

**BILDERBERG
MEETINGS**

**CHÂTEAU MONTEBELLO
CONFERENCE**

13-15 MAY 1983

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NOT FOR QUOTATION

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LIST OF ABBREVIATIONS:

AUS	Austria	IT	Italy
BEL	Belgium	NETH	Netherlands
CAN	Canada	NOR	Norway
DEN	Denmark	POR	Portugal
FIN	Finland	SPA	Spain
FR	France	SWE	Sweden
FRG	Federal Republic of Germany	SWI	Switzerland
GRE	Greece	TUR	Turkey
ICE	Iceland	UK	United Kingdom
INT	International	USA	Unites States of America
IRE	Ireland		

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INTRODUCTION

This report was prepared by Charles Getchell and Grant F. Winthrop, joint rapporteurs. The various individual interventions summarized in the "Discussion" sections have been grouped according to subject matter, and do not necessarily follow the exact chronological order of the discussions.

* * * * *

The thirty-first Bilderberg Meeting was held at the Château Montebello, Province of Quebec, Canada, on May 13, 14 and 15, 1983, under the chairmanship of Mr. Walter Scheel.

There were 112 participants from 18 Western European countries, the United States, Canada, and several international organizations. They represented a variety of fields: government and politics, industry, trade unions, diplomacy, the press, the military services, banking, the law, transportation, education, and institutes specialized in national and international studies.

All participants spoke in a personal capacity, without in any way committing the organization or government to which they belonged. To enable participants to speak frankly, the discussions were confidential, with no reporting being allowed.

The agenda was as follows:

- I. *East-West Relations: Containment, Détente or Confrontation*
- II. *Issues in Medium-Term Prospects for Growth in the World Economy*

In addition to this formal agenda, there was a discussion at the final session of current events of particular importance to the Atlantic alliance.

In opening the conference, the Chairman alluded to several subjects with which the participating countries had been concerned during the preceding year, including the long-anticipated change in the leadership of the Soviet Union, the continuing arms race, the Madrid conference on the Helsinki accords, and the worsening plight of the poor countries.

All of these matters touched directly on the problem of maintaining peace in the world. The fact that there had been no war in Europe since 1945 suggested that our policy there, under the leadership of the U.S., had been the right one. Over the years, Europe had regained its strength and self-confidence, and this had raised the problem of how best to coordinate joint action. An ideal partnership was hard to achieve — not so much because of faulty communication, which was easily remedied, but because of a frequent lack of transatlantic understanding. Americans and Europeans labored under prefabricated notions about one another, and about themselves, and the Bilderberg Meetings had for many years served the useful purpose of providing detailed information and insight into interests and motivations, priorities and assessments, on both sides of the Atlantic.

I. EAST-WEST RELATIONS: CONTAINMENT, DÉTENTE, OR CONFRONTATION

* * * *

“The Soviet Union And The West In The 1980’s: Containment, Détente Or Confrontation”

*Working Paper Prepared by Seweryn Bialer,
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As background for the discussion of East-West relations in the 1980’s, this paper (1) will argue that all three types of relations will and should be present; (2) will summarize the principal dilemmas in Soviet (a) domestic and (b) foreign policy-making at the point of Andropov’s succession; and (3) will consider the prospects for constructive influence on Soviet international conduct in this decade.

1.

Taking into consideration the nature and goals of Soviet-Western relations, it is highly probable that containment, détente *and* confrontation will all characterize Soviet-Western and particularly Soviet-American relations in the 1980’s. No one of these approaches will dominate. Indeed, I would argue that all three should be present as deliberate and coordinated policies of the Western Alliance.

The need to manage and regulate East-West conflict and cooperation has increased dramatically with the escalating dangers of increasingly powerful and accurate nuclear weapons and an unceasing arms race. It is probably the first time in history—and the direct result of the nuclear revolution—that two contending alliance systems separated by such deep divisions and sharp conflicts have exhibited such a relatively high level of conflict management and cooperation. *In conditions of nuclear revolution, strategic parity, and mutual assured destruction, détente between West and East in one form or another is simply unavoidable.*

The scope, intensity and forms of détente relations between East and West may differ over time, but détente as a relatively stable and many-sided relation between East and West is necessary in the remaining decades of the twentieth century if both the Soviet Union and the Western Alliance wish to avoid a highly dangerous runaway arms race and the potentially destabilizing and unpredictable consequences of conflict, as well as to promote cooperation in areas where their interests overlap.

Avoidance of nuclear war, however, does not exhaust the needs and goals of the Western Alliance. These include as well, for the Western Alliance and especially for the U.S., the prevention of Soviet global expansion, the survival of independent and democratic systems in the West, and orderly and evolutionary change in Third World countries. A major dilemma for the Western Alliance is how to arrest the multi-directional Soviet expansionism while at the same time minimizing the chances of nuclear escalation. If the policy of détente renders the competition more stable and thereby less dangerous, the policy of containing the Soviet Union is no less necessary and central. Indeed, *détente makes sense when it contains the expansion of Soviet power.* The policy of containment, its limitations, scope and central regional foci are of course subject to various interpretations within the Western Alliance. The policy itself, however, implemented with determination and skill, is essential to our survival.

To contain Soviet power successfully can be done only by increasing substantially the costs and risks to the Soviets of the kind of international conduct we witnessed from 1975 to 1979. The Soviet Union, taking advantage of nuclear parity and the fear of nuclear escalation, will continue to exploit targets of opportunity in the Third World. We may be certain that in the 1980's the Soviet Union will be strongly tempted to make use of direct and indirect military intervention in Third World turmoil as it seeks to enhance its global power position. The Western Alliance and particularly the U.S. have no choice but to make known their vital interests outside Europe and to prepare a credible response to Soviet expansion whenever those vital interests are threatened. For this response to be credible and therefore effective, the U.S. and Western Europe must be prepared for political, economic and military confrontation with the Soviet union or its satellites. *The global if selective containment of Soviet power can be achieved only if the threat of East-West confrontation is credible.*

Détente, containment and confrontation as policies of the Western Alliance are not mutually exclusive. Their particular mix will depend as much on agreement within the Alliance and on differing attitudes within Western countries and particularly the U.S. as it depends on Soviet international conduct. It is the latter, however, that is my principal concern.

The Western powers and especially the U.S. tend to regard the Soviet Union as the principal obstacle to the realization of their foreign policy goals and indeed the principal threat to their very existence. This evaluation is supported by the unceasing Soviet military buildup over two decades that in almost every category has moved far beyond what the West sees as reasonable defense needs. It is supported also by the pattern of growing Soviet expansionism in the 1970's and the unrelenting quest for greater global power and influence. If Western analysts dispute the weight of single elements in the overall pattern of Soviet expansionism, they do not dispute its sources.

To begin, the Soviet Union, like many states before it, is in an ascending stage of its great power ambitions and has only recently acquired capacities that are more or less congruous with those ambitions. Secondly, Soviet international conduct reflects the ideology of Soviet elites. This ideology should be understood not as a set of doctrinal dogmas which directly dictate action, but as a culture, as tendencies and patterns of thought and belief, that shape the mind-set of policymakers and proceed from the fusion of the most general doctrinal precepts with Soviet and Russian historical experience.

These two elements rarely conflict, but rather their mutual reinforcement adds virulence to Soviet international ambitions and expectations. Soviet military and foreign policy takes its direction from them and from the capacity to pursue them. *This is so regardless of the specific policies of Western powers.* The international strategic behavior of the Soviets may be unchanging over long periods of time—this does not mean, incidentally, that it cannot be changed—while their tactical behavior in the service of the strategy is quite flexible.

Soviet military and foreign policy exhibits primary and extreme concern with the security of homeland and empire and only secondarily with the projection of power abroad for purposes of gaining international influence and power commensurate in their view with their military might. Soviet military expenditures never suffice to make Soviet leaders secure. The leaders in fact pursue the unattainable goal of total security. It is unattainable first because the nuclear age excludes it and second because it contains an internal contradiction, for Soviet security travels only in tandem with the insecurity of its adversaries, a sure route to cyclical military buildup.

The Soviets believe that strategic parity with the U.S. should translate into visible gains for Soviet influence and power in the Third World. The key term in Soviet vocabulary and goals is "political equality" with the U.S. With regard to foreign policy it is not always clear what the term "equality" connotes. Is the model the optimistic and highly active U.S. of the 1950's and 1960's, or the sober U.S. of the late 1970's and early 1980's? I do not doubt that the earlier model of American policies and stature informs the Soviet goal of equality in the 1970's and 1980's.

Soviet foreign policymakers in this respect seek two goals: to reach a position that in the words of Brezhnev and Gromyko will "make impossible the solution of any international problem without Soviet participation" and to pursue a policy with regard to regional conflicts and civil wars that will extend Soviet power to control or influence decisively the policies and internal development of a growing number of states. Since the only foreign policy resource the Soviets possess in abundance to achieve these two goals is their military might, their intervention in regional conflicts and civil wars is a particular threat to the goals of stability and evolutionary change pursued by most Western powers. The danger is heightened by the fact that the two super-powers are obviously out of phase with one another at this stage of their international development and ambitions. American policies are as clearly defensive as Soviet policies are offensive.

2.

As Western democracies deliberate the direction of their own policies towards the Soviet Union, they cannot safely avoid thorough evaluation of the prospective policies and performance of the new Kremlin leadership. For some time now, I have been developing the proposition that the 1980's will see the pursuit of external expansion by an internally declining Soviet power. ("The Harsh Decade: The Soviet Union in the 1980s," *Foreign Affairs*, Summer 1981; "Reagan and Russia," *Foreign Affairs*, Winter 1982/83; "The Andropov Succession," *The New York Review of Books*, February 3, 1983.) The Western observer whose principal concern is Soviet foreign policy must evaluate the extent of the actual and anticipated decline and the likely effect of the internal situation on Soviet international goals and policies.

(a)

Only a very few times in the past has the Soviet Union faced such critical decisions primarily in the domestic area but also regarding foreign policy. The situation is vastly complicated by the coincidence of urgent social and political pressures for reform of the Soviet system and policies with the particularly vulnerable period of succession that will inevitably replace within a relatively short time not only the top leader but a significant number of aged officials at the top and middle echelons of all functional bureaucracies. To postpone or neglect these pressures by dint of inertia or political commitments and continue the drift of Brezhnev's last years will only accelerate the decay. Experience argues, however, that the new Soviet leaders will not willingly undertake any risky internal systemic change or drastic departures in foreign policy. Most disturbing to the leadership is the prospect that regardless of what they choose to do, no policies can achieve rapid improvement in a situation that in many respects is worse than at any time in the post-Stalin period.

The key to the unhealthy situation is of course the economy. Recent studies have concluded that the technological gap between Soviet and American industry remains as large today as it was when Stalin died in 1953. The decline of the Soviet rate of growth to about two per cent a year, the exhaustion of available mass new labor inputs, the lack of cheap raw materials, and the dramatically increased pressures

on investment resources spell the end of extensive growth, the only method of growth known to the Soviets from Stalin's first five-year plan until today. Today's problems are qualitatively different from those of the past. Economic performance can be improved only by means of intensive factors of growth—higher labor productivity, better diffusion of modern technology, and rapid improvement of a chronically neglected infrastructure. Unfortunately for the Soviet leaders, their system of planning, management and incentives is utterly unprepared and unwilling to switch to new intensive methods. Their inability to guarantee the population a respectable level of food consumption and sufficient industrial goods acts as a barrier to higher productivity of labor and management.

The social consequences of economic decline present the new Soviet leaders with the likelihood that the long industrial peace achieved thanks to Brezhnev's ability to increase the workers' real income from the 1960's to the late 1970's will erode. The leaders cannot predict how workers will respond either to the stagnation and decline of real wages that set in late in the 1970's and must continue through this decade or to the decline of intergenerational social mobility that must accompany the decrease in industrial growth, reduction of expenditures for education, and preferential access of the middle and upper middle class to the main source of upward mobility, higher education.

Finally, Soviet leaders may well face pressures for greater political, economic and cultural autonomy from within the non-Russian nations of the Soviet Union, about half the entire population. If the government under Brezhnev successfully managed the "internal empire" by a skillful combination of coercion, bribery and cooptation, the government of his successor will surely be hampered in this regard by the effects of economic conditions in the 1980's, not the least of which is a demographic trend which locates the bulk of the available new labor pool in Moslem areas.

Andropov has begun to consolidate his authority more rapidly than either of his predecessors. It seems he will have a high degree of autonomy in initiating and implementing a plan to improve economic performance. Today his power base rests mainly in the KGB, but he will come to control effectively the Soviet political elite—the professional party apparatus. All indications suggest that Andropov can formulate his political directions and economic decisions without decisive restraints from either the party apparatus or the professional military whose role in key internal and external policymaking has in the past been greatly exaggerated by the West. The principal question is whether Andropov will undertake major economic reforms. What we know about the Soviet system, about Andropov, and about his first months in office allows us to speculate that some policies in this area are already certain, some are very likely, and some are very unlikely.

It is certain that in the short or intermediate range Andropov will pursue a policy designed to elicit greater social, political and economic discipline from all strata of society. Already underway is a well advertised campaign in this regard which includes greater candor in admitting to the public the pessimistic economic prognosis and the expectation of inevitable austerity; greater visibility of an active, concerned new leadership in contrast to the paralysis of the old; and a forceful effort by means of coercive measures, inspections, demands for accountability, etc., to improve dramatically the discipline of workers and of the bureaucracy at all levels.

It is very likely the new leadership will undertake a major reform of agriculture, the most critical area for ensuring political and social stability. The reform may follow either the principle of greater privatization as in China or greater managerial freedom and flexibility as in Hungary. Since peasants have long ceased to threaten the Soviet system, they, along with their managers, can be given without risk more

extensive economic rights in exchange for higher production. The main difficulty in agrarian reform will come from lower party bureaucrats whose way of life and reason for existence it will severely undermine.

It is very unlikely that Andropov will be willing or able to effect a radical structural change in the economic system. Formidable obstacles preclude its satisfactory implementation, and Andropov will have to be content with marginal if important structural changes and with advantageous revisions of budgetary allocations. (No Soviet official or economist, it seems, considers the Hungarian economic model suitable for entirely different Soviet conditions.)

Thus Andropov will pursue in the political area a "law and order" policy and a higher level of authoritarianism and in the economic area a serious effort to improve economic performance through reform. The combination may well yield a marginal improvement without halting the secular trend of economic decline. It will probably do little to impede the attendant social decline, the most blatant and alarming manifestations of which include widespread alcoholism, corruption and lack of a work ethic. Nor will it relieve the pervasive cultural pessimism that increasingly pierces the curtain of official optimism.

Abundant evidence indicates that in the 1980's the political and social stability of the Soviet Union will be severely tried, the Soviet economic situation will be more critical than at any time since Stalin's death, and the manifest decline of the Soviet empire will accelerate. To leap from this evidence to predictions of a catastrophic systemic crisis (the present fashion in the West and especially in the Reagan entourage) is profoundly erroneous and opens the way to judgmental errors that can severely erode the prospects for managing the East-West competition. It is most unlikely that severe economic stress will provoke either political or economic collapse. It is unrealistic to act as if drastic escalation of costs in a new arms race will inhibit Soviet military growth. The Soviet Union is not now, nor will it be during the next decade, in the throes of a genuine systemic crisis.

Will the general domestic decline, the "muddling down" of economic growth, and the corrosive effects of social corruption be sufficient to force Soviet leaders to concentrate on internal over external goals or to impair their effectiveness in the international arena?—My best estimate is that they will not. The Soviet Union retains key foreign policy resources that may be sorely undercut but will remain no less potent ingredients of an activist foreign policy. The Soviet political system boasts enormous unused reserves of political and social stability that suffice to survive the deepest difficulties. Unbridled Russian nationalism remains an effective device to mobilize support for the regime. The Soviet economy has reached a level of production that even in conditions of declining growth can support an active foreign policy. The size of the Soviet military machine is so large and its modernization so advanced that even with lower growth in the 1980's it will still constitute a formidable foreign policy resource.

The Soviet military faces two major, though far from catastrophic, problems in the 1980's—one economic, the other demographic. The economic problem is not guns versus butter but rather investment in the industrial plant versus direct expenditures for guns—that is to say, between the need to develop and modernize the Soviet industrial plant that provides the backbone of future military strength versus the growth in weapons production and direct expenditures for the upkeep of the armed forces. The demographic problem consists in the assured dominance of non-Russian, non-Slavic draftees into the armed forces in the 1980's, a likely cause of social tension and impaired military proficiency. Yet both problems are far from heralding a substantial decline in the defensive or offensive strength of

the Soviet military as an instrument of Soviet foreign policy.

The entire direction of Soviet military and foreign policy over the successful Brezhnev decades also militates against a fundamental reorientation of Soviet policymakers to internal questions. Indeed, the bleak internal prospects could well compel Soviet leaders to seek more accessible and durable successes in the international arena. Moreover, during the next few years, foreign policy will certainly become more significant as a legitimizing element of Soviet rule in general and of party rule within the establishment in particular. At the same time, domestic difficulties can create strong pressures for Soviet leaders to engage in serious arms limitation and reduction talks with the West. They will certainly make even more imperative the importation of foreign technology. But even if such considerations act to limit the range and scale of Soviet adventures abroad, they cannot in the last analysis alter the basically activist and global Soviet foreign policy, so deeply rooted, as we have seen, in the domestic environment.

(b)

Andropov inherits a foreign policy characterized by lack of direction or cohesion. For the last three years, Soviet foreign policy has preferred "carrots" to "sticks." One important if not central reason for this retrenchment was the change in America's policy line during Mr. Carter's last year and Mr. Reagan's first two years. The Soviets have avoided testing Mr. Reagan as they seek to fathom what lies behind his rhetoric and the resurgence of radical conservatism in the U.S. Other reasons include the early onset of the succession struggle together with the decline of Brezhnev's ability to rule; the temporary overextension in Ethiopia, Afghanistan and especially Poland; and the desire to preserve détente with Western Europe and especially Germany as the détente with the U.S. began to unravel. This last consideration took on special meaning as the Soviet Union worked to prevent the deployment of intermediate nuclear forces in Europe. Even had these last three years offered more tempting targets for low-risk Soviet expansion, I believe the Soviet leaders would still have chosen the low profile in foreign policy.

Following this period of relative passivity, Andropov will surely seek to define a comprehensive and coherent general line, to establish clear priorities and orderly relations among the chosen goals and elements of policy. His choices will of course be affected significantly by Western and American policies; by the state of relations between the U.S. and its European allies, especially the Federal Republic of Germany; and by America's ability to localize the inevitable regional conflicts and civil wars in the Third World or to render prohibitive the costs of massive Soviet intervention in them. Putting aside those unpredictable variables, however, one can identify some tendencies likely to characterize Soviet foreign policy in the near and middle future.

In the short run, the process of succession itself dictates the basic tendencies of foreign policy. First, there is the need to insulate the unconsolidated leadership preoccupied with domestic problems from foreign challenges. The new leader is thus more open to initiatives for regulating and improving his country's relations with its principal adversaries. In relations with the U.S. and the Western Alliance, the central axis of Soviet foreign policy, peace issues will predominate over threats.

Second, the new leader will try to interrupt the bureaucratic inertia of his predecessor and dissociate himself from Brezhnev's failures. He will seek normalization of relations with the Peoples' Republic of China; he may seek improvement of relations with Japan; he could conceivably be encouraged by astute Western efforts to explore ways to extricate Soviet troops from Afghanistan while preserving

Soviet security interests and face.

Third, the new leadership at this vulnerable time will work to preserve what it considers vital international positions and interests. The principal position is Poland whose domination and political stability Andropov will pursue at any cost. The principal interests are the inherited balance of military power—strategic, theater and conventional—which will be preserved at almost any cost and the détente with Western Europe and particularly Germany which represents today the cornerstone of Soviet foreign policy.

With regard to the balance of military power, one should stress that this succession is the first when the Soviet Union operates from a position of strategic parity and theater nuclear and conventional superiority. *It is the first time in Soviet (and Russian) history when the Soviet Union is as strong as its key adversaries (and should, therefore, feel safe).* Accumulated military strength gives the new leader control over an awesome power enjoyed by neither of his two predecessors at the start of their rule. The key question of the succession is whether this enormous military might, which the Soviets are determined to maintain, will serve purposes of blackmail and offense or whether it will make the leadership more amenable to new and drastic arms control and reduction.

Apart from the basic tendencies in Soviet policy dictated by the requirements of succession, there are three specific problem areas which must be addressed by the new leaders either immediately or directly after the consolidation of power. Andropov cannot long avoid substituting for the drift of Brezhnev's last years a central policy line concerning the East European situation, relations with the U.S. and the Western Alliance, and Third World targets of opportunity.

The Soviet "external empire" has commenced its decline. The bloc already places heavy burdens on the Soviet Union in economic, military and political terms. In the 1980's the economic difficulties of bloc countries must increase; growth will decline drastically; and the unavoidable austerity programs may yet again spark social and political unrest. The Soviet Union is already cutting subsidies to its "allies" (Poland in particular), and it seems that it has no alternative but to force them (including Cuba) to rely more substantially on their own very limited resources.

As for the military situation, Soviet contingency planners probably calculate that the size of Soviet forces needed to keep East Europe subjugated in case of war already exceeds the size of elite units in Warsaw Pact countries that could be trusted to participate reliably, effectively and offensively in a Soviet strike against Western Europe. Politically, the Soviet Union will monitor the general situation and the policies of client governments very closely and compel rapid and decisive responses to any symptoms of the "Polish disease." Indeed, the situation in Eastern Europe has become more and more an embarrassment which costs the Soviets much of the influence they retain among Communist parties abroad while endangering their détente with Western Europe.

The basic Soviet approach to Eastern Europe will not be abandoned, however unsatisfactory it is in solving the crisis. Soviet security requires the domination of Eastern Europe just as the retention of these principal Soviet spoils of World War II constitutes a basic legitimizing element for the Soviet party and leadership among the elites and the population at large. The decisive preoccupation of Soviet leaders will be to preserve at any cost the political stability of Eastern Europe without at the same time contributing significantly to such stability from the economic point of view. If East European regimes cannot hope in the 1980's to strengthen their legitimacy through satisfactory economic performance, their only alternative is to pursue it through anti-Soviet, nationalistic policies. The East European stalemate

will persist in the 1980's in an ever harsher economic climate. It promises many dangers for the Soviet Union.

The second area where Andropov must formulate a coherent policy line concerns relations with the U.S. and the Western Alliance. The major questions are whether the Soviet Union can restore any semblance of détente with the U.S. while Mr. Reagan holds office, whether the 1984 American presidential election offers any realistic prospect for restoration of even a modest détente, and, if not, what general line will replace this policy that had promised them so much in the 1970's and delivered so little. Unfortunately for Andropov, there seems to be no substitute for a U.S.-Soviet détente that would confine competition to areas short of confrontation and foster some cooperation in areas where interests of the two superpowers overlap. For it is America and only America that has the resources and the will to alter the East-West military balance with or without Europe, as it has also the ability and unilateral capacity to accept the existing balance and negotiate serious arms control or reduction. It is America and only America that is committed to political and military globalism and to the erection of barriers against Soviet global expansion.

The Soviet foreign policy establishment, it would seem, attaches central importance to Soviet-American relations—even more so today, if that is possible, than in the immediate past. In periods like the present, when relations with the U.S. are unlikely to improve, it advocates a very active policy towards Western Europe as the second-best policy, the most promising alternative. The foreign policy establishment tends to divide, however, on strategic and tactical objectives concerning Western Europe. However, neither those who would court Europe mainly in order to influence American policies through European pressure nor those who would improve West European relations primarily to weaken the Western Alliance have any illusions about how much is to be gained from the West Europeans and how far differences between the U.S. and its West European allies can be exploited.

Andropov has not yet decided what can still be achieved with the Reagan administration, what changes in American conduct can be expected before the 1984 election, and how to relate long-range Soviet goals to détente and relations with Western Europe, especially Germany. For the rest of 1983, it would appear, the central issue will remain INF. The issue has enormous long-range implications and may, depending on the outcome, determine the formulation of Andropov's general line towards the West.

Andropov is developing a maxi-mini strategy concerning INF. His maximum strategy is to prevent deployment thanks to Germany's refusal. Should this strategy succeed—in my opinion it represents a Soviet hope rather than an expectation—the Atlantic Alliance will experience its greatest crisis, one with unpredictable political, economic and military consequences in Europe and especially in the U.S. While marginal in military terms, INF is far from marginal in political terms. Andropov's minimum strategy is to use the issue to undermine the alliance; and should the Soviets see that deployment cannot be stopped by Germany's rejection, they may present new proposals for a more equitable balance of intermediate-range missiles in Europe. Such proposals could lead to postponement of deployment and further negotiations on this issue and the related START.

Regardless of the outcome with INF, I believe Andropov will pursue his "peace offensive" and détente with Western Europe until he sees what emerges from the 1984 presidential election. By then, presumably, he will have consolidated his own power and thus be in a position to make important decisions on arms control and reduction as well as to negotiate compromise solutions on issues that engender conflict with the U.S.. Should President Reagan gain a second term, Andropov will

again face today's dilemmas. At such a point the tension-without-danger of today will become the "tension-with-danger" of tomorrow in a fluid and unpredictable situation which in my opinion will see the triumph of Soviet tactics over strategy—that is, the pursuit of tangible gains in the Third World regardless of the consequences for Soviet-American relations.

The third area that will require a central policy line is the Third World. One should regard the ambitious Soviet activity of the 1975-79 period neither as the only possible or likely pattern of Soviet conduct nor as a transitory aberration that ran a course not to be repeated. Andropov will certainly continue military assistance and military involvement as opportunities present themselves in the 1980's. His success will depend on the extent of his commitments and the determination of his opponents.

Soviet policies in the Third World vacillate, in Professor Ulam's apt phrase, between those of the "speculator" and those of the "rentier." The former accepts high visibility, high risk and high investment in the expectation of dramatic rewards. The latter prefers low visibility, low risk and minimal costs for more sure and modest rewards. In the short run I expect Andropov to be a "rentier." In the intermediate range I expect speculation to appeal as irresistibly to him as to his predecessor. Andropov will succumb more easily to temptation if the West European powers exhibit disinterest and insensitivity to the consequences of Soviet adventures in the Third World and if the U.S. proves unable to commit resources to such change in the Third World as could defuse regional conflicts and civil wars.

Aside from limits on Soviet foreign policy resources that can be expended in the Third World, Andropov will surely face tough decisions in exploiting Third World opportunities, especially given the harder line expounded recently by the U.S. The risk that Soviet actions will produce confrontation with the U.S.—which the Soviets do not want—will counsel the restraint of a "rentier." Moreover, foreign adventures will endanger progress along the central axis of their foreign policy—relations with the U.S.. As long as relations between the superpowers remain paralyzed, this consideration makes little difference. But when genuine prospects appear for improved relations and negotiations begin in earnest on key military issues, Soviet leaders will have serious choices to make.

In sum, Soviet planning of foreign policy in the intermediate and long range must confront basic incompatibilities among Soviet interests. An assertive policy of Soviet expansion in the Third World is incompatible with reduction of tension and avoidance of confrontation with the U.S.. The insatiable Soviet appetite for larger weapons programs and greater military strength conflicts with desires to forestall a new and costly arms spiral, to negotiate arms control measures, and to separate the question of military balance and arms control from their political and economic relations with the U.S.

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In the nuclear era there is no choice for either the U.S. or Western Europe but to negotiate with the Soviet Union on a broad range of issues and to strive for the dependable management of inevitable competition and conflict. Rather the question is whether the Western Alliance can influence the policies of the Soviet Union and, in particular, whether it can influence the choice of options open to the new Soviet leaders. My answer would be a qualified yes. Since any important action of the West clearly affects Soviet policy, however, the real question is whether our influence reflects deliberate effort as distinct from unintended consequence and whether such

deliberate effort can be elaborated and sustained in the democratic environment of our own policymaking. In the last analysis our influence will depend in part on the choice of our objectives with regard to Soviet policy and in part on our strength, unity, steadfastness and flexibility.

It is utterly utopian to believe that our influence on Soviet policies can lead to fundamental systemic change in the Soviet Union, a durable reorientation of Soviet policymakers from external to internal priorities, or an abandonment of any major arms buildup that Soviet leaders deem essential to the security of their country, their empire and their global stature. We cannot, moreover, significantly influence either the overall ambitious direction of Soviet foreign policy or the outcome of any alleged contest between alleged Soviet "hawks" and "doves." What we can and should try to influence with regard to the Soviets are the content of their specific military and foreign policies, their readiness to exploit foreign temptations, and the degree of moderation or extremism in their overall international conduct. This may not seem like much; but it is the most we can hope for; and, in the dangerous conditions of escalating nuclear armaments and world turmoil, even this modest influence may be a condition of our survival.

The two central goals of Western policies toward the Soviet Union are to prevent Soviet expansion and to achieve an equitable balance of military power. It is misleading, therefore, to focus our attention, as is often done when discussing East-West relations, on the narrow formulation of questions: Can a Soviet-American détente be restored? Should the West European détente with the Soviet Union continue given its potential for disrupting the Western Alliance? The bundle of policies, ideas and expectations we call "détente" is neither good nor bad in itself. The real question is how effectively it serves our two main goals vis-à-vis the Soviet Union.

On this score, the détente of 1970's vintage did not pass the test of effectiveness, at least from the American point of view. Détente became in the U.S. a symbol of America's lack of will and of the failure of the Western Alliance to preserve its unity and to influence constructively the international conduct of the Soviet Union. The word acquired a negative emotive meaning going well beyond the actual suppositions and assumptions on which it rested. Let me therefore avoid this term and speak rather about the substance, forms and instruments of policies which have as their goals the preservation or restoration of the East-West military balance, prevention of Soviet expansion, and regulation of the East-West conflict. Let us examine the many lessons we have learned from our experience in the 1970's and early 1980's as they bear on our present situation.

First, the *internal* strength of the U.S. and West European countries is as important in formulating and implementing effective policies with regard to the Soviet Union as their *external* strength. Mr. Kissinger's policy towards the Soviet Union during the early and mid-1970's was not wrong in itself. The expectations of what it could achieve, at what price, and how quickly were grossly exaggerated, however. That the policy collapsed was not the fault of either the policy or its chief architect but of the conditions which at that time prevailed in the United States and to some extent survive today—the post-Vietnam malaise, the depressed levels of military spending, the deleterious effects of Watergate on the American political system, particularly its executive branch.

Second, the unity of the Western Alliance is essential in formulating policy towards the Soviet Union, especially as regards the policy instruments chosen to influence Soviet international conduct. For America, the quest for unity is a frustrating experience. When the U.S. moves closer to the Soviet Union, its European allies

fear a Soviet-American "deal" or Soviet-American "condominium." When the U.S. moves away from the Soviet Union, its European allies fear that Europe will be dragged into confrontation with the Soviet Union or that the risk is heightened that war will be fought on European soil.

Third, the pendulum of American policies towards the Soviet Union tends to swing from one extreme to another and leaves for both the Soviet Union and Western Europe a disconcerting and accurate impression of unpredictability. Indeed, the American political system and national character militate against the pursuit of a steady and steadfast policy towards the Soviet Union beyond, at best, the four-year tenure of a president. To formulate and implement a comprehensive, consistent and well-calibrated policy towards the Soviet Union is especially difficult in the U.S.. Potent forces work against it: sensationalist media, a greatly weakened party system and tradition of bipartisan foreign policy, the tendency of the political public to view the Soviet Union in simplistic either-or terms rather than as an adversary with whom one both competes and cooperates.

Fourth, the nature and range of instruments that were developed to influence Soviet foreign policies during the early and mid-1970's are quite broad. They include the escalation of the costs and risks of Soviet expansion, the manipulation of the Soviet fear of confrontation with the U.S., the preservation of a just balance of military power, the offer of rewards in economic, political and status fields, etc. No combination of those instruments and the policies they serve will solve miraculously our conflict with the Soviet Union, however. There are no "quick fixes." The conflict can be regulated only through flexible and effective use of those instruments as disincentives and incentives. *Here a key lesson of the 1970's and early 1980's is that only when disincentives are credible, strong and continuous can incentives have any effect. But only when incentives are offered will disincentives have major effects.* The success of the skillful combination of incentives and disincentives will depend on reasoned agreement among the Allies to coordinate their use and in the last analysis on the internal political, economic and military strength of the democracies.

In the 1980's, the key question is not what the new Soviet leader's foreign policies will be. It is rather what those of the Western Alliance will be. What realistic goals should the Western Alliance pursue? To the end of this century and probably even beyond, democratic nations have no choice but to face the conflict with the Soviet Union while at the same time striving to cooperate in the mutual interest. Let us hope that this conflict will retreat from the dangerous threshold of nuclear escalation and confrontation and that a united Western Alliance can wait out the expansionist stage of Soviet development. Until this stage of Soviet national life passes, the U.S. and the Western Alliance have no choice but to pursue a policy of "Containment, Détente and Confrontation" towards the Soviet Union.

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DISCUSSION

Discussion of this agenda item was introduced by a panel of participants who commented in some detail on various aspects of the subject and suggested some lines which the discussion might follow. The panel consisted of Seweryn Bialer, Henry A. Kissinger, Helmut Schmidt and, for the afternoon session, Pierre Elliott Trudeau. Walter Scheel and George W. Ball acted as chairmen. The remarks of the panelists have been incorporated below in the summaries of each sub-topic.

Developments in the Soviet Union and its policies. An American observed that the Soviet Union faced in the coming years major decisions in its domestic and international affairs. This was so because of the confluence of several important events and trends, including the succession of new leadership, a severe economic crisis, the collapse of détente, the overextension of Soviet foreign policy, and the volatile situation in Eastern Europe.

Though the Soviet economy had advanced during the past twenty years, it faced a set of difficulties that required new, untried solutions. Growth had declined in every sector of the economy, the technological gap between the Soviet Union and the West was as great as ever, and Soviet agriculture was in crisis after four successive bad harvests and the failure of previous regimes to make effective investments in agriculture.

Soviet society, accustomed to a standard of living that had improved steadily from the time of Stalin's death until the mid-1970's, now faced a stagnating standard of living. The effects of this could be seen in the widespread corruption and declining work ethic among the industrial working class. Declining expectations had also given rise to political apathy.

In the military sphere, the Soviet Union faced a conflict between the demands of military leaders and the desires of the Communist party leaders. The former favored continuing high direct expenditures for weapons, while the latter supported long-term investments in the industrial-military sphere. The rapid growth of non-Russian ethnic groups also presented the military with a problem. And the growing role of the military in foreign policy was a potential difficulty for the political leadership.

The Soviet Union faced a general decline of their Eastern European empire in economic, political, and military terms. The Eastern European nations faced a harsh decade, with the prospect of cuts in Soviet subsidies giving rise to economic hardships, which in turn could be expected to yield social and political unrest.

In the field of foreign policy, the Soviet Union found its resources seriously overextended. It had little except military aid to offer. In their relations with the U.S., Soviet leaders had not found a substitute for détente. Their foreign policy had undergone a "general unravelling", with an emphasis on short-term goals at the expense of intermediate and long-term ones.

But, the speaker stressed, in spite of the challenges facing the Soviet Union, it was unlikely that major systemic change would take place. The price of change in the industrial area in the form of decentralization was potentially higher than doing nothing or making only minor adjustments. Military expenditures were unlikely to decrease in favor of other production because of the military's central role in foreign policy and its status as the system's internal showpiece. Likewise no important change in the Soviet Union's policy toward its Eastern European satellites could be expected, for not only was that empire a security concern, but it was also a "legitimizing force" for Soviet ruling elites, and they could be expected to remain totally committed to it. In foreign policy, the Soviet Union was still ascending as

a great power and its ambitions would not decrease with a change in leadership. With respect to the military challenge from the West, the Soviets would certainly meet it, regardless of cost.

Though sweeping, systemic changes could thus be discounted, subtle change had already begun under Andropov. These changes were not apparent to the general population, but the Soviet elites were well aware of the slow, methodical changes Andropov was carrying out. These changes included major personnel shifts, with the new leader removing many of his predecessor's people from office and replacing them with his own appointees, many of whom were younger men. Andropov was also transforming the central party apparatus into the main instrument of long range planning, rather than the overseer of the affairs of state. With respect to the military establishment, he had obtained for himself the post of head of the defense council and was creating an independent defense council staff. In the agricultural and industrial areas, there was evidence that Andropov had initiated some reforms, though not major ones.

As to Eastern Europe, the speaker predicted that Andropov would closely monitor political and economic events in order to prevent a situation from getting out of hand. He would insist on a commitment to political orthodoxy in Eastern Europe, and would attempt to intergrate those countries' policies with Soviet policy.

In foreign policy, the emphasis would be on the carrot instead of the stick, on peace offensive rather than military build-up. But at the same time, the Soviets would be determined to permit no change in the military balance with the West. In the short term, the Soviet leadership would be awaiting the outcome of the 1984 U.S. elections before settling on longer range foreign policy development.

In summary, the speaker felt that despite its current problems, the Soviet Union was not disintegrating nor was it on the verge of bankruptcy. It had major reserves of stability to draw upon, including the low expectations of citizens who had not experienced the postwar era of rising expectations; the tool of repression; political apathy; and Russian control over the internal empire. Finally, they had going for them traditional Russian nationalism. In short, the Soviets were experiencing a "crisis of effectiveness, not of survival."

A German speaker agreed that the Soviet Union would meet the Western challenge no matter what the cost. He pointed out that the Soviet leadership had a major advantage in the capacity of the Russian people to suffer. They could tell their people that, in order to preserve the peace, they would have to sacrifice some of their standard of living. In order to meet the threat from the West, they would have to lower their expectations. The speaker had no doubt the Soviet leaders could successfully play this card.

But how durable was this capacity to suffer, wondered a Greek participant. It was a factor for stability among the Slavic peoples, but not among the faster-growing Asian components of the Soviet population. This demographic problem would be potentially explosive for the USSR.

Several speakers referred to emerging Sino-Soviet rapprochement. Some felt it was a matter of concern for the West, but others saw China as a continuing long-term problem for the Soviet Union, in spite of any short-term thawing of relations.

It was generally agreed that economic difficulties presented the Russians with one of their greatest challenges. They had all the West's problems on top of a system that did not work. An American observed that Soviet leaders were faced with the necessity of making changes in their system without "losing their Marxist virginity." It was unlikely that Andropov, whom the speaker viewed as an interim leader, would make fundamental changes, but there was a danger that internal problems

could affect his foreign policy. Did he want a period of calm on the outside in order to deal with his internal problems, or did he want foreign policy issues to draw peoples' attention from problems at home? The West needed time to see how events in the USSR would develop.

The other major challenge in the view of many speakers was the situation in Eastern Europe. A German participant pointed out that what the Soviets used to see as a "belt of security" had become a "belt of insecurity." They had a growing problem of instability in their sphere of influence. A Belgian wondered if the Soviet Union could count on its Eastern European allies in a conventional war. An American agreed, saying that Poland, especially, was not only an economic and political problem, but also a military problem for Soviet contingency planning. The Polish situation had changed the central front of NATO. Poland was, for all practical purposes, not a member of the Warsaw Pact. The Soviets, who viewed earlier events in Hungary and Czechoslovakia as accidents, had good reason to worry that there was instead a trend developing in East European countries.

But a Turkish speaker warned against any illusions. The Western alliance had to be aware of the essential stability and coherence of Soviet policies. Their economy, however weak it might be, was resilient enough to sustain adequate military power in relation to the West. The Soviets were very clear about priorities. These were, first, to preserve and maintain their great power status, and, second, to keep their political and ideological hold over Eastern Europe. Finally, their obsession with security was not likely to moderate.

What should Western strategy be? While there was little disagreement about the challenges and difficulties facing the Soviet Union, several speakers warned that we should look to the state of the NATO alliance. While we could take some comfort from the weaknesses and difficulties facing the Soviets, we were not without our own problems. An International participant spoke of the "weakness, hesitation, and disarray" in NATO, which Moscow no doubt found encouraging. From the Soviet standpoint, he continued, Western countries were "permissive and lacked discipline."

It was true, a Briton argued, that the West had its own set of problems, especially economic ones, but we were basically strong. Our problems were more cyclical than systemic. But another British speaker wondered if a society that had either high inflation or high interest rates, that could not get them both down simultaneously, and that relied for economic stability on one of the most unstable regions of the world did not have a systemic problem, at least as viewed from the Soviet perspective.

Many speakers stressed the need for unity in the alliance. But a Portuguese asked if that were not a very difficult objective to achieve. It was impossible, he felt, to view Europe and North America as a whole. Their interests, situations, and views were vastly different. But, said a Belgian, the Soviets were masters at exploiting disunity in Europe and within the alliance, so unity had to be a high priority.

Unity in the alliance meant a unified strategy in dealing with the Soviet Union. An American view held that the alliance faced a complicated situation in which it was dealing with a nation that was an "ideological" opponent with whom we nonetheless were compelled to coexist." We had to oppose that nation's expansionism but also demonstrate that we did not seek confrontation. We had to defend our interests but realize that our capacity to change domestic institutions in a totalitarian system was limited.

The task of the alliance, continued the American, was to defend against a common threat and to achieve common objectives. The alliance faced difficulty in East-West relations and in global strategy because both of the purposes for which it existed

were under pressure simultaneously. There was no agreement on the nature of the threat nor on the common objectives we sought to achieve.

Another American agreed that, while the policies followed by the West would surely influence the choices made by Soviet leaders, it would be a mistake for the alliance to think it could, or should, have as a goal to influence internal developments in the USSR. We should be clear that our goal was containment of Russian expansionism by any means necessary, including military force, if our vital interests were threatened. A reintegration of alliance foreign policy along these lines was called for.

A French speaker stressed that the Soviet Union should see the alliance as "determined, but also cooperative." We should not seek to frighten the Soviets with harsh rhetoric, but we should define and follow a global strategy. The Soviet Union was an expansionary power, and we needed to state clearly that we would stop any moves to create imbalances in the world. But at the same time we had to reassure the Soviets that we were not out to threaten their security, or their economic or social development.

The time for the anti-communism of the 1950's had long since passed, one American said. We had to make clear we were not fighting the Soviet system, even though we did not like it, but rather the expansion of that system. An International speaker agreed, urging that we not appear to be on an anti-communist crusade, but simply determined to protect our way of life and our institutions. The proper prescription, said a German, was a "cooperative kind of security rather than an antagonistic kind."

Another German argued that the realistic goals of the alliance should be to defend itself by adequate political and military means and to deter the adversary from waging war and aggression; and at the same time to instigate the adversary's interest in partial political, military, and economic cooperation, especially in arms limitation and reduction. It was predictable that the Soviets would achieve nuclear parity with the West. The need now was to seek stabilization of peace through a stabilized military balance. Beginning in 1967, the alliance had pursued this kind of dual strategy, combining elements of cooperation, competition, containment, and conflict-readiness. This concept, which had taken 20 years to develop, was still valid but had been overshadowed and all but shattered by the most recent two U.S. administrations.

The speaker proceeded to trace the evolution of "Western grand strategy."

(1) After World War II, there had been a brief period defined essentially by the U.S. in terms of the Marshall Plan and a renunciation of nuclear weapons. The Soviets did not participate in the Marshall Plan and rejected nuclear renunciation. Stalin instead consolidated Russian rule over the states of Eastern Europe, threatened Berlin, and laid the foundation for the Soviet nuclear arsenal.

(2) The Russians had thereby provoked the second phase of grand strategy, that of the doctrine of massive nuclear retaliation and the concept of a global system of anti-Soviet alliances.

(3) The third phase was already in development during the second phase, going back to 1956 when the so-called "three wise men" asked for political consolidation of the alliance beyond the military field and demanded consultation among the allies in decision-making. President Kennedy had acknowledged those demands five years later in his "two-pillar" speech. During the 1960's the foreseeable Soviet nuclear parity had led to the 1967 abandonment of the strategy of massive retaliation and the adoption of the current strategy of flexible response and forward defense. This third phase was the most fruitful, yielding the test-ban, non-proliferation,

ABM, and strategic arms limitation treaties. These stabilized the balance in Europe and the equilibrium in the area of intercontinental missiles. They signified a partial security partnership between the two strategic nuclear powers.

Since 1976, Western grand strategy had gradually been withering away, with the East-West relationship on the decline. Both superpowers had lost their "mutual confidence in the calculability of the other side," which had existed within limits until the end of the Nixon-Ford-Kissinger era. Starting with the Carter administration, the consistency and continuity of Western grand strategy had been lost. The attempt by the current U.S. administration to apply economic sanctions against America's closest allies was indicative of the state of decay. There had been a whole succession of unilateral actions by the U.S., from the Olympic boycott to the grain embargo to the space warfare speech.

It was true that Soviet mistakes and violations had contributed to these developments. The Soviet "double complex of inferiority and security" with regard to global relations and world peace was dangerous and had caused a speeding up of the arms race. The Russians had involved themselves in the Middle East, Africa, Central America, had invaded Afghanistan, encouraged Vietnamese imperialism, and had taken advantage of the omission of Euro-strategic missiles from SALT by devising and deploying the SS-20, a weapon designed to divide Europe and the U.S. in time of crisis. Soviet actions had thus made the military component of Western grand strategy crucial.

NATO's military strategy. An International speaker reviewed the specific objectives of the current military strategy of the alliance. The two basic objectives of Western security arrangements were (1) to have a credible deterrent to overt aggression as well as political intimidation, which could result from the Soviet perception that we were unable to defend ourselves; and (2) to negotiate arms reduction accords and control measures for all categories of forces and arms.

We needed to give the Soviets incentives to negotiate seriously, and this required that, politically, we be viewed as cohesive and united, and, militarily, as able and willing to implement our deterrent strategy of flexible response. This was a valid strategy, but only if adequate forces existed for each leg of the triad. At the time of the adoption of the flexible response strategy, the West had had nuclear superiority in both the strategic and theatre fields and was confident that qualitative improvements could overcome Soviet numerical conventional superiority. But we had been surpassed in all three categories. Our forces improved each year, but the gap between them and the Warsaw Pact continued to widen.

The speaker was satisfied that we were on the right path toward redressing the nuclear imbalance, but, on the conventional side, the nations of the West had been derelict in meeting their commitments to force improvements. As a result, we had "mortgaged our defense to the nuclear response." Under present conditions, the commander of Western forces in Europe would have to request use of nuclear weapons fairly soon after an attack by the Soviet forces. We had "bought ourselves a short conventional war" because we lacked the manpower, ammunition, and pre-positioned material to sustain ourselves conventionally.

But, the International participant continued, the situation could be restored. As a defensive alliance, we did not need to match Warsaw Pact forces one for one. The alternative to the "short nuclear fuse" was to provide the alliance with the capacity to frustrate a conventional attack without resorting to nuclear weapons. We needed to motivate and train our soldiers, modernize our ships and aircraft, and make use of the emerging technology which would enable us to hit targets deep behind enemy lines, such as choke points, bridgeheads, command and control

headquarters, etc. We required not just new manned aircraft, which were becoming increasingly vulnerable to air defense, but surface-to-surface and air-to-surface missiles. To reach these goals, the Western nations would have to meet the targeted four per cent real increase in military spending from 1983 to 1988.

With a modern and strong conventional capacity, the speaker concluded, we would raise the nuclear threshold and force upon the Soviets the option of either withdrawing or being the first to escalate to nuclear weapons. Yet NATO strategy should not give up the first-use option, nor nuclear weapons themselves. It was crucial that we retain a "full spectrum" of nuclear weapons with the option to be the first to use them. This did not mean that we should not pursue a program of reducing the number of nuclear weapons on European soil, as we had been doing.

A German participant felt that military strategy could be boiled down to six basic principles: deterrence; credibility of deterrence in the adversary's eyes; adequacy of defense if conflict should break out; continuous reevaluation of adequacy to meet changing conditions; equilibrium, or balance of power so that both sides might have confidence; and acceptability at home. This last principle was perhaps our greatest challenge, as the NATO nations faced an increasing deficit in credibility with their politics.

The speaker agreed that it was necessary for the West to be able roughly to match the Soviet forces in the conventional field. This was true to a large extent because, under the principle of acceptability, the first use of nuclear weapons in response to a conventional attack would, as the decade went on, become increasingly unacceptable to Western public opinion. But, he felt, conventional equilibrium could not be achieved merely by spending money. The key ingredient needed was soldiers, properly motivated, trained, and educated. Only secondarily did we need to spend money on material, aircraft, weapons, etc. Those countries that believed they could build a strong conventional defense without conscription were deluding themselves. In West Germany, the Chancellor had the ability to call up 1.3 million men in a matter of days. Western strategists tended to forget this formidable force, whose existence rendered Warsaw Pact ground forces not greatly superior to NATO's. Indeed, while there were certain shortcomings in the alliance's conventional capability, Soviet superiority was much exaggerated. The Soviets had concentrated most of their build-up at sea, and still their fleet was inferior. They enjoyed some advantage in air power, largely because the West had put too much emphasis on the nuclear side of its air defense.

Soviet nuclear superiority was similarly exaggerated. Both sides still had adequate armaments to assure mutual destruction. In the strategic area, both sides still had assured destruction by second strike, with many windows of vulnerability. Only in the field of Euro-strategic missiles had the Soviets gained clear advantage, and this was an imbalance that had to be "put right" at the INF talks in Geneva.

An American agreed that reliance on nuclear weapons would eventually lead to a "political, military, and psychological dead end." But renunciation of first use of them, whether tacit or explicit, would lead to a "psychological disarmament" of the West. No level of conventional build-up could insure against the Soviet temptation to use nuclear blackmail. The West should not use nuclear weapons lightly, but it would be dangerous to adopt no first use as an operating principle.

Conventional build-up was appropriate, but it had to be viewed in perspective. Rarely, if ever, in history had a deterrent balance of conventional forces been achieved. Wars had been occurring for hundreds of years between countries who assessed their military balance as equal. And countries which turned out to have inferior numbers, as Germany did in two world wars, were able to achieve great

successes. The speaker warned that a stated policy of no first use would make war, even nuclear war, more likely. All wars had occurred where there were no nuclear weapons. It would be a mistake for the West to imply it would rather be defeated in a conventional war than start a nuclear one. No matter what we had declared, it was not likely we would ever accept a conventional defeat without resorting to nuclear weapons.

An International participant pointed out that the nuclear arsenal had preserved the peace for 30 years. The credibility of that deterrent would be weakened if the element of uncertainty were removed. It was important to remember that the alliance was defensive, and would not use any weapon first; it would only respond to an attack.

In the event of an attack by conventional means, wondered a Canadian, was not the presence of tactical nuclear weapons on the battlefield a temptation to use them? An International speaker responded that use of any nuclear weapon, whether initially or otherwise, required political authority. There was no predelegation on the use of nuclear weapons to the military commanders.

Another perspective was offered by a Swede, who said that it made little difference from the neutral point of view who used nuclear weapons first. It would be as deadly for all concerned. While the superpowers could shape the world, the neutrals had to try to live with the situation.

The age of nuclear weapons, said an American, confronted Western leaders with two contradictory tasks. First, we had to not talk recklessly about using them. Second, we had to elaborate "some scheme for their use that was not automatically destructive of all civilization." No one in high office with some control over nuclear weapons could accept that the only strategy was mass destruction. Other options had to be put forward. Conventional build-up was fine, but it had to stop short of renunciation of the nuclear arsenal. We had to relate our build-up to our mission, to define the purpose of our strategy. A bipartisan statement defining objectives and missions was needed in order to take the subject of defense out of the "endless debate between those who argued that we should have any weapon technologically possible and those who opposed any build-up on the grounds that we already had enough."

A Canadian agreed that it was possible to consider using nuclear weapons which would do less than wipe out humanity, as an exchange of ICBM's probably would, and which could be targeted to hit non-civilian targets. But this would be a tough sell to our publics. There was "a delicate balance between deterrence and reassurance," argued an American. It appeared that NATO's chief concern had shifted from crisis stability to war fighting, and this scared people. The implication that there could be victory in a protracted nuclear conflict or that there were alternatives to massive destruction did not make sense to many people.

The role of public opinion. A German emphasized that public opinion would be decisive in carrying out alliance strategy. Democracies would not be able to maintain military strategies that were not accepted by their people. More people today questioned the credibility of the alliance than defended it, as the debates over nuclear freeze, no first use, and MX and INF deployment suggested. If we lacked credibility at home, we might not be given the means to implement strategy by our parliaments.

An American agreed, saying it was wrong to look at domestic realities as a nuisance or constraint; they were rather a vital ingredient in any intelligent strategy. To set intelligent objectives, we first had to read the realities correctly, starting with the domestic ones.

It was a Portuguese speaker's opinion that we had to be mindful of the successor generation. Without taking it into consideration, we could not plan future defense strategies. Peace movements represented a significant segment of the population in most NATO countries, and they had great influence. Would they disappear ultimately, as such movements had in the past, or would their influence grow?

A Canadian found it frustrating that peace movements had begun to flourish at a time when the alliance was striving to meet the threat to peace posed by the build-up of Soviet armaments. Leaders found that their policies were often put forward to a populace that did not understand them, and often in a demagogic environment where peace movement spokesmen escaped the real issues by "invoking moral values." We were living in an immoral world, and we could not make decisions based on individual moral principles. We had to consider our adversary's morals. It was hard to get people to understand this, and that, perhaps, was a failure of political leadership.

But leaders had to meet the challenge, said a German. We had to pursue arms control and disarmament in a serious and credible way, but not as ends in themselves. For we had "overmilitarized the problem of peace." We needed to explain the political threat from the Soviet Union, which people in Europe, and in West Germany especially, had forgotten. States were not in conflict because they were armed, but because they had different interests and political concerns. There was a political influence race going on, which the Soviets were determined to win. There was the danger not just of war, but of an "overwhelming political hegemony" over Europe by the Soviets, who were working to create a climate of "preventive good behavior" in the Federal Republic. People who had not lived through the two Berlin crises did not realize this. The political threat had to be explained to the younger generation.

An American acknowledged that it was one of the roles of political leaders to lead public opinion, but how far was debatable. It was possible for leaders to dwell too much on public opinion. A Briton agreed, arguing that the military considerations of Western security should be the determining factor of whatever strategy we adopted. But we had to properly assess those considerations and present them to our publics "with clarity and calmness and an understanding of their nervousness about nuclear weapons."

Another American saw a danger that too much worry about public opinion allowed the most extreme, least reasonable forces to have a sort of veto over policies that would otherwise be properly pursued. A compatriot agreed, arguing that on too many matters of vital importance, the first assessment made was what could be sold domestically rather than what was necessary. There was a real risk for leaders in following public opinion. If in following public opinion, a leader's policy led to disaster, he would not be forgiven by his public, even though he sought to carry out its wishes. In the late 1930's Neville Chamberlain had taken the most popular course and, as a consequence, had been politically ruined. One could not ignore public opinion completely, nor should one be driven by it completely.

The INF negotiations. There was general agreement that educating and informing public opinion was vital to the ongoing INF talks. We needed to stick to the double-track decision, a German insisted, and to make an intense effort to come to a mutually satisfactory compromise. If some deployment of Euro-missiles was necessary in the end, the public would have to be convinced that the "utmost, sincere, and sustained effort to reach a compromise" had been made, and that it was due to the Soviet Union's intransigence that negotiations to obviate deployment had failed.

The need to be perceived by our publics as taking the negotiations seriously was agreed on by all speakers. That perception so far was not widespread. A Dutch participant said that while his government would have preferred negotiation on the threat of deployment rather than a decision to deploy if negotiations failed, it was prepared for some deployment to take place. Nevertheless, a very large proportion of the Dutch people did not think the negotiations were being taken seriously.

Similarly, in West Germany, pointed out a speaker from that country, a significant segment of the people would always oppose deployment. A 56 per cent vote for the Kohl government did not mean that 56 per cent of the population favored deployment. There would be riots and demonstrations at the time of deployment, he warned, which would present a major challenge to the West German government. A fellow German agreed, saying that Europe was in for a "hot autumn," and that the countries hosting the new weapons would have to be prepared for civil disobedience. It would not help much to try to educate people, as the "arcana of strategic thinkers" was far beyond most people's comprehension, especially the young. The more we tried to educate them, the more scared they would get.

It was true, said an American, that domestic considerations complicated the INF negotiations. The best course for the West to follow would be to define a "generous, reasonable position" and stick to it. Our problem was that we ran the risk of being accused of inflexibility. But if the Russians viewed the U.S. as feeling obliged to break every deadlock with a new proposal, they would never have an incentive to accept any proposal.

The INF problem, continued the speaker, was not so difficult intellectually, but it was very difficult politically. The challenge was to determine if there was any number of Soviet weapons for which the West should accept zero deployment. If there was not, what number could we treat as equivalent? Equivalence did not have to be defined in exact numerical terms, but we needed to come forward with a number and stick to it.

A German speaker traced the historical development of the INF negotiations—the failure of the Carter administration to include Euro-strategic weapons in the SALT talks, the basis of the December 1979 double-track decision, and the eventual agreement of Brezhnev to negotiate. What would ultimately be deployed would be decided on the basis of the negotiations. The zero option had never been a realistic proposal. A compromise had to be found between the Russians' position of zero for the West and 350 for themselves, and the Western position of zero for both sides.

An American viewed the deployment of Euro-missiles with alarm, suggesting that it would be followed by a new round of Soviet deployment. Where would the cycle stop? Another American believed the Soviets would deploy new SS-20 missiles in East Germany, aimed at West Germany, and in the northeast corner of the Soviet Union, aimed at the northern tier of U.S. cities.

Challenges outside the NATO area. It was an American concern that NATO lacked a framework to deal with challenges in the Third World. We had a "conceptual matrix for discussion of arms control and military strategy," but we had "neither mechanisms nor concepts for issues outside the NATO area." It was true that the alliance had no legal obligation to operate outside of its area, but countries did not defend each other because of legal obligations but because their perceptions of national and international interests compelled them to act.

As in our military strategy, we had to define our goals and objectives. Were we resisting the fact or the method of change? Was there something in the world we would never permit to happen? What would we resist in the name of security? If

we could not answer these questions, we could not state positive goals.

The next war was more likely to result from a crisis not sought by either the West or the Soviet Union, and which they could not or did not wish to control, than it was likely to result from an attack in Europe. Such a crisis in the Arabian Gulf area was a good possibility before the end of the decade. The reaction of the Middle Eastern countries to the Western capacity to protect its interests around the world would be crucial. (In the same way, it was not a trivial matter how Mexico, Colombia, and Venezuela perceived America's ability to define and protect its interests in Central America.) When the Gulf countries came to their moment of crisis, their perception of how the U.S. and its allies had performed elsewhere and our ability to achieve stated objectives would be vitally important. The NATO nations had to have some means of defining their goals and dealing with each other in a long-range manner and not simply in the framework of the exigencies of domestic politics.

A British participant endorsed this view, saying that the "irresolution of the West" was a matter of grave concern. If the West looked irresolute in Central America or the Middle East, its problems would be that much worse. Moderate men could not survive if they did not get understanding and help from the West in military, political, and economic terms. The danger was not just from the Soviet Union, but from the more extreme elements in their own countries who would seek to persuade the electorates that moderation would not pay.

Soviet achievements in the Third World, in a Turk's view, were not so much the result of successful Russian policies as of "erroneous policies" of the West. The Soviets had made many miscalculations, as Afghanistan showed. The West should take advantage of Soviet mistakes, an Austrian said, and formulate a credible Third World strategy. There was a large window of opportunity for the West in view of the disarray in non-aligned countries. But more than an imitation of Soviet strategy, which was based on military assistance, was required. A concerted economic strategy was called for. At the same time, said a Frenchman, we should be mindful that the "Marxist explanation of history" was quite attractive to many Third World countries, and we should try to get over our tendency to forget the ideological dimension.

A participant from the Netherlands was less inclined to favor any sort of Western intervention, arguing that it often pushed a Third World country into open Communist arms. Other speakers were critical of the U.S. tendency to view all Communist governments as in the Soviet camp. The response of one American was that once a country had gone Communist, it was difficult to prevent a Soviet orientation, or even Soviet bases in that country. It was a legitimate aim of the U.S. to try to prevent the rise of Communism in certain countries.

Our policy with respect to Third World areas, advised another American, should be to reach an agreement with the Soviets as to what were the rules of the game. We should draw the line at military intervention by the Soviets, a line they could not cross with impunity. But we had to learn to take preventive measures in areas where crises did not yet exist.

Another area of potential trouble for the West was the financial crisis in the Third World. This particularly troubled an American who did not share the view of many financial experts that the crisis had been overcome. The problem of debt in Third World countries could lead to radicalization, with countries renouncing the debt problem as simply a financial matter. We had to prevent Third World countries from imposing debt settlements on us "by means of radical domestic change." This would have the dangerous result of rewarding domestic radicalization

and would encourage those countries to think the way to deal with the West was to impose conditions on us by blackmail. The debt problem had to be solved as a development problem, and that was the responsibility of every country in the alliance. If we did not live up to that responsibility, we would face a balance of power shift as significant as any of NATO's more traditional concerns.

Conclusions. A German participant pointed out that, in spite of all the questioning and self-examination, the NATO partners should not lose sight of the fact that their alliance had preserved peace for three and a half decades for all its members and territories. It continued to be "one of the most successful alliances in modern times." It had demonstrated many times its ability to adapt and adjust to changing conditions and situations. By no means was the alliance "shrinking to its knees."

An American speaker urged that in our negotiations with the Soviet Union we convey to them a "sober definition" of what the purpose of the exercise was. Their asset was persistence. They "stuck to their positions and harvested the fruits of our impatience."

Our need was to define for ourselves our objectives and to create an international structure less driven by domestic considerations. In view of our capabilities and our tasks, there was no reason why we should not be the group of nations creating the emerging world order. Our course would be determined by our effectiveness.

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II. ISSUES IN MEDIUM-TERM PROSPECTS FOR GROWTH IN THE WORLD ECONOMY

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A. PROTECTIONISM AND EMPLOYMENT

"The Future of World Trade"

*Working Paper Prepared by Raymond Barre,
Former Prime Minister of France, Member of the National Assembly*

I.

Over the past 30 years, world trade has been a major factor in the growth of the international economy. Its steady expansion has contributed towards the prosperity of the nations, whereas the drop in world trade made the Great Slump of the thirties even worse. Between 1948 and 1973, world trade grew at an annual rate of 8 per cent, while world production was rising at the rate of 5 per cent.

At the present time, world trade is passing through a very difficult period.

— A recent survey by GATT shows that the volume of trade fell by 2 per cent in 1982. In dollar terms, international trade declined by 6 per cent compared with 1981 under the combined impact of this fall in volume and the rise in the value of the dollar. An increase of 1 per cent in the volume of trade in agricultural products, although well below the 4 per cent increase recorded in 1981, was the only positive feature of the world trade picture last year.

— Despite all the efforts over the past 20 years to promote freer international trade — efforts that have been kept up since the first oil shock in 1974 — and to prevent any resort to protectionism, there is now growing pressure for restrictions on freedom of trade as a result of the economic recession and the rise in unemployment. The weekly review "The Economist" pointed out on 3 April 1982 that 25 per cent of world-trade is now carried on through barter agreements, 25 per cent is the result of internal transactions within multinational corporations, and a further quarter is subject to quotas or agreements for the "voluntary" limitation of exports; which means that trade carried on through the machinery of the market only accounts for 25 per cent of the whole. This quarter of world trade is exercising a growing attraction as its share shrinks.

— The disintegration of the international monetary system and the introduction of floating exchange rates have, in recent years, stimulated protectionist pressures because the instability of exchange rates and their over-reaction to the forces at work in the currency markets have set off defensive reactions among producers and consumers alike, curtailed incentives to long-term investment, placed a premium on speculative short-term investments and had a depressing effect on international business.

The overvaluation of the pound sterling and the dollar, together with the undervaluation of the yen, are probably more important factors in the evolution of world trade patterns than tariff or non-tariff barriers, however inadvisable those may be.

— The problem of the indebtedness of the developing countries also hampers the growth of world trade. Yawning balance-of-payments gaps and the cost of servicing their debts may force these countries to cut down their imports and protect their

domestic markets, while trying to give an artificial stimulus to their exports. The stability of the international economy may be seriously threatened by the trend of all countries to import less and export more. The whole world would thereby be caught up in a vicious circle of deflation and depression.

II.

When beset by problems such as these, is it possible to maintain free trade policies in the industrialized countries and to encourage them in the developing countries?

A negative reply is provided by the "Cambridge school", which argues that the liberalization of international trade since the end of the Second World War has led to unemployment and prevented the efficient use of the economic resources of all the countries concerned. The economists of this school propose their own formula of "controlled trade" on a world-wide scale. They contend that protectionism is necessary both to industrialize the developing countries and to safeguard the aging industries of the declining economies. They also take the line that free trade nowadays is a myth: OPEC controls the price of oil, Japanese industry is heavily subsidized, and the U.S. obstructs imports of steel and cars. They accordingly urge that states should impose uniform tariffs sufficiently high to prevent any rise in imports and to enable substantial resources to be allocated to the development of national industries. Lastly, they recommend the conclusion of an international agreement on a new set of tariffs and "voluntary export restrictions."

These arguments find a ready audience, in both the industrialized and the developing countries, among politicians and trade union leaders who are worried by the level of unemployment and hope to lower it by restricting imports.

III.

Historical experience shows that all periods of economic stagnation or recession have given renewed impetus to protectionism; it also shows that protectionism has never been a cure for recession, but a force for economic contraction, a fall in overall economic productivity, the misallocation of economic resources and a reduction in living standards. In today's world, where trade liberalization has provided a powerful stimulus to economic development and industrial growth, the raising of trade barriers would be a step backwards. It is essential, therefore that the industrialized countries and the developing countries alike should strive, in their own interest, to maintain a world free-trade system. But such an objective can only be achieved through a joint effort by all the countries concerned.

(1) It is plain that a world economic upturn would be the best way of ensuring that many countries do not resort to protectionist measures, because it would lead to trade expansion.

The upturn that has been apparent in the U.S. since the beginning of the year is an encouraging sign. But it is essential that it should develop into sustained expansion, which will depend in the main on lower real interest rates in the U.S. and, as a result, throughout the world. Only a fall in real interest rates can provide the necessary impetus to investment and the resumption of growth. The spread of the American recovery throughout the world will depend on the proper management of the other leading economies, especially the Federal Republic of Germany and Japan.

(2) The best way to avert protectionism and expand international trade will be through a return to greater international monetary stability. Nobody nowadays will

dispute the adverse effects of the floating exchange rate system. Obviously, the time is not yet ripe for a return to a fixed but adjustable system, akin to the one provided for in the Bretton Woods agreements. But two major steps forward could be taken without delay:

— The leading countries in international monetary relations could adopt an *exchange rate policy* as part of their general economic policy. Recent experience has shown that exchange rates cannot simply be left to market forces, and that of any effective policy of growth and stability requires action to be taken to influence the exchange rate through monetary policy, budgetary policy and appropriate intervention by the central bank.

— The main central banks could co-ordinate their currency operations, not in order to maintain unrealistic exchange rates, but to prevent excessive fluctuations. There is nothing, except dogmatic theory, to prevent intervention along these lines, which the central banks should carry out pragmatically. The de facto stabilization of exchange rates might pave the way for a more ambitious regulation of the international monetary system once differences between rates of inflation have been narrowed sufficiently.

(3) As long as the recovery does not gather momentum and make itself felt more widely, I think it would be dangerous to contemplate fresh world-wide negotiations aimed at freeing trade. The important thing is to maintain the *current* degree of free trade. Looked at from this standpoint, the ministerial conference of GATT in November 1982 should not be regarded as a failure. The results certainly fell short of the illusory expectations that had been raised, but they are important even so, if set in the context of the current world economic situation. It is important that the contracting parties should have undertaken "to reduce trade frictions, to control protectionist pressure, to avoid the use of export subsidies incompatible with Article 16 of the GATT and to promote the liberalization and expansion of trade."

The Conference laid down an even more ambitious program than was announced: improvements in the safeguard system; specific problems in trade in agricultural products; and the elimination or liberalization of quantitative restrictions.

Lastly, the Conference decided to review the problems arising out of trade in services and to decide by 1984 whether an international agreement on services would be opportune. This foreshadows a new stage in world trading relations. If the whole world economic pattern is to be changed so that the countries of the Third World can develop the industries they need for their industrialization and secure access to the markets of the industrialized countries, the services sector, which is playing an increasingly prominent role in the industrialized countries, must be able to play an active part in international trade.

(4) The long-term solution to the problem of the indebtedness of the developing countries will depend on the latter's ability to *export* more to the creditor countries. We are faced with a classic example of the problem of "international transfers." In order to cope with it, the short-term loans granted to the developing countries must be converted into long-term loans, the interest rates on the loans must be reduced and the debtor countries must be able, over the long term, to repay their debts *in real terms*.

(5) In the trading relations between the developed and developing countries, it is obvious that uncontrolled free trade is no more the answer than protectionism. If we are to avoid strains and breakdowns during the process of adjustment that will be required in both groups of countries, there must be machinery for producing an "orderly growth of trade", in other words:

— multilateral agreements enabling the developing countries to expand their exports regularly without causing sudden, intolerable harm to the industries or economies of the developed countries, and giving the industrialized countries time to carry out the necessary structural adjustments;

— the *progressive* relinquishment by the developing countries, as they industrialize, of the protective devices shielding their domestic markets and of the subsidies they grant to their exports; this is essential to ensure that the industrialized countries are not saddled with a lasting, unilateral handicap.

(6) The case of Japan should not be underestimated because of the small share of its domestic market acquired by foreign manufactured goods. Leaving aside the "voluntary" limitation of exports, which can only be a passing phase, growing participation by Japan in the international trade system will depend on the opening up of its domestic market and proper management of the yen within an orderly system of international monetary relationships.

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"The Prospects for Full Employment"

*Working Paper Prepared by Thomas R. Donahue, Secretary-Treasurer,
American Federation of Labor & Congress of Industrial Organizations*

I wish I could share in the optimism that some pundits and politicians have been expressing about the prospects for world economic recovery. But to the extent that much of that optimism is based on the notion that the "invisible hand" is about to perform magic while we and our governments sit and watch, I think it is badly misplaced. In the view of the AFL-CIO, the signs of economic recovery are sparse, tentative and fragile. For the working people of all of our countries, recovery is all but invisible. Unemployment remains the most urgent threat to social stability throughout the world, as it has been for three years.

In the U.S., by the most conservative count, 11 1/2 million people are looking for jobs that do not exist. More than double that number in other OECD countries raises the total to 34 million in the advanced industrialized nations. The Trade Union Advisory Committee to the OECD estimates that unemployment in the OECD countries will rise to 40 million in early 1984. That is not just one number in a set of economic indicators that will be automatically adjusted or offset by changes in other numbers, such as the Dow Jones averages or the closing figures on stock exchanges anywhere. In fact, however, a good portion of the current problems in our economies was caused by treating the unemployment figure as if it were just one more economic indicator — a "lagging indicator," at that.

The monetarists who prescribed a stiff dose of unemployment as a cure for inflation, and the politicians who took their advice, have infected the Western nations and the world at large with a virulent social disease, which affects working people first and most seriously, but then spreads its disease-effects throughout society.

In the U.S., the fact that April's unemployment figures were, at first glance, no worse than those of March, brought a great deal of self-congratulation from administration spokesmen. And yet those figures showed that unemployment is growing among adult males, the heads of families. In all countries, mass unem-

ployment falls, like war, most heavily on the young. In March, the latest figures showed at least one out of four persons under the age of 25 in the European Common Market was without work, without any economic or social function to perform. It ranged from 15 per cent in West Germany to 35 per cent in the Netherlands. In my country, unemployment among the young is no less catastrophic. Overall, it is 21 per cent. For young blacks, it stands above 50 per cent, and that figure is matched or exceeded among whole populations in less developed countries.

To disinherit the young, to deny them the opportunity to start families and establish a secure and respected role in the life of the community and the nation, is not the way to ensure the future of civilization. If we are ever going to have a world of stable, productive, self-reliant citizens who value order and respect the rights of others, full employment has to become the primary economic goal of every society. The prospects for that full employment seem dim and distant even in the long term. In the medium term, we see no hope for full employment, if current policies are maintained.

In the U.S., the rate of work force growth will slow in the 1980's, and will about match the growth of the work force in the European nations. In the U.S., that growth will raise our 1980 work force of 106 million workers to 122 million in 1990. As that total work force grows, all of the industrial nations see their industrial base shrinking with the shift of some goods-producing employment to the less developed countries and the continuing automation and robotization of what will remain. At the same time, we see some growth in employment in the service industries or information industries. In the U.S., there has been an overall shift in employment of seven per cent from goods-producing to service industries. In 1970, 34 per cent total employment was in goods-producing industries and 66 per cent in services. By 1990, we will have only 27 per cent of our work force in goods-producing industries and 73 per cent in services.

Job shrinkage continues, so far unabated, in our manufacturing industries, with no prospect for returns to pre-recession levels. American and multi-national employers continue to move manufacturing processes from the U.S. in search of the lower wages of the less developed countries. Robotization, only in its infancy in the U.S., will claim about 300,000 jobs by 1990, with a potential for replacing three million workers in the U.S. metal working industry in the following 10 to 20 years. No one has yet accurately estimated the impact of automation on the growing office-clerical employment, though one French study estimates a 30 per cent reduction in white-collar employment flowing from office automation — with the use of word-processors and mini-computers.

The so-called high-tech industries do not hold promise for mass employment in the industrial nations. Indeed, the movement of production jobs in high-tech industries to low-wage countries is already developing. High-tech does hold some promise for employment of scientists and engineers and computer analysts and programmers, but not for less-skilled employment.

Consequently, what we see ahead in the U.S. in the short and medium term is continuing high unemployment into 1990, even if one assumes a general economic recovery by that time. Further, as lower-paid service industry employment grows and the higher-paid manufacturing employment shrinks, the entire wage base of a nation is lowered with consequent effects on standard of living, on consumption patterns and on tax revenues to the government.

These conditions are, in varying degrees, being played out in most of the industrial nations. If they are to be addressed, we will need not only a general economic recovery and restoration of employment, but as soon as our economy can accept

it, there will be the need to reduce working hours without loss of income, and to create and maintain government employment programs to take up the slack.

We all recognize that it is no longer possible or desirable, if it ever was, for any one nation or group of nations to force their way to economic growth or full employment at the expense of other nations. World recovery depends on world cooperation. Any recovery program has to flow from negotiations among all countries (regardless of their economic position) within existing frameworks, such as the OECD, and be extended as rapidly as possible to every country willing to join in the effort. Instead of maneuvering for immediate individual advantage, these countries must strive for common progress and attack directly the sources, rather than the symptoms, of economic imbalance.

Banks and international credit agencies, including the International Monetary Fund, have to stop disrupting world trade by treating each client country as if it existed in a vacuum and could solve all of its problems by promoting exports, excluding imports and disregarding the interests of other nations. There must be immediate negotiations to reduce real interest rates in order to reduce their role in determining currency values and the flow of capital. The international monetary system must be stabilized to create a climate for open multilateral trade and productive long-term investment. The IMF must reclaim and regain from private banks its powers of surveillance over exchange rates and exchange markets.

There must be an end to unchecked beggar-thy-neighbor mercantilism on the part of nations that use trade as a weapon to capture the markets and destroy the industries and jobs of other nations. On all sides, we have to learn to look at and talk about the world as it is, without cloaking our intentions in dishonest slogans and pious catch-phrases. Calling exclusionary export enclaves "free-trade zones," instead of protectionist zones, and subsidizing business at the taxpayer's expense in "free enterprise zones" shows nothing but contempt for the intelligence of the people. The pretense that governments subsidize exports purely as a generous kindness to the consumers of other lands will not continue to arouse gratitude once those consumers find that the result is unemployment. A persistent national tradition of manipulating currency exchange rates to advantage exports ought not be allowed to masquerade as a "free market response." The voice which calls for protection of workers' employment ought not be scorned as "neo-protectionism" while the voice which dictates an export penetration strategy designed to wipe out the last five per cent of a nation's domestic production in a particular product is allowed to pass as "good business."

For our part, as American trade unionists, we intend to persist down two related roads. We will call for and be fully prepared to practice fair trade among nations. For so long as there is no fair trade, we will struggle to protect our jobs and our interests against those who seek to take advantage of us. Nonetheless, we believe that trade among nations, developed and developing alike, has to be made into an engine of mutual growth. There must be recognition that nations must include both producers and consumers, and that producers and consumers are the same people. In this world, consumers are, and must be, producers as well, or there will be no consumers, no markets and no production at all. That's the fundamental economic reason why full employment should be the paramount goal of all our countries, separately and collectively, but there are other reasons that transcend economics.

In a series of social encyclicals over the last century, four great Popes have argued for recognition of man's position at the center of the economic order — with that order serving man, not vice versa. In the latest of these encyclicals, "On Human Work," Pope John Paul II has developed the thought of the earlier Popes

to its logical and theological conclusion by declaring that human work is a key — "probably the essential key" — to the whole social question, and by establishing the principle of the priority of labor over capital as a postulate of the order of social morality. "There is dignity in work," Pope John Paul says, "and work must provide fulfillment as a human being. It must be arranged so that it is not only worthy of man, but also so that it corresponds to man's dignity, expresses this dignity, and increases it."

In that way, the Pope formulated a plain fact of which I think working people have been conscious through the ages: the fact that work, in and of itself, is much more than an economic function. It is the central human activity through which each person shapes, develops and defines himself as an individual and as a member of the human community. In the section on unemployment, Pope John Paul flatly declares that the role of national governments and international agencies "is to act against unemployment, which in all cases is an evil and which, when it reaches a certain level, can become a real social disaster." Such a disaster has plagued this world of ours for too many years, and it is time that our governments awakened to their duty, as Pope John Paul spells out that duty.

"The state," he notes, "must conduct a just labor policy," in which "the objective rights of the workers are fully respected. The attainment of the worker's rights cannot however be doomed to be merely a result of economic systems which on a larger or smaller scale are guided chiefly by the criterion of maximum profit. On the contrary, it is respect for the objective rights of the worker that must constitute the adequate and fundamental criterion for shaping the whole economy, both on the level of the individual society and state and within the whole of the world economic policy and of the systems of international relationships that derive from it."

In the human enterprise with work as its center, Pope John Paul declares, trade unions are not only legitimate and necessary, they are "indispensable." Over the last century, some of the goals of a just labor policy have been realized and achieved through collective bargaining and legislative activity, with our unions, always, at the center of the struggle. That struggle is far from finished, but the nature of that struggle — the struggle to establish and continually reaffirm man's dignity — is visible throughout the world, most clearly, perhaps, in Poland.

Who would dare to say that the struggle that unites the Catholic Church and the trade unionists of Solidarity in common cause against the monolithic, totalitarian power of the state is more economic or more political than moral? The immediate human goals of Solidarity and the universal values of the Church blend into a seamless pattern from which neither element can be separated without doing violence to both. Both act to affirm human dignity. In that spirit, the AFL-CIO and the international trade union movement call upon the decision makers of banking, industry and government to reconsider what their responsibilities really are. Their roles need to be re-examined in terms of what contributions they can make to the advancement of human life and human dignity in the world — what they can do in pursuance of a full employment economy structured to serve man as its first priority.

If the economic structure is to be revised to give priority to human life and work over capital, how many and far-reaching are the changes required of national policy and corporate policy? Is it not required that the corporate balance sheet give at least as much attention to the number and quality of jobs it has provided as it does to the profits it has provided? If the worker is to be the center of corporate planning and thought, is it not a moral wrong to allow particular facilities to

deteriorate through inadequate reinvestment, and to close those facilities and throw hundreds or thousands out of work? Is it not necessary to give greater attention to safety and health than to increased production, where that increase is achieved by diluting those measures? Is it not necessary for the transnational corporation to be a force for social improvement in Third World nations, recognizing and enhancing the human dignity of its employees, rather than exploiting and perpetuating an underdeveloped wage system?

In national policy, is it not necessary for government, once and for all, to enforce social policies that acknowledge the legitimacy and the necessity of worker organizations, and occupational safety and health policies that acknowledge the worker's right to life, liberty and the pursuit of happiness, in the most fundamental terms? Is it not necessary, if the human potential is to be developed to its highest level, for all nations to establish, maintain and continually improve minimum standards of education, health care, nutrition and housing, and to provide the training, encouragement and opportunity that every human being needs to realize his humanity through productive work? Is it not necessary for government to take counsel, in concert with industry and labor, on ways to maximize opportunity, productivity and social and economic stability, rather than manipulating the tax structure to reward the one and punish the other? Is it not necessary to agree that government is the employer of last resort and that national government must develop and use international mechanisms which will guarantee full employment? Is it not necessary to measure trade effects not alone in trade balances but in job placement or displacement balances?

We have so long talked in the short-hand of economic symbols that we have not only made man and employment secondary to monetary values, but we are now speaking of a recovery in which the restoration of workers to jobs becomes the last measure, and to the extent that unemployment persists, we will redefine it so as to make our economic symbolism more acceptable. The goal of all nations must be a full employment society in which each person has the opportunity for education, training and decent employment which will create the possibility not just to have more but to be more. That is a goal for our time; a goal to be sought by all who feel the obligation to foster human dignity, with or without theological imperatives. That is the goal and the program of workers and their unions in my country and throughout the world. I am most grateful for the opportunity to set it before you.

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DISCUSSION

The discussion of this part of this agenda item was led by Donald S. Macdonald as chairman and Raymond Barre and Thomas R. Donahue, authors of working documents, as panelists.

A French participant began by referring to the close links between unemployment and trade policies, and the difficulty of fighting unemployment and resisting protectionism at the same time. The problem of unemployment was now so great that many people were trying to solve it at any cost, including resort to artificial stimulants. Fortunately, though, our governments had so far avoided damaging protectionist measures. The situation was now better than in the early '70s, after the first oil shock, with the useful OECD trade pledge having been renewed every

year since 1974. People recognized that protectionism was a short-term remedy with high long-term financial and structural costs in distorting the allocation of resources. "Textbook" free trade was admittedly non-existent, but protectionism had historically had an inverse relation to economic activity, prosperity and rising standards of living. Examples of protectionism could be found in every part of the world, but the speaker would not give in to "catastrophic views." We had to recognize the advantages of specialization over autarky, and to resist the artificial creation or maintenance of jobs by protectionist devices.

Until the economic recovery had accelerated, though, and unemployment declined, it would be dangerous to move too fast toward dismantling existing trade restrictions. A more realistic goal would be to try to maintain the present level of free trade while allowing time for necessary structural adaptation. The underlying problem of American steel, for example, was not dumping, but an antiquated industry faced with Japanese competition that was more efficiently managed. As such industries adapted, subsidies could be phased out progressively, and we had to make clear our intention to do so. But in Europe and the U.S. the rigidity of wages and the relative immobility of resources made quick adaptation impossible. To "abandon ourselves to market forces and uncontrolled free trade" in a time of recession and high unemployment would be to invite serious political problems and reactive breakdowns. For these reasons, the author advocated the collective management of orderly growth in world trade, and the "adoption of mutually acceptable rules of the game" — not to counter fundamental economic trends but to allow time for the sustainable adaptation of structures.

An American speaker began by quoting the following statement which Lane Kirkland, president of the AFL-CIO, had recently given to a press conference:

I think I may use this occasion to announce my conversion to the principles of Adam Smith and David Ricardo and John Stuart Mill. I think the arguments for free trade are so convincing that it would be nice if we had some, and we ought to really do something about it. So I am thinking of drafting a bill that would be introduced in the next Congress — it will be called the "Free Trade, Anti-Protectionism and Anti-Hypocrisy Act of 1983." And it will go something like this:

Whereas, certain practices distort the free flow of commerce and diminish the wealth of nations, deprive consumers of the benefits of comparative advantage, and are otherwise contrary to national policy, now;

Therefore, first, it shall henceforth be illegal for any American corporation or person to engage in a transaction involving a product of which any portion is required to be manufactured abroad because of the existence in another country of a domestic content statute;

Secondly, it shall henceforth be illegal to engage in a barter transaction with a state-trading monopoly — that will be known as the Donald Kendall and Armand Hammer clause;

Third, it shall henceforth be illegal to engage in a transaction involving any product or commodity for which any part of the price or terms is subsidized, directly or indirectly, by the state;

Fourth, it shall be illegal to engage in any transaction involving a commodity the price or supply of which is controlled by an international cartel.

Fifth, it shall be illegal to engage in any transaction involving the use of a currency of which the exchange rate is managed or manipulated by a state.

We'll have some definitions. We'll say, inasmuch as discussion of this subject has been poisoned by word pollution, certain terminology must be made standard.

For example, those entities now known as "free trade zones," that is to say locations in certain territories where goods are produced under a restriction that none of them can be imported into the domestic market of the country where they are produced shall hereinafter be known as "protectionist zones."

On the enforcement part, the bill will say — and this may require a Constitutional amendment; inasmuch as it is commonly understood by those well versed in these matters, that considerations of human values and human rights and human standards ought not to be treated as relevant in determining the flow of commerce or a criteria affecting economic transactions between nations — this is to say, that all values are fungible — now, therefore: as means of enforcement, any punitive measures practiced by any trading nation in the world, shall be available for the enforcement of this statute.

Therefore, for the first offense, the perpetrator shall have his right hand severed at the wrist. For the second offense, five years at hard labor at the prevailing wage in a Mexican asbestos plant. And for the third offense, as soon as any necessary treaty arrangements can be contrived, the offender shall be sentenced to ten years in the Gulag.

One added proviso: any person who, after the enactment of this statute, advocates, condones, engages in, or conspires to engage in the violation of any of these provisions, who is thereafter apprehended in the act of making a free trade speech to the Council on Foreign Relations, to the Aspen Institute, to Bilderberg, to Ditchley, or to any other such forum, national or international, shall have his tongue extracted by heated tongs.

The speaker went on to challenge anyone to find "free trade" anywhere in the world today. The doctrine of comparative advantage was all well and good, but Ricardo's definition of it was far from the present system of subsidized loans and state capitalism. "Comparative advantage" now meant that advantage which accrued to the country whose work force would work for the lowest wage. "Free trade" had come to mean "access to *your* markets," and license to pursue mercantilist policies. The action of the Japanese in taking the last five per cent of the U.S. motorcycle industry was an "absolutely outlandish piece of mercantilism," unworthy of any responsible business community. As for the automobile industry, Japanese cars accounted for 22 per cent of U.S. domestic car sales, compared with 2.6 per cent in France, 10 in Germany, 11 in the U.K., and one-tenth of one per cent in Italy. The American economy was the most open in the world, and this had had a heavy impact on employment in the U.S. We had to develop a sensible way to manage international trade collectively, while avoiding clichés and shibboleths. The U.S., in particular, needed an industrial policy aimed at growth in employment. If there was indeed no free trade, we should at least seek orderly growth through *fair* trade. Despite all our complaints, we had nevertheless achieved a level of civility between Europe and North America — and within the OECD in general, except for Japan — in our attempts to manage trade. Our aim should be to bring the Japanese up to that level of civility; for the past decade there had been no reality in our discussions with them. They simply did not understand the negotiating process and what our relations with each other ought to be.

A French participant intervened to suggest that the relatively limited success of Japanese autos in Europe, compared to America, was due not so much to government intervention — of which there had admittedly been some — as to the fact that the European cars were already fuel efficient when gasoline prices rose. Good products would always sell well, he said, if the public were left free to make the choices.

An Italian participant commented that the Japanese had responded well to the necessities of industrial society. They had committed themselves to large investments and had a productive labor force. But their "good behavior" did not carry over into the trade field, where they were taking advantage of being highly industrialized but not highly socialized. A Belgian added that the unrealistic currency relationship between the yen and the dollar served the protectionist purposes of the Japanese.

A German participant alluded to two broad complaints. One — heard particularly from Americans — was that the European Common Agricultural Policy (CAP) was protectionist; the other, that the French were all for strengthening free trade within the European Community (EC), while using the political identity and economic development of the EC to enhance protectionism vis-à-vis other countries, notably Japan and the U.S. Responding to the first criticism, a French man pointed out that the U.S. enjoyed a \$7 billion surplus in agricultural trade with the EC. If the effect of the CAP were indeed protectionist, the result would be an EC surplus or equilibrium in agricultural trade, not a large deficit. Admittedly, the CAP was costly, but it was not more protectionist than other policies. If it was a question of cutting the Community's budget — for instance to reduce the UK's contribution — then one should look at the country which enjoyed the greatest financial benefit from the CAP: the Netherlands.

On the second point, the speaker said that in the international trade rounds, France had never acted to raise trade barriers against the U.S. and Japan. In return, his country had urged the Japanese to fix targets for progressive increases in their imports of foreign goods, but they had always refused.

A Dutch speaker intervened here with three comments. First, there was no sensible reason why the CAP had to grow more expensive each year. Second, the Dutch problem with the Japanese was not their exports to the Netherlands, but their reluctance to open their market to Dutch products. Why not "play hard" with the Japanese the same way we did with the Russians in the arms talks? Finally, the speaker did not agree that we could not do better now than maintain the present level of free trade. There were special opportunities for more and freer trade, such as between the Atlantic countries and the Third World.

An International participant questioned the credibility of "new rules of the game" negotiated during a time of crisis. None of our countries had been very successful at managing industrial adjustments. We needed still more time for that — even if we were not sure just what to do with it. But what sort of counterpart could we offer in terms of a discipline to be collectively agreed, sanctioned and monitored? High technology developments were likely to increase tensions among the industrialized countries (e.g., the proposed U.S. legislation integrating notions of extra-territoriality into the control of sensitive technology transfers). It would be hard to monitor such controls, and in this and other areas we needed an informal group to deal with the inapplicability of outmoded rules — not a "super-GATT" or an "inner-GATT," but at least a forum where industrial nations could talk about the fundamental new elements for which we had not yet codified or conceived of rules. We could not "muddle around" much longer.

A Frenchman agreed that the high technology revolution brought with it a risk of the rebirth of protectionism, despite our best efforts to prevent it. Countries which were hard put to improve efficiency — as in Europe — would seek protection from the more efficient — the Americans and the Asians. Vast investments in training would be needed to close that efficiency gap, and in the meantime we would have to guard against a "protectionist reflex."

An Austrian speaker feared that a rebirth of protectionism would threaten the very survival of the economies of the smaller industrial countries such as his own, which exported some 40 per cent of its GNP. Prosperity there was achieved only by a constant search for new customers and markets abroad.

Germany faced the same challenge, according to a speaker from the Federal Republic. "If we don't export, we starve." Competition was essential to whet international competitiveness, which was why the speaker was so opposed to trade restrictions and import barriers. He was rather dubious about the claim that the U.S. was the most "open economy," and he wondered if the comparative quality of German and Japanese motorcycles, for instance, did not explain why the last five per cent of the U.S. market in the hands of domestic producers was threatened. Apropos of the proposal of the French author, the speaker did not see how we could envisage the "collective management of trade," "organized liberalism," or any such notion of "avoiding uncontrolled free trade" and still adhere to the GATT. That would be the route to bilateralism and the undermining of our whole multilateral framework. It was up to the politicians to explain to public opinion the need to avoid protectionism.

An American participant said that he, too, was uneasy about phrases like "orderly growth" and "managed trade," especially if that implied new organizations to do the managing. The purpose of existing international organizations in the financial field had been to oversee free capital and exchange markets; the trend in recent years had been toward removing deviations. The burden of proof should lie on any proponent of a deviation from free markets. After all, what standards could one substitute? "Fair?" "Just?" "Organized?" Those were not really standards; no one knew what they meant. The American author had seemed to read Lane Kirkland's "anti-hypocrisy" proposals as justifying further deviations from free markets because some already existed. The speaker sensed an unhelpful "theological" overtone in the discussion of this subject.

A Danish participant argued that we should not wait for the economic recovery to gather further momentum before taking concerted action to dismantle existing protectionist measures, such as subsidies and manipulated exchange rates. The experience of the 1950s and '60s had shown a close link between the liberalization imposed on Europe by the U.S. and strong economic growth. The dismantling of barriers had fostered structural change, investment, technical innovation and competitiveness. We had got rid of the traditional barriers like tariffs and quotas, but had added new subsidies to preserve old-fashioned industries for the wrong purposes. On the subject of so-called "temporary subsidies," a German intervention quoted the maxim "*C'est le provisoire qui dure.*"

A number of interventions mentioned the effect of exchange rates on trade patterns. An American said that foreign exchange misalignments had a major distorting effect on trade, and gave rise to protectionism. A Belgian felt that unrealistic exchange relationships — notably the dollar/yen — would not be righted until the U.S. adopted a sounder fiscal policy. A French speaker alluded to the consequences for the world trading system of very unstable floating rates. We were not yet ready to return to fixed parities, he said, but cooperation would be beneficial to reduce the scope of fluctuation. The over-reacting, or over-shooting, was very destabilizing for trade.

A Spaniard, on the other hand, thought that floating rates were not, in and of themselves, a source of instability. It was the shortcomings of economic policy that caused the distortions in world trade. Given those distortions, the maintenance of fixed parities might have made things worse. We had recently seen in Argentina,

Mexico and Chile the damaging consequences of an absence of exchange rate flexibility.

An Italian speaker wondered whether the proposed "collective management" of trade could not be handled informally but effectively by the relatively small number of multinational companies who accounted for an estimated 25-30 per cent of international trade. There was a strong anti-protectionist sentiment among those companies, and it would be easier to mobilize them than to start a new international institution involving 150 to 175 countries. An American speaker, though, pointed to the lack of national identity of the multinationals. Their responsibility was simply to their various host countries. How did they reconcile conflicting responsibilities?

A French man agreed that it would be sensible to use the multinationals, which were indeed non-protectionist and which worked to optimize trade relations between countries. But as far as international institutions were concerned it was not necessary to start from scratch, as we already had devices and organizations such as the GATT and the multifibre agreement. He went on to reiterate that he did not favor bilateralism, and that his proposal for the orderly management of international trade was a pragmatic one based on doubts about the efficacy of our technical mechanisms. If we could maintain the target of free trade and phase out protectionist measures, while finding technical devices for solving for a limited period our problems with the less-developed countries, then we would contribute more to the health of the international economy than would be achieved by attending conferences and paying lip service to free trade. He was supported in this by an Austrian speaker, who called for much closer cooperation in international economic and monetary affairs to better manage our global interdependence.

An American participant discussed the background of protectionist forces in his country, where pressure to subsidize exports had grown out of interest and exchange rate levels attributable to the federal budget deficits. Another factor was that the role of government and the importance of foreign trade — both as a percentage of GNP — had grown dramatically in the U.S. over the past decade. One result was that politicians had acquired the inclination, as well as the power, to keep international trade developments from undercutting their domestic objectives. This was doubly important since the focus of government intervention had shifted from tariffs and quotas in the '60s to the support of selected industrial sectors in the '80s. We needed a more sophisticated approach, a *modus vivendi* among the industrial democracies to ease economic transition. It would be unfortunate, for example, if too many of our industries were to switch into the same new specialties.

A Greek participant started his intervention by observing that there were still sectors characterized by free trade and the operation of supply and demand. Non-liner shipping was one of these. To be sure, there were protectionist pressures, as for cargo reservations, but no company or group had anything like monopoly power. The speaker went on to argue that the American authors' case had demonstrated that protectionism did not in fact help employment. The protectionism of recent years had not only increased unemployment, but it had also aggravated inflation by leading to dampening anti-inflationary measures earlier in the business cycle than would otherwise have been the case. Thus it was in the interest of trade unions to oppose protectionism.

How to deal with this relationship between protectionism and unemployment was the subject of numerous interventions. An American speaker said that there was no way to persuade an unemployed textile worker, for instance, that a reduction of trade barriers was to his advantage. On the issue of "jobs vs. no jobs," workers were for jobs, regardless of terminology. Some thirty million workers were unem-

ployed in the OECD countries, a figure that was projected to rise to 40 million. In the U.S., workers and their employers were beginning to join forces to stem the rising tide of imports. The issue of job creation ought to be at the top of our agenda, and we needed the combined action of industry, labor and government for retraining, technological innovation and transitional adjustment. Government had to play a more direct role on a sectoral basis. If central banks were lenders of last resort, why should not governments be employers of last resort? We could not look indefinitely to the dole to prevent social disorder engendered by joblessness.

Two compatriots lent their support to this view. One said that the projected U.S. unemployment rate of seven per cent into 1987 was intolerable. Not enough new high technology jobs could be counted on, so a massive program of public works was required. Another cited the example of middle-aged white men unemployed in the U.S. for the first time in their lives. Their anger, fear and frustration were sure to be registered at the ballot box in future elections.

Another American participant said that if free trade were the right course, and if the resulting structural unemployment threatened to reach socially unacceptable levels, then our governments would be bound to intervene — not to create “make-work” jobs, but to insure that needed work was done, such as retraining workers, rebuilding transportation systems, and improving other public services.

A Belgian speaker called for concerted measures among the industrial countries to combat unemployment, which was particularly devastating to young people on the threshold of their careers. He hoped that the sacrifices now being made by young workers would lead to tangible results.

Acknowledging that unemployment was a central problem today was easier than agreeing on the right solution, as the discussion showed. A German speaker emphasized the importance of capital investment in industry, and said that the decisive question was how to encourage it. Just as workers expected to be paid, so did the other productive factor, capital. When profits declined, new capital expenditures did too. But profitable companies were inclined to invest and to create and maintain jobs. So the essential prerequisite for job creation was a sufficient financial reward for invested capital. Had our industrial partners — including labor and governments — taken account of this basic condition of the free market in our highly competitive environment?

Apparently not, according to an American intervention. The speaker said that if unemployment were to be solved on a sustainable basis, it would have to be accomplished in a reasonably stable, non-inflationary way. The U.S. had been doing fairly well with inflation, but satisfaction had to be tempered by the fact that this had been accomplished in the trough of the biggest postwar recession. But what would happen in the labor markets if the recovery proceeded? In the past 18 months, real wages for the employed had risen for the first time in five years. There were recent indications, though, of restiveness among the auto workers — not about jobs, but about wages. Their slogan was “Let’s get it back, and more.” There was substantial unemployment in the industry, but the average hourly compensation of auto workers was still some 60 per cent above the national average. To cite a specific case, the recent Chrysler settlement had been forced to a higher level by the Canadian strike. Airline machinists had secured wage increases of 32 per cent over the next three years, in a “contract straight out of the ’70s.” In the speaker’s opinion, these tendencies were counterproductive in terms of jobs. Many union leaders seemed to understand this, but were the rank and file aware of the inconsistency of their demands with the goal of full employment? Were their minds open to such alternatives as profit-sharing and corporate board membership, and

to the need to reconsider the appropriateness of industry-wide bargaining?

An American responded that the restiveness of U.S. workers was attributable to their perceptions as expressed through the democratic structure of their unions. The burdens of the recession had not been equally borne in the U.S., and people could not be persuaded indefinitely to accept inequitable sacrifices. Real wages were still below the level of a decade ago, and labor hoped to recoup at least some of its losses through future increases. Recent settlements might be seen by some as too generous, but they were after all the fruit of a generation of collective bargaining experience. Labor was incapable of bludgeoning employers, and in fact it could be said that union concessions had saved companies like Chrysler and Eastern Airlines. There was a fundamentally hostile attitude of U.S. employers toward unions that had to be changed. Labor was open to solutions such as profit-sharing and productivity improvement, but probably not corporate board membership. The suggestions, though, that industry-wide bargaining was the culprit were not constructive.

Giving people jobs by expanding public works was not the answer, according to a German participant. That would mean increased government deficits and higher interest rates. Nor could we successfully reduce working hours without loss of income, as had been suggested. That was bound to “catapult people out of jobs.” It was hard to say it, but labor had become too expensive. Minimum-wage unemployment was a well-known phenomenon in the U.S., and the Federal Republic was beginning to share that experience. Our economies would all benefit from more deregulation, innovation and capital expenditure. But promoting private investment in industry was difficult when government bonds yielded more than job-creating investments. That anomaly needed to be corrected.

A Spaniard shared the concern about unemployment, but he objected to the absence of practical, concrete proposals in the American paper. Reducing working hours while maintaining income was surely “the quickest way to go broke.” (It was acknowledged in the discussion that weekly working hours had been substantially reduced over the years, but speakers pointed out that incomes had been maintained by increases in productivity.)

Unemployment in Belgium had been alleviated recently by a combination of measures. A speaker from that country described the program of their National Employers’ Association, which involved extensive part-time work and special attention to jobs for the young — one out of four people under 25 being out of work. This required close coordination between schools and business. Beyond such particular measures, more fundamental steps had to be taken to restore economic health and full employment. The speaker mentioned lowering inflation and budget deficits, correcting balance of payments disequilibria, and opposing protectionism. The considerations were not merely financial, but human and moral as well.

A French participant remarked that one’s prescription for unemployment depended on one’s analysis. An optimistic view was that it was basically a problem of adjustment, of structural adaptation. But a more detached analysis might lead to the rather pessimistic conclusion that 20th century technological developments had inevitably reduced the place of humans in industry, as had happened to horses in the last century. Another French speaker did not think that comparison apt. He found himself somewhere between optimism and pessimism: unemployment would eventually be resolved by the necessary adaptation, but it would take a long time.

A British participant agreed that the unemployment problem was structural in nature, but he thought that technological developments could not have been the major cause of our unprecedented level of 34 million unemployed. The deflationary measures of the last few years had been more to blame — essential though they

may have been. We had learned that the classic methods of re-expanding the economy ran a big risk of fueling inflation, especially in an economy like Britain's. New thinking was badly needed in this area. To paraphrase Lincoln: "The Western world will not long endure half employed and half on the dole."

A Frenchman commented on some of the statistics cited in the American working paper. First of all, the prediction in the French report that the office work force would decline by 30 per cent assumed a static volume of transactions. The more reasonable interpretation, then, was that office productivity was likely to increase by that 30 per cent. The speaker referred to two British banks which were the most automated in the world. Their total employment had risen steadily over five recent years because the volume of transactions had grown faster than productivity gains. There was no obvious correlation, he said, between automation and unemployment. Japan, with 50,000 robots, had an unemployment rate of 2.5 per cent, while the U.S., with only 7,000 robots, had an unemployment rate of over 10 per cent. It was fashionable to speak of high technology, but the "smokestack industries" would still be with us, if only for strategic reasons. One could not imagine the U.S. without automobile or steel industries, although they would of course be applying new technologies. The Japanese steel industry had become the most automated in the world. In 1981, it had the same number of workers as in 1968 — 260,000 — but was producing three times as many tons per man as any other nation. Successful structural adaptation required training for many years hence, so that workers would never find themselves out of jobs for economic reasons. The educational system had an important role to play in this, along with companies. Twenty per cent of Japanese postgraduate students were in scientific and engineering fields, compared to 5.9 per cent in the U.S. On the other hand, America produced more new lawyers every year than there were practicing in all of Japan. A French speaker endorsed the need for large investments in training to meet the high technology revolution.

Opposing robotization, according to an American, meant resisting the kind of change which would lead to a reduced work week and a higher standard of living. Shorter hours had historically been achieved by productivity gains. Labor had the choice of taking those gains in the form of more leisure or higher wages. The speaker could not see why shifts from manufacturing into service industries presented a major problem — except for trade union organizers. If Americans had accepted their former structure as frozen, they would have remained largely an agricultural economy indefinitely.

An American participant felt that, even if many new jobs were created in high technology fields, the adjustment would be painful to many workers. He went on to say that the problems of unemployment, growth and trade were closely inter-related, and that solution of the first two was a precondition for resolving most trade issues. He was supported in this by Belgian, German and American speakers. A number of participants then intervened to discuss the prospects for economic recovery, structural change and growth.

A Dutchman pointed out that for many years growth had enabled business to live with low margins, but that time was past. Our societies were now in what he called a "regressive state," in which entrepreneurial activity did not happen so easily. We reasoned backward, saying that economic activity had declined because of high interest rates and slow growth, but the truth was that business hesitated to make new investments when risks were high and profits low. It was essential to "fight back," and the key was the training of young people, particularly in high technology.

We should confess that we had not yet found the right way to solve our problems, urged an Austrian. As the previous speaker had suggested, the postwar expansionist period was over and we had lost the momentum for future growth. It seemed unlikely that we would regain it in the near future, but would the necessary adjustment take five, 10 or 15 years? Our economic policies had to be thoroughly re-thought, because if we did not solve the unemployment problem we would face momentous political consequences. And what was the incentive to make new investments if our industries were running at 60-65 per cent of capacity? In many medium-sized companies, expansion plans had been shelved, and in larger companies it took two to four years to develop new investment programs.

An American speaker discussed the momentum of the economic recovery in his country, which he said was livelier than might have been expected. Industrial production had risen five to six per cent over the last four months, with inventories still being liquidated at a rapid rate. Involuntary liquidation would have to reverse itself with the maintenance of demand. Moreover, sizable tax reductions were likely to fuel consumer spending. But as the recovery accelerated, chances grew of a major collision in the U.S. financial markets, and much turned on the budgetary problem (which would be discussed at length in the next section).

A Belgian speaker shared this apprehension about a clash between the needs of the public and private sectors which could stifle the recovery. Renewed economic growth was essential, not only for employment and free trade, but also to enable us to pay for our defense.

Signs of recovery were emerging less clearly in Europe, according to a participant from the Netherlands, and it looked as if might be at best a cyclical recovery. The recession would have achieved very little, at a high cost in unemployment and damaged aspirations among the young. Deep-rooted systemic problems remained, linked to the effects of the dramatic rise in the public sector in the 1970's. In many countries it had reached unsustainably high levels, in the form of public expenditures, taxes, transfer payments, social security and various entitlement programs. Despite a decade of attempts at reform with the backing of a "public consensus," government spending remained high and the market sector was shrivelling. Europeans were witnessing the erosion of profits and the private capital base, bigger public budgets and higher real interest rates. It seemed as if there was a crisis in our political decision-making process, with the limited room for maneuver offered as an excuse for doing nothing. The speaker was optimistic in the short run, but "deeply pessimistic" about the longer term prospects for our economies.

An International participant reported on the political agreements reached at a recent OECD ministerial meeting to help sustain the recovery which was now undoubtedly underway. Action had to be taken on government budgets, especially in the U.S., with its key link to world interest and exchange rates. This would ease protectionist pressures. A climate had to be fostered to encourage private investment and favor the growth of employment and demand. Distortions created over the last few years had to be relaxed or dismantled. Subsidies and other arrangements to protect employment had been understandable at the time, but would prove damaging if retained.

A Greek participant endorsed the prescription of reducing structural budget deficits and real interest rates, and encouraging the flow of resources to areas where productivity could be improved. But he also suggested that a major push for trade and investment in the developing world would do much to revitalize our Western economies. We should pay special attention to that part of the Third World which was capable of applying existing technology and soon joining the developed world.

The speaker was joined by another Greek and a German in suggesting a kind of "Marshall Plan" for the underdeveloped countries, involving a greater flow of credit at lower interest rates, the encouragement of private investment, and de-emphasis of military build-ups (which would promote the rule of law). In return, the Third World countries would be in a better position to buy our capital goods and to repay their debts. A Dutch speaker also saw the less-developed world as a source of useful new activity for the depressed Western economies.

Another German, however, argued that Third World conditions were so different from those in postwar Europe that proposals for a "Marshall Plan" were "totally misleading" and bound to raise expectations that we could not fulfill.

A Portuguese participant saw the seeds of a major economic crisis in the continued transfer of finance and technology to the LDCs. If the recipients exploited these transfers successfully, they would export products in competition with Western industry (as the Asians had done) and displace even more of our workers. If on the other hand they failed, we would be stuck with more bad debts (as with some of the Latin American countries). So trouble would be averted only if future technology transfers were made within the framework of programs for the creation of new technological industries in our own countries to absorb redundant workers.

Finally, this part of the discussion touched on the question of East-West trade, which a French participant said was important not only for Europe, with its historic Eastern trade links, but also for the grain trade of the Americans. Moreover, the subject had to be considered from a political as well as an economic point of view.

As an International speaker pointed out, the East Europeans had not really proved themselves capable of competing in our industrial markets, but a Dutchman commented that there was no good reason not to promote trade between East and West. An Austrian participant alluded to the fact that the drying up of credits in the West was intensifying the dependence of the Eastern European countries on the Soviet Union.

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B. RISKS IN BANKING AND FINANCE

"The Western Banking System and the International Debt
Situation: Facts, History, Prospects and Issues"

*Working Paper Prepared by Alexandre Lamfalussy,
Assistant General Manager, Bank for International Settlements*

Facts and figures

1. As can be seen from the attached table, the most striking feature of the international financial scene between the first oil shock and mid-1982 was the active participation of the industrial countries' commercial banks in balance-of-payments financing. This was a new development: at the end of 1973, the gross claims of the BIS reporting banks* on outside-area countries totalled no more than \$75.5 billion; moreover, their *net* creditor positions vis-à-vis groups of borrowing countries were quite small: \$4.5 billion vis-à-vis the group of non-oil LDCs and \$5 billion

*Up to 1977, the reporting area covers the G-10 countries, Switzerland and the branches of U.S. banks in the offshore centers. From that year it covers also Austria, Denmark and Ireland.

vis-à-vis eastern Europe. Conversely, OPEC's net deposits with the banks amounted to only \$9.5 billion.

2. In strong contrast to developments up to 1973, between end-1973 and mid-1982 banks' gross claims on outside-area countries rose from the initial \$75.5 billion to \$513 billion. Of this total, gross claims on non-oil LDCs expanded from \$32 to \$242 billion, those on eastern Europe from \$9.5 to \$54 billion, and those on the group of smaller industrial countries from \$23 to \$104 billion. In even stronger contrast, by mid-1982 all three groups of countries had become very large-scale net borrowers from the banks: non-oil LDCs for \$142 billion, eastern Europe for \$42 billion, and the outside-area industrial countries for \$56 billion.

These net borrowings provided balance-of-payments financing for all three deficit areas. The aggregate estimated current-account deficit of the non-oil LDCs during this period (\$294 billion) was covered to the extent of 45 per cent by net banking capital inflows (\$132 billion). A similar percentage of the aggregate deficit of the smaller industrial countries was covered by bank credits, and an even higher one of that of the socialist countries.

And this is not the whole story. There was also a substantial amount of balance-of-payments financing *within* the reporting area (France, Italy, Belgium, Denmark, Sweden), something which the table does not reveal.

3. On the resources side, the banks benefited from large OPEC deposits during this period, although it should be emphasized (a) that for the period as a whole the net deposits were relatively small in relation to OPEC's accumulated current-account surplus, and (b) that net banking capital outflows from the reporting area (mainly from the U.S.) played a much bigger rôle in providing funds for international financing than the direct recycling of OPEC surpluses.

4. As a result of these developments, western banking systems are now having to confront the large-scale external debt-servicing problems that started emerging in 1981-82 with an international exposure substantially higher than it had been ten years earlier. Such exposure may be measured in different ways. External claims have by now reached 30, 40, and in some cases even 50 per cent of total assets. In the case of non-U.S. banks, assets and liabilities denominated in foreign currencies (mainly in dollars) frequently account for between 20 and 40 per cent of the total balance sheet. Last but not least, claims on "problem countries" have become very high in relation to equity, and indeed in many instances substantially exceed it.

The origins and current state of the international debt situation

5. There is now a fairly general consensus about the origins of the debt-servicing problems, although views may differ as to the relative weights that should be attributed to the various factors.

The story began with the first oil shock, which introduced in 1974-75 a new type of major imbalance in the world payments system. There was a sharp increase in the external financing need of the oil-importing countries, together with an equally dramatic rise in the financial surplus of OPEC. At this stage, much to the relief of almost everybody, banks stepped in as intermediaries: thus "recycling" began.

International bank lending, however, continued even after the digestion of the first oil shock. While debt service ratios remained quite manageable until around 1976, a number of countries began to "overborrow", especially from 1977-78 onwards—and by this I mean that their external debt was beginning to reach levels, or at least was expanding at rates, that would have become unsustainable even under favorable international economic and interest rate conditions. Depending on one's particular viewpoint, this may be called mismanagement by the borrowing

country, or overlending by the banks. In fact, of course, supply has to meet demand, or vice versa, for there to be a transaction. At any rate, the IMF was "crowded out" from its business of conditional lending by the borrowers' market for bank credits, and thus lost its clout.

Who bears the "responsibility" for this development? The relatively lax U.S. monetary policy pursued until 1979? Negative real dollar interest rates until the same year? Lack of control of international (and not only Euromarket) bank lending by the authorities? Banks' unwillingness to assess country risks properly—despite the availability of country bank debt figures on a quarterly basis since 1974? With hindsight, we now know that probably all these influences bear some responsibility for the emergence of overlending. But what would have been the alternative? Had banks failed to enter the balance-of-payments business, the world economy would have started to stagnate immediately after the first oil shock, or might even have spiralled into a full-blown depression. It would have been nice to have had some deficit financing, but no so much. Who could have said where to draw the line, and who could have enforced a decision limiting the growth of international lending?

But ultimately stagnation did hit the industrial countries, hand in hand with very high nominal and real interest rates, declining world trade and falling commodity prices. As a result, debt service ratios worsened dramatically for all debtor countries, and reached unsustainable levels even where there was no obvious mismanagement of the borrowing country's domestic economy—where, for instance, the counterpart of the current-account deficit was investment, even export-oriented investment, rather than consumption.

Finally, political shocks—Poland, the Falklands war—suddenly brought it home to the banks that sovereign debt was not risk-free, and this led to the "regionalization syndrome". Banks stopped lending to whole groups of countries—first to eastern Europe, then to Latin America—and even tried to get their money back whenever this was feasible, thereby giving added impetus to the generalization of debt-servicing problems.

6. There is also fairly general agreement that an international debt crisis has so far been averted, by which I mean that the debt-servicing problems have been sufficiently contained to prevent them from having a globally crippling influence on the world financial system and on world trade. Several factors have operated to bring this about: the emergency loans extended by the central banks through the BIS to pre-finance conditional IMF lending; the swiftly negotiated, huge IMF loans themselves; the change of attitude of the U.S. administration towards increasing IMF quotas; the acceptance (and in some cases already effective implementation) of drastic domestic adjustment policies by a number of borrowing countries; the acceptance by the banks of *de facto* defaults, unilateral moratoria and protracted rescheduling negotiations—and, in some major instances, even the granting of new loans (admittedly under "suasion" by the IMF); last but not least, the sharp reduction of nominal interest rates, which, thanks to floating rate arrangements, are working themselves quickly through the system to alleviate the interest burden.

Prospects and policy issues

7. Prospects and the corresponding policy issues can be grouped under three headings: (a) the short-term outlook, or how to keep the situation under control; (b) medium-term prospects, or how to improve the world economic climate; and (c) the longer-term "systemic" problems.

8. Our ability to keep the situation under control depends to a large extent on:

— the IMF's ability to pursue its lending policy, which, in turn, is conditional upon the swift implementation of the quota increases and (probably) also on other resources being made available to the Fund; in addition to those that might be forthcoming under the extended GAB. Specifically, this raises the question of market borrowing by the Fund;

— the banks' continuing to keep steady nerves, despite the spread of standstills, moratoria, restructurings and reschedulings. This means not only that they refrain from triggering defaults, or from activating cross-default clauses, but also that they do not withdraw from new international lending on a worldwide scale, since such action could easily lengthen the list of "problem countries";

— the debtor countries' scrupulously adhering to the IMF's policy prescriptions so as to avoid becoming ineligible for further Fund disbursements.

9. Most of these actions are, however, simply in the nature of a "holding operation". More fundamental relief can only come from developments in the world economy such as to validate the adjustment efforts undertaken by the debtor countries by helping them to improve their current-account positions. What is clearly needed is an increase in the volume of LDC exports, an improvement in their terms of trade, and a further decline in short-term dollar interest rates, since, despite the sharp fall in nominal terms, real dollar rates have so far remained appallingly high.

Should no such favorable developments materialize, there is a serious risk that financing packages put together under the auspices of the Fund will fall short of actual financing needs. Additional finance will not be easy to find—in other words, deficit countries may be forced to undertake further adjustment measures. In the absence of an improvement in the world economic climate, the only avenue open to the LDCs to achieve the necessary balance-of-payments adjustment would be a drastic cutback in imports. This would obviously have a depressive effect on the industrial countries themselves (as the U.S. has learnt over the last ten months); at the same time it could not be achieved without a substantial decline in real incomes within the developing countries, at the risk of triggering serious domestic upheavals as well as unforeseeable political reactions—also in the field of external debt management.

Given the worldwide pattern of current-account imbalances and of inflationary constraints on growth, the revival of the world economy cannot take place other than through the expansion of domestic demand in those large industrial countries that (a) could afford to run a current-account deficit for some time (the U.S.) or are in a comfortable balance-of-payments position (Japan, Germany, United Kingdom) and (b) have achieved considerable success in their fight against inflation (all four of these countries). Is this expansion going to take place spontaneously, and sufficiently quickly to alleviate the current-account position of the debtor countries? Maybe; but if not, what could be done about it? And if it does take place, how can it, with large structural U.S. budget deficits looming on the horizon, be prevented from leading at best to a stabilization of U.S. real interest rates at their current high level or, at worst, to an increase in these rates?

10. Even on the somewhat optimistic assumption that skillful financial management will keep the situation under control until such time as the business upswing in the western industrial world brings more fundamental relief to the debtor countries, we still have to face a number of longer-term "systemic" problems, of which I mention only two.

Firstly, there remains the "stock" problem of the maturity profile of the outstanding bank debt. At end-June 1982, of the total external bank debt (\$390 billion) of the 24 most important debtor countries outside the BIS reporting area, 44 per

cent, i.e., \$171 billion, was due to mature during the following twelve months. Despite some large-scale reschedulings, my guess is that the share of short-term claims has risen since then. A maturity profile of this kind is bound to exert a destabilizing influence on the world economy by magnifying whatever "external" shocks may occur in the future. A number of consolidation schemes, some of them comprising elements of burden-sharing between debtors, creditors and western governments, are being aired at present. We should be careful not to promote those schemes that would make it even more difficult to solve the "flow" problem.

For there is, secondly, the "flow" problem, i.e., that of financing future current-account deficits. An expansion of domestic demand in industrial countries may for some time reduce external deficits in the rest of the world; with luck and good management we may avoid a third oil shock and hence the re-emergence of oil deficits; but the world economy cannot function on the assumption of negligible current-account imbalances. Such imbalances are bound to reappear as a reflection of cyclical desynchronization, policy differences or "real" shocks, or simply because there can be no transfer of real resources to developing countries without these countries running persistent current-account deficits.

There are a number of tricky questions that come to mind in this context. Will the banks be willing to participate on a sufficiently large scale in future balance-of-payments financing? If so, how and on what terms? *Should* they participate? What capital flows could conceivably replace bank financing? Is there not a danger that the banks' reluctance to grant genuinely "financial" medium-term credits will lead to bilateral, exclusively trade-related financing deals with all the "real" distortions that such deals may imply? Or would this be a lesser evil than no financing at all?

* * *

*Position of banks reporting to the BIS vis-à-vis groups of countries outside the reporting area**
(in billions of U.S. dollars)

	<i>Outstanding credits and deposits</i>		<i>Changes between</i>
	<i>end-1973</i>	<i>end-June 1982</i>	<i>the two dates**</i>
<i>OPEC</i>			
Deposits with banks	16.0	146.3	130.3
Credits from banks	6.5	75.0	68.5
Net	9.5	71.3	61.8
Accumulated current-account position 1974-1982 (first half)			407.5
<i>Non-oil LDCs</i>			
Deposits with banks	27.5	99.5	72.0
Credits from banks	32.0	241.9	209.9
Net	- 4.5	- 142.4	- 137.9
Accumulated current-account position 1974-1982 (first half)			- 294.0

Developed countries outside the reporting area

Deposits with banks	27.0	48.7	21.2
Credits from banks	23.0	104.3	81.3
Net	4.0	- 55.6	- 60.1
Accumulated current-account position 1974-1982 (first half)			- 153.0
<i>Eastern Europe</i>			
Deposits with banks	4.5	11.8	7.3
Credits from banks	9.5	54.1	44.6
Net	- 5.0	- 42.3	- 37.3
Accumulated current-account position 1974-1982 (first half)			- 74.0
<i>Unallocated</i>			
Deposits with banks	7.5	53.1	45.6
Credits from banks	4.5	37.8	33.3
Net	3.0	15.3	12.3
<i>Total (position of the reporting area with inverted signs)</i>			
Deposits with banks	82.5	359.4	276.4
Credits from banks	75.5	513.1	437.6
Net	7.0	- 153.7	- 161.2

*Estimates by the BIS.

**(-) in the net position vis-à-vis banks equals net borrowings from banks during the period.

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"International Banking Problems And Medium-Term Growth Prospects"

*Working Paper Prepared by Hans H. Angermueller,
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Since World War II the standard of living in virtually every nation of the world has risen from year to year. Progress and growth became the normal expectation. There remained, of course, substantial differences in standards of living from country to country and, within larger countries, even from area to area; however, the direction was toward constant improvement.

This trend of uninterrupted progress toward ultimate prosperity began to erode in the early seventies. There were many causes: the welfare state grew faster than productivity; high taxes reduced incentives; large governmental budget deficits persisted and grew; interest rates, both nominal and "real," increased; and monetary expansion and inflation rates began to escalate. But what transformed these mounting structural problems into a crisis were the two oil shocks of 1974 and 1979.

The first shock (which increased the price of basic energy—oil at first, then gas—by 300 per cent from its 1973 level) within a few years transferred about \$200 billion from the Third World and industrialized nations to the OPEC countries. Much of these funds found their way from the OPEC oil exporters back into the world's commercial banking system, and that system, as was its function, channeled them back to creditworthy borrowers in the Third World and industrialized countries. This first "petrodollar recycling" process worked until, by 1978, spending initiatives in the oil producing countries had returned the relative current account status of the Third World and industrialized countries back to their pre-1974 levels. However, a five-fold increase in a commodity as fundamental as energy added to world inflation pressures.

During 1979-80, the second oil shock (which hiked the energy price up to 900 per cent of its 1973 level) transferred *another* \$200 billion from the Third World and industrialized countries to OPEC. Again, the commercial banking system undertook a petrodollar recycling process, but by now several major industrialized country governments (including Germany, Japan, Britain and the U.S.) had instituted stringent policies to control the increasingly rampant inflation in their countries while other industrialized countries (such as France, Italy and Denmark), as well as a number of Third World countries, chose to defer corrective action and live with relatively high inflation.

But for seven years, from the end of 1973 to the end of 1980, the Third World countries, despite the higher cost of energy and rising internal rates of inflation, managed to grow their export earnings at a compound annual rate of 20.6 per cent! This rate of growth just about matched the 21.3 per cent compounded annual growth rate of the long-term external debt incurred as a result of the petrodollar recycling process. In other words, the Third World had, for the most part, put the borrowed monies to good use.

However, as the anti-inflationary policies following the second oil shock took hold, interest rates and unemployment rates in the industrialized countries rose to unprecedented levels. The dilemma in pursuing decisive inflation control appears to be that costs and benefits are not distributed equally over time. Costs are much more immediate than benefits, and therefore have given rise to claims that policies to increase unemployment are the mechanism to reduce inflation. But, of course, such claims mistake the cause and effect. No policymaker ever sets out to increase unemployment deliberately. However, policies to reduce inflation have invariably resulted in involuntary unemployment, especially early in the inflation-fighting cycle. On the other side of the coin, the benefits from low inflation have typically been much slower to materialize. A quantum permanent reduction in inflation appears to involve an approximate four-year cycle as we saw in Germany and Switzerland in the early 1970's and in Britain more recently. As the Nobel Laureate Friedrich von Hayek has said, the only time to fight inflation and recession is during the prior expansion—in other words, patience and moderation in economic policies during a recovery will go far toward reducing the probability of future inflation and recessions. Unfortunately, however, the four-year curative cycle seldom seems to coincide with the periods of political incumbencies, perhaps accounting for frequent premature abandonment of anti-inflation measures.

The anti-inflationary measures initiated by the major industrialized countries in the late 1970's resulted in a general recession which translated itself for the Third World into (i) higher interest rates which increased the debt burden of the Third World borrowers, and (ii) a 33 per cent drop in major commodity prices, the backbone of many non-industrialized economies. Not surprisingly, the increased

dollar outflow of Third World countries and their reduced dollar inflows resulted in a number of liquidity crises.

Today a major concern in the global marketplace relates to these liquidity crises and their potential for retarding a world economic recovery. As austerity programs—IMF-induced or otherwise—are implemented, one sees Third World import restraints operating concurrently with their own export promotion. But clearly the world economy, as a whole, cannot export more and, at the same time, import less. So the present fear is that the world economy will become fragmented into insular individual national economies threatening the economic progress of all.

Though such a fear at this time is quite valid, the focus on Third World country austerity programs is misplaced. These programs are an effort to put individual developing countries on a viable medium-term policy track, so they can rejoin the rest of the world on a path of sustainable economic growth. So the import restraint programs presently in effect will pave the way for faster expansion of these markets in the future.

Yet, all pressure and incentives of the modern state, whether it is industrialized or developing, work against the passive acceptance of cutthroat "foreign" competition. In recent years, subtle barriers to imports and manipulation of exchange rates have become the accepted way to protect local markets. Today the difficult problem, at this rather sensitive point in the world's recovery, will be to have the industrialized countries (who constitute, by far, the largest markets in the world) keep their borders open for Third World imports, both manufactured and commodity, while the Third World countries temporarily close their borders to certain industrialized country imports.

But the magnitude and near-term costs of such Third World import control programs should not be overstated. Even after two decades of broadening economic and financial linkages between the North and the South, the Third World remains a relatively minor player in international trade (see Tables 1 and 2). The over-

Table 1: *Matrix of World Trade, 1980*
(\$ billions)

Origin/Destination	North America			Oil Exporting LDCs	Non-Oil LDCs	Total All Exports
	North America	72.6	60.3	24.3	19.1	67.2
EEC	42.0	355.2	6.4	51.6	65.1	662.4
Japan	34.1	17.1	-	18.5	38.1	129.5
Oil exporting LDCs	61.2	90.9	51.0	3.8	59.0	298.0
Non-oil LDCs	64.1	57.1	24.9	17.4	53.8	253.6

Table 2: *Matrix of World Trade in Manufactures, 1980*
(\$ billions)

Origin/Destination	North America			Oil Exporting LDCs	Non-Oil LDCs	Total All Exports
	North America	48.5	35.8	8.4	14.5	44.7
EEC	33.8	244.0	5.2	42.1	53.1	487.7
Japan	32.8	16.2	-	17.7	35.2	122.7
Oil exporting LDCs	0.2	1.8	0.1	N.A.	N.A.	6.0
Non-oil LDCs	31.2	23.5	5.7	N.A.	N.A.	99.2

Source: GATT, *International Trade 1981/82*.

whelming proportion of world trade continues to take place among the industrialized countries. And the proportions are further skewed in manufactures trade. A quick economic upturn in the Third World is not a critical prerequisite for the upward march of the rest of the world's economic activity.

However, the converse is not true. The industrial country markets remain very important indeed to the Third World. Some 60 per cent of Third World manufactured exports and a similar proportion of their total exports are destined for the industrialized countries. And it is here that there is cause for pessimism.

Over the last 12 months, there has been a growing trend toward protectionism and market closure. I am sure we each have a favorite story to tell. Among recently publicized protectionist measures are sugar import quotas, and more recently, tariffs on motorcycle imports into the U.S., barriers erected against video-tape recorders by France and innumerable other non-tariff actions. Such interventions into specific markets always appear eminently reasonable and are invariably billed as short-term. But, collectively, such protectionist measures threaten to fragment the world economy. In an increasingly integrated international system, trade disruptions will have pervasive and adverse economic growth consequences.

In other words, the rate at which world trade expands is a good indicator of the rate at which the world's economies, and the well-being of its people, grow. Therefore, to promote world trade—particularly Third World trade—it is important that the major industrial country governments hold a tight rein on the prevailing trend toward protectionism.

Doing so will ultimately help them as a group to maintain healthy growth rates, perhaps averaging 4-5 per cent in inflation-adjusted terms, during 1983-84. Such growth rates are not unusual for short periods following a recession; however, they are higher than has been sustained over longer periods of time, even in the so-called "steady growth" periods of the late 1950's and early 1960's.

But, beyond the 1983-84 time period, say looking out over a five- to ten-year horizon, controlling protectionist trends will not alone maintain a high level of steady growth. Another aspect of government policy threatens to slow industrial country growth, and that is the increasing appropriation of economic resources by governments. Almost without exception, total government spending, as a proportion of the national output of goods and services in industrial nations, has risen dramatically in just the last decade (Table 3). Higher rates of taxation and deficit spending hinder the private sector's willingness and ability to fuel our economic engines. As a result, net investment rates have been decelerating in the industrial countries since the late 1960's (Table 4). This phenomenon has not gone unnoticed in the political arena. President Reagan's "supply side" economics and Prime Minister Thatcher's efforts to cut the British public sector are only the most visible. In a number of Western European nations, including Holland and Belgium, policies such as public sector wage limitations and cuts in indexation schemes are being put into effect. Such policies would have been unthinkable as recently as in 1980.

The political resolve in industrial countries to combat both burdensome taxation and high levels of government spending should not be allowed to melt away at the first sign of economic recovery. As indicated earlier, the time to fight recession and inflation is during an earlier expansion.

Naturally, political realism would suggest that neither the battle against protectionism nor increased government spending will be easy.

The OECD has 32 million unemployed, some of them reduced to this state by Third World competition and virtually all of them seeking assistance and support

from their respective governments, including both financial support and job protection against imports.

However, persistent efforts to resist these politically tempting measures must be maintained. If such efforts are reasonably successful, it is quite possible that the industrial countries will resume a path of sustained growth.

But we will not resume this path as individual countries, for most of us have become so dependent on the world economy that we cannot achieve satisfactory and sustainable economic growth on our own. No country will alone be able to spend itself out of recession. We can only grow out of it together. Our aspirations to return to the cooperative world order—of the kind that did so much for so many since World War II—will depend on the overall economic growth and stability of the industrialized world and the preservation of a global free trading system.

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Table 3
Government Outlays as a Percentage of GDP

	Peaks in Business Activity		
	1969	1973	1979
United States	30.8	31.2	32.8
Japan	21.5	22.1	31.6
Germany	37.6	40.5	46.4
Britain	41.5	41.1	43.5
France	39.6	38.5	45.4
Netherlands	43.9	48.7	59.5
Sweden	42.8	44.9	65.1

Table 4
Net Investment as a Percentage of GDP

	Peaks in Business Activity		
	1969	1973	1979
United States	9.2	9.7	7.5
Japan	24.1	13.8	19.7
Germany	16.2	14.9	13.0
Britain	11.4	11.9	7.6
France	16.8	16.6	11.8
Netherlands	18.4	16.2	12.4
Sweden	15.0	11.8	9.1

Source: OECD

DISCUSSION

This part of the discussion was led by Willem F. Duisenberg, chairman, with a panel composed of Hans Angermueller and Alexandre Lamfalussy, authors of the working papers, and Paul A. Volcker.

An International speaker outlined what he described as the "terrible mess" of the international financial world. Some 25 to 30 countries now found themselves obliged to reschedule or restructure their external debt. This amounted to two-thirds to three-quarters of the total international debt outstanding, or as much as \$300 billion. An open crisis had been averted by the concerted action of central banks, the IMF, lending banks, and the borrowing governments, but we were running into difficulty maintaining these "holding operations" for a number of reasons: (1) The process of putting together rescue packages had become much more time consuming; the Yugoslavian case had been dragging on for four months, compared with the few days that had been required for Mexico. (2) The IMF had used up practically all its facilities and could not increase its loans to major borrowers. (3) The plight of the participating commercial banks was constraining.

Whatever the short-term resolution, long-term problems remained: (1) The "moral suasion" issue was a delicate one; the wrong kind of relationship had been established in 1977-80, when the commercial banks had crowded the IMF out of its conditional lending. We had to be careful not to allow that to happen again. (2) The "stock problem" concerning the consolidation of outstanding debt. (3) The long-term financing needs of the LDCs.

An American participant remarked that a large number of parties could share responsibility for the "mess," including OPEC, the banks, and the governments of the borrowing countries. The events of the past year had shattered some illusions: that governments were necessarily involved as parties in bilateral cross-border loans; that the interbank loan market was essentially riskless; and that central banks, as lenders of last resort, would always have hard currency reserves. On the positive side, the major parties had managed to get together last year to address the problem in a traditional but uniquely cooperative fashion. But, as the International speaker had said, the result was fundamentally a holding operation. To make it durable would require the recovery of the world economy and the adherence of borrowing countries to their agreed adjustment programs, including the reduction of non-essential imports. As the restructuring packages became more esoteric, the situation would be more difficult to manage, but so far no debtor country had hinted at any action inconsistent with traditional restructuring. The speaker did not exclude the possibility of a default, but he thought it was not probable. So it was up to all of us to deal with current liquidity problems while awaiting the effects of the economic recovery. Growth was the key to the international financial situation, as it was to unemployment.

An International speaker referred to the steps which the debtor countries, in cooperation with the financial authorities, had taken to avert a crisis. They had immediately clamped down on their imports, so as to restore their balance of payments and reduce the demand for money. But this phase could not be sustained. Over the next year or two they would need enough finance to allow them to rebuild an adequate level of imports. In the longer run, continued lending would serve only borrower and lender if the external borrowing helped develop market-oriented economies capable of competing in the developed world (as, for example, the East Europeans were not able to do). They should not only be capable of competing, but *allowed* to do so. So the medium-term task was to nurture a market orientation

among the leaders of the Third World, while further opening up our own markets to their exports. There was a direct relationship between the maintenance of the financial and trading system and the debt-servicing possibilities of the LDCs. The heads of the OECD, IMF and GATT had met to discuss means of dismantling trade barriers and restoring confidence in the financial system over the next two to three years, and they hoped to have some practical proposals to make public this autumn. The debt issue was not just a banking matter, but a problem of world economic cooperation, he concluded.

Another American said that he felt relatively optimistic about the "mess," inasmuch as we had so far kept it from becoming a crisis. It was easy to put restructuring plans on paper, but their practicality was another matter. Most of the plans the speaker had seen suggested public money to one degree or another, and he was not sure where it would come from. (In reply to a Swiss question on this point, the speaker said he had not meant to imply that the U.S. government would not supply export financing, but that it was not likely to subsidize interest rates on the renewal of old debt. One of the problems with subsidized finance was deciding who was entitled to it.) Getting an increase for the U.S. IMF quota was proving difficult, and additional outlays from industry for LDC financing were unlikely in the near future. As for the adjustment programs of debtor countries, some looked promising and others less so. Despite the calm surface, the situation was eroding, and our best hope was that the momentum of the recovery would accelerate and restore economic growth around the world. In the meantime, the maturing debt would be rolled over, as the lenders had no alternative. A Belgian participant was heard to ask what the scenario for the debtor countries would be if in fact there was no economic upturn.

A Spaniard intervened to say that, at none of the IMF/World Bank meetings he had attended, had he ever heard the private banks criticized for "crowding out" conditional lending. Nor was he aware that "suasion" had been used to limit private lending.

An International speaker replied to two questions from Italian participants. To one, he said that the major packages, such as for Mexico and Brazil, had assumed no sizable improvement in the terms of trade for those countries. If such improvement occurred, that would be a major help. The other questioner asked why the "stock problem" of outstanding LDC debt was placed in the "long-term systemic" category when roughly half of that debt was due within the next 12 months. The reply was that the short-term maturities had been "frozen" as part of the restructuring/rescheduling process, and would not be repaid within the year.

A fundamental problem with the rescheduling process, in the opinion of an American, was the uncertainty involved in renewing loans from year to year, and the loss of valuable time spent in renegotiations by officials of debtor countries, who would be better occupied dealing with substantive matters at home. Rescheduling also involved costs — fees, risk spreads — which would in time grate on the feelings of the debtors and risk producing extreme political reactions. If the burden were eventually felt to be too heavy, radical forces might be brought to power in the Third World. As others had said, the debt problem had to be seen as a development issue and not simply a financial one. The speaker endorsed the idea of increased support for the IMF, the IBRD and regional banks, but individual industrial countries might have to consider what role they should play in emergencies, as lender of last resort or otherwise. The U.S., for example, sold 8.7 per cent of its exports to Mexico, which made that country a sort of integral part of the U.S. economy.

An International participant said that, while we could all agree in a general way on short- and medium-term strategies for the less-developed countries, there was for the longer run the tough challenge of how to get new money in the right places. This was the special province of the World Bank, whose activities the speaker discussed at some length. As a development institution, the IBRD had a 15- to 20-year focus, compared with the three- to seven-year time frame of agencies like the IMF and BIS. The Bank was emphasizing several mechanisms and procedures for helping Third World countries, among them: (1) new techniques of co-financing, which appealed to commercial banks who were willing to extend their term loan maturities a year or two beyond the usual seven or eight years; (2) quicker disbursements, especially for structural adjustment loans; and (3) more consultative groups, chaired by the IBRD, for pledging and coordinating. The World Bank was one of the underutilized factors in the international community's quest for solutions. With appropriate increases in the member countries' quotas, the Bank could borrow and lend more and derive greater leverage from its expertise. This would be particularly valuable at a time when private and official development assistance was not growing. Raising the Bank's lending strength above its present artificially low levels would cost its shareholders nothing in the short run and little in the long run, as the national quotas had negligible budgetary impact.

As a Briton put it, not only had the stable parity of the Bretton Woods fixed exchange rates disappeared, but so had the assumption that the IMF was the institution for solving temporary liquidity problems resulting from balance of payments disequilibria. IMF lending now came to about \$18 billion, only a tenth of what the Eurocurrency market combined. The balance had completely shifted, and IMF was struggling to get its quotas raised. Two things were needed: (1) the ad hoc process which had produced the Mexican package ought to be "systemized," so it could be relied on in future; and (2) official agencies such as the IMF, IBRD and IDA ought to be endowed with larger resources if they were to provide the basis on which money could be raised in other forums. These proposals were endorsed by a Dutch participant.

A Swiss participant described the recent creation of the Institute of International Finance (IIF), whose purpose was two-fold: (1) to improve the collection and dissemination of statistics on the debtor countries and their economic development for the benefit of borrowers and lenders, and (2) to provide a platform for a continuous dialogue between the major groups of players in the international financial arena. It would not be a lender itself, nor a focal point of syndications or credit ratings. The IIF had been founded earlier in 1983 by 36 major commercial banks from Europe, Japan, Canada and the U.S., and would eventually have close to 1,000 members. It was located in Washington, D.C., to be near the IMF and IBRD, and indeed its success would depend largely on its close cooperation with those agencies and the BIS.

The health of the international banking and financial systems was obviously important in both the short and long run, and many interventions touched on this subject throughout the day's discussion. With respect to the role of the commercial banks in the restructuring process, a Swiss participant said that they would of course make a contribution, but that they could not increase their lending significantly because of a "blatant lack of capital" and worrisome balance sheet deterioration. Consequently, international agencies and regional investment banks would be called upon to play a major role. Governments of the developed countries would also have to step in, but this was not illogical, inasmuch as the original borrowing had served to aid industrial exports from those countries.

Whether finance followed trade or vice versa, a German speaker pointed out that probably 90 per cent of the international lending of Western banks had been to finance trade. Those banks were now being criticized for having lent too much or imprudently to Third World or "threshold" countries, but if they had not done so there would have been a crash some years ago. Avoiding that crash incidentally enabled the industrialized countries to export, which was tantamount to fighting unemployment in the large trading economies. The loans made by the private banking sector to the LDCs over the past decade should be viewed in that light, as a service to domestic industries. Did the bankers now expect to be repaid? They "hoped so." This suggested less than certitude, which is why they were setting up large loss reserves — probably larger in Europe than in the U.S. But the bankers were also hoping for cooperation — among banks, official institutions, and the debtor countries themselves — to ease the problem. That was not equivalent to solving it, which would require a sustained recovery, the opening of our markets to the LDCs, and indeed doing whatever was needed to help them reach a more advanced economic level.

Strong support for these remarks was heard from an Austrian participant, who recalled that the official institutions had not been prepared to handle the recycling of funds toward the LDCs at the time of the first oil shock. But the resulting plight of the commercial banking system could not now be solved by setting up reserves, no matter how prudent that might be. What would bad debt charges of \$400 billion do to bank balance sheets? Governments were applying restrictive measures through their regulatory agencies, but this ran counter to the apparent expectation that banks would continue to extend credit to poor countries despite the absence of any general framework.

But, asked a Dutchman, how could banks be expected to go on extending these questionable loans against which they had to establish loss reserves? He put the problem in dramatic relief by observing that to write off the presumably bad LDC loans would require all of the gross profits of the 25 largest banks in the world for a period of 13 to 15 years. Much of the new lending would be export financing, which now entailed a large component of political risk. That was rightly the province of governments, not the private banking sector.

An International speaker intervened to say that more export credit lines were not what was needed by the LDCs just now, as most of them were committed to cutting their imports. So it was not surprising that those facilities had been oversubscribed; they would never be used. The Dutch speaker argued that it made no difference whether the credits were labeled "export" or "balance of payment," but a German thought it was unwise all the same to expose governments to the political pressure to grant balance of payment credits — a responsibility which was best left to the international institutions.

A British participant described the banking business as in a "very sick situation," which would not be cured by the economic recovery. The capital crisis of the banks was extremely urgent, and it had been brought about by the accounting principles of certain institutions in certain countries regarding bad loans. The patient was in a "sorry state," and governments might have to step in.

An American speaker referred to legislation pending in the U.S. Congress which had been characterized as "penalizing bank earnings." He asked if there were not some way to sanction new reserves for banks who were prepared to grant new credits to questionable countries, i.e., an opportunity to share costs with the government, which would not after all be collecting taxes on the reserves set aside. It was unfortunate, by the way, that the banking industry had taken "the wrong

position" on the withholding tax issue, thus alienating many Congressmen at a time when that was not needed.

A compatriot responded that the large U.S. banks, having initially opposed the withholding tax, had withdrawn their opposition after enactment and geared up to comply. The main resistance after that point had come from the smaller banks who were not eager to take on the expense of the necessary computer programming. As for the Senate version of the IMF bill, the U.S. banking industry had no fundamental problem with that, but there was a bill circulating in the House which, if literally applied, would wipe out the earnings of virtually all the major banks.

Another American said that he was not as pessimistic as the previous British speaker about the condition of the banking industry. He looked to the prospective economic recovery, combined with the calm skillfulness of banks and international institutions, and the cooperation of borrowers, to insure that the debts would eventually be repaid. It might not be on schedule, but neither would there be a calamitous crisis.

While the discussion of this part of this agenda item dealt mainly with the LDC debts and the condition of the banks, it touched also on fiscal and budgetary policies and interest rates. A Canadian participant had noticed running throughout the papers and the discussion the theme of high real interest rates. Unfortunately, the public seemed to have the impression that it was simply up to central banks and governments to lower them. This overlooked the fact that central banks were governed mainly by the marketplace. Interest rates remained high because the market was not convinced that we had wrestled inflation to the ground; in fact, there were expectations of a return to inflation. We had to resist the temptation to pump more money into the system; the only way to bring interest rates down was by attacking high national budget deficits. Our dilemma was that those deficits contained a high component of social welfare and job creation.

A Belgian pointed out that the effect of the U.S. federal budget deficit was felt around the world through the high level of interest rates it caused. Outsiders should not presume to suggest where that budget should be cut ("No representation without taxation"), but it was to be hoped that America would find the courage to adopt a sounder, more politically difficult fiscal policy.

A German participant argued that investors in the European and Japanese capital markets were partially financing the U.S. federal budget deficit. So long as they — as well as Americans — could get a better yield on U.S. government securities, there was little incentive to make direct, job-creating investments in the private sector. The economic upswing would be flat and short so long as the federal deficit went far beyond the savings quota of American society. Responsible leaders could not get away with just putting the blame on a few senators; it was up to them to speak out to the public. To those who would assign the highest priority to military spending, the speaker replied that nothing was more important to defense than the health and growth of the economy. A worldwide depression would destabilize many more countries than those in Central America. British and Dutch participants lent their support to this intervention, and one of them wondered whether a political trade-off between deficits and interest rates could not be accomplished.

An American participant conceded that interest rates were too high for a long sustained recovery, but not too high at the moment, given the large U.S. budgetary deficit and the purchasing power it was throwing out. As the recovery accelerated there was a chance of a major collision in the financial markets because of the needs of the government. Probably nine-tenths of the Congress condemned budgetary deficits, but reform was everyone's second priority, the first being defense or social

spending. One problem with the trade-off suggested by a previous speaker was the time lag involved in feeling the effect of a reduced budget, which took a couple of years.

In closing this session, the chairman recalled that, some years ago, a group of Amsterdam bankers had negotiated with the ambassador of a newly developing country a consortium loan for five years. It could not be repaid at maturity and had to be rescheduled. It was finally repaid after 30 years. The year of the loan was 1782. The ambassador was John Adams.

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III. DISCUSSION OF CURRENT EVENTS

The current events session focused on the formulation and conduct of U.S. foreign policy. The discussion covered America's relations with its allies, arms control negotiations and weapons programs, economic affairs, and policies in the Middle East and Central America. An American speaker provided detailed reviews of U.S. policies in those last two areas.

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The U.S. and its allies. Speakers from a number of countries expressed concern about what they saw as "unpredictable swings of the pendulum" of U.S. foreign policy. Unpredictability and inconsistency had characterized the Carter administration's policies, and the situation had not much improved under President Reagan.

A Canadian argued that a shift of power from the President to Congress was to blame. There had been a traditional rivalry between the two branches of government, but now Congress was more powerful and assertive. The speaker was worried by a "decline in internationalism and a growing nationalistic mood" in Congress; there were trends toward unilateralism and protectionism which could be expected to be troublesome. Congress was competing with the President as an initiator of policy and was becoming increasingly undisciplined and unrestrained by the executive branch.

A Turkish participant offered an example of how this dichotomy in America's policy formulation troubled its allies. The administration had proposed a high level of military aid to Turkey only to have an initiative raised in Congress a few weeks later to cut off all military aid to that country.

The Canadian speaker sought to provide a perspective on the U.S. from its closest neighbor. He said that the U.S. and Canada were at odds on a surprising number of issues. Canada found it a challenge to "develop its own distinct society, project its own identity, and fulfill its own domestic and international aspirations while living next door to the most creative and dynamic society" in the world. The U.S. tended to lean on Canada from time to time, and to criticize many of its policies. But the U.S. was, in the words of one Canadian, "Canada's best friend, whether we like it or not."

A fellow Canadian was more critical of the U.S., saying that too often the U.S. attacked Canada's interests and still expected Canadian support for its policies. The U.S. had to learn to respect the essential concerns of its allies.

An American urged that his country's policies be viewed in light of the problems the U.S. had faced in recent years. There had been a breakdown in the domestic consensus about the nature, goals, and purposes of U.S. foreign policy that had begun even before the Carter years. During the Nixon and Ford administrations, the U.S. had been faced with the difficult task of having to conduct a foreign policy of limited means in a climate of ambiguous dangers, at a time when national cohesion was disintegrating due to Vietnam and Watergate. The U.S. had been slow to recover from this period. The problem had been exacerbated, too, by the sometimes reckless and cynical manner in which the domestic debate had been conducted.

Another American saw the problem not as a breakdown in the consensus of the elite, but as a movement of the public away from support of an internationalist position as the result of economic problems. People were simply more concerned with jobs and the economy. But, added another speaker, the effects of Vietnam

were still very much alive, as the debate on Central America illustrated.

A widely expressed criticism was that the rhetoric coming out of Washington had been excessive and confusing. This prompted an exchange of views among several American participants. One argued that there was more strategy and continuity in U.S. policy than had been suggested, and that the problem had been one of rhetoric. A fellow countryman agreed, saying that the administration's policies were better than the rhetoric by which they were defended. Other speakers felt that the administration's rhetoric had been considerably toned down from its early days. Perhaps, suggested yet another American, there was a danger in toning down rhetoric too much. Policies, in order to be effective, had sometimes to be put forth in strong terms.

A final American intervention on the subject sided with those Europeans who still found U.S. rhetoric confusing, and argued that rhetoric and policy could not really be separated; rhetoric *was* policy. The problem, in the speaker's view, was a "divided administration". There were internal fights among the President's staff, the National Security Council, the State Department and the Defense Department, all of whom were trying to make policy.

Another American acknowledged that mistakes had been made in the past, that there had been problems in "settling down". But it was important to remember that the administration had been voted into office with a mandate to change the old way of doing business.

It was a Canadian speaker's view that, while the aberrations of Vietnam and Watergate had caused some "lurching around" of U.S. policy, these episodes were well in the past. Indeed, the U.S. had some justification to view its allies as being somewhat erratic themselves, complaining alternately about American strength and American weakness.

Putting the past aside, a German found it encouraging that the U.S. was reasserting itself as the leader of the Western alliance. That leadership had been badly missed. Europeans had criticized the U.S. for not providing leadership, now they should not criticize too harshly its reacceptance of it. It was not easy to assume the role of leader of a group of democratic nations. In doing so, the U.S. should remember that its relationship with Europe had changed. Europe had become stronger, and the alliance was now one of equal partners, with the small nations playing an important role. Leadership, the speaker continued, meant consultation before taking action, not information about actions already taken. The alliance could ill afford any more "unhappy surprises" like the grain embargo or the pipeline decision. But he expressed satisfaction that the U.S. was once again striving to lead.

Economic policies. A Greek participant summed up the feeling of many when he said that the unpredictability of U.S. economic policies, especially with regard to interest rates, was more harmful to the cohesion of the alliance than the unpredictability of U.S. foreign policy.

A Briton asserted that economic and trade policies presented a great challenge to alliance unity. Some NATO countries were "all but bribing" the Soviets to trade with them, while others supported sanctions against the Soviet Union. A German wondered why the U.S. seemed to view trade as a defensive rather than an offensive element in foreign policy. Sanctions against Poland, for example, did not really work against Soviet global aspirations. It was wrong to view trade as a "big stick". Another German voiced concern that new demands by the U.S. to impose sanctions or trade limitations on the East at the expense of domestic jobs in the West would put great pressure on European governments, and likely make deployment of the

Pershing missiles more difficult for the German government to carry out.

A speaker from Canada predicted growing protectionism in the U.S. There could be no reduction of the U.S. trade deficit without "far-reaching structural change." The U.S. could only buy time for its uncompetitive industry. Congress would increasingly respond to the popular American feeling that the U.S. had been unfairly treated in the world.

We ought to be glad that the U.S. was striving for economic stability and to bring down inflation, said a German. But the means by which those goals were being accomplished were open to criticism. The policy mix was not correct, with too much emphasis on monetary over fiscal policy. High interest rates would choke off economic recovery, and the reason for those high rates was the huge U.S. budget deficit.

An International speaker viewed that deficit with great alarm. He had the impression that U.S. officials were not inclined to take immediate action to lower the deficit. The speaker was not reassured by the comments of some Americans in government that the problem would be "taken care of later." Without immediate action, the U.S. would probably have only a short recovery, and Europe would have none.

Arms control and weapons programs. A Norwegian speaker, while acknowledging that there was a remarkable consensus among all participants on the need to pursue both tracks of the two-track decision with regard to INF, expressed doubts about the sincerity and seriousness with which the U.S. was negotiating in Geneva. There was a widespread feeling in Europe that the determination to deploy Pershing II and Cruise missiles had been amply demonstrated, but that the negotiations had been slow and unproductive. It appeared to the speaker that the U.S. had essentially made the decision to deploy, regardless of the outcome of the negotiations.

The U.S., in the speaker's view, was spreading fear about Soviet power, and using "scare tactics" which gave a misleading impression of the military balance. It was hard for European leaders to "defend facts which we do not believe are correct." The speaker referred to a recent poll in the U.S. in which 60 per cent of those surveyed believed the Soviet Union was a threat to peace, but 75 per cent felt new U.S. weapons programs would lead to a parallel build-up of Soviet weaponry. The anti-nuclear sentiment was strong not just in Europe, but in the U.S. as well, as the freeze movement showed.

A German agreed that many in Europe felt President Reagan had abandoned the negotiation side of the two-track decision. That decision had been made on the assumption that détente would continue. Now, if the U.S. administration wanted to dispel the growing doubts about its sincerity, it had to "tone down its rhetoric, not impose economic warfare on Europe, not engage in a geopolitical crusade against the Soviet Union, and be serious and be seen to be serious in Geneva." The speaker felt that the proposals that arose during the Nitze-Kvitsinsky "walk in the woods" would have formed a sound basis for a negotiated settlement, and he regretted that the U.S. had not accepted them.

An American responded that the U.S. had been prepared to pursue the Nitze-Kvitsinsky channel, but that the proposals themselves were not considered acceptable because they called for the deployment of Pershing missiles. The speaker sought to clarify his country's policy with respect to the INF negotiations and to dispel the notion that it was not taking them seriously. It was often overlooked that one of the administration's earliest decisions had been to adhere to the two-track decision and to return to the negotiating table to seek an agreement. The zero-option proposal

was a serious attempt to formulate an INF negotiating strategy, and was thought to be sound both politically and militarily. The only proposal made by the Soviets was to abandon the NATO deployment entirely. The U.S. had made a new proposal that forces on both sides be equal at a number chosen by the Soviets. Now it was becoming apparent the U.S. would come up with yet another proposal to break the deadlock. The U.S. found itself in the position of being expected to meet every instance of Soviet intransigence.

But the administration was committed to searching for a solution. It was not a foregone conclusion that we would have to deploy in order to get an agreement, but it was imperative that the Soviets realize there was no third alternative. Failure of the alliance to carry through with the deployment would have "politically dangerous consequences." Further, no agreement could be reached if doubts persisted in the alliance as to the sincerity of the U.S. negotiators.

Various speakers felt sure of American sincerity, but stressed the need to convey that impression to the public. An American worried that we were getting to a point where the only thing that would be accepted as proof of U.S. sincerity would be to do what the Russians wanted.

A Turk agreed, warning that questioning U.S. sincerity only played into the hands of Soviet propagandists, whose strategy was to isolate Europe from the U.S. They had gone to great lengths to portray President Reagan as a warmonger. We had to be careful not to give credence to the Soviet view that whatever they did was right and whatever we did was wrong.

Responding to other points raised by the Norwegian speaker, an International participant stressed that all of the NATO nations had studied the military balance and reached a consensus view that imbalance in favor of the Soviets was real and not distorted by the U.S. And an American said it would be wrong to put too much emphasis on the freeze resolution passed by Congress; it was an "abstract document incorporating a wide spectrum of points of view," or, in the words of a Congressman, a "letter to Santa Claus."

With regard to concerns that the U.S. had embarked on a major arms build-up, an American stressed that his country's aim was not to restore strategic superiority, but to replace and modernize weapons that were nearing obsolescence, as compared with much newer Soviet armaments. The West had to maintain the credibility of deterrence in the face of Soviet forces that were essentially brand new. This modernization could be, and was being, carried out in phase with a general arms reduction. The U.S. had 8,000 fewer nuclear weapons deployed around the world than in 1967, with less megatonnage than in 1960. It had phased out roughly two weapons for each new one introduced since 1967. It was the desire of the U.S. to modernize its armaments while searching for stabilizing arms agreements. It was hoped that the modernization could be achieved at vastly reduced levels of forces on both sides.

U.S. policy in the Middle East. The major objective of U.S. policy in that region was, according to an American speaker, to achieve a just and lasting peace between Israel and its Arab neighbors.

With respect to the current situation in Lebanon, the U.S. had three goals: (1) the withdrawal of all external forces, (2) the restoration of Lebanese sovereignty over all its territories, and (3) effective security arrangements to safeguard Israel's northern border. The broader goal of U.S. policy in the region was to show the parties concerned that negotiations could be effective and were the only way to achieve peace.

From the Israeli point of view, the Lebanese withdrawal accord was a positive achievement because Lebanon became the second Arab country to negotiate and

reach agreement directly with Israel. The agreement called for an end to hostilities and specified both parties' right and obligation to live at peace with each other within secure, recognized national boundaries. It also provided for security arrangements designed to prevent the return of outside forces to the security area.

From Lebanon's viewpoint, the agreement was the first step toward the withdrawal of foreign forces, and would allow Lebanon to establish a strong central government. But the agreement was not a peace treaty and thus allowed Lebanon to maintain its relations with other Arab nations.

Though Syria had denounced the agreement, the U.S. believed there was a reasonable chance that Syrian forces would withdraw once the Lebanese parliament endorsed it. Syria itself had stated that its forces were in Lebanon by invitation. Part of the diplomatic strategy was to encourage moderate Arab states to urge Syria to withdraw. There was considerable risk of war with Syrian and Israeli forces "cheek-by-jowl", and Syria would probably be on the losing end of any conflict. Finally, the speaker suggested, Syria would not want to be the country responsible for Israel's staying in Lebanon.

As for the broader peace process, the U.S. was concerned about the Palestinians in the West Bank and Gaza. The U.S. approach was to handle the problem by getting all parties concerned to the negotiating table. The PLO had done nothing for these people, and by delaying the start of negotiations it had given Israel more time to continue its settlements policy. The European proposal that negotiations start with the U.S. endorsing Palestinian self-determination was a "non-starter," because that was a "code word" for an independent Palestinian state. Under such circumstances, Israel would never negotiate. Nor was it productive to suggest that the U.S. deal directly with the PLO. The U.S. insisted that, as a precondition to joining any negotiation, the PLO recognize the right of Israel to exist.

A Turkish speaker praised the U.S. achievements in the Middle East, but questioned how there could be a serious negotiation without the PLO, which, in spite of its setbacks and disunity, was still a force to be reckoned with, and from which no Arab state could afford to disassociate itself. The speaker did not share the American confidence that the Syrians could be induced to withdraw from Lebanon. If Syria withdrew, the Soviets would lose their cards in the region.

An American argued that while the U.S. was perhaps in the best position to bring peace to Lebanon, it was not necessarily in the best position to bring peace to the Middle East. It was being blackmailed, or at least victimized, by its client. Israel had been obstructing negotiations, even rejecting something less than self-determination as a basis to get them going. The U.S. had been able to do nothing about the settlements policy. Failure to involve all the parties, including the PLO, would ultimately reintroduce the Russians into the equation.

An Austrian agreed that the central problem was how to bring the PLO into the negotiations. The Middle East was an area of vital concern to the interests and security of Europe, and it was appropriate for European leaders to put forward proposals for a negotiated political settlement. The PLO now seemed willing to negotiate, but ironically, it was the other side that was unwilling.

Conflicting views within the alliance about the role of the PLO worried one American participant. These conflicts had slowed down progress toward a settlement, he warned, and "enormous political difficulties" were now developing. We had given the Soviets and the Syrians an incentive to continue the Lebanese crisis to see what would happen.

One speaker wondered why the U.S. did not exert pressure on Israel to give up its settlements policy. An American replied that a policy of pressure would not

succeed. The U.S. had been successful not because it had been able to force Israel to "knuckle under," but because it had been able to get both sides to negotiate. The way to bring the PLO into the negotiations was to get them to take the first step of recognizing the right of the other party to exist.

U.S. policy in Central America. The Reagan administration, said an American speaker, recognized that the conflict in the region had its sources in poverty, economic underdevelopment, and failure of the social, economic and political institutions. These conditions had to be changed, but external intervention from Cuba and the Soviet Union only made matters worse. This intervention had led to the "betrayal" of the Sandinista revolution and the success of the paramilitary forces opposed to the government of El Salvador. In that country, the guerillas were destroying the national economy by wrecking its infrastructure.

U.S. policy with regard to El Salvador had four goals: (1) reform of the political and social institutions to promote democratic government and respect for human rights, (2) support for economic development, (3) provision of military assistance in order to shield the democratic process and protect institutional reform, and (4) support for negotiation to achieve a political solution.

The U.S. sought to promote free elections in El Salvador, open to all, with guarantees against intimidation. It favored a continuation of the progress already made in agrarian reform, as well as judicial reform to protect human rights. It would aim to provide economic assistance necessary to rebuild the economy, to provide military assistance to shield these processes, and to support negotiations, especially regional ones. The U.S. did not support power-sharing negotiations between the government and the guerillas, but rather negotiations on conditions of elections and on the democratic process.

In Nicaragua, the speaker continued, the U.S. had not sought conflict. It had provided support initially to the Sandinistas, but policies of repression and support for the insurgents in El Salvador had led to deteriorating relations and a cut-off of aid. The U.S. had since sought a diplomatic accommodation, but had been rebuffed by the Sandinistas in its efforts to promote bilateral and regional negotiations. At present the U.S. supported the Contadora initiative.

Specifically, the U.S. would be in favor of the withdrawal of all foreign military advisors and troops, renunciation of support for insurgencies in neighboring countries, and non-importation of offensive weapons into the area. All these objectives would have to be achieved on the basis of a reciprocal and verifiable agreement binding on all parties.

There were no "quick answers," the American observed, but we nevertheless were running out of time. The democracy that the U.S. saw emerging in El Salvador could not survive if the economy were being wrecked. The fledgling institutions needed protection.

A Spaniard offered a different perspective on the problems in Central America. He had "full understanding and respect" for the U.S. position with respect to an area that had "undeniable strategic importance" to it. But the situation had to be viewed from the perspective of the historic difficulties in the inter-American relationship. U.S. policies in the region had ranged from neglect to full-scale intervention.

One had to realize that we were seeing a group of different conflicts, each with indigenous causes—economic and social imbalances and oligarchical domination. Only secondarily was it an East-West issue, only lately had external forces become involved.

It was easy to support the basic goals of American policy, but the U.S. tendency was to emphasize "negative aims," namely to halt the spread of Communism. Other countries stressed positive goals such as human rights, economic development, and social justice. The U.S. method tended to be military, while other countries favored dialogue and negotiation. The problem of Central America was complex and required a complex solution. It was imperative to prevent enlargement of the conflict.

Spain felt the initiative had to come from the Latin American countries, and therefore it supported the Contadora group. A multilateral framework was needed to consider the overall problems in the area, and within that framework there had to be bilateral talks between governments, and between opposition forces and governments.

There were in Central America moderate groups seeking a peaceful solution. Not all of the opposition in El Salvador were armed Marxists. The moderates needed support. The U.S. faced a credibility problem if it was seen to be siding with the old, corrupt, tyrannical governments. A vast social change was taking place, and the causes, not the effects, had to be fought.

A Canadian agreed, saying that while it was true the U.S. had important strategic interests in Central America, the revolution "could not be turned off", nothing would stop the process of change which was the result of years of oppression. Military aid was a "losing game," and the U.S. would be better regarded by future generations of Central Americans if it offered political and economic support only.

An American supported this view, saying that the younger generation of Latin Americans was fed up with repressive, unjust regimes. The U.S. had a sorry record of intervening in the Central American, Caribbean, and Latin American regions, and it "never seemed to learn the lessons of its own history." The U.S. was badly prejudicing its future with the younger generation in these areas.

A Spanish participant thought the U.S. had already lost its credibility in Latin America as the result of its support of Britain in the Falklands conflict. Latin American countries were suspicious of U.S. goals in Central America.

Other speakers expressed doubts about the wisdom and effectiveness of U.S. policy in Central America. An American questioned whether the governments being shielded with military assistance had any intention of carrying out political and economic reform. The U.S. might have, at most, some short-term success with its current policies. But it would have to redefine its interests in the region and figure out how to deal with the inevitable revolutions. U.S. support for the regime in El Salvador, in the speaker's view, "fed the causes by which the war began."

Another American supported military assistance to the government of El Salvador because it was clear that the guerillas were "hardcore Marxists, not agrarian reformers." But the question was how far to go in supporting the government. If they could not survive even with U.S. weapons, instruction, and training, then there was not much more to be done. But, in one participant's view, the U.S. had so far used only "moderate, if not to say negligible, means in Central America."

Europeans, said an International speaker, should be more discreet when criticizing the U.S. about its Central America policies. The choice in that region was not between a good government and a bad government, but between a relatively corrupt, undemocratic regime that was pro-Western and a more corrupt, tyrannical regime that was pro-Soviet.

Queried why the U.S. supported new elections in El Salvador, an American wondered what else his country was to support. Usually the U.S. was criticized for supporting authoritarian regimes. In Central America it was supporting the alter-

native of electoral government. As to the possibility raised by several speakers of including Cuba in negotiations, the American speaker said his government would be open-minded about including Cuba in a multilateral approach if Cuba would first renounce the exportation of its revolution.

The whole Central American issue, argued another American, was complicated by an ill-informed debate between conservatives and liberals, who romanticized the rebels and failed to realize there could be no reform or economic program without the shield of military assistance.

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CLOSING REMARKS

In closing the Conference, the Chairman expressed the gratitude of all those present to the Canadian hosts, under the leadership of Donald Macdonald, with the assistance of Bernard C. Thillaye; to the various agencies of the Canadian provincial and national government; to the authors of the working papers; to the interpreters and the Bilderberg secretariat; and to the hotel staff, all of whom had contributed generously and efficiently to the success of the meeting.