced by unspecified spending reductions and increased government efficiency. No fiscal offsets were included, however, when his Government formally submitted the measures to Parliament.

Unemployment/Labor Market Reforms. In addition to the fiscal incentives for job creation, the Berlusconi Government has proposed a series of measures aimed at increasing firms' hiring freedom. The government proposals would increase firms' flexibility in hiring temporary and part-time workers. The Government also proposed allowing firms to offer an "admission wage," below the industry-wide wage levels set in collective bargaining agreements.

The proposals are as important for what they exclude as for what they cover. They would not eliminate the requirement that firms hire all permanent workers through the local government employment agencies, who exercise veto power over firms hiring decisions. The proposals also include no measures that would increase firms' ability to dismiss permanent workers, the main disincentive to new hires. The proposals also would not eliminate or curtail the system of national wage contracts, which make no allowance for lower productivity and living costs in the south. This eliminates any incentive to locate plants in the south rather than the north, contributing to continued high unemployment and lower living standards in southern Italy. Organized labor opposed even these limited reform proposals, forcing the government to delay their submission to Parliament.

Privatization. Italy's privatization program is now well established, with the sale of three large banks this year following the sale of a number of smaller firms last year. Berlusconi has pledged to accelerate the Ciampi Government's privatization timetable, with sales of the state insurance, telecommunications, and electric companies scheduled for later this year.

Policy Judgment

It is not yet clear whether Prime Minister Berlusconi fully understands the need to reduce Italy's fiscal deficit. No independent analysis has yet been done to determine the overall impact of his recent fiscal proposals. If these and subsequent measures are perceived as increasing the size of the deficit, financial markets' increased confidence in Italy's economic policies, built up over the past two years, may evaporate. Treasury Minister Dini has asserted that the net fiscal impact of the recent measures will be limited. Dini appears to realize that Italy has no choice but to continue the process of fiscal consolidation. He has promised to hold the growth of government spending below the inflation rate. If he succeeds, this would put Italy's public finances on a sound footing, creating a solid basis for sustained, stable economic growth.

UNITED KINGDOM: ECONOMIC OUTLOOK

Overview

- o With recovery underway following the long recession, the principal economic problem now facing British policy officials is how to sustain recovery without reigniting inflation or escalating the already high budget deficit which Treasury forecasts to amount to 6.1% of GDP in 1994.
- o The UK recovery has relied largely on consumer spending. April's tax increases, while necessary to get the budget deficit under control, risk a reduction in consumer spending that could endanger the recovery.
- o More than just a moderate increase in inflation (already discounted) could be around the corner. A doubling of public sector pay increases despite last year's pledge for a freeze has caused average earnings growth to pick up by one percentage point (4% in April vs. 3% (y/y) in 1993). This development, along with accelerating monetary growth, indirect tax increases, and the UK's historically poor inflation performance, could lead to a resurgence of price pressure.

Economic Prospects

With private consumption driving the recovery, the UK economy grew 1.9% in 1993, the highest growth among the European G-7, albeit low for a recovery year. It will continue to be Europe's bright spot, as preliminary estimates of Q1 1994 GDP show a growth rate of 2.6% (y/y/saar). Treasury predicts growth of 2.7% in 1994, other estimates for which are being reportedly revised upward.

Unemployment, although declining, remains high at 9.4%, or 2.7 million, (but at a lower rate than in France, Italy, and Canada).

Retail price inflation (RPI) remained below 2% for all of 1993, the best inflation performance in 30 years. Most of the improvement is genuine, but the reduction has been exaggerated by the decline in mortgage interest rates and cuts in taxes included in the RPI.

The current account deficit, estimated at \$16.4 billion or 1.7% of GDP in 1993, remains at higher levels than should be the case with a still weak economy. Even a modest recovery could expand external deficits to untenable levels. Weak markets in

Europe and a corporate tendency to increase profits rather than market share (by raising sterling export prices) are minimizing the positive effects of the pound's depreciation.

Withdrawal of the pound from the Exchange Rate Mechanism (ERM) in September 1992 has allowed substantial monetary easing, with official short-term interest rates falling from 10% before the first ERM crisis to their current level of 5.25%, with the last cut announced in February. However, HMG has been reluctant to reduce interest rates as much as it would like for domestic policy reasons. It would do so, if German and other European rates were to continue downward. Any further decline in rates would support a much-needed recovery in housing and business investment.

Fiscal policy was expansionary through 1993. But Chancellor Clarke announced measures to be put in place in 1994 to decrease the deficit at a more rapid pace than previously forecast. HMG aims to bring the budget deficit into balance by FY 1998-99.

Policy Judgment

While recent economic developments indicate stronger near-term growth prospects, the outlook for the UK's trading partners on the continent is still not strong. Further interest rate cuts to stimulate the domestic economy would be beneficial. Nominal long-term rates in the UK have increased 221 basis points since the Fed hiked rates in February, the highest increase among the G-7. While gilt yields have uncoupled from U.S. bond yields since the Fed's most recent cuts, real long-term rates are still much higher than in the 1960's. These rates are not appropriate for an economy well below capacity limits. The recovery remains checked by low house prices (the UK owner-occupancy rate is 70%), high household debt and April's large tax hikes.

The OECD estimates that the shift in the UK structural fiscal balance (general government) in 1993 was by far the most stimulative among the G-7. It estimates that the structural deficit next year would be second largest among the G-7, second only to Italy. Chancellor Clarke's tax increases, in addition to those announced in March 1993 by his predecessor, Norman Lamont, were put in place in April 1994 to reduce the deficit. A lower budget deficit should also facilitate further reductions in long-term interest rates. However, further monitoring of the budget deficit is needed to ensure fiscal sustainability. Given that HMG's consolidation efforts may be a drag on demand, the present and future monetary policy conditions should be aimed at targeting these contractionary forces. However, the signs of increasing wage pressures implies that the next monetary adjustment will have to be carefully considered.

Treasury/IMI: Susan Rzemien
6/20/94

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U.K.

KEY ECONOMIC INDICATORS

	<u>1992</u>		<u>1993</u>		<u>1994^F</u>		<u>1995^F</u>	
	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>
<u>Real GDP</u>								
<u>(% Change, y/y)</u>	-0.6	-0.1	1.9	2.4	2.7	2.9	2.5	2.0
Invstmt/GDP (%)	15.4%		15.1%		15.4%			
Savings/GDP (%)	13.5%		12.3%		12.8%			
<u>Unemployment Rate</u>	9.8		10.4		9.6		8.9	
<u>CPI (% Change)</u>	3.7	3.0	1.6	1.6	2.8	3.1	3.5	3.8
(Includes mortgage interest)								
<u>BOP (\$BIL.)</u>								
Curr. Acct.	-1.6		-16.4		-12.6		-13.8	
Curr. Acct./%GDP	-1.7		-1.7		-1.3		-1.1	
<u>Exchange Rates</u>								
\$/Sterling	1.77		1.50		1.50		1.50	
Real Trade-weighted	-3.6		-8.7					
<u>FISCAL BAL/GDP</u>								
Central Govt.	-6.9		-7.7		-6.2		-5.0	
General Govt.	-6.4		-7.7		-6.1		-4.9	
Structural Bal. ²	-3.5		-5.0		-4.4		-3.9	
<u>MONETARY</u>								
MO (% Change)	2.5		5.4		6.0		6.0	
M4 (% Change)	5.5		4.4		4.5		4.5	
3M. Int. Rate	7.0		5.1 ¹		5.3		5.8	
LT Int. Rate	8.9		8.5 ¹		8.0		8.5	
Real 3M. Int. Rate	3.5		3.5		2.5		2.3	
Real LT Int. Rate	5.4		5.3		5.2		5.0	

F = U.S. Treasury Forecast, 1994-1995

¹ As of June 10, 1994.

² OECD estimate of general gov't. balance with output at potential level.

Treasury/IMI: Susan Rzemien

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CANADA: ECONOMIC OUTLOOK

Overview

- o Canadian interest rates and the Canadian dollar have taken a beating this spring. Much of this was in reaction to the tighter monetary policy being implemented by the U.S. Federal Reserve. Political uncertainty about the future of Quebec, a high level of outstanding debt and limited progress on curbing the fiscal deficit have contributed to the market's volatility.
- o Real GDP grew at an annualized rate of 4.4% in the first quarter this year. Growth was led by a significant increase in consumer spending.
- o In general, the economic recovery has been modest, 2.2% real GDP growth in 1993 and 3.1% growth forecast by Treasury for this year, with a limited impact on the rate of unemployment which still remains at about 11%.
- o The IMF estimates that the output gap at the end of 1993 was 5% of potential GDP.

Economic Prospects

Canada's recovery has been powered largely by exports, particularly to the U.S.; residential construction; and strong business investment. The current account deficit narrowed 12% in the first quarter from the previous quarter mainly because of increased travel expenditures in Canada at the same time Canadians were curbing their travel abroad. The deficit is expected to continue to shrink as exports respond to economic growth in the United States and a weaker Canadian dollar. Increased borrowing abroad and higher interest rates will continue to keep the services balance negative despite the drop in Canadian travel abroad that resulted from the depreciated Canadian dollar.

Upcoming elections in Quebec are expected to result in a victory for the separatist Parti Québécois (PQ). The PQ has promised to hold a referendum on sovereignty in 1995. In the past, markets have reacted negatively in advance of events increasing constitutional uncertainty, with a rally near the date of the event and up to a quarter after when the markets usually returned to their underlying trends. Higher interest rates are to be expected as the elections approach this fall, slowing economic growth.

The inflation rate has reached a record low, 1.8% in 1993 and 0.7% forecast by Treasury for this year. Much of this year's decline in the rate was due to the sharp reduction in tobacco excise taxes in February (a reaction to smuggling from the United States). Increases in the prices of imported goods have not been passed on to any significant degree because of restrained domestic growth and strong competitive pressures at the retail level.

The Bank of Canada and the Department of Finance have continued to set the target range for inflation at 1 to 3%. With low underlying inflation, the BOC has been pursuing a policy to reduce interest rates gradually, but has been undercut by recent market volatility.

Policy Stance

Finance Minister Martin has reiterated the Liberals' campaign pledge to reduce the deficit/GDP ratio to 3% in three years but it is still not clear how they intend to do this. Despite such measures as a 2% cut in foreign assistance and an extension of the current government salary freeze, the deficit for FY1994-95 will not be significantly reduced, it is projected to be C\$39.7 billion (5% of GDP). Most changes in the budget appear to await the outcome of a number of proposed task force studies.

Canada's recent high unemployment rates are the result of both cyclical and structural problems in the economy. The minimum rate of unemployment consistent with low inflation is believed to be 8 - 8.5% compared with 5.5 - 6.0% in the United States. The persistence of unusually high regional unemployment rates, particularly in the Atlantic provinces, points to the need to improve labor mobility. Unemployment insurance that is more generous in high unemployment areas, plus benefits to seasonal fisheries workers and fishermen, provides additional disincentives for labor migration.

Treasury/IMI: Barbara E. Holloway
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CANADA
KEY ECONOMIC INDICATORS

	<u>1991</u>		<u>1992</u>		<u>1993</u>		<u>1994^f</u>		<u>1995^f</u>	
	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>	<u>y/y</u>	<u>4Q/4Q</u>
<u>REAL GDP</u>	-1.7%	-0.2%	0.7%	0.5%	2.2%	3.2%	3.1%	3.0%	3.1%	3.3%
Saving/GDP	15.2%		14.5%		14.8%		NA		NA	
Investment/GDP	19.5%		18.9%		18.3%		18.8%		19.2%	
Unemployment Rate	10.3%		11.3%		11.2%		10.9%		10.9%	
<u>CPI</u>	5.6%	4.1%	1.5%	1.8%	1.8%	1.8%	0.6%	0.7%	2.1%	2.2%
<u>BOP (\$BIL.)</u>										
Current Acct. Bal.	-25.3		-21.9		-23.8		-20.2		-19.6	
Current Acct./GDP	-4.3%		-3.8%		-4.3%		-3.7%		-3.6%	
<u>Exchange Rate</u>										
CS/US\$ Nominal	0.87		0.83		0.78		0.73		0.72	
Real Trade-Weighted	-2.5%		-6.4%		-3.2%		NA		NA	
<u>FISCAL BAL %/GDP</u>										
Fed. Govt. ¹	-4.5%		-3.7%		-4.0%		-3.4%		-3.0%	
Gen. Govt. ¹	-6.3%		-6.6%		-6.5%		-5.8%		-4.9%	
Structural Balance ³	-4.1%		-3.5%		-3.4%		-3.3%		-2.6%	
<u>MONETARY GROWTH (yr. end)</u>										
M2	+10.6%		+5.5%		+3.5%		NA		NA	
<u>Interest Rates (End-Dec.)</u>										
90-day	7.55%		7.05%		4.00%		6.50% ²		4.5% ⁴	
10 yr Govt Bond	8.46%		7.91%		6.57%		9.04% ²		6.4% ⁴	
Real 90-day	1.95%		5.55%		2.20%		5.40%		2.4%	
Real 10 year	2.86%		6.41%		4.77%		7.61%		4.3%	

^f Treasury forecast except where noted.

¹ NIA Basis - Including Social Security.

² June 17, 1994.

³ IMF estimate of general government balance with output level at potential level.

⁴ IMF forecast.

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URUGUAY ROUND IMPLEMENTATION

U.S. Objectives

- o Stress U.S. commitment to 1994 passage of the Uruguay Round implementing legislation.
- o Urge countries to take the necessary steps to implement the Uruguay Round as soon as possible.

Background

The Uruguay Round agreements created the World Trade Organization (WTO) to replace the GATT. The Agreement establishing the WTO encompassed the current GATT structure and extends it to new disciplines. We do not expect that the new organization will be different in character from that of the existing GATT and its secretariat.

In Marrakesh, Ministers agreed on the desirability of the WTO entering into force January 1, 1995. The WTO will not enter into force, however, until a "critical mass" of countries are ready to join the organization. It is generally understood that this critical mass includes the U.S., EU and Japan. The U.S. is committed to seeking approval for the Uruguay Round in 1994. Other countries need to make similar efforts in order for the organization to come into effect as soon as possible.

Principle issues which require resolution in order for the USG to gain Congressional approval of the Uruguay Round agreements include Pay-Go, extension of fast-track authority and timing.

Other G-7 Positions

- o OECD Ministers have publicly endorsed the January 1, 1995 target date.
- o Canada expects to introduce legislation to Parliament before the summer recess, with the aim of passage in the early fall session.

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THE WORLD TRADE ORGANIZATION (WTO) - INSTITUTIONAL ISSUES

U.S. Objectives

- o Seek to appoint the best qualified candidate as the next WTO Director General, without linkage to the EU high-level jobs reshuffle or the OECD Secretary General position.
- o Assess the views of members on the WTO site.

Site for the WTO: Germany and Switzerland have made generous offers to host the WTO.

New WTO Director General: GATT Director General Peter Sutherland (Ireland) intends to step down before the WTO comes into effect. The WTO will need a strong, energetic head capable of overseeing the WTO's expanded mandate and ready to work constructively on new trade issues. The only declared candidates are former Italian Minister of Trade Renato Ruggiero and Brazil's Finance Minister and former GATT Ambassador, Rubens Ricupero.

Unofficial candidates are Mexican President Salinas, former New Zealand Prime Minister Mike Moore, New Zealand Trade Minister Philip Burdon, the Egyptian representative at the GATT, Ambassador Zahran, and former Moroccan Minister of Foreign Commerce, Hassan Abouyoub. Also rumored are EU trade negotiator Leon Brittan (who publicly has disclaimed interest in the post) and EU Industry Commissioner Martin Bangemann.

We would like to see the WTO post de-linked from the OECD position. While the Europeans clearly see the WTO post as an important piece of the upcoming EU jobs-shuffle, we do not see either the WTO or OECD as EU sinecures (former GATT heads have been from Canada and Switzerland). The U.S. strongly supports the candidacy of Canada's Johnston for the OECD.

Other G-7 Positions

Site of the WTO:

- o France has already expressed its preference for Geneva as the WTO site, while other G-7 countries are still developing their positions.

New WTO Director General:

- o The EU's preference will be to have one of its own in the WTO post to help out with high-level EU reshuffling of positions.
- o The Canadians are concerned that a North American candidate for the WTO position will hurt the chances of their candidate, Johnston, for the OECD Secretary General post.

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NEW TRADE ISSUES

U.S. priorities for next generation trade issues are threefold: trade and environment, international labor standards and trade and competition policy.

I. Trade and the Environment:

U.S. Objectives

- o Endorse full and timely examination of trade and environment (T&E) issues in the WTO Committee on Trade and Environment and continued work towards substantive conclusions next year in the OECD Joint Session of Trade and Environment Experts.

Background

The Marrakesh Ministerial adopted, by consensus, a work program on T&E and created a standing Committee on T&E in the WTO with broad terms of reference and a requirement to report on its work to the WTO's General Council two years after the WTO enters into force.

The OECD Joint Session of T&E Experts continues work to develop guidelines on the use of trade measures to protect the environment. Sustantative results are expected for the 1995 Ministerial.

U.S. interagency discussions chaired by NSC have outlined a domestic framework under which environmentally related trade measures should be considered. This overall approach also puts great emphasis on multilateral vs. unilateral solutions.

Other Key Country Positions

G-7 and OECD countries tend to view international environmental agreements and multilaterally agreed standards as the basis on which environment-related trade measures must rest. The U.S. has a number of laws mandating environmentally oriented trade embargoes. While many are based on multilateral standards, several are decried as "unilateralism" by OECD nations. Japan in particular has called for a declaration against "unilateralism or managed trade" in trade matters generally. In discussions with the EU, our framework on the use of trade measures has received a sympathetic hearing.

II. International Labor Standards

U.S. Objectives

- o Underscore our belief in the need for serious global dialogue on the issue of international labor standards, including in the WTO.

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- o Assert our objective of increasing cooperation in this area to foster development and our opposition to using improved labor standards as a form of protectionism.

Background

We were unable to obtain a declaration at Marrakech to formally recognize the relationship between trade and labor standards, but a compromise was reached which will allow the U.S. to raise this issue in the WTO Preparatory Committee.

The U.S. is not seeking to deny the principle of comparative advantage based on lower labor costs in developing countries. We do, however, believe that trade competition based on denial of internationally recognized worker rights is not legitimate. There has been stiff resistance to our proposal from key developing countries, which allege that U.S. intentions are protectionist. The limited support we have from the EU has been hard-won and remains cautious.

Both the OECD Employment, Labor and Social Affairs and Trade Committees have agreed to a joint examination of international labor standards. The Dutch are hosting a workshop on labor standards under OECD auspices in September.

Other Key Country Positions

- o France has been sympathetic. Some in France subscribe to the notion of "social dumping" and seek countervailing tariffs to offset low wage rates in exporting countries.
- o The UK is unwilling to acknowledge that there is a trade-related problem concerning international labor standards. They have asked for an informal OECD meeting in advance of the September meeting in the Netherlands.

III. Trade and Competition Policy:

U.S. Objectives

- o Further our stated goal that "antitrust and other competition policies" should be on the post-Uruguay Round agenda.
- o Find out what others are thinking about the best ways and organizations to discuss competition policy.

Background

Antitrust law and policy are not currently subject to international rules. Aside from some general mechanisms for cooperation developed at the OECD and in a few bilateral agreements, antitrust policy is developed and enforced by individual governments in accordance with national objectives. The EU uses competition law to further EU market integration, while we are principally concerned with consumer welfare. The

trade community sees disciplining of restrictive business practices as becoming increasingly important.

Other Key Country Positions

- o Most countries have expressed their belief that the issue warrants careful analysis.

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IMF RESOURCES

Objectives

- Reach agreement to expand IMF resources available to support intensified reform in Russia, other former USSR states and Eastern Europe (the Economies in Transition, or EITs):
 - o Extend the scope and duration of the IMF Systemic Transformation Facility (STF).
 - o Raise access limits for traditional IMF lending.
 - o Provide "catch-up" allocations of Special Drawing Rights (SDRs) to newer members of the IMF (which will particularly benefit the EITs).
- Confirm that Paris Club creditors are prepared to negotiate a multi-year debt rescheduling with Russia following a stand-by agreement between Russia and the IMF.

Background

Russia has made important progress in stabilizing its economy, with the help of multilateral support. Now Russia must build on its momentum and move towards full stabilization. At the same time, Russia must devote resources to re-knitting its social safety net in order to alleviate the hardships of transition and maintain popular backing for reform. Other former Soviet states face challenges similar to Russia's. In addition, many of them must contend with the loss of financial transfers and subsidized oil exports from Russia at the same time that their traditional trade relations have collapsed.

In view of these extraordinary challenges the United States has proposed that the IMF augment the resources available to support the transition to democratic, market economies. We have also promoted a multi-year debt rescheduling of Paris Club debt for Russia, based on appropriate Russian policies. These initiatives follow on the policy of intensified IMF engagement to support Russian reform advanced by President Clinton during his meeting with President Yeltsin last January.

1. **Expand the special IMF lending program for transition economies.** Last year, at U.S. urging, the IMF created the Systemic Transformation Facility to provide support for initial stabilization in EITs. Russia was eligible to borrow \$3 billion under the STF (50 percent of its quota, in two tranches) and has now drawn this entire amount. Kazakhstan, Kyrgyzstan and Moldova have also drawn both STF tranches. The STF is set to expire at the end of 1994.

We have proposed to extend the duration of the STF beyond 1994 and to raise the amount that eligible countries may borrow.

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Currently, discussion is underway regarding a third STF tranche of 35 percent of quota in connection with an IMF stand-by agreement. This would allow Russia to receive \$2 billion; Ukraine, which is still eligible to draw \$700 million, could then draw another \$500 million; and the total additional amount for all EITs would be over \$5 billion.

2. **Increase access to traditional IMF resources.** Under present guidelines, IMF members may borrow up to a maximum of 68 percent of their IMF quota annually for traditional economic adjustment support. We have proposed to raise the annual maximum to 100%; agreement is likely between 85-100%. This would increase the amounts potentially available by close to \$1 billion for Russia, over \$200 million for Ukraine, and about \$2.5 billion for all the former USSR and Eastern European countries.

3. **Catch-up Allocations of Special Drawing Rights (SDRs) to New Members.** The IMF can issue a special reserve asset, the SDR, to members. The last SDR allocation was in 1981, well before Russia and most other transition economies became IMF members. As a result, these countries face an inequity. Several alternatives for a new allocation to correct this situation are under discussion, which could provide up to \$1 billion for Russia, \$220 million for Ukraine, and about \$2.5 billion for all former USSR and Eastern European countries. Use of the SDR is not conditioned on reform.

Multi-year debt rescheduling. In view of Russia's critical budget and balance of payments positions, Paris Club creditor countries negotiated debt rescheduling agreements with Russia in both 1993 and 1994. However, the need to negotiate rescheduling on an annual basis is burdensome for Russia and by dealing with only one year at a time, does not allow Russia to develop a clear picture of its financial needs over the medium term.

To alleviate this situation, we have proposed that Paris Club creditors agree to reschedule debt payments due over a period of several years. This rescheduling would be contingent on Russia reaching a stand-by agreement with the IMF, which is a standard condition for Paris Club reschedulings. A stand-by agreement could be reached as early as this fall. Other Paris Club creditors have agreed to consider such a rescheduling.

Other G-7 Positions

-- The G-7 has reached consensus to expand IMF resources available to support economic reform in transition economies. Some debate is continuing on the modalities for doing this, but we expect this to be resolved by the time of the Summit.

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-- The G-7 has agreed in principle to consider a multi-year rescheduling agreement on the basis of appropriate IMF-supported programs.

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U.S. BILATERAL ASSISTANCE TO RUSSIA

The United States sees support for economic and political reform in Russia and the other new independent states of the former Soviet Union as one of its highest foreign policy priorities. To demonstrate its commitment to the success of reform in Russia, the United States has committed significant resources to help Russia with the transition to market economies and democratic governance and help, through humanitarian assistance, to alleviate the social costs of the transition. To date, the United States has obligated \$2.4 billion in assistance to Russia: this figure includes funding provided under the auspices of the FREEDOM Support Act, the Department of Agriculture's food commodity programs, and the Defense Department's Nunn-Lugar program.

A major expression of U.S. support for Russia was the Vancouver Assistance Package, which was announced during the Clinton-Yeltsin Summit in April 1993. This \$1.6 billion package included major programs in the areas of economic reforms, including privatization and macroeconomic advisors; democracy programs, such as exchanges, Rule of Law, and Sister Universities; investment support credits and assistance to enable OPIC and Eximbank to help expand U.S. business involvement in Russia and to establish the Russian-American Enterprise Fund; nuclear power reactor safety assistance; and demilitarization assistance to help with weapons dismantlement. U.S. Government agencies were able to fulfill President Clinton's pledge to President Yeltsin that the package would be fully obligated by the end of the calendar year: the exception being the \$2.2 million Export Control Initiative, which was on hold pending agreement with the Russians on a suitable framework. As of the end of the third quarter of fiscal year 1994, expenditures for the Vancouver Package represented 80% of obligations.

The U.S. Government was able to expand the programs offered in the Vancouver Package of Assistance because of Congressional approval of a \$2.5 billion NIS assistance package in September 1993. The U.S. Government plans to provide over \$1.6 billion of these funds to Russia to meet President Clinton's promise at Vancouver for additional support in the key areas of economic and democratic reform, with some limited funding for humanitarian assistance. In addition, President Clinton asked for, and Congress approved, another \$400 million in assistance in 1994 for the dismantlement and safe storage of weapons and defense conversion in Russia, Ukraine, Kazakhstan and Belarus.

Assistance funding for Russia has provided support for many activities in key priority areas such as private sector development, trade and investment, exchanges and training, energy, and environment. Many of these activities were initiated during 1993 and expanded with a significant increase in

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assistance funding for Russia in fiscal year 1994.

- Private Sector Development: Since 1992, the U.S. Government, via USAID, has provided over \$150 million in equipment and technical assistance to the Russian State Property Committee to support its voucher privatization program. By April 1994, the Russian Government had divested from state ownership nearly 100,000 (of some 125,000) small and medium enterprises and 10,000 (of some 20,000) large enterprises. The **Russian-American Enterprise Fund**, which will provide needed capital to small and medium-sized private firms, was established in September 1993 with first funding decisions expected by summer 1994. The U.S. Government established the **Fund for Large Enterprises** with a capitalization of \$100 million in late 1993 to provide capital to large enterprises which had completed the Russian Government's mass privatization program. To facilitate agricultural development, the U.S. established a **Joint Commission** with Russia, which will lend revenues from local sales of donated USDA commodities to rural infrastructure and entrepreneurial projects. The U.S.-Russia Joint Commission will make its first loan by mid-summer.

- Trade and Investment: OPIC has provided nearly \$400 million in financing support and over \$575 million in insurance to facilitate U.S. private sector investment in Russia. Key projects include U.S. West International's telecommunications modernization project, Dresser Industries oil exploration projects in Western Siberia, and Caterpillar involvement in a multinational consortium to produce, sell, and service heavy-duty trucks. **Eximbank** has provided over \$390 million in guarantees for U.S. sales to Russia since fiscal year 1992. Eximbank's Oil and Gas Framework Agreement became operational in the first quarter of fiscal year 1994 and over \$1.2 billion in applications for EXIM support have been submitted and are in process. Preliminary approval has been given by Eximbank's board and the case referred to Congress for the first transaction under the Framework Agreement supporting \$272 million in U.S. exports.

- Exchanges and Training and Democracy Programs: Current planning calls for the NIS Assistance Program to surpass the Marshall Plan in the number of participants in our exchanges and training program (26,000). In 1993, 3000 Russians participated in training programs in the U.S., and we plan for 20,000 Russians to visit the U.S. to participate in **educational and training programs** in the areas of business, public administration, and law. A consortium comprised of U.S. legal experts and institutions, including law schools, think tanks and non-governmental organizations, is cooperating with Russian counterparts to strengthen the **laws, legal institutions and civic structures** which support democratic and market-oriented societies. The American Bar Association will continue to cooperate with the Government of Russia on the re-introduction of a **trial-by-jury** system in

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nine regions. We have provided assistance in **municipal financial management** to the cities of Moscow, Nizhny Novgorod, and Vladivostok.

- Energy: Major energy initiatives under the energy assistance rubric include **nuclear reactor safety, energy efficiency and market reform, and the Energy-Environment Commodity Import Program**. Efforts to provide nuclear safety assistance--which is budgeted at over \$120 million for Russia and Ukraine--have been stymied by the issue of liability coverage for the U.S. contractors who would carry out the work. USAID transferred the first tranche of a total of \$14 million to the EBRD-administered Nuclear Safety Account, which will support implementation of the G-7's nuclear safety initiatives for Russia and Ukraine. Five U.S./Russian working groups are drafting a Joint Energy Alternatives Study and the Joint Nuclear Power Alternative Study, initiatives of the December 1993 Gore-Chernomyrdin Commission. USAID is in the final phase of preparations for the much anticipated \$90 million Energy and Environment Commodity Import Program.
- Environment: Several activities are underway with the key goal of helping to ensure that Russia's continuing industrial development will not occur in a manner inimical to the environment. A design team recently returned from a visit to Lake Baikal and is completing the program design for the **Lake Baikal Watershed** project. Implementation of the **Moscow Region Water Quality Management** project began in June. Equipment and technicians are in place to begin an inventory of pollution sources in the **Volgograd Air Quality Management** project. In December 1993, the **Non-Governmental Organization Strengthening** project awarded 29 grants, totalling \$61,000, to NGOs to support environmental youth camps, educational seminars, and efforts to organize to protect environmentally damaged areas. At the same time, 19 cooperative activities grants, totalling \$750,000, were awarded for activities that include protecting the Siberian Tiger and developing training in environmental impact assessments. Additional small project grants will be awarded in late spring.

The Departments of Agriculture and Defense have actively engaged in programs of assistance for Russia. Since fiscal year 1992, USDA has obligated over \$1.95 billion for food commodities and ocean freight via Section 416(b) and Food for Progress. Under the auspices of the Cooperative Threat Reduction program (Nunn-Lugar), DoD has proposed obligations totalling approximately \$484 million to support agreements with the Russian Federation for assistance to facilitate weapons destruction and nonproliferation.

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G-7 ASSISTANCE TO RUSSIA: 1990-1993 (millions of U.S. dollars)

COUNTRY	EXTENDED		DRAWN	
	Total	of which is grant assistance	Total	of which is grant assistance
GERMANY ⁽¹⁾	\$48,190	\$10,860	\$41,790	\$7,615
US	\$15,490	\$6,765	\$6,345	\$1,230
ITALY	\$5,805	\$30	\$2,645	\$30
JAPAN	\$4,780	\$500	\$840	\$80
FRANCE	\$3,255	\$90	\$2,515	\$35
CANADA	\$2,350	\$220	\$1,835	\$25
UK	\$1,145	\$370	\$840	\$110
EU	\$3,660	\$2,460	\$1,370	\$600
TOTAL	\$84,675	\$21,295	\$58,180	\$9,725

1. Total includes troop withdrawal assistance as well as pledges made before, but disbursed after, 1990.

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MULTILATERAL SUPPORT FOR RUSSIAN ECONOMIC REFORM

Last April in Tokyo, G-7 Foreign and Finance Ministers developed a support program for Russia to provide up to \$43.4 billion. This extraordinary initiative reflected the critical importance to world peace of Russia's successful transition to a democratic market economy and Russia's special needs during this unique transition process.

The G-7 stands by its commitment to provide the full amount of support agreed upon at Tokyo. Of this total, about \$30 billion has already been approved to support structural reform and initial efforts toward sound macroeconomic policies and for debt rescheduling. The remainder of our support has not yet been activated because Russia has not yet made adequate progress in implementing a full stabilization program.

The report below provides an update on the status of the four parts of the Tokyo package (amounts are in billions of dollars) and on other G-7 support initiatives.

<u>MULTILATERAL SUPPORT PROGRAM</u>	<u>AMOUNT</u>	<u>APPROVED</u>
I. <u>Support for Structural Reforms</u>	\$14.2	\$10.6

Structural support for Russia is needed to help privatize industry, build market institutions and infrastructure and develop sectors such as energy and agriculture. It can proceed apart from the pace of stabilization support.

The World Bank agreed to provide up to \$3.4 billion in loans to support restructuring. We expect that \$2.3 billion of this total will have been approved around the time of the Naples Summit, including loans to support oil sector restructuring, highway rehabilitation, financial institution development and privatization. The EBRD also approved \$250 million in co-financing for a World Bank oil sector loan.

Under the \$300 million Small and Medium Enterprise Fund (SME) initiative, the G-7 and the EBRD will each provide \$150 million to finance small emerging entrepreneurs. A pilot project is currently underway and will be reviewed as the basis for the entire project.

The G-7 agreed that their export credit agencies (ECAs) could provide \$10 billion to finance needed capital imports. Over \$5 billion in ECA assistance was granted in 1993 and a similar amount is expected in 1994. The United States will provide up to \$2 billion under its oil and gas framework agreement.

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II. Support for Initial Stabilization \$4.1 \$4.1

In 1993, the IMF created the Systemic Transformation Facility (STF) to support initial stabilization. Russia has drawn \$3 billion under the STF in two equal tranches, in June 1993 and April 1994.

The World Bank also agreed to provide up to \$1.1 billion in initial stabilization support through critical import loans. The Bank has disbursed almost all of the remaining \$500 million under a \$600 million critical import loan made in 1992 and a second loan of \$600 million is expected to be approved this July.

III. Support for Full Stabilization \$10.1 \$0

The G-7 envisaged that Russia would move from initial stabilization supported by the STF toward full economic stabilization with the support of an IMF (standby) loan of up to \$4.1 billion. If Russia successfully implements the economic program agreed as part of the second STF program, discussions on a full stabilization program that can be supported by an IMF standby loan are expected to begin in the second half of 1994.

The G-7 also agreed to create a \$6 billion currency stabilization fund to support the ruble, once Russia has implemented a rigorous standby program for several months.

IV. Official Debt Rescheduling \$15 \$15

In April 1993, Paris Club countries rescheduled roughly \$15 billion of official principal and interest payments due in 1993. The United States rescheduled \$1.1 billion.

TOTAL MULTILATERAL SUPPORT \$43.4 \$29.7

Special Privatization and Restructuring Program (SPRP)

Responding to a U.S. proposal, G-7 heads of State, the World Bank, IFC and EBRD agreed in Tokyo to create the SPRP, to assist in restructuring large firms. The SPRP will provide up to \$3 billion in equity, loans and ECA support for enterprise restructuring. A network of up to ten regional venture funds is being established to make investments in Russian firms.

The United States contributed \$100 million in grant support under the SPRP to create the Fund for Large Enterprise Restructuring (FLER). The FLER is now up and running under former Treasury Secretary Michael Blumenthal and will provide equity and loans to newly privatized Russian firms. The United States also pledged \$250 million in ECA support under the SPRP.

Support Implementation Group (SIG)

At the Vancouver Summit, Presidents Clinton and Yeltsin agreed to explore creation of a body to coordinate external assistance for Russian reform. The United States took the lead in creating the SIG, which was endorsed by the G-7 in Tokyo and initiated its activities on September 1 in Moscow.

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STATUS OF G-7 MULTILATERAL SUPPORT PACKAGE FOR RUSSIA
expected as of July 31, 1994

	<u>Pledges</u>	<u>Approved</u>	<u>Disbursed</u>
I. <u>Support for Structural Reforms</u>	\$14.2 bil.	\$10.6 bil.	\$8.0 bil.
World Bank Sectoral Loan Commitments	\$3.4 bil.	\$2.29 bil.	\$28 mil.
Co-financing of World Bank oil sector loan	\$500 mil.	\$250 mil.	---
EBRD Small and Medium Enterprise Fund	\$300 mil.	\$55 mil.	\$6 mil.
Export Credit Agency Credits and Guarantees	\$10 bil.	\$8.0 bil.	\$8.0 bil. ¹
II. <u>Support for Initial Stabilization</u>	\$4.1 bil.	\$4.1 bil.	\$3.5 bil.
IMF Systemic Transformation Facility	\$3 bil.	\$3.0 bil.	\$3.0 bil.
World Bank Import Rehabilitation Loan	\$1.1 bil.	\$1.1 bil.	\$485 mil.
II. <u>Support for Full Stabilization</u>	\$10.1 bil.	---	---
IF Standby Loan	\$4.1 bil.	---	---
IMF Currency Stabilization Loan	\$6.0 bil.	---	---
IV. <u>Official Debt Rescheduling</u>	\$15 bil.	\$15 bil.	\$15 bil.
<u>TOTAL</u>	\$43.4 bil.	\$29.7 bil.	\$26.5 bil.

¹ Includes \$5.2 billion in 1993 and \$2.8 billion from January to July 1994 in G-7 plus EU export credits. The 1993 figure reflects IMF estimates, which are consistent with Russian numbers. The 1994 figure is derived by dividing in half the IMF estimate of \$5.7 billion in bilateral credits for the entire calendar year. However, the 1994 total, which is based on lenders' intentions reported to the IMF, may not be realized due to a recent law passed by the Duma to restrict foreign borrowing.

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RUSSIA -- PARIS CLUB DEBT DEAL

On June 4 in Paris, Russia and seventeen creditor governments signed a rescheduling agreement deferring about \$7 billion in payments due in 1994. Repayment will begin in 1997, with some categories of debt stretched out as long as 15 years. The agreement calls for approximately \$3 billion in Russian payments to these 17 official creditors in 1994; total debt payments for 1994 will be roughly \$4.5 billion, including payments to the multilaterals, banks, suppliers and non-Paris Club governments. This compares with total debt payments in 1993 of \$2.2 billion, of which \$1.7 billion went to Paris Club creditors. The 1993 rescheduling provided shorter repayment terms, however.

The agreement thus meets the U.S. (and G-7) objective of limiting Russian debt service payments in 1994 to an amount manageable within Russia's budgetary framework.

The agreement also includes language, previously worked out within the G-7, stating the creditors' willingness "to consider the possibility of a multi-year rescheduling agreement on the basis of appropriate IMF-supported programs" for Russia's debt obligations in 1995 and beyond. Scheduled debt service to the official creditors totals about \$9 billion for 1995 and \$7 billion for 1996; a need for further debt relief is likely.

The purpose of a multi-year agreement would be to provide the Russians with greater certainty about their future debt obligations for their budgetary planning. Such an agreement would be contingent on continued IMF-supported economic reform, but we wish to preserve flexibility regarding the specific form of IMF support that would be linked to debt relief.

The language on the possibility of a multi-year rescheduling, a U.S. initiative, was agreed to by the G-7 financial deputies in Frankfurt on May 26 and again in the June 4 agreement. The Germans have been pushing for special recognition of the unresolved issues between Russia and its private creditors, of which German firms are the largest country grouping. The Italians' long-standing debt reconciliation issue with the Russians, which had blocked signature of their 1993 bilateral rescheduling, was resolved in the recent Paris meeting.

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UKRAINE ECONOMIC OUTLOOK

Objectives

- o Underscore the importance of Ukraine to the G-7.
- o Urge Ukraine to undertake a comprehensive market reform effort.
- o Emphasize the G-7's readiness to mobilize large scale, international financial assistance to support renewed reform, which could be in the order of \$5-6 billion over a two-year period, following the commencement of genuine reforms.
- o Concrete support for Ukraine's reforms is further demonstrated by the delegation of nongovernmental experts, comprised of the U.S., Germany, Britain and Canada, scheduled to visit Kiev in late July for technical discussions on Ukraine's reform plan.
- o Further plans include G-7 support for an autumn conference on Ukraine's economic transition in Halifax.

Background

Ukraine's economy is in a state of severe crisis as a result of the Government's mismanagement of the economy and widespread state controls which have produced paralysis and impoverished much of the population. To date, reform efforts have been piecemeal, inconsistent and compromised by a lack of economic leadership; the key obstacle to market reform. Moreover, the current Government is dominated by industrialists which eschew market reforms and view production decline and unemployment as the primary threats facing the economy. Increasing state controls and lax monetary and fiscal policies produced a hyperinflation by the end of 1993. In 1994, the country's economic crisis has been no less severe, with inflation temporarily subsiding, only to be replaced by unsustainable payment arrears and increasingly distorted price and foreign exchange controls.

Beginning in the Fall of last year, the U.S. began a concerted effort to expand the scope of the bilateral and G-7 relationship with Ukraine beyond security issues, to include economic reform and assistance issues. U.S. and Ukrainian economic delegations have since exchanged several increasingly constructive visits on Ukraine's economy. Since the beginning of 1994, the IMF has also had several missions in Kiev to work on a STF program, and technical discussions have been making good progress. The primary obstacle to market reform, however, remains the lack of enduring political commitment on the part of the Government. Spring elections to the Parliament (Rada) and June Presidential, local and final Rada run-off votes will transform Ukraine's

political landscape, but whether these elections will produce a critical mass of support for genuine market reform remains highly uncertain.

Ukraine's critical economic situation is illustrated in its recent economic statistics:

- GDP dropped 35% in the twelve months ending in April, after falling 16% in 1993 and 20% in 1992.
- Fiscal policy was uncontrolled in 1993, with the budget deficit hitting 40% of GDP. The 1994 budget remains unclear.
- Monetary policy was similarly uncontrolled in 1993, with virtually open-ended credits issued to the agriculture and coal sectors in the summer. During the first five months of 1994, the Government severely restricted new credit to the economy, which reduced inflation but created unsustainable arrears. There are now reports that in June, the Government ended this tight monetary policy and increased credit by the equivalent of half the current money supply, in preparation for the June 26 presidential vote. Credit continues to be allocated administratively at very negative real interest rates.
- These policies caused monthly inflation to hit over 90% in December, before slowing to 5-10% in February - April, due to tighter credit policy. It is expected to accelerate in July.
- Price controls are widespread, with energy sold at less than 20% of world prices, on average.
- Since the beginning of 1993, the currency has fallen to less than 3% of its end-1992 introductory value against the U.S. dollar and 5% of its value against the ruble. Significant foreign exchange restrictions have caused capital flight estimated as high as \$12 billion.
- The most acute problem facing Ukraine remains access to imported energy. Ukraine is unable to stay current on its large energy bills and remains at the mercy of suppliers continuing to send energy without immediate prospect of payment. Turkmenistan and Russia have both sporadically cut-off Ukraine due to nonpayment.
- The country's privatization program has made little progress. Laws are contradictory and broad-based privatization remains elusive. The Rada passed a law to privatize 20,000 small firms and 8,000 medium and large firms; about 28% of total assets by the end of 1994, but there has been little concrete action. The Government also recently signed a MOU to work with USAID, EU and the World Bank on improving the country's privatization program, but major disagreements prevent it from being implemented.

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G-7 Position

There is broad agreement among the G-7 on an overall approach to Ukraine, although some countries may hesitate to discuss specific IFI assistance numbers at this time. Germany is especially eager for the G-7 to increase its engagement in Ukraine. The Canadians also have a strong interest in Ukraine due to their role as host of the 1995 Summit and their large Ukrainian ethnic population and have proposed a conference on Ukraine's market transition this Fall.

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UKRAINE: POLITICAL SITUATION

The early presidential election, scheduled for June 26, is expected to take place as planned despite President Kravchuk's numerous efforts to seek a postponement. None of the leading candidates, Kravchuk, former PM Kuchma, parliamentary speaker Moroz and former parliamentary speaker Plyushch, appear to have sufficient support for a first round victory. A run-off, probably by July 10, will likely put Kravchuk against Kuchma -- a race which Kravchuk is by no means guaranteed to win. Kuchma openly favors closer economic ties with Russia. While he also has advocated re-examining Ukraine's nuclear dismantlement obligations, he has expressed support for the Trilateral Statement and does not appear poised to put those obligations at risk.

No matter who wins, we intend to continue to press Ukraine to move quickly to implement a comprehensive economic reform program and to accede to the NPT as a non-nuclear weapons state at the earliest possible time. Meanwhile, Ukraine continues to carry out its obligations under the January 14 Trilateral Statement, having already transferred 240 warheads to Russia for dismantlement. In addition, our G-7 partners are working with us and Ukraine to develop bilateral nuclear dismantlement-related assistance projects. Thus far, the U.S., Canada and Japan have committed the largest amounts of assistance.

Crimea's May 20 vote to reinstate the 1992 constitution, though not a definitive act of secession, is the latest unilateral attempt to introduce elements of a regime of de facto legal separation from Ukraine. The Crimean parliament's actions touched off a number of heated exchanges between Kiev and Simferopol and a few shots between Kiev and Moscow, fueled by unconfirmed press reports of troop movements. Secretary Christopher's May 21 reply to Foreign Minister Zlenko's widely distributed appeal emphasized continuing U.S. support for Ukraine's territorial integrity and urged Ukraine to continue to exercise restraint and to seek a peaceful resolution.

Tensions have eased. Ukrainian and Crimean parliamentary delegations agreed to recommend that neither side undertake further unilateral actions until joint working groups could study the problem and offer recommendations. Meanwhile, Ukrainian and Russian Prime Ministers met in Moscow May 23-25 for further discussions on Black Sea Fleet issues. This dialogue continues as well, but a final resolution of all outstanding problems is not expected soon.

Embassy Kiev believes the politics of the Crimea crisis is driven in part by the uncertain outcome of the presidential elections. Both leading candidates -- Kravchuk and Kuchma -- have reason to exploit the Crimean problem for political gain, given the implications for Ukraine's territorial integrity.

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UKRAINE: CHERNOBYL NUCLEAR POWER PLANT

Since the 1992 Munich Summit, the U.S. has endeavored to provide assistance for the immediate safety needs at the riskiest Soviet-designed reactors in the former USSR and in Central and Eastern Europe. The 1993 Tokyo Summit endorsed this policy and extended it to include work with the World Bank and other international financial institutions (IFIs) to develop longer-term energy strategies to permit early closure of the riskiest reactors. The USG is involved in near-term and long-term Ukrainian energy concerns through both bilateral and multilateral fora; the G-7 Nuclear Safety Working Group (NSWG) and the Nuclear Safety Account (NSA) at the European Bank for Reconstruction and Development are the primary multilateral instruments through which the USG interacts and negotiates nuclear safety assistance policy.

Both the United States and the G-7 seek to persuade Ukraine to close Chernobyl. Chernobyl has four RBMK reactors, the riskiest Soviet-designed reactor type (flawed by a design lacking containment to prevent release of radioactivity in an accident). Last October, the Ukrainian parliament authorized the continued operation of the remaining Chernobyl reactors, reversing a previous decree requiring a December 1993 shutdown of Units 1 and 3 at Chernobyl and continued closure of Unit 2.

A bilateral Joint Statement signed in March by Deputy Energy Secretary Energy White and Ukrainian Deputy Prime Minister Shmarov, committed Ukraine, in principle, to early closure of Chernobyl once Ukraine acquired energy resources to replace Chernobyl. Shmarov outlined to White, to an IAEA-sponsored Ukraine nuclear safety meeting in Vienna, and to the G-7, Ukraine's needs for a "balanced" energy supply, including completion of three to five more modern nuclear power plants under construction, a decommissioning plan for Chernobyl and a means of addressing social costs associated with dislocation of workers employed at Chernobyl.

Since April, the G-7 Nuclear Safety Working Group has met twice with Shmarov to prioritize Ukraine's energy needs and consider whether the West might provide a combination of limited grants and loans in exchange for Ukraine's commitment to early closure of Chernobyl. While the Europeans are more directly engaged in this issue than the USG and would likely provide more resources, they are looking to us to provide a reasonable share.

In addition to the West's efforts to get the operating Chernobyl Units closed in the near term, the concrete sarcophagus, or shelter, surrounding Unit 4 is in need of repair; installed following the 1986 accident which destroyed the unit, it is said to be leaking radioactive water and wastes. The European Union

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is conducting a year-long study on what needs to be done to the sarcophagus. Until that study is completed, neither the USG, nor the rest of the Western donors can act on the deteriorating sarcophagus.

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THE NUCLEAR SAFETY ACCOUNT AT THE EUROPEAN BANK FOR
RECONSTRUCTION AND DEVELOPMENT (EBRD)

The NSA was set up as a supplementary mechanism to address immediate operational safety and technical safety improvement measures not covered by bilateral programs. It is administered by the European Bank for Reconstruction and Development (EBRD) and focuses on reactors of greatest risk, the Soviet-designed RBMK (Chernobyl-type) and VVER-440/230 types. Projects have included short-term, low-cost measures that can reduce risk from their continued operation significantly.

Should the NSA be used as a resource upon which to draw for assistance as part of a Chernobyl shutdown plan, a G-7-mandated change in the NSA mandate may be necessitated. The NSA was set up to provide near-term nuclear safety assistance to the riskiest of the Soviet-designed reactors. Provision of funding for the costs associated with Chernobyl closure or funding for completion of three VVER-1000 reactors would be a marked change in the NSA mandate.

At issue is the limited amount of funds in the NSA and donor assistance priorities for countries operating these risky Soviet-designed reactors. One option currently under discussion in the G-7 is replenishment of the NSA. While the Europeans could be expected to contribute the majority of funds, the U.S. may be asked to pitch in \$10-20 million to the Nuclear Safety Account, for decommissioning costs at Chernobyl. That amount is ten percent of an estimated \$100-200 million NSA replenishment total. The need for replenishment would also presuppose the NSA going forward with the three other Russian projects in addition to a project at Chernobyl.

In a letter dated June 13, 1994, Chancellor Kohl and President Mitterrand requested President Clinton's urgent attention to the issue of replenishment of the NSA, particularly after negotiation of Chernobyl closure. They continued that France and Germany have shouldered the bulk of financial contributions to the NSA and that the USG should urgently consider additional contributions in the near term.

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DEVELOPMENT ISSUES

Post-Cold War economic and security realities, coincident with budget pressures in all the G-7 countries, have led to a rethinking of development priorities. Two broad themes have emerged. First, donor and recipient countries must actively recognize that sustainable growth depends ultimately not on foreign aid, but on the correct mix of economic policies. The signing of the Uruguay Round agreement and the creation of a World Trade Organization are important steps toward opening markets which will, along with attractive investment regimes, create jobs and raise living standards in the most efficient way possible. Second, official development assistance must complement and encourage private sector activity, focusing on the poor, in a way which encourages recipients to expand their own capacities. This promotes sustainable growth.

Sustainable development requires policies and projects designed to foster sound economies, democracy and anti-corruption efforts, environmental quality and reduced population growth. Building on recent developments, including the replenishment of the Global Environmental Facility, "good governance" language in international financial institution (IFI) policy documents, successful IDB replenishment negotiations and preparations for the September Cairo Conference on Population and Development, we want to encourage donor coordination on integrating these themes into bilateral and multilateral assistance strategies. OECD outreach to developing countries should help anti-corruption efforts, especially on international business-related bribery.

With no prospect of increased levels of bilateral assistance, the role of IFIs becomes more important and even greater care must be taken to assure the effectiveness of existing development funds. The creation of the Development Committee Task Force during the World Bank Development Assistance Committee meeting in April was an important step in that direction. In addition to improving the effectiveness of the use of their funds the IFIs will have to become more engaged in social sector programming and seeking ways to leverage private sector investment by establishing guarantee programs.

In the interest of using limited funds efficiently we also believe it is important to seek improvements in development assistance through existing mechanisms. As a case in point, we are opposed to efforts to examine commodity dependence of developing countries that might entail new organizations and funding demands, when UNCTAD already provides a forum for such discussions. As a result of UNCTAD VIII, UNCTAD has now moved away from promotion of market intervention approaches implicit in the Integrated Program on Commodities.

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The other G-7 members are roughly in agreement with our position. The Japanese and French are continuing efforts to help the poorest commodity-dependent developing countries through an international gathering of experts and government officials, but this has been opposed by the U.S., British and Germans. The Germans may raise the idea of linking levels of military expenditure to development assistance an idea which is also being studied within the United Nations and other MDBs.

The Europeans are strongly backing the study of "migration and development," i.e., how development tools can help affect (prevent) migration. A response to domestic pressures resulting from migration flows into Europe, international development agencies have so far been reluctant to take on the issue. The U.S. participates in an informal inter-governmental working group on migration that is examining the subject, but we have not yet developed a position on the topic. Others want to bring it to a formal arena.

INTERNATIONAL DEBT STRATEGY

U.S. Objectives

We have two objectives: (1) To achieve G-7 consensus on the level of, and the basis for, deeper debt reduction for eligible poorest countries; and (2) to recognize recent progress under the international debt strategy.

Background

The Poorest Countries

The Paris Club agreed in December 1991 to "Enhanced Toronto Terms" (sometimes called "Trinidad Terms" or "London Terms") for the poorest countries. The application of these terms allows creditors to choose among options that result in a 50 percent reduction of non-concessional (Eximbank, CCC) debt service, on a net present value basis, of the consolidated periods. Another option allows longer reschedulings (over 25 years including 16 years grace). Concessional debt is being rescheduled over 30 years, including 12 years' grace on principal payments. In addition, the Paris Club is considering questions related to the treatment of the stock of non-concessional debt after a period of sustained economic performance.

The poorest countries that have benefitted include Benin, Bolivia, Burkina Faso, Cameroon, Côte d'Ivoire, Central African Republic, Equatorial Guinea, Ethiopia, Guinea, Guyana, Honduras, Mali, Mauritania, Mozambique, Nicaragua, Sierra Leone, Tanzania, Togo, Uganda and Zambia.

Until recently the U.S. used the rescheduling option (25 years including 16 years grace), rather than the debt/debt service reduction options. The Administration has been successful in securing Congressional authorization and funding to enable us to join the rest of the international community in reducing the non-concessional debts of the poorest nations in line with existing 50% debt/debt service reduction under Enhanced Toronto Terms for insolvent countries. Nonetheless, because of legislative and budget constraints, we are unable to extend the debt reduction option to all countries that qualify for Enhanced Toronto Terms, e.g., Côte d'Ivoire. Niger and Senegal were the first beneficiaries of the U.S. ability to offer 50% debt reduction.

We support moving to deeper debt reduction for eligible poorest countries -- a general policy of up to 67% debt reduction on a case-by-case basis. We would also like to provide even deeper reduction for countries achieving a democracy standard. We are also prepared to engage in stock reduction for countries as they return to the Paris Club for their second treatment under Enhanced Toronto Terms, if they have demonstrated adequate performance at that time. However, we will need to keep the rescheduling option since there may be countries not eligible for

debt reduction pursuant to our legislative authority or policy guidelines but nonetheless deserving of some debt relief.

Middle-Income Countries with Commercial Bank Debt Problems

The progress under the debt strategy to address commercial bank debt problems has been substantial. A key feature of the strategy has been the availability of IMF, World Bank and IDB financial support to collateralize the new reduced debt instruments.

Twelve countries, now including Brazil, have reached debt reduction or refinancing agreements with their commercial banks, accounting for over 92% of the \$260 billion in outstanding commercial bank debt of the 16 major debtor nations. Recently, Bulgaria, the Dominican Republic and Jordan, not counted among the 16 major debtors, also completed agreements with their banks. Poland has recently reached an agreement-in-principle.

In particular, the combination of debt reduction and economic reforms has helped to jump-start Latin economies and has produced major capital flows and fiscal benefits.

Other Summit Country Views

The other G-7 countries (with the exception of Japan) want to move to deeper debt reduction for the poorest countries. They are pressing the U.S. to drop the rescheduling option to ensure equitable treatment among creditors. The Japanese want to pursue a new money option rather than provide debt reduction.

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G-7: COMMODITIES (JAPANESE/FRENCH INITIATIVE)

Prior to the June 1993 Tokyo G-7 meeting, Japan proposed that the G-7 endorse a major new commodity initiative, including the convening of a meeting of eminent "Wise Men" to set a new agenda for assisting developing country commodity producers. The U.S. and the UK opposed the idea vigorously, and it was not in the G-7 communique.

Most commodities are near historically low price levels in nominal terms. Many developing countries depend largely on commodity exports for their foreign exchange earnings. The IBRD recently estimated there has been a transfer of \$100 billion from developing to developed countries due to low commodity prices. While that estimate is subject to question, the extremely low prices are due to the global recession, new sources for many primary commodities, increased availability of supplies from the CIS and reduced consumption of traditional materials per unit of GDP in developed countries. Although prices are likely to improve as the EU and Japan join us in economic recovery, the fundamental factors cited above will continue to have a restraining influence.

Ironically, since most basic commodities are price inelastic, improving the efficiency of commodity production and diversification into other commodities may make sense in individual cases, but as a global approach it may aggravate problems of overproduction and consequent depressed prices.

Moreover, the economic problems of many developing countries are linked to persistent social, cultural and political factors that impede development. Isolated attempts to solve the commodities problem that do not take account of the need for and constraints upon, overall economic policy reform will be of questionable value in the long run.

As a result of Eighth UN Conference on Trade and Development (UNCTAD VIII), the UNCTAD Committee on Commodities is pursuing an agenda that emphasizes market measures for reducing risk, diversification, foreign private investment and improved national policies, all of which are consistent with our approach to commodity issues. We would not wish to see UNCTAD's promising market oriented initiatives impeded by a G-7 initiative.

There is a possibility that Japan and France may resuscitate their proposal and plan to sponsor a meeting of experts later in the year. We are told the meeting would include representatives of international organizations, academics and government personnel "in their personal capacity." Among the main subjects to be discussed: expanding demand for basic commodities, improving production efficiency, mitigating environmental impacts of commodity production and resources/funding.

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Although the French have agreed to co-sponsor this project with the Japanese, they appear unenthusiastic about it. There are no other supporters in the G-7 and the British and Germans are likely to join us in strongly opposing it.

The Japanese assure us the Franco-Japanese initiative is not intended to re-invigorate the Integrated Program on Commodities, promote the establishment of new commodity organizations with economic provisions, or stimulate new demands for financial assistance to developing countries. Nonetheless, we remain concerned that the initiative risks generating expectations of major financial assistance and renewed calls for market intervention to support prices of primary commodities, at a time when we have largely disengaged ourselves from commodity agreements with economic provisions.

We would like to avoid a major new initiative on commodities coming from the G-7 meeting. Given the lack of support of the G-7 for the idea previously, we doubt the Japanese will find a more receptive audience this time.

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ARAB BOYCOTT

We seek inclusion of a statement in the summit declaration calling upon the Arab League states to end the boycott. We also hope to enlist our G-7 partners in lobbying Arab League states to support the convening of a special meeting of Arab League foreign ministers to consider action against the boycott.

Last year's summit declaration included, in the context of a paragraph on the Middle East peace process, a statement that "the Arab boycott should end". This year we are proposing a more proactive statement: "The G-7 member states call on Arab League states to end their boycott of Israel."

While pursuing an end to the boycott in its entirety, we continue to look for opportunities to undermine its effectiveness. We are pressing the PLO and friendly Arab governments to request a special meeting of Arab League foreign ministers with a view towards an Arab League decision that would (1) lift the secondary and tertiary aspects of the boycott and (2) permit individual member states to decide for themselves whether to enforce the primary aspect of the boycott. G-7 lobbying of Arab League governments in support of ministerial action against the boycott would complement our efforts.

During the past year we have made progress against the boycott. Kuwait is implementing its June 1993 decision to end its enforcement of the secondary and tertiary aspects of the boycott. Omani officials have informed us that they, too, are ceasing enforcement of the secondary and tertiary aspects. Collectively, the GCC states are taking six of ten concrete steps we recommended to weaken their enforcement of the secondary and tertiary aspects.

Meanwhile, some Arab states and citizens have had direct commercial contacts with Israel. Morocco and Israel are considering closer aviation ties. Qataris and Israelis have discussed a natural gas deal. A delegation of Saudi businessmen visited Israel in February.

Economic agreements among the parties to the peace process have also served to undermine the boycott. The April Palestinian-Israeli economic agreement entails economic cooperation that is inconsistent with enforcement of the boycott. In addition, Jordan and Israel have reached an understanding on banking arrangements in the West Bank and are considering further economic cooperation.

The Germans have been the most active of our G-7 partners in opposing the boycott. They have called for an end to the boycott and, in correspondence with USTR Kantor, have agreed to our suggestion of G-7 action against the boycott. Italy is also

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taking a more active stance against the boycott. In May, during a meeting with the Conference of Presidents of Major Jewish Organizations, Italian Foreign Minister Antonio Martino reportedly said that the new government would introduce legislation to create an Italian anti-boycott regime.

The Japanese have also taken steps against the boycott. This includes anti-boycott demarches to Arab states, public calls for an end to enforcement of the secondary and tertiary aspects against Japanese firms, and, this May, urging Asad to lift the boycott. Canada has an anti-boycott policy that incorporates aspects of our anti-boycott laws, but, as far as we know, has not demarched boycotting states on the issue.

While deploring the boycott, Michael Heseltine, President of the UK Board of Trade, told USTR Kantor that the primary boycott will remain "until there is a comprehensive settlement." We are not aware of any recent French actions or statements on the boycott, but note that the French have traditionally preferred anti-boycott action within the EU context to G-7 action.

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IRAQ

Since the March 1994 UNSC sanctions review meeting, some members of the Council, notably France and Russia, have been pressing to ease economic and political pressure on Iraq. These countries advocate recognizing Iraq's limited cooperation with the UN in the hope this will encourage greater compliance in the future. The French and Russians would like if not to expedite, at least to set definite limits on, the remaining steps Iraq must take before the Council can act to lift the oil export sanction.

Before there can be any consideration of easing oil export sanctions, the UN Special Commission (UNSCOM) must fully implement and test its weapons of mass destruction long-term monitoring regime. The French, and some other members of the Council, want to fix a date certain for the beginning of the weapons monitoring trial period and limit its duration. We have firmly opposed imposing any limits on the UNSCOM's execution of its mandate and believe that easing sanctions will result in lesser rather than greater Iraqi compliance.

Among the G-7, the French are the most active in seeking to ease pressure on Iraq. The French and others are motivated by commercial interests to preposition themselves to dominate the post-sanctions market in Iraq. The Russians are motivated by a desire to recover significant debts from Iraq and resume a lucrative arms trade with Iraq. The British and the Canadians remain solidly with us on the need to maintain pressure on Iraq until it is in full compliance with all resolutions. The Germans, Japanese and Italians, while interested in resuming post-sanctions commercial ties with Iraq, have not taken public positions on the question of easing sanctions.

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IRAN

We are seeking a G-7 consensus that Iran should receive no new official credits or guarantees until it ends its unacceptable behavior -- especially its continuing supply of weapons and funding to violent opponents of the peace process. All of our G-7 partners except the UK are resisting a cut-off of credit. Bonn's position is that new FRG credits "are not available" for the moment because of Iran's financial disarray.

Japan is alone in providing bilateral aid to Tehran. The second tranche of Tokyo's aid for the Karun River hydroelectric project is nearing approval. Tokyo is feeling our pressure, but will not end the aid program unless convinced that this issue is an administration priority.

While Tehran's actions motivate our policy, we cannot ignore Iran's disgraceful rhetoric. Iranian leaders have renewed calls for the destruction of Israel, but tell some in Europe and Japan that they are only playing to Iranian domestic audiences.

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BOSNIA

OBJECTIVES

- o Seek agreement to have the G-7 Summit endorse Contact Group efforts to develop a reasonable, viable territorial compromise and stress the importance of pressing the Bosnian parties to seize the current opportunity to move toward final settlement.
- o Express support for the current cease-fire and urge the sides to consider a longer-term cessation of hostilities.
- o Stress the need to maintain international unity and resolve, especially as we approach a critical juncture in the talks and consider how to respond if the Contact Group map is not accepted.
- o Urge all nations to give active support and cooperation to the War Crimes Tribunal; stress the importance of gaining consensus on a Chief Prosecutor.
- o Renew our commitment to provide reconstruction/rehabilitation assistance and (under certain conditions) ground troops for settlement implementation.

BACKGROUND

- o The Contact Group met June 16 to finalize its territorial proposals, which would be offered to the parties as the framework for a reasonable, viable settlement. If consensus is reached, we favor a ministerial to bless the proposals and authorize the Contact Group to present an agreed map to the parties.
 - o The Group will also consider means of pressing the parties to accept the 51/49 percent formula, and options for courses of action should either or both refuse.
 - o Akashi wants to continue talks with the parties on extending the cease-fire.
 - o The President's discussions of the Churkin proposal, including indications the U.S. would consider sanctions relief if the Serbs accepted the Contact Group's plans and pulled back to the proposed 51/49 borders, have left the Europeans with the impression that our stand on lifting sanctions may have moderated.
- We may be prepared to reconsider our sanctions policy in the (in our view unlikely) event of government rejection of a map and Serb acceptance of it.

- Our continuing objective, however, is to use the sanctions to maximize leverage on the Serbs to take concrete actions to implement a settlement.
- o For a variety of reasons including political disputes among UNSC member countries, the War Crimes Tribunal has of yet not settled on a prosecutor.
 - o The Deputy Prosecutor (the Australian Graham Blewitt) is moving ahead with his job and expects to prosecute the first criminals this fall. The U.S. is the only country to have contributed staff to the prosecutor's office.
 - o In the assistance sphere, we have provided the largest quantity of humanitarian aid to the region of any single state (over \$560 million since 1991).

KEY POINTS

- o We have reached a critical moment in the conflict, when the parties are poised either to move forward toward a settlement or to slide backward into expanded fighting.
- o International unity and resolve are at a premium; they could make a difference in whether or not the parties seize the current opportunity to reach a negotiated settlement.
- o We must send a clear message to the parties that the Contact Group's territorial compromise offers the parties the best chance they have of achieving a negotiated settlement and that missing the opportunity for peace means serious risks for all concerned.
- o G-7 political directors should reaffirm that the Contact Group's plan stands the best chance of gaining broad international support and thus of forming the basis for a just and lasting peace.
- o G-7 political directors should also express support for the UN-brokered cease-fire and continuing efforts to bring about a longer-term cessation of hostilities.
- o The Contact Group is alternatives should one or both sides reject the Contact Group's plans. Sanctions remain the strongest international instrument of pressure on the Serbs, and we need to ensure we use them to maximize leverage to implement a settlement.
- o The U.S. has provided both money and personnel to the Tribunal. As of yet, no other country has offered either. What do you intend to do to support the Tribunal?
- o As conditions improve in the Federation, initial plans are being put forth for Bosnian reconstruction. What are your views on how the process can be encouraged? What is your country's situation with regard to availability of funds?

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ALGERIA AND FRENCH OBJECTIVES

The USG objective in dealing with the G-7 on Algeria has been to urge the Europeans to maintain a tough line with the Algerian regime on the need for political dialogue at the same time that it is implementing an IMF-supported economic reform program.

The crisis in Algeria continues to simmer, fueled by frustration arising from three decades of political exclusion, economic mismanagement, and social injustice. The unpopular, military-backed regime has lost considerable ground to the armed Islamist insurgents who have been fighting to topple it for over two years. Despite promises by President Zeroual to open a dialogue with the moderate Islamist opposition, no progress has yet taken place. The Algerian government has rallied its security forces to inflict heavy casualties on the insurgents since March. Nonetheless, attacks on police and military targets continue on a daily basis, and the prognosis for sustained gains against the Islamists through a strategy of repression is poor.

The regime is implementing a bold program of structural economic adjustment under IMF guidance. These reforms, coupled with the recently concluded debt rescheduling through the Paris Club, could ease economic hardship in the medium term. Algeria possesses extensive oil and gas resources. Long-term prospects for economic recovery, however, depend on a peaceful resolution of the internal political conflict through negotiation.

The U.S. government has stressed to Algerian leaders at the highest levels the urgent need for real political dialogue which brings disaffected elements of the populace into a process to chart a new, democratic course for Algeria. We agree with the major Algerian parties, which insist that this process must involve an early return to elections and a broadening of political participation to encompass all factions, including Islamist leaders who reject terrorism. Recognizing the importance of economic reform for an eventual economic recovery and for the long-term well-being of the Algerian people, the U.S. government gave encouragement to the regime in its negotiations with the IMF and the Paris Club. We have made it clear that the U.S. is not in a position to provide direct assistance.

France plays a dominant role in determining European policy towards the crisis in Algeria, which the French government considers its most pressing problem in the Middle East. The French warn of the possibility of deepening civil war leading to an Islamist takeover. The potential fallout of such a development for French interests includes: a flood of refugees into France, persecution of the French-oriented Algerian upper classes and radicalization of the Muslim community in France.

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In contrast to the more reserved U.S. stance, the French government has openly declared its backing for the Algerian regime and is providing material assistance in an attempt to bolster it. Paris has put intense pressure on other European governments to give unconditional support to the Algerian regime, and the European Union has extended over \$200 million in loans to Algeria. The French approach emphasizes progress in economic restructuring, rather than political dialogue or respect for human rights.

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COCOM SUCCESSOR REGIME

COCOM ended on March 31. We are negotiating a new multilateral regime to control the transfer of arms and sensitive dual-use goods to countries of concern. The new regime is to be global in scope, with a distinct regional focus. Our objective is to develop a broader international consensus supporting transparency and restraint in arms and dual-use trade, especially where the risks of regional instability and conflict are deemed to be the highest. Membership would be broad and based on adherence to effective export controls, international nonproliferation norms and responsible national export policies (i.e., no arms sales to rogue states like Iran).

The March 29-30 High-Level Meeting (HLM) in The Hague endorsed an overall framework for the successor regime. Participants at the HLM (NATO members minus Iceland plus Japan, Australia, New Zealand and the European neutrals) agreed to work to establish the new regime by October 1994 (since deferred to November). France was isolated in its opposition to including arms in the new regime.

Italy, Germany, Japan and Canada have been very supportive of the new regime. UK and France dislike (and France opposes) meaningful transparency and consultation mechanisms on arms. There is implicit agreement to avoid arms sales to states whose policies are sources of concern, with a common understanding that this applies to Iran, Iraq, Libya and North Korea. Despite the remaining differences, a recent working group meeting in Paris made good progress toward agreement on information exchange and other points that may lead to an acceptable, effective regime.

The question of Russian membership is now the chief impediment to establishment of the COCOM successor regime. Russian participation as a founding member is sought, but continued Russian arms sales to Iran go against the very purposes of the regime. All six G-7 partners oppose Russian arms sales to Iran. The UK and France, however, have been reluctant to agree that an end to these transfers is a necessary condition for Russian membership, arguing that it will be easier to influence Russian behavior after they join. In addition they have made Russian participation a prerequisite for final agreement on the arms side of the new regime.

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NON-PROLIFERATION

At the Summit we should underscore the importance we place on checking and reversing weapons proliferation. And we should highlight key non-proliferation elements from the G-7 political statement in order to promote a concrete work program on this issue.

Non-proliferation issues will be included in the Chairman's Statement to be issued by the Italian hosts at the end of the Summit, reflecting discussions among the Seven and Russia ("7+1"). At the June 17 G-7 non-proliferation experts meeting, U.S. experts sought to emphasize these high priority goals for that statement:

- Fissile Materials: This is the issue most in need of your active intervention. We should seek to overcome allied footdragging and secure a strong endorsement for the fissile material production cutoff treaty proposed by the President at the UNGA in September, 1993. While not openly opposing such a treaty, the British and French are concerned about the costs of implementing it at their currently unsafeguarded nuclear facilities. Russia has endorsed the treaty proposal. We should also encourage cooperation with Russia to improve controls and accountability over nuclear materials in both civil and military sectors and seek G-7 commitment to avoid the accumulation of excessive plutonium stocks by civil nuclear programs. We will need to be careful that this is not seen by the Europeans or Japanese as a frontal attack on their plans to use plutonium in their civil nuclear activities, as this is a point of high political sensitivity.
- North Korea: We should seek 7+1 support for the international effort to bring North Korea back into NPT compliance and apprise leaders of the status of the third round of U.S. space talks.
- South Asia: We should in the first instance seek 7+1 support to cap, rollback and eventually eliminate existing Indian and Pakistani nuclear weapons programs, head off the impending deployment of ballistic missiles and establish a multilateral forum on arms control, non-proliferation and regional security in South Asia. We should persuade our partners to promote those goals with India and Pakistan.

All 7+1 countries should be generally supportive of our pitch: Japan and Russia have both offered to co-sponsor multilaterals (Pakistan is cool to any co-sponsors.) The Canadians also want to participate.

- Iraq: (Covered in a separate paper)

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-- Nuclear Smuggling: We should direct our national authorities to coordinate with each other on combatting nuclear smuggling. We should develop a plan of action that involves other interested states. The 7+1 should undertake to provide assistance to strengthen physical protection and nuclear materials accounting. We should seek agreement first to share information on this problem and then to coordinate law enforcement and other anti-smuggling assistance to affected states. Most countries should support it in principle.

Land Mine Controls: We would like the 7+1 to support moratoria on the export of anti-personnel land mines, efforts to strengthen the Convention on Conventional Weapons and its protocol on landmine use, increased assistance to demining throughout the world and early commencement of negotiations on a multilateral landmine control regime.

Russia and Italy (major exporters of landmines) have both been reasonably receptive to our moratoria. The UK and Canada would like exceptions to preserve landmine trade with us (we don't agree), and France is firmly on board.

-- Successor to COCOM: We should welcome the progress made toward setting up a new multilateral export control regime and press for agreement on the establishment of a successor regime by the late Fall 1994 target date, in order to restrict the acquisition of armaments and sensitive dual-use items for military uses by states such as Iran, Iraq, Libya and North Korea.

Russia will not be receptive to anything beyond a general description of the problem, and none of the 7+1 will be very supportive of naming target countries or regions. On the principal of the successor, France and the UK still object to including arms sales in the new regime; Italy, Germany, Japan and Canada are supportive of our position that arms sales must be included.

-- Others: We should reaffirm our support for indefinite and unconditional extension of the Nuclear Nonproliferation Treaty, commit ourselves to work for the earliest possible ratification of the Chemical Weapons Convention by our governments and for entry into force early in 1995, seek new measures to strengthen the Biological Weapons Convention and reaffirm our support for conclusion of a multilateral comprehensive nuclear test ban treaty as soon as possible.

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TERRORISM

We wish to maintain G-7 focus on counter-terrorism issues, especially on Libya and Iran. In Libya's case we want G-7 support for increased pressure on Tripoli to comply with UNSC resolutions on the Pan Am 103 and UTA terrorist attacks. We also wish to persuade the G-7 to condition their economic ties with Iran on improved Iranian performance in terrorism and other areas.

There has been no progress in bringing the two Libyan suspects to trial in the U.S. or the UK for the December 1988 bombing of Pan Am 103, nor full Libyan cooperation with the French on UTA 772. Libya has been pressing for a trial before Scottish judges sitting in the Hague, an idea endorsed by the Arab League, the New York Times and high levels of the Egyptian government.

We and the British have rejected this proposal, which is logistically impractical, would complicate prosecution and is intended to divide the Perm-3 and entangle us in endless negotiations over details; the French have concurred in this rejection. Libya is continuing its campaign to get off the hook, courting the French and Spanish with commercial deals, intensifying diplomatic efforts with the Vatican and among the non-permanent members of the UNSC and pushing through innumerable intermediaries for a dialogue with the USG.

Libya has taken only easily reversible and cosmetic steps to reduce support for terrorism; it is widely believed the Libyans were behind the December kidnapping in Cairo of dissident (and U.S. resident) Mansour Kikhia; his wife has publicly accused them of trying to buy her silence.

The USG is committed to tightening sanctions, absent clear signs of progress in meeting UNSC requirements; you are on record as favoring a world-wide embargo on imports of Libyan oil. This proposal is unlikely to win approval in the UNSC, which has led us to weigh other options: stronger pressure to implement existing sanctions and expansion of the existing financial assets freeze to cover some portion of current oil revenues which are not now frozen.

The G-7 agree with us that Libya continues to support terrorism and have supported sanctions to date, but they show no enthusiasm for tightening sanctions further. An oil embargo would threaten the viability of the French, Italian and Spanish economies. The

French and Italians fear Qadhafi's fall might further destabilize North Africa; in general the West Europeans, who buy 90 per cent of Libya's oil exports, prefer to give existing sanctions more time to take effect.

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We continue to regard Iran as currently the most active state sponsor of terrorism. In addition to its direct involvement in mounting assassinations against dissidents in Germany, Italy, France and Turkey, Iranian support for both Islamic and secular terrorist groups -- especially Hizballah and the PFLP-GC -- remains a cause for serious concern. Iran also seeks to expand its ties to radical Islamic groups in Egypt and elsewhere in North Africa. The USG will continue to keep the focus on unacceptable Iranian behavior in such areas as terrorism, the acquisition of WMD and human rights.

Some Western observers have attempted to draw a false distinction between the actions and policy of a "moderate" Iranian regime and "hard-line" elements or private Iranian organizations. Some of our allies, notably Germany, have embraced this false dichotomy in order better to follow national commercial and political interests. Although Japan has eagerly pursued commercial ties with Iran while adopting a cautious approach on terrorism issues, in recent months the GOJ has made laudable representations to Iran on such issues as the Middle East peace process and Iranian-North Korean missile deals.

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BURMA

Burma is one of the world's worst abusers of human rights, source of much of the world's heroin and East Asia's largest producer of refugees. While the ruling State Law and Order Restoration Council (SLORC) has taken some modest steps since March 1992 (when General Than Shwe became chairman) to ease martial law, such as releasing some political prisoners, lifting the curfew and re-opening universities, there has been no fundamental change in its repressive rule.

Although our influence on this closed society is limited, the U.S. continues to press for democratic reform and to maintain international pressure for respect for human rights. Our efforts toward these goals include co-sponsoring or supporting UNGA and UNHRC resolutions deploring Burmese human rights abuses for the past three years, adopting an arms embargo and cutting off all bilateral assistance and holding multilateral assistance to a minimum focused only on basic human needs.

Basic political liberties for the Burmese people are either non-existent or sharply curtailed. The military regime has refused to implement the results of the 1990 elections. The Burmese Army continues to employ forced labor under inhumane conditions in its campaigns against the ethnic minorities.

In January 1993, the SLORC convened a hand-picked National Convention, now in recess until September, to draft guidelines for a new constitution, a process which may take years. Delegates who have voiced opinions not consonant with the SLORC's position have been removed.

Nobel Peace Prize winner Aung San Suu Kyi and other political prisoners remain under detention. Congressman Bill Richardson (D-NM) held unprecedented meetings with Aung San Suu Kyi and Burmese military strongman LTG Khin Nyunt in Rangoon in mid-February. Aung San Suu Kyi expressed eagerness for a high-level dialogue with the junta while urging the international community to increase pressure for reform. The regime has ruled out talks in the foreseeable future.

Burma continues to purchase major items of military equipment from China, Poland and other countries for use against ethnic insurgencies. The US, the EC and Australia maintain voluntary arms embargoes against Burma.

Over 72,000 asylum seekers from Burma, including 65,000 ethnic minorities, reside in camps along the Thai-Burma border. In 1991-92, over 270,000 Rohingyas [Burmese Muslims] fled Arakan province for Bangladesh as a result of widespread persecution by

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the Burmese military. Repatriation, with UNHCR monitoring, is now underway, but progressing slowly.

Burma is the world's largest producer of heroin. The SLORC undertakes few law enforcement measures and has reached political accommodations with some ethnic insurgent groups which permit them to continue trafficking in return for ceasing hostilities against the central government. The USG does not certify Burma as cooperating in the fight against narcotics. The USG provides no direct assistance to Burma; bilateral counter-narcotics cooperation is limited to working-level DEA/GOB liaison.

The G-7 countries all share our goals of improving human rights, promoting democracy and suppressing narcotics. The European members and Canada have backed our tactical approach of maintaining international pressure. This includes a voluntary arms embargo, suspension of government-to-government aid to Rangoon, voting against loans to Burma in the IFI's and adoption of successive, strong UNGA and UNHCR resolutions deploring the regime's human rights abuses and urging democratic change. However, France and Germany have recently indicated interest in combining this approach with increased engagement.

Japan's view is closer to the ASEAN approach of avoiding direct criticism of Rangoon and engaging Burma through economic ties and friendly relations to best promote reforms. Japan is engaging more with Burma and providing modest new bilateral humanitarian assistance and training programs.

At a Deputies Committee in March, the NSC determined that the Political Declaration at the G-7 Summit should include a reference to Burma. Our principal goal is to work closely with G-7 countries and others to find ways to increase pressure on the SLORC to reform. The U.S. urges the G-7 to include a reference to Burma in the summit political declaration noting Burma's deplorable human rights situation, urging a dialogue between the regime and Aung San Suu Kyi and calling for her unconditional release and that of all other prisoners of conscience.

The U.S. believes the G-7 countries' should increase efforts to promote democratic reform in Burma. We urge that these include encouraging the junta to talk with detained opposition leader and Nobel Laureate Aung San Suu Kyi as the key to breaking the political impasse and pressing the military to observe basic human rights and freedoms; calling for expanded voluntary or mandatory arms embargoes by other countries; urging the ASEAN countries to put more substance in their policy of constructive engagement towards Burma by establishing benchmarks to evaluate the progress of the military regime towards genuine reform.

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INTERNATIONAL NARCOTICS CONTROL

The United States considers international narcotics trafficking to be a fundamental threat to democracy and sustainable development around the world. This premise underlies PDD-14 -- U.S. Policy on International Counter-narcotics Trafficking in the Western Hemisphere -- and is stressed in the President's National Drug Control Strategy. Both documents direct the United States to refocus its international drug control efforts in response to the growing narcotics threat to democratic and economic reforms, new drug control opportunities in the post-Cold War environment and tighter budgets.

The policy has four key areas of emphasis. First, it focuses support on those countries that have the political will to confront the drug trade. Second, it directs more emphasis on institution-building and sustainable development so that host nations can shoulder more of the drug control effort and drug producers can have economic alternatives to turn to. Third, it stresses greater international cooperation and more involvement by multilateral organizations, including the international financial institutions (IFIs) and multilateral development banks (MDBs). Fourth, it calls for a greater attack on the leading trafficking organizations, including stepped up efforts to control money laundering and the diversion of essential drug-producing chemicals. It says that "halting money laundering must be an integral part of the overall strategy."

The G-7 Summit has been an important forum for developing international consensus and action against the international drug trade and can be used to support our international drug control objectives again. The 1989 Summit mandated the Financial Action Task Force (FATF). The 26-member FATF has been our most effective vehicle for promoting international action against drug money laundering. The 1990 Summit mandated the Chemical Action Task Force which is providing the foundation for international cooperation in chemical diversion control.

This year, in support of our policy to place more emphasis on institution-building, and to stress greater involvement by MDBs and IFIs, we want to use the Summit to note the G-7's interest in having the MDBs and IFIs include more specific counter-narcotics objectives in their program development. G-7 members, however, are reluctant to link development with law enforcement. Emphasis, therefore, should be on programs that provide financing for alternative/sustainable development and enhance governance.

Accordingly, we should mobilize Summit support behind our efforts to get MDBs and IFIs to more implicitly attack drug trafficking in their program development. These range from efforts to help farmers move away from drug production to support for democratic institution building through administration of justice programs.

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UN ISSUES: PEACEKEEPING ASSESSMENT REDUCTION

The UN established the peacekeeping scale of assessments in 1973. There have been significant changes in the world economy since then that we think should be reflected in revisions to the scale. The U.S. share of the world economy in the early 1970's was over 30 percent and today is barely above 25 percent.

Three months ago we began a campaign to reduce our share of UN peacekeeping assessments from 31.7 percent to 25 percent. Congress has since enacted legislation that would bar U.S. payments in excess of 25 percent beginning in fiscal year 1996.

We want to achieve a more rational, equitable and up-to-date assessment through a consensus among UN member states. This would broaden support for UN peacekeeping and put funding on a more sustainable and predictable foundation. It would also better reflect the fact that the UN is an instrument of all member states. We have raised this issue with G-7/P-5 governments at high levels on four occasions, including at the May and June Political Directors' meetings and in a letter from Warren Christopher June 14 to G-7/P-5 foreign ministers. Although we have not yet received answers to his letter, other responses have been lukewarm because of the realization that decreasing our payment will mean other countries will have to increase their payments.

Failure by the international community to address this issue will lead to an increasingly large gap between the UN peacekeeping budget and the monies actually available to fund it. The consequence will be either a huge deficit in funds, or highly inflated budgets purposely overestimated because the parties know only a portion of the bill will be paid. Either outcome will threaten the international system and affect UN credibility and effectiveness.

Boutros-Ghali supports our goal and has mounted an appeal to ten other countries (none members of the G-7) to increase the proportion of peacekeeping assessments they pay. The countries selected were among those with relatively high rates of per capita income, but which benefit from a discount under the UN scale of peacekeeping assessments. Responses from these countries have also been lukewarm.

We hope that you will be able to secure G-7 support for strengthening the UN system and improving its efficiency, including instituting an Office of the Inspector General. Although we do not expect explicit Summit support of a 25 percent cap, we can hope for endorsement of the principle that no nation should pay an excessive share. We hope you will gain support for this position, including a statement supporting it in the Summit Declaration.

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G-7 Responses to Demarche on Reducing U.S. Peacekeeping Assessment Rate and Resulting Added Costs* for Each

UK would not welcome a revision that increases UK contribution; have presented a proposal that simplifies assessment rates (marginally reduces the UK rate), but does not reduce the U.S. rate to 25 percent.

Added cost: \$8.1 million.

Canada supports a full review of UN assessments, but notes Canada already pays more than it is formally assessed due to voluntary contributions and uncompensated troop contribution costs.

Added cost: \$9.2 million.

France sensitive political issue in view of considerable drain on the French budget and great delay in reimbursement of troop contribution costs; definitive response must await thorough study of proposal; recognize the need for some countries (i.e., Japan and the Gulf states) to pay more, but likely to oppose any change that would result in higher payments for France.

Added cost: \$9.5 million.

Germany understands need for U.S. to reduce burden of UN assessments; urges overall updating of assessment scale and movement of some countries to higher categories; much easier to sell increase based on FRG's assumption of a permanent Council seat.

Added cost: \$26.5 million.

Italy still studying the proposal; acknowledge logic that reducing excessive U.S. financial burden would help to strengthen the UN; not in a position to increase Italy's own contributions.

Added cost: \$12.8 million.

Japan hope to consider peacekeeping funding separately from issue of regular assessments; reducing regular budget ceiling to 20 percent "is a little drastic."

Added cost: \$36.9 million.

Russia concerned that U.S. proposal would require Russia to pay more; supports the U.K. proposal.

Added cost: \$10.7 million.

* The added costs indicate what the increased assessments (for both the UN regular and peacekeeping budgets) for each country would be if our revised scales were in effect in 1994. Figures are based on estimated total UN peacekeeping assessments in 1994 of \$3.5 billion and can be no more than indicative.

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OECD SECRETARY GENERAL CONTEST

The second five-year term of the incumbent Secretary General (SYG) of the OECD, Jean-Claude Paye of France, expires this September. The U.S. and most other members believe that although Paye has led the OECD with integrity, 10 years is long enough. In particular, while we have been careful not to paint this as an "anti-European" issue, we believe that the OECD could revitalize its sometimes Euro-centric and cautious approach through new leadership.

With encouragement from the U.S. and Japan, Canadian Prime Minister Chretien in December 1993 proposed Donald Johnston, the President of the PM's Liberal Party, and a former government minister and member of parliament, to replace Paye. Johnston, a highly-regarded lawyer and expert on public finance, is credited with engineering Chretien's and the Liberal Party's impressive victory in the October 1993 general elections. Johnston is considered a strong proponent of free trade and broke with his party to support the U.S.-Canada Free Trade Agreement. The Canadian Government and Johnston have mounted an active campaign, and Johnston has now visited all OECD member countries to meet with key ministerial-level officials.

There are three other announced candidates: former UK Chancellor of the Exchequer Nigel Lawson, the incumbent Jean-Claude Paye, a French diplomat and Lorenz Schomerus, a high-ranking German civil servant. None of these candidates has generated much enthusiasm. The decision on the SYG issue will be made by consensus of the 25 members of the OECD. The consensus mechanism poses particular difficulty as one country can (theoretically at least) block a large majority. The last time OECD members needed to elect a new SYG, the incumbent (Van Lennep of the Netherlands) was extended for several years before a consensus emerged. To ensure the decision is not unduly delayed, the U.S. and several other OECD members have stated for the record that we will not support even a short extension for Mr. Paye. Of the non-G-7 members of the OECD, Australia, New Zealand, Mexico, Iceland and Turkey support Johnston. Greece, Switzerland, Finland, Norway and Sweden may be leaning toward backing Johnston.

To reduce the possibility of stalemate, Canadian PM Chretien has begun an active campaign of telephone lobbying to his counterparts in other member countries, winning support from Mexico and Australia in the process. Canadian Trade Minister McLaren and Foreign Minister Oullett lobbied their counterparts at the OECD Ministerial June 7-8, but progress was limited. At a small closed luncheon discussion June 7 ministers agreed that the issue needed to be resolved "as soon as possible," although they rejected Iceland's attempt to impose a July deadline.

Japan strongly supports Johnston and has joined several U.S. and

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Canadian demarches in OECD capitals on his behalf. France, the UK and Germany back their respective national champions and have shown no signs of withdrawing, even though none of the European candidates has as much support as Johnston. While Italy does not have a candidate in the OECD contest, the GOI may be seeking EU support for former Trade Minister Ruggiero as the first director general of the World Trade Organization. Some Europeans have criticized Johnston as not charismatic enough or as relatively unknown in international circles.

The real impediment to Johnston's selection, however, seems to be that France, Germany, the UK, Belgium and several other EU members see the OECD SYG slot as just one piece of the larger European institution jobs puzzle, which also includes the EU Commission, the WEU and the EU Council. EU member governments have hinted that they prefer to wait for the EU's Corfu Summit at the end of June to see if a deal can be worked that satisfies the aspirants to these positions.

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MONEY LAUNDERING

The 1989 Summit mandated the creation of a G-7-led mechanism (the Financial Action Task Force, or FATF) to counter illicit money laundering activities. The FATF, whose membership is comprised of 28 jurisdictions and regional organizations representing the world's major financial centers, has become our most effective multilateral vehicle for promoting international action against money laundering.

The FATF's basic action plan dates from April 1990, when the Task Force, then comprised of 15 members, agreed on forty action recommendations aimed at establishing a network of comprehensive reforms to address money laundering and to facilitate greater cooperation in international investigations, prosecutions and property seizures. The FATF has worked, in particular, to define the responsibilities of financial institutions related to illicit transactions and to clarify the limits of bank secrecy laws with regard to criminal investigations.

The Task Force concentrated its efforts in 1993-94 on reviewing progress on the basic action plan and undertaking an external relations program to promote the widest possible international action against money laundering. Nearly all member jurisdictions have now enacted laws to make drug money laundering a criminal offense, with two of the three remaining members likely to do so within the next twelve months. These activities were reviewed at the FATF's most recent conference, held in mid-June in Paris, with the formal adoption of a Progress Report detailing achievements to date. In addition to the creation of a Task Force for the Caribbean area, the FATF agreed to extend its operations through the year 1999. Plans call for a second review of member compliance in 1998.

The FATF has embarked on a program of anti-money laundering seminars and missions in non-member jurisdictions. In addition to major seminars in Riyadh and in Moscow last fall, FATF activities have focused on the Bahamas, Israel, China and the Far East. The FATF is monitoring developments in Eastern Europe closely as well.

Growth in non-drug-related money laundering has made such activity a priority for the FATF and an issue for the G-7 communique. Investment of illicit proceeds into legitimate businesses, including banks, is growing and poses a political and economic threat to the countries where it is occurring. FATF members are also concerned about the linkage of organized transnational crime and money laundering. Sixteen members have made the laundering of proceeds of crimes others than drug trafficking a crime. Another five are expected to do so before the end of 1994.

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Legislative proposals before Congress address money laundering concerns. These proposals also address the problems created by the need for close scrutiny of questionable transactions and the rapid development of financial technologies and practices.

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ILLICIT PAYMENTS

Both industrial and developing countries have recently paid increasing attention to the problem of illicit payments. The USG is concerned about the growing incidence of business-related bribery not only for the serious harm it does to non-bribing American firms, but also because it retards economic development and democracy overseas. Secretary Christopher has spoken publicly on numerous occasions on the need to address this issue.

After four years of negotiating effort, the OECD adopted a Recommendation in May urging member countries to take effective action to combat and deter illicit payments. Apart from Italy, other G-7 members favored a weaker statement than the one finally adopted and were brought around only after strong U.S. urging. Firms from OECD member countries are the main bribe givers, and the onus is now on their governments to take action to deter bribery or explain to other members why they needn't. The most effective step they could take would be to criminalize bribery of foreign officials, as does our Foreign Corrupt Practices Act and the Recommendation suggests this and several other measures.

Monitoring members' implementation of the Recommendation will proceed according to the OECD's established peer review mechanism, but action will not occur overnight. Raising the issue in the G-7, besides maintaining a high public profile for the issue, would tell other members that the USG intends to remain seized with it and will be monitoring their implementation of the political commitment represented by the OECD Recommendation. We do not propose extensive discussion of illicit payments by leaders, but a communique reference to the problem of bribery and G-7 commitment to respond.

The communique language we are seeking does not go significantly beyond the OECD formula, which ministers endorsed June 7 and thus should not spark opposition from other members. Still, given the history of U.S. activism on this issue, it would be preferable if we could second a proposal by host Italy to include this reference.

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HISTORY OF THE G-7

Economic summits of the major industrial democracies have been an annual event since 1975, when French President Valery Giscard d'Estaing invited his colleagues from the U.S., UK, Germany, Japan and (after some pressure) Italy to an informal gathering at the Chateau de Rambouillet on major economic issues. The novelty of the summit was that presidents and prime ministers, rather than finance ministers and central bankers, were meeting multilaterally to discuss economic issues.

The meeting was originally conceived as an opportunity to discuss monetary cooperation, but was broadened to include macro-economic management, trade, East-West relations, energy and North-South relations. The next year, President Ford hosted a similar gathering in San Juan, Puerto Rico. It became a tradition for a different country each year to host the summit and for its leader to act as chair. Canada joined the group beginning in 1977 (making it the G-7), and the President of the EC Commission has participated since 1978 for discussion of matters within Community competence. The leader of the EC (now EU) Presidency country also participates when not already a G-7 member (this happened for the first time in 1980, with Belgium).

The economic themes discussed at the summits have remained fairly constant throughout the past two decades, although the focus has varied depending on circumstances. Energy issues were featured during the years of oil crisis, trade during the years when multilateral negotiations were occurring. In 1978 the Bonn summit was used as a forcing event to make the key compromises to conclude the Tokyo Round. USTR Strauss threatened to bring any unresolved Round issues to the G-7 summit. None of our trading partners were prepared to see their heads of state negotiating trade matters, and deals were quickly cut on essential issues. The 1993 Tokyo summit similarly endorsed a trade package agreed by the Quad negotiators immediately prior to the leaders' meeting.

Political discussions were not on the agenda for the original summit meetings, but increasingly the leaders took advantage of the opportunity to hold informal exchanges of views on the key political and security issues of the day. During the first fifteen years, the discussions tended to focus around East-West issues, terrorism and the situation in the Middle East. With the end of the Cold War and the collapse of the communist system in much of the world, a new set of political issues, centered on integrating Central and Eastern Europe into the global economic system and support for reform in Russia and the NIS, began to predominate. At the 1991 London summit, Soviet leader Michael Gorbachev was a featured guest. He was followed by Russian President Boris Yeltsin in succeeding years. The inclusion of

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Russia in political discussions now appears to have become a permanent feature of the summits.

Institutionally, the summits have evolved considerably since 1975. The original "sherpas" (the name refers to the humble bearers who assisted Himalayan climbers) were the personal representatives of the leaders; indeed, three of the first group of sherpas were not even in government service at the time. Gradually, however, a summit hierarchy has accreted. Sherpas are now assisted by "sous-sherpas" (generally one from the Foreign Ministry and one from the Finance Ministry) and even "sous-sous-sherpas." They hold regular meetings throughout the year to plan the summit agenda and communique. The G-7 process also now includes regular meetings of Finance Ministers and Political Directors. The summits have become major political events (the press corps; which was only 400 in 1975, was 10,000 at the 1993 Tokyo summit).

President Giscard's original concept was an informal, ad hoc meeting of leaders, with no scheduled date for reconvening. In contrast to this concept, others have seen summits as steering committees for the harmonization of national policies whose meetings should be regular and whose participation should be broad enough to ensure treatment of all relevant issues. There has even been discussion of a G-7 Secretariat. Over the past year, however, summit participants have given much thought to moving the meetings back towards a more informal format. John Major has been active in pushing for a more informal, less structured summit, a concept that most G-7 participants seemed to endorse in Tokyo. This has led to a Naples summit with greater time set aside for discussion among heads alone.