ROME,
The Trilateral Commission's Tenth Anniversary Plenary Meeting
April 1983
Rome, April 17–19, 1983

At The Vatican
John Paul II
Georges Berthoin

Trilateral Relations
Raymond Barre
Nobuhiko Ushiba
Henry Kissinger

International Finance
Paul Volcker
Toshio Nakamura
Harold Lever

North-South
Chedli Klibi

The Italian Scene
Romano Prodi
Mario Monti
Guglielmo Negri

$3.00

The Trilateral Commission held its 1983 plenary conference in Rome, April 17 to 19, under the chairmanship of Georges Berthoin. The conference, marking the Commission's 10th anniversary, was highlighted by a meeting with President Sandro Pertini at the Quirinale and a dinner at the Palazzo Barberini, hosted by Giovanni Agnelli, in honor of Prime Minister Amintore Fanfani.

In his remarks to the 250-odd Commission members and special guests assembled in Rome, President Pertini expressed his "pleasure to note that your debates have focused on the two most wrenching problems of our time...: that of disarmament, and that of assistance to the less developed countries — those countries where thousands of human beings die every year of hunger and malnutrition. And while these legions of innocents are decimated," the President of the Italian Republic continued, "$650 billion are spent to build nuclear weapons which, if they were ever to be used, would mark the end of mankind. All men of good will, and most of all those who hold in their hands the destiny of nations and their people, must unite at all cost against the reign of death and for the exaltation of life."

This issue of *Triadoue* contains, out of necessity, only a selection from the major addresses delivered in the course of three days of debates which included sessions on:
- the current state of trilateral relations;
- current developments in the host country, Italy;
- the Soviet Union and the trilateral countries in the post-Brezhnev era;

In addition, the Commission's Rome plenary was marked by a number of special events with guest speakers who included: Chedli Klibi, Secretary-General of The Arab League; Harold Lever, Former Chancellor of the Duchy of Lancaster, and Chairman of the Governing Board of the World Jewish Congress; Toshio Nakamura, Chairman of Mitsubishi Bank (who spoke at a dinner at the Palazzo Colonna, hosted by Giovanni Auletta Armenise, Chairman of the Banca Nazionale dell'Agricoltura); Karl-Heinz Narjes, Member of the Commission of the European Communities; and Paul A. Volcker, Chairman of the Board of Governors of the U.S. Federal Reserve System.

The themes of both draft reports discussed in Rome — security and Third World development — were central to an inspirational moment of the Rome conference: His Holiness Pope John Paul II's address to the Commissioners, whom he received in private audience at the Vatican. The complete text of the Pontiff's remarks, together with the greetings of European Chairman Georges Berthoin on behalf of the Commission, provide an ideal opening to this *Triadoue*. 
At the Vatican

- Berthoin greets the Pope before the Commission
Your Holiness,

On behalf of each of us in this group, my first words cannot be anything else than gratitude and respect.

To be welcomed in Rome by the Successor of Peter, 1950 years after the death and the resurrection of Jesus Christ, is, for the Trilateral Commission, the most moving and inspiring encouragement.

We are Japanese, Americans, Canadians, Europeans from Norway, Denmark, Germany, Belgium, The Netherlands, Britain, Ireland, Portugal, Spain, Italy and France. We are all citizens of democratic countries and, as such, in our thoughts and in our deeds, not only do we share a common respect for the dignity of man but we enjoy the freedom to make our respect a fact.

We represent, in a voluntary association, a rare, if not unique, combination of experiences and responsibilities in the art of government, in the representation and defense of workers, in the leadership of business, either public or private, in the pursuit and transfer of knowledge, in the gathering and dissemination of information, in the management of an increasingly interdependent world.

We are members of the Christian Community or we follow the teaching of other religions or we experience doubt, but in our diversity we are all united in the same respect for the values Your Holiness brings so fervently to mankind through your faith, your teaching, your courage, your pastoral visits.

We cannot fail to be impressed by such huge crowds, in so many countries, in such different religious and political contexts, who welcome the messenger of hope and through him, express, almost physically, their ardent quest for the unity, the dignity, the peace of the world.

For our modest part, we meet, from time to time, to study and discuss the mechanics of hope.

This week in Rome, we learn about new Italian developments. We examine what divides and unites Japan, North America and Western Europe; how to keep money as a productive tool, not an erratic and destructive master. We listen to the appeals of our Jewish and Muslim brothers for peace in Jerusalem.

We measure the obstacles still existing on the way to further an essential, urgent European unity. We immerse ourselves in the formidable problems of defense and arms control as necessary components of international peace through a properly managed balance. We try to find, in interpretation, both realistic and generous, of our own responsibility, more effective ways to bring harmony between the poorer and richer parts of the world. We try to understand, with increasing concern, the path contemporary Russia follows and which transforms, in the eyes of the whole world, this part of the great and patient Slavonic family into the very negation of the principles of its foundation.

These are some of the mechanics of hope in which we are involved with a strong dedication to the understanding of others and the search for common solutions, with a sense of purpose which explains our own creation ten years ago and which has never weakened since.

But, we know well our limits. We know enough of the world to feel that, beyond the mechanics, there must be a message of hope, that it must reach each man, each woman, individually, in the quietness and uniqueness of human privacy. This explains why each of us here, whoever we are, wherever we come from, whatever faith or creed we embrace, goes towards you, the messenger of hope, with humility and open arms.

This is why this visit "ad limina apostolorum" to the Successor of Peter is, for our group, an occasion to show our gratitude, our respect, but is, above all, the blessed opportunity to receive the message.

Holy Father, we have no fear, because you told the world: "There is hope," and the world heard you.

Georges Berthoin
Dear Friends,

It is a pleasure for me to meet the members of the Trilateral Commission, and it is also, and perhaps especially, an occasion for reflection. For I am aware that you represent a rare concentration of ability, expert knowledge and experience. This great accumulation of knowledge in the political, economic, financial and sociological spheres provides you with the means of considerable power. And how can power be exercised morally if it is not accompanied by an acute sense of responsibility?

It is not for me to interfere in your technological researches. However, the subject of your work is so closely connected with human beings that you constantly find yourselves at the frontier between technology and ethics. In this respect I am very much interested in your work on East-West relations, international cooperation, the search for peace in the Middle East, and arms limitation, as well as other issues.

This ethical dimension of your activity is heightened by your geographical origins. You all come from the wealthy parts of this world, and for this reason you have a responsibility for encouraging people to face their duty of international human solidarity, for, as my predecessor Paul VI said in his Encyclical Populorum Progressio, “This duty is the concern especially of better-off nations” (no. 44). Again, when one speaks of human solidarity and politics, and international solidarity and politics in particular, one cannot forget the words of John XXIII: “The same moral law, which governs relations between individual human beings, serves also to regulate the relations of political communities with one another” (Pacem in Terris, part III). International solidarity applies not only to the relations between nations but also to all the instruments of relations between nations, including those at the level of government and of multinational companies. In every sphere there are ethical and moral exigencies. These ethical and moral exigencies touch the many factors of technology and bear directly on the productivity and profit of enterprises, as I have alluded to in Laborem Exercens (cf. no. 17). In a word, all activity must be at the service of life — the life of individuals and communities wherever they may be — and this activity must not violate the laws of life, the generation of life, the dignity of life, especially the life of the poor.

I am pleased to learn that you are spending these days discussing a study of strategies of development — a study which must emphasize the double effort to be made: on the one hand by the poorer countries, to secure their self-development; and on the other hand by the richer countries, to create economic and trading conditions that will help to meet the essential needs of the people in the developing regions, and that will also favor a more just sharing of resources. But here I ask myself a question — a question that I put to you as well: why, at the end of the first third of the Third Development Decade is the global situation of North-South relations more alarming than it was at the
beginning of the sixties? Why is the gap between rich and poor constantly growing wider? In reply, one may point to the energy crisis of the seventies, which brought the developed world itself face-to-face with a striking number of social challenges. Permit me to mention, as a complement to this, the inadequate attention given to one of the main themes of Populorum Progressio: "The integral development of the human person".

It is an illusion to pursue solely material development. Everything, including the dynamism of production and profit themselves, is rooted in the awareness of human dignity. Attacking this dignity weakens all efforts for development. On the other hand, creating social, cultural and spiritual conditions which protect people from all situations of oppression, exploitation and degrading dependence is a guarantee of the success of development projects. "In brief, to seek to do more know more and have more in order to be more" (Populorum Progressio, 6).

In addition, peaceful relations between peoples equally figure among your concerns. This is a matter much more closely connected with development than appears at first sight, for the ethical truth that I have just evoked is at the root of authentic peace. Certainly, one must not neglect the patient efforts of negotiators, or studies full of technical solutions that would make it possible to fix the balance of power at an ever lower level. On numerous occasions I have encouraged them. At the beginning of the year, I devoted a Message to the importance of dialogue as a means for guaranteeing security. This presupposes, of course, that such dialogue is sincere, is without deception, and is free of any intention of deceiving the other party.

Here I would repeat in your presence what has already been proclaimed before the United Nations: "The production and the possession of armaments are a consequence of an ethical crisis that is disrupting society in all its political, social and economic dimensions. Peace, as I have already said several times, is the result of respect for ethical principles. True disarmament, that which will actually guarantee peace among peoples, will come about only with the resolution of the ethical crisis. To the extent that the efforts at arms reduction and then of total disarmament are not matched by parallel ethical renewal, they are doomed in advance to failure. The attempt must be made to put our world aright and to eliminate the spiritual confusion born from a narrow-minded search for interest or privilege or by the defense of ideological claims: this is a task of first priority if we wish to measure any progress in the struggle for disarmament. Otherwise we are condemned to remain at face-saving activities" (Message for the United Nations Second Special Session on Disarmament, 12).

As you see in the spheres with which you concern yourselves with competence, it is impossible to separate technology and ethics. Without the aid of ethics, political activity does not secure the common good but becomes an unbearable and detestable exploitation of man by man.

And so I would urge you to continue with good will your efforts and researches without ever neglecting or transgressing the moral dimension of international relations — and to do everything for the service of the human person:

And may God, the Creator of the human person and the Lord of life, render effective your contribution to humanity and implant peace in your own hearts.

John Paul II
The State of Trilateral Relations

An important session of the Tri-lateral Commission's Rome conference was devoted to the state of relations among the industrialized democracies of Western Europe, North America and Japan. It was opened by Raymond Barre, former Prime Minister of France; Henry Kissinger, former U.S. Secretary of State; and Nobukiko Ushiba, former Japanese Minister of External Economic Affairs. Their presentations appear here in extenso.
Judging the present state of relations between Western Europe, North America and Japan is rather a perilous exercise. As all countries have to face big problems and heavy difficulties in various fields, it is not easy to measure the influence of objective common factors on their respective situations. Moreover, those problems and difficulties cannot be rapidly overcome so that there is a great temptation to impute some responsibility for them to others or to put forward pretexts. Lastly, we can observe two different attitudes when trilateral relations are discussed: general statements of friendship and cooperation, which tend to play down divergencies and tensions; or a verbal dramatization, which does not prevent the finding of solutions, but creates some confusion in public opinion.

I will discuss from a European point of view three topics which appear to me of great importance and interest in the present international situation: East-West relationships, international trade, and economic and monetary problems.

**EAST-WEST RELATIONS**

East-West relations are dominated now by the problem of *arms balance and arms control*. For Europeans, 1983 is the year of Euro-missiles deployment, as decided by NATO countries if there is no agreement in the Geneva negotiations between the United States and the Soviet Union.

This question is very complex. I will not enter into technicalities, but only underline the crux of the matter. In 1978, Chancellor Schmidt drew attention to the imbalance resulting from the deployment of SS-20 missiles targeted on Western Europe. In December 1979, NATO countries decided to modernize their forces with the deployment of Pershing II missiles and ground-based cruise missiles, but offered at the same time to negotiate with the Soviet Union, before the end of 1983, an agreement on medium-range missiles which would make such deployment unnecessary. Since this decision, the evolution of the situation has been uncertain and somewhat confused. A strong opposition to the deployment of Pershing and cruise missiles arose from some groups in Western Germany and in Great Britain. President Reagan proposed the so-called “zero option”. Mr. Andropov proposed to reduce SS-20 missiles in Europe to the level of French and British missiles, if the United States did not deploy the newer...
missiles. This proposal was rightly rejected by the Allies because both Britain and France regard their nuclear missiles as weapons of last resort. President Reagan was pressed to propose an "interim agreement", while maintaining the "zero solution" as an ultimate objective.

To have a clear view of the problems linked to the Euro-missiles debate, I will make four points:

1) European countries ask for American missiles not because they need more nuclear firepower, but because they need a reassurance of America’s commitment to their defense. The Soviet build-up threatens to "decouple" America from its partners and leave them prey to political "diktat". It is necessary to restore confidence, compromised by some statements weakening the credibility of the U.S. nuclear commitment to Europe.

2) The deployment of U.S. missiles is justified less by the need to offset the SS-20s than by the necessity to have NATO forces backed by missiles that would strike deep in Soviet territory, taking account of the increasing difficulty, for NATO bombers to penetrate Soviet anti-aircraft defenses.

3) The "zero option" would be contrary to Western interests if it was implemented, because it would suppress the U.S. arms which could strike the Soviet Union from Western Europe and would leave intact Soviet planes and missiles of shorter range than the SS-20, but based in the satellite countries and able to reach Western Germany, the Benelux countries and even Great Britain and France.

4) If, under the pressure of the Soviet Union and European pacifist movements, the Euro-missiles were not deployed in NATO countries, Western European countries would create a very dangerous precedent, giving the Soviet Union a right to veto the type of arms they dispose of on their own territory. It would be a sort of abdication, with large political consequences.

If this analysis is correct, Europeans and Americans have to support the deployment of Pershing and cruise missiles on schedule in NATO countries at the end of 1983 in order to link firmly U.S. power to European security and reduce neutralist tendencies as long as they result from a lack of confidence.

It is not certain that an interim agreement could be reached at Geneva that would allow the United States to begin deployment of Euro-missiles while establishing a mutually balanced ceiling for medium-range missiles on both sides. The Russians may well prefer to see no agreement and the beginning of a deployment that could provoke unrest in Western Europe and be exploited as a consequence of United States "belligerence". This is why the United States Administration has to test fully and sincerely possibilities of a compromise with Moscow during the coming months, avoid anti-Soviet rhetoric and maintain a full understanding with European governments. Thus the Alliance could face with serenity and determination the psychological offensive of the Soviet Union and wait for the next round of negotiations.

Another aspect of East-West relations concerns trade. Western European countries do not want a form of economic warfare against the Soviet Union. Without showing any complacency toward the Communist ideology and regime, they tend to think that socialist countries should be brought progressively into the international trading and financial system. By this way, peaceful cooperation would be increased and political dialogue would be facilitated. The Europeans have coexisted with Russia for centuries; if an armed conflict was to erupt, it would take place on their territory. There is an inclination to give a chance to "détente". At any rate, European governments do not think that
economic sanctions or restrictions on trade and credit would force the Soviet Union to moderate its foreign and security policies. They share finally the view expressed recently by Ambassador George Kennan: "The attempt to prevent or set back the entire economic development of another people has no place in the politics of a democratic state in times of peace. These are means for preparing a new war, not the means for preventing one." But Europeans accept the need to supervise and limit exports of high-technology products to the Soviet Union. They agree to avoid "preferential treatment" in credit conditions and to have a more cautious banking policy toward Eastern countries. In short, they want reasonable business, a policy "of trade, but not aid".

On all the above points, divergencies can arise between the United States and Europe for understandable reasons: Their respective interests do not fully and always coincide, even if they remain very close partners in the Atlantic Alliance. To sum up, containment, arms control, détente would have to be the three elements of a long-term global strategy for East-West relations.

INTERNATIONAL TRADE

Turning to international trade problems, there are many disagreements between Western Europe and the United States. The United States criticizes the Community on various matters:
- steel exports, in spite of an accepted compromise;
- Common Agricultural Policy, in spite of the fact that the United States enjoys a large surplus in its trade with the Community;
- aeronautic industries, mainly French, because of subsidies.

More generally, the United States wants a greater degree of free trade, and blames the EEC for its protectionist stance in the last Ministerial meeting of the GATT.

I will underline three points:
- First, EEC countries have shown very clearly in the GATT meeting that they want to maintain the cohesion of the Community in international trade relations. Excessive pressure would be useless.
- Secondly, the choice today is not between the present degree and a higher degree of free trade, but between the present degree of free trade and a regression of free trade. It is dangerous in the present economic situation of the world — with high unemployment rates and economic stagnation — to look for new "trade rounds". We would open Pandora's Box and give the opportunity for backward steps. We have to maintain the "trade pledge" accepted by OECD countries since 1974 till recovery allows for a new expansion of world trade and new progress in the liberalization of trade.
- Thirdly, as regards farm policy, subsidies are not only a European phenomenon. In 1982, the U.S. Government and the European Community (including expenditures by member states) each subsidized farmers by about 30 billion dollars. The drop of U.S. farm exports has to be explained by other factors, mainly by the overvaluation of the dollar.

As for commercial relations between the EEC and Japan, I would like to suggest that Europeans cannot blame Japanese industries for being competitive and that protectionist measures against Japan could affect the development of fruitful and necessary industrial cooperation between Japan and European countries. But Japan has to understand that its big surplus with the EEC (10 billion dollars in 1982) has to be reduced by an opening of its markets to foreign products. Restraining exports is a useful, but temporary measure. The decisions announced last March by the Japanese government to make its standards and operating test procedures more accessible to foreign manufacturers appear as encouraging progress. But more vigorous action is required to avert negative moves in the future.

ECONOMIC AND MONETARY PROBLEMS

Turning to economic and monetary problems, Europeans have been and remain worried by the high level of real interest rates in the United States and by the wide variations in the value of the dollar relative to their currencies.

On this point I want to avoid any misunderstanding. I think it is of common interest that inflation durably retreat in the United States. The return to price stability in the United States is a key condition for the improvement of the world economic situation and for a new period of sustained expansion. I think also that the present recovery in the United States will contribute to the reduction of economic tensions in the world economy and I hope that it will accelerate at the end of this year. But it is obvious that the persistent high level of real interest rates and the

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It gives me great pleasure to be here on this tenth anniversary plenary of the Trilateral Commission. I want first to review the importance of the trilateral relationship in historical perspective from Japan's point of view, and then outline some major features that affect Japan's relations with its partners.

HISTORICAL PERSPECTIVE

The Second World War had a profound effect on all of our countries, but the lessons which we drew from the war were not necessarily the same. For the United States and parts of Europe, the primary lessons lay in the need for collective security, deterrence, and, for Europe, integration. For Japan there was a more simple revulsion against militarism and war; Japan wanted to avoid power politics, a course initially encouraged by the Occupation authorities. Although joined to the U.S. by an alliance, this alliance was not genuinely collective in view of the interpretation of the Constitution prohibiting Japan from undertaking security commitments to foreign countries. And although Japan hosted U.S. forces, it sought to minimize any involvement in issues of U.S. global strategy.

Another legacy of the war was a heightened awareness of Japan's weak agricultural, economic and resource base. Few Japanese had realized before the war how awesome an economic gap existed between Japan and the United States. After the war Japan devoted itself almost single-mindedly to economic development and improvement of the people's living standards. This effort was not particularly export-oriented; we relied in the early stages on heavy protection and assistance from the United States.
Japan was not accepted after the war as part of the developed world. It was treated basically as a defeated and developing country. It was only in the late 1950s and early 1960s that Japan began, primarily because of the insistence of the United States, to be brought into international organizations such as the OECD, GATT, and the IMF as an industrial country which would have to assume the same burdens and be subject to the same treatment as other industrialized countries. This was an important step in Japan's history, and it was not without debate either internally or externally. There were many in Japan who believed that Japan's economy was still too weak to accept trade and capital liberalization. On the outside, there were those who felt that Japan should not be included in these institutions because of its low wage structure, cultural differences, and other reasons. Despite Japan's inclusion in GATT, some European countries and even developing countries refused to give most-favored-nation treatment to Japan.

In other words, Japan was partly in the trilateral world and partly still outside. But its continuing rapid economic growth, which made it the second largest free economy by the 1970s, and the economic crises at the beginning of that decade created a need for more intense international consultation and cooperation in which it was vital that Japan be included. Both Japan and the other trilateral countries realized this.

THE "TRILATERAL" RELATIONSHIP

The creation of the Trilateral Commission in the early 1970s was symbolic of this need for more intensive consultation and for the active involvement of Japan as a fully-engaged member of the developed, democratic world.

The new annual summit also had a very important symbolic significance in Japan. Hitherto Japan had joined ongoing U.S. and European-led institutions as a late-comer; now, for the first time, it participated in the summits as a founding member of that exclusive trilateral group.

The emphasis on a trilateral relationship focused around the summit carried enormous benefits for Japan. First, in the turbulent 1970s, Japan was concerned about its position as a lonely outpost of the advanced, industrial world in Asia. The evolving trilateral relationship provided a kind of psychological safety net that reassured Japan that the international systems that protected its interests would be maintained and that Japan's voice could be heard. Secondly, for Japan the trilateral relationship as a small multilateral grouping was in some ways more comfortable than the bilateral relationship with the United States; not as a substitute, but as a supplement to the U.S. relationship. Trilateralism gave Japan an opportunity to be associated with European countries of similar size and with some interests that were more compatible than those of the United States. Moreover, because the summits were initially economic in nature, in view of Japan's military phobia, it could participate more readily than in a more politically-oriented grouping.

Japan, however, was still unable to fully articulate its interests and positions, as was often only too painfully obvious; nor was Japan accepted into the informal summit inner core of the U.S., Great Britain, France, and West Germany.

In sum, the trilateral relationship has been enormously beneficial to Japan, in reinforcing its ties to the West and in helping develop a fuller sense of participation in international institutions and regimes which affect Japan's welfare. At the same time, Japan was gradually improving the quality of its participation in such institutions.

This process of the assimilation of Japan into the postwar international system is an important test of whether the system is flexible enough to accommodate new countries, whose participation may create difficulties. We are still unsure of the outcome of this test because the recessionary atmosphere of the late 1970s and early 1980s has placed new strains on the system.

Today the fabric of the postwar system is being severely tested. What is most disturbing is that our countries seem to lack flexibility in their dealings with each other, partly because of domestic political constraints. Disagreements more readily become confrontations, and governments are more easily forced into taking unilateral actions. And outside the official governmental relations, the rhetoric of economic nationalism becomes harsher and less generous.

JAPAN AND EUROPE

Whereas one of the important benefits of trilateralism was to develop Japan's relations with Europe, it is from Europe that we now find the most serious attacks. The European Economic
Community is charging that Japan's trading system is so strange, so unique, that the international GATT rules cannot be applied. Japan, they say, disproportionately benefits from tariff reductions and most-favored-nation treatment. Moreover, some European countries seem hesitant to develop new forums to bring Japan more fully into international political discussions, such as appropriate and coordinated trade sanctions policies or consultations among the major allies on intermediate-range nuclear forces negotiations.

European-Japanese relations are complicated by inadequate information about each other, by differences of perceptions about the world situation, and by some real differences of interests. In the political/security sphere, both sides share common, fundamental security interests in deterring Soviet threats and promoting realistic arms control. However, Europe sees Japan as a competitor for American security resources, a competitor which is failing to make an adequate effort to defend itself. For Japan, European security interests can complicate Japan's security environment. For example, strengthening China can make sense in terms of diverting Soviet attention and forces away from Europe and toward its Eastern frontier, but this raises tensions and increases Soviet forces in regions near Japan. Recently, Japan has also become worried that INF negotiations might result in shifts of SS-20s from Soviet Europe to Soviet Asia.

Thus regional differences of emphasis tend to separate Japan and Europe, and this may become more pronounced as Japan's attention to issues of strategic doctrine increases. Even in the Middle East where Japanese and European security interests are similar, competition over political favor with Arab governments and oil resources is more evident than the extent to which each side's actions are complementary.

Few Europeans know that Japan provides significant financial contributions to Turkey and Pakistan, that it has borne 70 percent of the costs to deepen and widen the Suez Canal, making it usable for large U.S. carriers, and that it facilitates the "home-porting" of American forces which patrol the Indian Ocean, although these activities have significant implications for NATO.

Without perceived positive security relations, Japan appears to Europe to be little more than an economic threat. As a result, the dominant theme of European-Japanese relations has been harsh European attacks on Japanese trade policies and vigorous Japanese defenses. It is essential, therefore, to try to develop both a more comprehensive appreciation of the European-Japanese relationship and improved mutual understanding of respective trade policies. I personally welcome an impartial review of Japan's trade policy, if that is balanced by a review of European trade policies as they affect Japan.

JAPAN AND THE UNITED STATES

The U.S.-Japanese relationship, by contrast, has improved on the political front while it remains deeply troubled by the growth of protectionist sentiments on the trade front. In governmental circles, there is a great awareness of the mutual value of the two countries' relationship and a genuine effort to work out differences. Our main problems remain the economic and political climate in the U.S. on one hand, and political and bureaucratic constraints in Japan on the other. Often in each country, domestic problems or the need for economic adjustment, as in the cases of the U.S. auto industry and the Japanese farm sector, are falsely attributed to the other country.

On the political side, Japan's increased willingness to take positions and assume responsibilities is appreciated in the U.S., even if the U.S. tends to underestimate our constraints. Such constraints have recently forced Prime Minister Nakasone to soften his rhetoric on security threats. But Japan and the U.S. certainly do not see eye to eye on all issues. Some differences include the American penchant to stress the military dimensions of the Soviet threat and appropriate responses, the de-emphasis on North-South economic relations in U.S. foreign policy, and the failure of the U.S. to manage its political relationship with China.

There exist extensive dialogues on all these issues at the more specialized professional levels, but it is difficult to translate these efforts into influence at the higher political levels.

Underlying the tensions in trilateral relations are several longer-term, historical trends. First, the long-term growth of interdependence requires structural economic changes, difficult in any case, but especially so in a recession. Secondly, there are shifts in the relative power of the trilateral countries, and between them and the rest of the world, which increase the number of important actors and

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I will not go into my views on all the issues before the trilateral countries. I would rather like to define some of the problems before us that it seems to me require resolution.

BREAKDOWN OF AMERICAN FOREIGN POLICY CONSENSUS

To speak for the American side in this trilateral meeting is in itself a difficulty, because one of the biggest problems we have had in the conduct of American foreign policy for nearly a decade and a half is the breakdown of the consensus on the kind of foreign policy we should have. There are any number of reasons for this breakdown — the emergence of a new generation, the impact of the Vietnam War, the change in economic relationships, changes in technology — but the fact of the matter is that for a good period now much of our foreign policy has been influenced by a kind of bureaucratic maneuvering that makes the outcome ambiguous even for Americans. If you look at the “zero option” proposal for example from a bureaucratic point of view, you will recognize in it a combination of people on the left who wanted to do away with missiles in Europe and of people on the right who wanted to make a proposal they were sure the Soviet Union would not accept so that they could abandon the negotiations.

What has been lacking in a variety of Administrations is a clear consensus, and in the absence of this we have become unnecessarily unpredictable to both partners and adversaries. Every new Administration has claimed not only that it would change the world, but has implied that it was about to create the world. Every new Administration begins with a reassessment of previous policies, an event that has to be extremely unsettling to foreign leaders who have staked their own political future onto ours.

So one has to begin with an appeal as an American to the American members — to try to reestablish some kind of consensus on what it is we are trying to do in the world under conditions that are radically different from those associated with the so-called great period of American foreign policy in the immediate post-war period. We have to remember that the United States had an atomic monopoly then and we also had 52 percent of the world’s GNP, so our capacity to overwhelm problems with resources was infinitely greater than it is today.
ALLIANCE COHESION, NUCLEAR WEAPONS, CONVENTIONAL DEFENSE

Having made this point about the United States, let me speak about a number of more general problems. The first is that the nature of the alliance is inevitably shifting. In the past alliances have had one of two purposes: either defense against a common threat or achievement of a common objective. I think it is fair to say that we are now in a period in which we are not agreed on the nature of the threat or on the national interest that the alliance reflects. An alliance can change in one of two ways: Either the threat seems to become so overwhelming that the alliance is no longer seen as a protection, or the threat loses its menace and the alliance is no longer considered necessary. I would argue that both of these tendencies have been occurring simultaneously in many of our countries. Some groups believe the threat is so overwhelming that military defense is worse than surrender or accommodation. Other groups believe that there really isn’t any military threat and therefore the defense effort is unnecessary.

Finally, there is no agreement on what level of defense is necessary. I think there is emerging a rather clear consensus in all tripartite countries that we ought to reduce reliance on nuclear weapons. But the real problem we face is more complicated. We have to reduce reliance on nuclear weapons but not stigmatize them to such a point that we are encouraging unilateral disarmament and psychological abdication on the part of our populations and — in time — of our leaders as well.

It is all very well to criticize the American Administration for implying that it is possible to have a protracted nuclear war. Anyone who has had to face the question of what he would recommend if aggression took place has had to deal with that issue in his own mind. I do not myself believe that one can safely embark on a nuclear war without a very high risk of escalation. But I also believe that a political leader would be reckless if he did not plan to limit consequences should the worst happen. It would be the height of irresponsibility for an American President not to plan how to use nuclear weapons in a less than all out fashion, granting that he should not rely on them and granting that he should not embark lightly on their use. The muscular rhetoric of the early days of this Administration has been abused in dismissing what is, both morally and politically, a crucial objective. Nuclear weapons under any kind of arms control scheme will exist in large numbers. We rely on them for deterrence which must imply that at some point, for some reason, however remote, they may be used. Therefore, we must have some strategic concept that does not stake humanity on every decision. And we should be careful in our political debates to take the complexities into account.

The same is true of the alternative, which is conventional defense. As some of you know, I have been arguing for thirty years that we must increase our conventional defenses; but it requires a more careful analysis than simply quoting NATO commanders. In the history of warfare, conventional defense has never proved an adequate deterrent. In the last four hundred years, there have been innumerable wars between armies that on paper looked equal and in which nevertheless one side prevailed. What one means by adequate conventional defense therefore requires careful analysis. Very careful study is also required of whether in fact our publics, our leaders, and our parliaments are willing to support the expenditures that might be necessary over an indefinite period of time. I don't have the answer to that question; but I do not think we should simply say, because some new ammunition is now available, that we have solved the problem of conventional defense — or forget that we would then face the problem of relating this to a foreign policy.

STRATEGY FOR ARMS CONTROL AND DEFENSE

There is often an assumption that arms control is a good thing in itself and that therefore one has to
prepare a shopping list among various ideas to see which project could be proposed at any particular point. It seems to me the fundamental problem in arms control at the moment is that we are living on the intellectual capital of the 1950s. What we need first — before we can make a reasonable judgment among the various alternatives before us — is a theory of what it is we are trying to do and how it relates to the strategy which we believe is necessary. That is all the more important because every country now is facing very significant peace movements, built upon heterogeneous motivations. Even granting the most noble intentions, many of these people have rather simple notions of how to deal with the problem of arms control and the problem of strategy. Inevitably political leaders are tempted — including incumbents, but especially opposition leaders — to appeal to these movements as a reservoir of support. Leaders run the enormous risk of supporting arguments that they cannot possibly implement, thereby contributing to cynicism and frustration and lack of belief in the democratic process. At the same time governments are encouraged to keep making proposals which at some point inevitably must lose touch with reality.

I spoke to a European leader a few weeks ago and asked him what he thought of the interim proposal of President Reagan. He was all for it, because it solved his immediate political problem; but, he said, come October we are going to have to have a new proposal. What sort of proposal, I asked him. He had no idea of what sort of proposal he wanted in October, but something would occur that would enable the United States to put forward a new scheme. Well, if this is the case, if every deadlock has to be broken by a new American proposal, there will never be a solution. Moreover, we will be demoralizing ourselves and our publics if we have neither a strategy for defense nor a strategy for arms control. If every problem becomes a purely tactical issue, we will not have any criteria by which a rational democratic debate can take place. And we will have no criteria by which the Soviets can guide their actions.

DEALING WITH THE SOVIET UNION

By any objective analysis of the Soviet situation, one would have to conclude that a negotiation on a broad front is an imperative for the Soviet Union. Here is a system that has been in power for nearly seventy years which has not solved the problem of legitimate succession, either in its top post or in its politburo. In Andropov it has its oldest leader at a
comparable period in his career. He will be sixty-nine in two months, and every previous leader required six to eight years to establish himself in an unchallenged position. He does not have six to eight years. Andropov himself has described the mess in the Soviet economy more eloquently than I can. Imagine the leader of one of our countries coming into office and saying his task will be to stamp out corruption, drunkenness, hooliganism — these are hardly noble, inspiring objectives to set before the people. One could say that structurally Andropov represents a very interesting phenomenon: a coalition of the two organizations in the Soviet system that have a command structure independent of the Communist Party, namely the KGB and the military. This could be perceived as the beginning of a kind of bonapartism. I mention all of this only to indicate it is not probable that the Soviet Union is looking for confrontations with the West right now and indeed ought to be looking, on a rational analysis, for some degree of accommodation, provided it is not given for nothing what it should be negotiating for.

Some seem to suggest that the solution to every problem is supposed to be a meeting between President Reagan and Secretary Andropov. The issues are not personal disagreements. Anybody who has been at a summit meeting knows that they can ratify solutions, but they cannot originate answers.

The major necessity in dealing with the Soviet Union at this point is to put before them some definition of what we understand to be the causes of tension. The less sentimental we make them, the less personalized, the less we give the impression that we necessarily share the same perception of the threats, the more likely it is that we will find some practical basis on which to come to an agreement. I agree that we have to avoid excessive rhetoric, but excessive sentimentality can be equally dangerous. Precision is crucial. And I must say unity is essential, and if we can maintain this I am actually uncharacteristically optimistic about our future.

**ECONOMIC POLICY COORDINATION**

It seems to me that the key to our prospects is not in the field of military balance, important as that is, nor even entirely in the field of negotiations with the Soviet Union, but in the field of economic policy. If we do not solve the problem of recession in the industrial democracies, no government is going to have enough public support to conduct any effective long range foreign policy. It is not possible, it seems to me, for the industrial democracies to continue uncoordinated fiscal and monetary policies and have sustained economic growth. It is not enough to inveigh against protectionism and to advocate free trade in the abstract when the realities of the period are that all the political pressures are in favor of protectionism. Free trade was developed and then carried out by three or four states. Now we have twenty to twenty-five players. And to believe that that will work itself out automatically or by occasional conferences of trade ministers is to minimize the political pressure in each country behind a new form of mercantilism. I do not advocate this, I predict it, if we do not deal with this in time.

**DEVELOPING COUNTRY DEBT**

I also want to say a word about the debt problem. I am no expert on how to solve the problem financially. But I do not believe that the crisis of last year was the end of the process. I believe a new crisis is almost inevitable. Of course, if the United States has a huge economic recovery, if commodity prices go up, if the trade balances of the developing countries go into surplus dramatically, then my prediction may be delayed or it may never come to pass; but the economists here have not convinced me that any one of these "ifs" is going to occur, much less a combination of them. Indeed, the measures that have been taken to overcome the crisis last year make a long-term solution less likely, simply because I do not believe that fifteen countries can practice austerity simultaneously without undermining the export possibilities of the developed countries and therefore their own export possibilities.

I know we are warned against sweeping plans that are not practical. And I'm not calling for a sweeping plan, much less an impractical sweeping plan. It seems to me we have two choices. One is to wait until a crisis occurs and then deal with it on an ad hoc basis. In those circumstances, it is highly likely that the crisis will be triggered by some radical government, that this government will then be rewarded by having many of its demands met, and that we will therefore have contributed to the radicalization of the Third World. The other possibility is to analyze, at least quietly, what is likely to happen. It seems to me likely that
somebody somewhere along the line will not live up to the conditions that the IMF is setting for them and will try to enforce a change in the terms. The trilateral countries ought to address now, at least on a standby basis, what the wisest course is in such circumstances. Even better would be to try to channel the relationships of the developing countries to the developed countries into a positive direction before some radical political change in one of the key countries forces us to move.

I want to make one concluding comment. Complex as these problems are, every problem that I have described here is capable of solution within the context of our countries, within the framework of our domestic policies and our interrelationships. Our adversaries are facing huge structural problems; we are facing major policy problems. So what I have described here is a list of problems but also an agenda, a possible agenda for the future. On an analysis of our capabilities, we have every reason to be hopeful and optimistic.

Barre from p.10

Instability of the dollar are detrimental to other countries and particularly to European countries. We should not use those factors as an excuse for our own mistakes. Difficulties which European countries have to face find their basic roots domestically. It is not up to the United States to solve European economic problems. But, in a world which becomes more and more interdependent, any country has to take account of the international implications of the policies it adopts, more specially when a country is the most powerful economy in the world.

We can therefore express our worry on two points:

- The policy mix in the United States has given too predominant a part to monetary policy. Budgetary policy has to contribute more to a balanced economic policy. A reduction of the budget deficit in the forthcoming years is the necessary condition for a durable deceleration of real interest rates in the United States and, consequently, in the world. This would make less difficult the solution of the debt problem and could contribute to more realistic exchange rate relationships.

- The wide fluctuations of the dollar, in the absence of any intervention by the Federal Reserve, is a factor of uncertainty and disequilibrium in world monetary relations. We wish that the American monetary authorities would agree to participate in a collective management of exchange rates through adequate interventions by central banks. Such interventions would not be intended to defend unrealistic exchange rates, but would reduce the erratic fluctuations of exchange rates. A new "Bretton Woods Conference" would take a long time. We can already initiate an exchange rate stabilization policy on practical grounds. Such a policy would help, in my opinion, to correct the undervaluation of the yen.

I have discussed present problems. But trilateral cooperation should not be limited to solving today's problems. Our main objective should be to work together in order to meet tomorrow's challenges. We need more confidence; let us show broad vision and statesmanship, for the benefit of all of us, for the benefit of world peace and progress.

Ushiba from p.13

Complicate international leadership. Third, there are changing standards of international fairness and expectations of what lies within the discretion of individual countries and what should be accommodated to international rules and coordination.

These trends are unlikely to be altered and must, therefore, be addressed by governments. They present special challenges for each of our regions. For example, both the U.S. and Japan have long traditions of isolation and are not accustomed to the kind of international cooperation implied by the concepts of sharing responsibilities and international policymaking.

In accommodating these trends we must be realistic about what governments can and cannot do in the short term. Sensitivity to each other's political and economic situations is important. It is also essential in light of these situations to try to revise existing international rules and devise new ones that are rigid enough to provide standards of international discipline, but not so rigid that they become unworkable.

There is no doubt that Japan has much to do to adjust itself better to the international system, to increase its sharing of responsibilities, and to better articulate its own viewpoints and ideas. A decade of participation in the Trilateral Commission has helped a great deal to increase awareness in Japan of these tasks and prepare us to perform them better.
Current international financial problems were a central theme throughout the Commission’s discussions in Rome. We reproduce three of the main addresses on the subject — by Paul Volcker, Chairman of the Board of the U.S. Federal Reserve System; Lord Lever of Manchester, former Cabinet member and economic and financial advisor to several British Prime Ministers; and Toshio Nakamura, Chairman of Mitsubishi Bank, Ltd.

Toshio Nakamura
The birth of the Trilateral Commission, ten years ago, was at least in part a response to a perceived "crisis" in international cooperation — not least in the monetary area. Certainly, the early 1970s were a time of monetary trauma. We were in the midst of the difficult transition from fixed to floating exchange rates — a process many saw as the essence of a breakdown in cooperation.

At the same time, there was a recognition — belated — that Japan had arrived on the scene as a strong and modern industrial and financial power and a powerful competitive force. It plainly needed to be brought into the center of cooperative policy consideration.

From one perspective, economic and monetary developments in virtually all our countries have seemed to be moving downhill during the life of the Trilateral Commission. I won't attribute any cause and effect. Certainly we have unemployment not seen before in the postwar world. We managed to combine rising unemployment with accelerating inflation. Productivity growth has declined.

It has been quite a contrast to the optimistic years of the 1960s. Then, we in the developed world exuberantly thought we had — more or less — found the intellectual and political keys to the kingdom of sustaining full employment. We would turn our energies to reinforcing growth and spreading its benefits through the world, building on the established international institutions — the IMF, the World Bank, and GATT — to strengthen our cooperation. We could complete the "social agenda" in our own countries. So the recent problems have been all the more shocking.

From today's troubled perspective, it is easy to overlook and forget how much was, in fact, accomplished toward those objectives in the 1970s. The growth of developing countries was maintained at historically rapid rates right up to and even beyond the second oil shock. In our own countries, the social safety nets (for retirement, for unemployment, for health) were greatly expanded — one reason, I suppose, why the present unemployment has come to be a dominant and intractable part of our national budgets.

But, of course, the dominant impression through the 1970s, and into the 1980s has been increasingly one of uncertainty, disappointment, and even fear. The gloom in that room today seemed to me pretty thick. At first, inflation accelerated, and seemed to be intractable. As we moved to deal with that and the financial system came under heavy pressure, worldwide recession raised — wrongly — the spectre of the 1930s in some minds. There have been increasing complaints about a breakdown of cooperation and understanding.

I was asked recently, as part of a survey of monetary officials, whether I sensed that international economic cooperation had in fact declined over the past 10 to 15 years. What people mean by cooperation is highly subjective, and I doubt my answer was enlightening to the inquirers. But, the question intrigues me, and I have tried it out on my colleagues at home and abroad. The responses have often surprised me. For instance, the troubled transition to floating exchange rates — the very event that I sense helped precipitate the formation of the Trilateral Commission — was cited by some as, in retrospect, a prime example of cooperation; in that view, it was something that had to be done, it was inherently contentious and unsettling, but it was accomplished without driving the world into competing antagonistic blocs. Indeed, trade and capital movements, at least for a time, flourished. Conversely, those inclined to equate cooperation with a clear international structure and collective decisions — multilateral aid, a strong GATT apparatus, a monetary system with clear rules and obligations — saw an erosion.

What surprised me — and may console you — is that in my informal survey a number of officials actually on the firing line throughout this past decade, in the U.S. and Europe, responded in quite another way. In the face of severe challenge from technological change, from economic and political "shocks," and from the sense of more difficult and complicated domestic problems, they were inclined to see more willingness to consult in a
meaningful way. They felt we are now more open
and candid with each other, that we exchange more
information — and collect more of it together, and
that we are at least as willing as before to recognize
joint problems and consider joint solutions. Im-
licit or explicit in that view was that mutual
recognition of the desirability, where possible, of
looking to "market" solutions could itself be a
constructive act of cooperation.

Well, I won't make much of those fragmentary
and inconclusive responses except to say that there
may be more international understanding in the
area of economic policy than we sometimes realize
in the midst of our concern about today's events —
that we have something on which to build. The
question posed for me is less abstract — in what
directions should we now proceed on the monetary
and banking front?

You will understand, I am sure, that to my taste,
the fashionable emphasis on U.S. monetary policy
as the dominant force for good or evil in the world
economy has been enormously exaggerated — but
I take it there is some interest in the subject. I also
realize that some have argued — I would say from
an excessively narrow point of view — that our
monetary policy has not, in recent years, appeared
to be a model of international cooperation. Ob-
viously, high interest rates — and maybe even
more importantly, sharp swings in interest rates —
have had an enormous influence on international
capital flows and exchange rates. Other countries,
as a result, have sometimes been faced with
sharpened dilemmas in the conduct of their own
economic policies. The fact that those same capital
flows and exchange rate movements were trouble-
some to the U.S. itself was, under the
circumstances, little source of comfort. The ques-
tion naturally arises — wasn't there a better way, a
more cooperative way for the future?

I don't want to debate or defend everything;
obviously, we could, in concept, have had a better
policy mix. But the real source of the problem, and
the basic reason for the approach adopted and its
difficulty, seems to be straightforward and not
unique to the United States.

The point of departure was that, after the
deteriorating performance of the 1970s, a base for
economic growth and financial and exchange rate
stability could not be restored without dealing
with inflation. You can disagree with that proposi-
tion or not, but I do believe there was a public
consensus that the job needed to be done — a
willingness to take and support strong measures.
That was true because there was widespread
concern that an already unsatisfactory situation —
a rising trend of prices and unemployment —
could deteriorate further in an alarming way.

For one reason or another, other instruments of
stabilization policy were immobilized; for better or
worse, the full burden of dealing with inflation was
left to monetary policy. The technique chosen was
not very subtle — restraint, as consistent as we
could make it, on growth of money and credit.

The process of disinflation at first was slow —
amost invisible. There was enormous skepticism
whether it could be done at all. The combination
of strong expectations about inflation built into
wage and price behavior, economic rigidities, and
growing budget deficits all made it harder, and
strong pressures on credit markets and interest
rates persisted longer than anticipated. But for a
long while there was little, if any, room for
modifying policy, in response to domestic or
international concerns, without giving the wrong
"signals," increasing the risk that the whole process
of restoring stability — domestically or interna-
tionally — would be aborted or long delayed.

I would point out that a number of other
trilateral countries had come to more
or less the same
conclusion — that the domestic inflation problem demanded priority. The point was in fact urged by the IMF and accepted at successive summit meetings. There was a common recognition that the prospects for future stability of any international system — the possibility of restoring stability to exchange rates, low interest rates, and sustained growth — would ultimately depend on the success of those measures to restore domestic stability in the leading countries, and most of all the United States.

We can now see clear results in terms of declining inflation rates. But, we also have to recognize that stabilizing prices at a time of the most severe recession in 40 years is in no sense “victory.” The real achievement can only be found in a non-inflationary economic expansion and, in the process, repair and strengthening of the strained fabric of international finance and trade.

From an American perspective, there seem to be substantial grounds for optimism. Basic cost trends — particularly wage increases — have been moderated, and productivity seems to be picking up once again. A recovery has started, and forces are in place to keep it going for a while, even though the recovery so far is still very limited and uneven. The risks of a third round of large oil price increases in a relevant time horizon have been dissipated, barring political upset in the Middle East. Interest rates remain very high by any historic standard, but continuation of the progress against inflation should, in time, provide a base for further declines to help sustain the recovery.

While there are exceptions in this country and elsewhere, a number of industrial countries seem to be in a somewhat similar stage of development. It is an environment that, potentially, should be conducive to more stable exchange rates, gradual recovery of world investment, and less financial and economic pressure on the developing world. But, there are, of course, hazards and risks as well. They won’t disappear without strong effort, and the solutions will test the strength of international cooperation.

The most obvious of those hazards, in terms of the international dimension, is posed by the pressures in the international banking and credit markets growing out of the heavy indebtedness of a number of important developing countries. The problems of Latin America, Hungary and Yugoslavia have become familiar. The hard fact is most large developing countries have been placed in some financial jeopardy, and financial constraints have abruptly halted growth and potentially placed severe strain on their political and social fabric. Given their large exposures, the financial health of our trilateral banks is potentially affected. While all of our countries can, in time of need, provide strong and effective support to our banking systems, our credit markets could not be fully insulated from the repercussions of an international financial crisis.

In the light of the threat, we can take some satisfaction from the fact that the situation has, in fact, called forth a strong international cooperative effort. There was no “rule book,” no pre-agreed approaches or single international institutions exactly suited to the job. But the fact is the IMF and the BIS, national governments and central banks of the Group of Ten, borrowing countries and the lending banks, all quickly recognized the nature of the problem and the common interest in working together to contain it.

We should not delude ourselves into believing that containment of the problem is equivalent to a solution — the surface calm can be deceiving. There is a sense in which the purely financial manipulations — the provision of new money by the commercial banks and the “bridging” credits by central banks, the various “standstills” and rescheduled loans — are stopgaps. We have rapidly moved from a market-driven system of lending to many developing countries to highly organized lending programs — hardly a satisfactory or indefinitely sustainable situation. Nor is any return to “normalcy,” in that respect imminent. For their part, the borrowing countries, whatever their mood today, could not find the present situation tolerable indefinitely.

All of this is a situation ready-made for spawning paper plans for some kind of grand reorganization of international lending — it’s a game anyone with a little knowledge and a little imagination is tempted to play — economists, bankers, public officials, even former public officials. You start by setting out who will lend how much for how many years at what interest rate in accord with some notion as to how much the borrowers can reasonably afford to pay, how much our governments will be willing to put up, and
how much the banks should, or can be asked, to lose. Then, presumably, we ask everyone to stand still while we have a grand negotiation.

I have to say that, while I admire the ingenuity, those across-the-board plans seem to me impractical. The world isn’t going to stand still, and the vision of a negotiated global solution will be counter-productive if it diverts attention from the practical immediate problems. In the U.S. we have to work hard, with less than certain results, to have the Congress participate in an enlargement of the IMF and GAB, and I detect no probability of a favorable and timely response to a request for budget outlays to, as it would inevitably be put, “bail out” banks and “foreigners.” I doubt that prospect would be all that better elsewhere. If public funds or private concessions could be negotiated on a generalized basis, there would be strong pressures to extend those benefits as a matter of simple equity to virtually all developing country borrowers; a system that provided relief only to those least prudent in the past could hardly be defended. In the wake of such negotiations, in return to “normal,” in the sense of developing countries restoring their access to new private credit, would be hard to foresee. In the end their long-run growth prospects could be inadvertently damaged.

Plainly, the problem cannot be “papered over,” but I believe we can see, out of the present situation, the prospect of more fundamental solutions. First, for their part, the major borrowers do have to adjust their economies — internally and externally — to restore a base for growth. It can be a harsh process, but that process is eased, not made more difficult, by cooperation with the IMF, the World Bank, and private creditors — all of which will and do provide support when they have grounds for confidence that progress is being made. We can potentially, with the enlargement of the Fund and imaginative World Bank participation, provide more time and resources for countries doing their part. Second, the “austerity” programs of the borrowers — to be successful in a timely way — will need to be complemented by growth and by lower interest rates in the developed world. I have already indicated some grounds for encouragement on that score — but we have a way to go to make that promise a reality.

That brings me to the second of the obstacles to sustained, non-inflationary expansion that I referred to earlier. National budgets are preeminently the stuff of domestic politics, and of national economic policy; for the past two and a half years, the debates in the U.S. Congress have been dominated by the issue. The resolution of that debate — along with the parallel debates in other countries — is going to have a great deal to do with the growth of the world economy — and the stability of the monetary system — in the years ahead.

The outline of the problem is familiar enough, and I won’t linger over it. The potential for a continuing clash of credit demands in the marketplace as the private economy grows — a clash that would be reflected in continuing abnormally high interest rates and doubtful prospects for investment and housing — and therefore, for the sustainability of an orderly recovery is clear enough.

Internationally, the pressure would tend to attract capital from abroad, with continuing consequences for the dollar exchange rate, for distorting our trade and competitive position, and for the balance of world saving and investment.

The problem cannot be solved by monetary policy — we are put in the impossible position of validating inflation through money creation — which couldn’t work for long — or squeezing the private sector for money.

In the midst of recession, with inflation and private credit demands both declining, interest rates could drop substantially. In implementing policy, we could take into account the best assessment we can make of the trend in business activity, and such factors as the strains in financial markets and the exchange rate. But flexibility is constrained by the need to maintain the path toward greater price stability, and the budget deficit inevitably keeps interest rates higher than they would otherwise be.

Fundamentally, monetary policy aimed at domestic stability should not be at odds with the needs of the international system. As central bankers have argued ad nauseam over the past decade, the stability of exchange rates, and the international monetary system as a whole, must rest on the stability of its component parts — the main national economies, and most of all, the dollar.
But that fundamental does not dispose of the issue. The fact is exchange rates have been highly volatile throughout the “floating era.” While some or most of the major swings have had a rationale in terms of divergences in inflation rates, competitive positions, or “structural” changes, the extent and timing of the changes have, even in retrospect, been hard to explain in terms of economic logic. We can take the view that there is no arguing with the wisdom of the market — that what happens, happens, and shouldn’t be second-guessed by officials and bureaucrats with biases of their own. But the question remains whether we can’t do a better job — whether the volatility might continue in a less inflationary world, or whether exchange rate instability doesn’t itself complicate or undercut our economic objectives.

More specifically, we need to ask ourselves whether we can — or to what extent we can — cooperatively work more effectively together to dampen extreme exchange rate swings that, by common agreement among trading partners, are out of keeping with underlying needs and trends.

My own answer would be we can — if the objective is defined and pursued with appropriate modesty, recognizing the large limitations on our ability to determine the “right” exchange rate and on the tools at our disposal.

One means often suggested of working toward greater stability would be to intervene directly in a more coordinated way in the exchange markets. Fashions in that respect have changed from time to time in the U.S., in Japan, and in European countries. Philosophical and practical differences in that respect led to a decision at the last Economic Summit to study the issue together, and that material will shortly be made available. I suspect important differences in emphasis will remain. But as I review the material, an unsurprising “middle-of-the-road” view emerges: The evidence suggests that intervention is a limited tool that cannot, in itself, alter major market forces, but there may be times and circumstances in which it can be useful in damping fluctuations, expressing policy intentions, and supporting other measures.

To be successful, market participants will have to be convinced that nations take greater exchange rate stability seriously among their basic policy objectives. And stating the point that way illustrates the difficulty: When points of conflict seem to arise, the exchange rate objective has often given way.

But the objectives of domestic and exchange rate stability need not be in conflict. We have now plenty of evidence that extreme and prolonged swings in exchange rates can themselves be damaging to domestic objectives, and changes in exchange rates provide evidence about the state of expectations and the degree of domestic economic pressure. More often than not, I suspect that a policy response to strong movements in exchange rates will turn out to be justified on domestic grounds as well. In other words, exchange rate movements can help “tell us” something useful, and we should be prepared to listen, accepting that “discipline” of exchange rates can reinforce the domestic objective of stability. To take U.S. experience as an example, the tightening of domestic policy in late 1978, and again in 1979, had an important international “ingredient,” but was certainly in the direction consistent with domestic needs.

At the same time, we need to recognize the limitations on our ability to assess or enforce an “appropriate” exchange rate. Exchange rates are inherently two-sided, and effective action to stabilize them often depends upon cooperative action. But national views on what is an “appropriate” exchange rate may, and often do, differ. Even if some broad consensus could be reached on an appropriate zone or range of exchange rates, experience with fixed exchange rates clearly indicates that there will be strong differences on who takes the burden of policy action to maintain the exchange rate. As recent European events demonstrate again, that is a matter of strong domestic economic and political sensitivity. It was reasoning along these lines that led to the decision to float in the first place — to in a sense, leave it to the market to resolve the matter.

My conclusion is that, if we are not too ambitious, we can constructively do something to help stabilize exchange rates within the general framework of the floating system. As we see inflationary forces receding, and as confidence in our ability to keep inflation under control increases, we should have room for more short-term flexibility in monetary policy. We should be properly modest about our ability to judge the “right” exchange rate, but we can probably reach a consensus from time to time when those rates seem
“wrong” — at levels that are unsustainable and mutually damaging to our economic objectives. In such instances, the question of intervention could be approached pragmatically, reinforced if needed by domestic policy.

After 10 years of floating, a much more ambitious question is again being posed by a few in the U.S. and elsewhere: Is the time coming to reverse the approach entirely, and conduct monetary policy primarily with a view toward defending a fixed exchange rate, presumably in the interests of domestic discipline as well as international cooperation?

I have no time to deal with that question fully this evening. Let me simply say a case can be made that the symbolism and reality of fixed exchange rates, in the right circumstances, can be a powerful force for cooperation. But it requires a strong political commitment, understanding, and support. We in the U.S. do follow the regional efforts in Europe with interest, but the special benefits and urgency about the matter within the closely linked economies of the Common Market seem to me absent in the larger trilateral world. We have too fresh in our minds the breakdown of the Bretton Woods system to make a renewed effort feasible and credible without a long period of preparation, and without a stronger foundation of domestic stability. In important ways — particularly the ever-closer linkages among financial markets — a fixed-exchange rate system would be subject to greater pressures than before, and the dispersal of economic and political power in the world would make it more difficult to manage and operate.

For all those reasons, the vision of a new Bretton Woods seems to me at the least premature, and potentially counter-productive as a diversion from the practical problems of international cooperation in the period ahead. The path of pragmatic evolution seems to me the only feasible choice now.

That doesn’t sound dramatic. And it can be a fully satisfactory choice if we succeed in maintaining the progress against inflation that we can see today — and if the signs of recovery can be built into a sustained period of non-inflationary expansion. After years of strain and pain, the prospects seem to me brighter than in many years.

I count myself among the cautious optimists who believe we have retained, and even strength-
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— sottolinea il rapporto —
sarà la possibile conseguen-
za della crisi attuale, non
si cercherà di
dio». Nel tras

nei Paesi ricchi. Il protezio-
nismo, attuato soprattutto
con ostacoli non tariffari ai
prodotti del Terzo mondo, ha
ulteriormente impoverito i
Paesi di nuova industri
zazione. Una situazion
sta si è creata
alimentare
Paesi
Host Auletta Armenise with Watanabe at Palazzo Colonna

Final press conference: from left, Ortona, Watanabe, Berthoin, Rockefeller, Sharp

President Pertini receives the Commission
Debts, Deficits and the Banks

There is no doubt in my mind that the world is in the midst of a major international banking crisis and that crucial issues affecting the political and economic stability of the Western world are involved. In seeking the means to emerge from it we would be wise to examine with great care how we got into our difficulties.

Origins of the Crisis

The rise in the price of oil, which commenced in late 1973, presented the oil-importing less developed countries (LDCs) with a very difficult choice. They could either attempt to impose savage and abrupt deflation or run a series of large current account deficits, to be covered by borrowing from abroad. Ideally, if this finance was to be made available to the LDCs, it should have been on terms which explicitly recognized their fragile economic and political position. The terms should have reflected the inability of most of the LDCs to meet even their interest obligations, let alone make repayments of principal, except after a very considerable period of growth and adjustment. In almost all cases, the length of this period and the uncertainties involved made it necessary for the lending to enjoy some predictable support from the governments of the advanced countries. This support has never been forthcoming: Even now these governments have not seriously begun to clarify and define their purposes or to organize cooperatively the means for achieving them.

When it became clear that the private banking system was ready to recycle funds from the OPEC surplus to the LDCs, Western governments gave their approval and encouragement. However, they saw no systematic role for themselves in regulating the recycling. As a result, this lending was not underpinned by the resources of the developed world as a whole but by only a small and vulnerable part of those resources — the capital and reserves of its principal banks.

Instead of a measured flow, directed appropriately and on sensible terms, we have had a vast unmanaged lending by all the world's great banks. The banks were in no position to make effective decisions on the aggregate amount to be lent to the LDCs as a group or on its apportionment between them; nor could they enforce appropriate terms or economic responses from the borrowing countries.

In the case of the oil-importing LDCs, the lending was extended far beyond the new price burdens, and in addition vast loans were made to oil exporters like Mexico and Venezuela, who were in fact beneficiaries of the oil price rise.

It was inevitable that these arrangements would build up to crisis. The LDCs can service their debts in real terms only by delivering to the world more goods and services than they themselves take in. The day when this will be feasible or desirable is obviously in most cases very far distant. In the meantime, these countries can pay their commercial debts punctually only by punctually borrowing new money. In addition, they require further funds to cover each year's new deficits. An ever mounting and unmanaged debt was bound to bring into question the credibility of many of the debtors and hence this system of lending itself.

Prolonged recession and the move to higher real interest rates have accelerated this movement to crisis but they were not its fundamental cause. This is well demonstrated by the fact that many
oil-exporting LDCs, who greatly benefited by the change in their terms of trade, have proved as vulnerable as those who suffered from them. And interest rates, taking the period as a whole, were not in real terms high; further, it is hardly a good argument that a lending system is sound as long as interest rates are negative, i.e. when inflation produces an automatic repayment of the debt.

An extraordinary range of perverse erudition has been mobilized by governments and private bankers in defense of these arrangements. The bankers like them because the authorities approved them and, on paper at any rate, they were making large profits. The borrowers liked them because they placed little restraint on the volume or purposes of the borrowing. OPEC liked them because they effectively supported the cartel price — not at their risk but at that of the banking system. The aid lobby liked them because they provided a transfer of resources to the LDCs on a scale greater than ever known before — and nobody wants to shoot Santa Claus. Western governments liked them because they allowed them to evade their responsibilities and continue their ill-founded belief that this lending could be dealt with indefinitely by unassisted bank intermediation.

PRESENT PROBLEMS

The LDCs are now around $600-700 billion in debt, about half of it to the private banking system and most of the rest to public export credit agencies and private traders. The central problem facing the LDC sovereign borrowers is that they have largely lost their credit rating, but not their need for finance. Their current account deficits have not disappeared, but the money to finance them is drying up; the deflationary and politically destabilizing consequences are already underway.

Any worthwhile solution to the debt problem must head off and subsequently reverse this accumulating deflationary momentum. It will also require the authorities to face fully the problems of banks, namely, that they have made vast loans which are not repayable within the time scale of a purely banking operation and cannot be refinanced without some assistance from the governments of the leading countries.

There has been a good deal of irrelevant moralizing on this second issue, which has led many of those proposing remedies to twist and turn in an effort to evade the charge of “bailing out the banks.” It should not be forgotten that without bank lending, there would have been a world crisis long ago, which is why the lending was approved by the governments of the advanced countries in the first place. Though a purely bank intermediation of the OPEC surplus was by no means ideal, there was no other method available at the time. Indeed, the authorities not only encouraged the original lending, but now demand continuing and increasing exposure by the private banks to meet the political and economic purposes of the world economy.

But the healthy functioning of the private banking system is a matter of central importance to the world economy. Not only the LDCs but all major economies are today dependent to a greater extent than ever before in history on the ability of the banking system to provide funds for their operation and growth. The unique post-war rate of economic growth and of international trade, and later the prolonged inflation and recession, have greatly extended the role of the banking system in ways which raise many neglected problems in addition to those involved in the lending to the LDCs. If, in these circumstances, we leave our banking system saddled with over $300 billion of defaulted or non-performing LDC debts in the years ahead, its central role in financing world recovery will be seriously prejudiced. The charge of “bailing out the banks” should not divert the authorities from their central task, namely to protect the world’s economic and political prospects by substituting a sustainable system for the existing arrangements for deficit finance of the poorer countries.

Many authorities profess to believe that the swift emergency reaction by governments, central banks and private banks to the crisis is itself a solution, or at any rate that similar action would be adequate to deal with future contingencies and that when world trade recovers, the situation will, before too long, reach a workable equilibrium. The basis for this view is the much touted assertion that the LDCs present “a liquidity problem, not a solvency crisis.” This implies that, within a relatively short period, the debtors will be able to service their contracted obligations and finance their economies thereafter, perhaps with some further assistance from the IMF and after appropriate adjustment policies. The realities of the situation do not permit
this view. Indeed, it amounts to little more than semantic camouflage to justify the continuation of self-deception and complacency.

It is true that we have so far avoided dramatic breakdowns and have marginally limited the destabilizing pressures on the LDCs. But their situation continues to deteriorate to an alarming extent. We have neither relieved the damage to the functioning of the banking system resulting from this dead-weight of non-performing debt, nor brought into being any arrangements to provide a measured flow of funds for the future. Defaults, by an ever growing number of sovereign debtors, are being papered over by rescheduling arrangements, i.e., by substituting future promises to pay for those that have already been defaulted. These piecemeal arrangements leave the fundamental dangers and anomalies of the situation untouched. Even after profound strengthening of the IMF, we will lack that element of coherent support from the authorities necessary to stabilize this ballooning LDC debt. In the meantime, world trade continues to contract and the prospect of world recovery is itself being threatened.

We have only felt the impact of the early stages of these widespread defaults. True, countries cannot go bankrupt, but they can default. Further rescue operations will be required, but it will be increasingly difficult to reproduce the actions which have so far precariously avoided breakdowns. Almost certainly, energetic central bank action will continue to avoid spectacular failures. But many aspects of these rescues, especially in relation to interbank funds, are not themselves sustainable. We are merely continuing in a modified form the behavior that got us into these difficulties in the first place. There has been no attempt to formulate government decisions within an intellectually reputable framework or to outline any strategy to deal with the mounting damage and dangers of the situation.

Some have suggested that the market reaction to these problems will itself make the necessary corrections and that we must accept the consequences to the LDCs and the banks. In other words, exemplary defaults and bankruptcies should be permitted. This attitude, too, ignores the realities of the situation. In every modern society, banks are controlled by regulation, not by the penalty of insolvency. We are not dealing with the isolated misjudgments of a few banks, but with the worldwide overcommitment of an interlocking banking system, approved and encouraged by the authorities. I suspect that those who urge governments or central bankers to shrug off their responsibilities are engaging in the expression of ritual orthodoxies rather than seriously expecting that we will accept the disasters which would follow acceptance of their counsel.

More constructively, there have been proposals made by people of considerable experience to relieve some of the problems of the LDCs and the banking system. These range from transfers at a discount of some or all of the bank debts to an international institution, to rather vaguely formulated international guarantees of existing debt. I have no space here for a detailed critique of these proposals. In my view, they do not sufficiently relieve the banks of the dead-weight of existing non-performing debt which threatens their functioning, nor do they deal adequately or practically with the need to provide a measured flow of future funds to the LDCs.

**HOW TO DEAL WITH THESE PROBLEMS?**

The leading powers are rightly moving to extend the role of their existing agencies. But little thought has been given to one of the most important of them, namely the export credit agencies. We have long recognized that world trade can only flourish if the public authorities provide export guarantees on a very substantial scale, and all the major countries have set up agencies for this purpose. Each agency acting independently has supported its exporters' trade with guarantees and has placed limits on the amount guaranteed of any one country's imports. This system works reasonably well for most countries. There is, however, a vital piece missing in the case of the LDCs. Any system for insuring trade credits will break down if, at the end of the line, the foreign currency to meet the obligations is not available to the debtors.

Most LDCs are likely to remain in current account deficit for many years. This means that, even if LDC importers are able to make payment in their own country's currency, the central bank of the deficit country will have to provide the foreign currency required. Since 1974, this requirement has been covered by the system of bank lending. But that system has broken down and the funds are no longer forthcoming in the quantities re-
quired. The result is not only that the LDCs are unable to meet their obligations to the banks, but there have been widespread defaults to their existing trade creditors. And they have no firm basis for financing future trade. The system of bank credit has broken down and that of trade insurance is breaking down, too. And a breakdown on this scale in credit arrangements, trade and banking, will not be selective; its negative impact will extend far more widely than the LDC area.

We should now extend the power of the export guarantee agencies to cover some exports of capital as well as those of goods. We need international arrangements under which the export agencies insure not only trade flows, but also appropriate current account deficits of the LDCs. Clearly, safeguards for such insurance will be required. The agencies would have to act cooperatively in setting country limits for the insurance of these bank credits. They would have to let it be known to the central banks of the borrowing countries that they would insure bank lending to deal with current account deficits only after receiving the advice of the IMF. Thus, any LDC country would know that they would receive the advantage of this insurance, without which they could not readily borrow on the market, only if they satisfied the IMF that their policies were broadly reasonable and their borrowing requirements limited accordingly. The IMF would be in continuous consultation with the leading borrowers and would agree and monitor outline programs with them; they would make recommendations to the agencies for the insurance of capital export credits through the banks up to the amount of each year's reasonable current account deficit.

With insured credit to cover the current account deficit, each LDC central bank would be in a position to meet the interest payments on existing debt (but not repayment of capital). They would
also be in a position to meet the trading deficit, thus avoiding the breakdown of the export insurance system. Once insurance is available, the required credits would readily be funded in the markets. The existing debts due to the banks would cease to be non-performing assets: The normal action by their central banks as lenders of last resort would be available to deal with any cash flow problems arising from the rescheduling of capital repayments. The LDCs would receive sufficient new funds to permit soundly-based economic policies in the future. And the increased funding of the IMF and other agencies would be a further and necessary back-up for these arrangements.

In other words, public and private finance would be combined into a viable system for maintaining and financing world trade, stabilizing existing bank debt and bringing about the adjustments by the LDC economies which would permit their sustainable growth. To achieve this, the leading countries would have to replace vague good intentions with specific decisions on how much they are prepared to contribute to this problem and on the manner of their support.

Borrowers who have for nearly a decade been encouraged to believe they could borrow without restriction will, in many cases, resent this proposal. Charges of neo-imperialism will be much heard. These charges are totally groundless. We would make it clear that any country was free to pursue any policies it wished. In the past, we have permitted and, indeed, encouraged lending which has financed wars, ludicrous levels of armament purchases and economic megalomania of all kinds. If any country wishes to indulge in these negative expenditures, it would be entirely free to do so, but there is no reason why we should permit our banks to provide the finance. Credit is justified only where the circumstances of the borrowing offers the reasonable hope of economic strengthening and growth of the borrower. There is no automatic right to borrow or obligation to lend. And it is in the interest of both borrower and lender that the money should be used productively. Clearly, the mandate and personnel of the IMF will need to be completely reappraised if it is to perform this new role in world monetary affairs. While the lenders will require protection for their funds and purposes, the LDC borrowers must be assured that the IMF structure adequately recognizes their political and economic problems, too.

I recognize that there will be great political difficulties in winning acceptance for effective solutions to the problems I have discussed. My proposals do not involve the creation of any new institution, but they do significantly extend the role of the existing export/import agencies. These proposals will therefore not be palatable to governments which have for so long lived with the delusion that these major world problems could be handled with negligible effort, responsibility or decision on their part. It will be even more difficult to win acceptance from legislatures, at present more receptive to populist pressures than aware of the complexities and dangers of the situation.

Too many of our governments, and even our private bankers, have a vested political interest in defending the good sense and soundness of what has been done in these past years to make them ready supporters of reform. But now that the unsustainable delusions of the past have been shattered, the grave dangers of the situation will have to be faced. Governments must make up their minds on what they are able and willing to do, and give reasonable definition to their purposes. It is indefensible that those who acquiesced in reckless flow of funds in the past should now reject as impractical the organizing of a monitored and measured flow of funds for the future.

For the reasons I have advanced, I believe that these problems are of central importance to the world economy. They will not be resolved by a series of piecemeal emergency measures. Without a coherent outline strategy, we will flounder from emergency to emergency, each more difficult to resolve. World trading will take a beating. The political and economic destabilization of the South American and other LDCs will accelerate dangerously and the world's private banking systems will be greatly injured in their solvency, credibility and performance. Yet the sums involved, though large for both the borrowers and the lenders, are small in relation to the world economy. Even now, a sufficient understanding by the leading governments of their responsibilities in an increasingly integrated world and a firm purpose to discharge them could produce a radical and hopeful change in our prospects.
I do not need to tell you that the international financial crisis is one of the major problems facing the world economy today. The problem is two-fold: Many developing countries are struggling to keep up with payments of interest and principal on their massive external debts. At the same time, private banks are increasingly cautious about extending overseas loans, making it more difficult for developing countries to procure the capital needed to put their economic houses in order.

Should this credit dilemma result in a breakdown of international financing mechanisms, it will spell disaster not only for developing countries and banks, but will also have immeasurable repercussions on the industrialized countries' own economic and financial systems as well.

It is encouraging, however, to note that there is a growing awareness of the threat posed to the world economy, and moves are now underway to set up international cooperation programs to resolve the crisis. I believe we can overcome the threats to the international financial community, if we maintain and strengthen our international cooperation.

Looking first at recent developments in international financial markets, the total value of syndicated Euro-loans arranged for non-OPEC developing countries fell 15 percent in 1982. Within this category, loans provided to Eastern Europe fell $7.3 billion in 1979 to only $0.8 billion last year. At the same time, total syndicated loans were halved, from $19 billion in the first half of last year to $9.3 billion in the second half, when the Mexican crisis erupted.

These trends have continued this year. Indeed, banks have become increasingly cautious in their international lending, as developing countries' economies continue to deteriorate in view of the uncertainty surrounding the future of oil prices and their impact on international financial markets. It has become extremely difficult for the Latin American and East European countries to raise money in international financial markets, and even the low-risk countries of Southeast Asia have found banks increasingly reluctant to participate in loan syndicates. According to Euromoney, some experts predict that syndicated loans themselves are a thing of the past.

Can the international financial markets survive if the credit crisis remains unresolved? Or, what should we do to prevent their breakdown? Before attempting to answer these questions, a review of the situation leading to the present crisis is called for.

Only in the last decade has international finance mushroomed. In the 1960s, OPEC did not have large balance-of-payment surpluses; furthermore there was near equilibrium in the surpluses recorded by industrialized nations and the deficits posted by non-OPEC developing countries. The Euromarket at the time was almost exclusively used for short-term interbank financing.

The oil crisis of 1973-74 completely transformed world money flow and international financial markets. The greatest concern then was that sharp oil price rises would upset international balance-of-payments. Indeed, the OPEC countries' current account surpluses jumped more than seven-fold in just one year, from $8 billion in 1973 to $60 billion in 1974. At the same time, the current account deficits of non-OPEC developing countries rose nearly four-fold, from $6 billion in 1973 to $23 billion in 1974. However, the recycling of oil money and the adjustment of balances-of-payment have subsequently proceeded much more smoothly than most people had expected. The international financial markets played a major role in this recycling, as banks accepted deposits from OPEC countries to make loans to non-OPEC developing countries. According to OECD statistics, the accumulated deficit in non-OPEC developing countries' current accounts rose by approximately $110 billion in the four years from 1974 to 1978, just before the second oil crisis. Yet meanwhile, these same countries were able to borrow $70 billion in long- and short-term loans from international financial markets — a sum equivalent to more than half of their cumulative current account deficits — and even to build up their foreign currency reserves substantially.
It should also be pointed out that the IMF, with the cooperation of industrialized countries and some oil-producing countries, has introduced a number of innovative financing systems for oil-consuming nations, especially for non-OPEC developing countries since 1974. The flow of oil money through these international institutions, though small in absolute terms, has played an important role in facilitating the recycling of funds through international financial markets.

Likewise, private-sector banks adopted a more active lending policy towards non-OPEC developing countries following the first oil crisis; non-OPEC developing countries became the only promising market open to banks. As a result, banks worldwide sought to expand their operations by stepping up loans to non-OPEC developing countries.

The medium- and long-term debt burden of developing countries grew from $180 billion in 1975 to $345 billion in 1978, an average annual increase of 24 percent over the three-year period. Still, these obligations reached excessive levels only in a few countries. They remained manageable in most cases because exports were expanding steadily due to global inflation, which itself meant either very low or even negative real interest rates on debts. The ratio of principal and interest payments on external debts to foreign currency earnings is known as the debt service ratio, and in major developing countries this rose gradually, beginning in 1974, and still averaged only slightly over 20 percent, even in 1978. There was every reason to believe that the major developing countries would be able to cope with their external debts. In fact, the rapid growth achieved by these countries as they borrowed to offset their balance-of-payments deficits had done much to mitigate the deflationary impact of higher oil prices and to sustain global recovery since 1976.

However, the situation was entirely different after the second oil crisis of 1978. To begin with, there was a much harsher economic climate in all developing countries, including oil-exporting nations. Today it is generally agreed that inflation is the number one issue in industrialized countries' economic management. Given the difficulties of controlling fiscal deficit, this war on inflation has been fought primarily with financial weapons. Credit squeezes have pushed interest rates to record highs worldwide, and have plunged major countries into their longest recession since World War II. Burdened with higher interest rates and falling exports, developing countries have suddenly found themselves crushed by their external debts.

The situation has been further aggravated by developing countries' and banks' failure to recognize the trend and to act soon enough. Many developing countries maintained high-growth policies, and there was insufficient winding-down of these economies. Banks, meanwhile, were slow to see a rapid deterioration in developing countries' creditworthiness, while non-OPEC developing nations' medium- and long-term external debt outstanding has grown by an annual average of 16 percent since 1980. It was obviously impossible for the developing countries to continue borrowing *ad infinitum*, and last summer, when Mexico had difficulties on its external debt repayments, the severity of the international credit crisis became fully evident.

When the problem is stated in these simple historical terms, the solution becomes clear. Although many proposals have been advocated for resolving this international credit crisis, they center on the following three points:

1) Debtor nations must readjust their economies. They must forgo rapid growth and a reliance on international borrowings, in order to restore equilibrium to their balance-of-payments. Some nations, including Mexico, Brazil, and Argentina, have already instituted economic reconstruction programs under IMF supervision.

2) The debtor nations must continue to receive the funds they need for an orderly restructuring of their economies. Any sharp cutoff in financing to debtor nations will only make economic recovery more difficult, possibly provoking serious social unrest and economic dislocation. Accordingly, it is imperative that banks continue to lend these countries the money needed for their recovery programs.

3) Still closer international cooperation between the IMF and the governments and monetary authorities of industrialized nations is required for a smooth implementation of these policies. Work is already in progress on a coordinated response. Since the Mexican financial crisis last year, there has been increasing acceptance of a mechanism permitting industrialized countries' governments and central banks to provide short-term financing...
through the Bank for International Settlements (BIS), to help debtor nations through liquidity crises. Last January’s agreement of industrialized nations’ finance ministers to increase the capital of the IMF and expand the framework of the General Agreement to Borrow (GAB), is encouraging as another major step in international cooperation centered on the IMF.

And I would now like to talk about Japan’s response.

Japan has cooperated actively in these efforts, and we intend to continue playing a role commensurate with our position in the international community.

At the official level, Japan should expand its assistance to developing countries and give still greater support to the IMF, World Bank, regional development banks, and other international organizations to help resolve this international credit crisis. It is also an important that efforts be made to improve the financial positions of private-sector banks, so they can continue lending the necessary funds to debtor nations.

Looking first at assistance to developing countries, despite its own huge national budget deficit, in 1981 the Japanese government announced an ambitious plan to increase aid in order to fulfill its international responsibilities. Under this medium-term plan, total Official Development Assistance (ODA) extended in the first half of the 1980s will be double that of the latter half of the 1970s. This will be achieved by larger government loans and boosting contributions and subscriptions to international organizations’ capital increases.

Japan has already expressed strong support both for the IMF capital increase and an expansion of the General Agreement to Borrow and has stated its willingness to meet its share of contributions.

On improving the financial positions of private-sector banks, a number of policies have been implemented under Ministry of Finance supervision. For example, the reports banks must file on their overseas exposure used to cover only medium- and long-term lending. This was expanded late last year to include short-term loans to major debtor countries. In addition, new guidelines require gradual increases in the ratio of medium- and long-term funding for medium and long-term loans, and a diversification of funding sources. To ensure sounder asset management by Japanese banks, the Ministry of Finance has also introduced guidelines for the ratio of foreign-currency-denominated assets to shareholders’ equity and for a new bad debt provision to cover loans to main borrower nations. Japan’s measures to strengthen its banks’ position are, I believe, comparable to those being carried out in other countries.

Yet much remains to be done. Domestic markets must be opened further to exports from developing countries. Since last year, Japan has announced several trade packages to lower tariffs, streamline import inspection procedures, and other measures to increase market accessibility. We must also further liberalize our domestic capital market, in response to overseas demand for yen funds. We intend to continue dealing with such issues in a positive manner.

Nevertheless, it must be pointed out that all these efforts are short-term measures, intended to avert a collapse in the international financing system, and that the recovery of economic health in industrialized countries is essential for the long-term solution to borrower nations’ economic difficulties and the international credit crisis. It is encouraging to note that all major countries agree on this point. Despite the serious recession, all countries are pursuing efforts to reduce inflation, restructure public finances, and revive the private sector. As a result, inflation is gradually being brought under control and the long-awaited recovery in the world economy is finally in sight.

However, it is clear that inflation and high interest rates will be rekindled if we ignore the need to balance government budgets and introduce excessively inflationary policies to hasten economic recovery. Inflation may act temporarily to ease developing countries’ debt burdens, but in the longer term it simply leads to a new round of indebtedness and sows the seeds of another financial crisis. The international financing system may not survive repeated crises of such magnitude.

To summarize our situation today, the international financing system, having responded successfully to the first oil crisis, is now being called upon to develop new responses to the post-1978 oil crisis environment. Moreover, uncertainty about the ability of the international financial system to respond to these environmental changes is one factor behind the current international credit crisis.
The recently announced OPEC oil price cuts cloud the outlook further for international finance. While lower oil prices will have a negative impact, by reducing exports to OPEC countries, ultimately they will contribute to economic revitalization by reducing the oil import bills of consumer nations and bringing down both inflation and interest rates.

At the same time, however, the oil price cuts are worrying for the international financial structure. First, oil-producing countries may be expected to begin drawing down their overseas assets. While there are varying estimates on the scale of this drawing-down of assets, the total is projected to reach about $30 billion, assuming oil prices stabilize at around $29 per barrel.

Second, lower oil prices have further intensified the external debt problems for Mexico, Venezuela, and other oil-exporting countries, and some OPEC countries are expected to become borrowers from international financial markets. OPEC's shift from lending to borrowing will represent a major change for these markets.

As I mentioned earlier, I think it is possible to minimize disruption in international financial markets through increased international cooperation and stronger policies to deal with credit problems.

According to BIS statistics, the Euromarket showed a net increase of approximately $500 billion in the last eight years. Of this increase, deposits from OPEC countries increased by only about $60 billion, that is, approximately one-tenth of the total. Overall, it seems to me that the present state of international financial markets is adequate enough to absorb the possible shift in OPEC's external assets.

Of course, some banks may suffer liquidity problems if their OPEC funds are withdrawn, but there is already an international agreement that the governments and central banks should serve as lenders of last resort to tide banks over such temporary shortfalls. Moreover, it should be possible for the IMF and other international institutions to cope with deteriorating foreign exchange positions and increased borrowing by oil-producing countries. Our most important task is to strengthen international financial markets. I believe this goal is within our reach. If we can accomplish it, the international financing system will absorb these environmental changes smoothly.

We must, of course, be prepared for the fact that it will take considerable time and effort for the international financing system to adjust. The debtor countries probably will have to endure several years of very slow growth. And it will be some years before international financial markets regain their vigor.

We might recall that the future of the world economy and international finance also seemed grim at the time of the first oil crisis. Yet cooperation between the IMF, industrialized countries, and some oil-producing countries enabled the system to overcome the unprecedented impact of a four-fold increase in oil prices. It is impossible to forecast all the changes which will take place in the future, and the system can only respond to environmental changes as they occur. Some confusion is perhaps inevitable in this process of change, but international cooperative arrangements are already in progress. If debtor and creditor nations join together to pool their wisdom in the spirit of cooperation, I am confident the difficulties ahead will be overcome.
This year's guest speaker before the Commission on North-South relations was Chedli Klibi, the Secretary-General of the Arab League. Following is an excerpt from Dr. Klibi's presentation, focusing on the development-related problems facing the Arab countries, and their relationships with both the developed and developing worlds.

North-South

Chedli Klibi

The most critical developmental issues in the Arab world can be grouped into the following basic categories:

1) The need for a diversified production structure of Arab economy. As we saw earlier, production patterns in most Arab countries are geared to the production and export of raw-materials, mainly in the areas of agriculture, mining and petroleum. Manufacturing industries are rather feeble while agricultural production is still largely undeveloped. We have seen how this could undermine the stability of Arab economy by making it extremely vulnerable to the fluctuations of raw-material prices and demand. A further complication is that the terms of trade tend overwhelmingly to favor the exporters of industrial products at the expense of those of raw-materials. As a result, Arab exports of raw materials are constantly suffering from a gradual erosion of their real value. To offset this loss in value, Arab countries have no other choice but to increase the volume of their exports in order to pay for the import of the same volume of manufactured products. Furthermore, the export of raw materials, in their crude form, deprive the Arab countries, as I pointed out earlier, of the opportunity to employ a part of its available labor-force — an opportunity which is obviously of great value to handling the problem of unemployment arising from a fast population-growth.
There is no doubt that so many acute problems cannot be properly dealt with without an adequate diversification of Arab production-structures which should be given due importance and in which the production of agriculture should be so developed as to bridge gradually the food-gap the Arab world is suffering from and which is threatening not only its economic independence but also its freedom and its independent political decision-making.

2) The diversification of Arab production-structures should be such as to allow for a relative increase in G.D.P. rates likely to ensure, at the same time, a higher standard of living for Arab masses and a larger savings-capacity to be invested on major infrastructural projects in all sectors of developmental activity. It must be noted, at this point, that the required effort in this respect is all the greater as the necessary development infrastructure is inadequate, if not altogether nonexistent, in many Arab countries. Road-networks, electricity, transport, communications and all such infrastructural needs are to be properly met, which means a big chunk would have to be sliced out from the savings-package.

3) To achieve development in all its previously outlined implications and requirements presupposes intense domestic efforts in the areas of sound development planning, adequate manpower promotion and the mobilization of savings for the financing of development projects. But such domestic efforts, no matter how great and far-reaching, are not enough to ensure, by themselves, the success of the development-process. They must, indeed, be met with favorable conditions on the international economic front. To illustrate, I would mention four areas where direct interaction with the advanced industrialized countries is mandatory:

- There is, first, the need of the Arab world for the necessary development-related "technology."
- There is also the need to remove all strings and obstacles to the Arab countries' exports of the outcome of their growth and to ensure a certain competitiveness of such exports on industrial countries' markets.
- There is, thirdly, the need to reconsider the prices of raw materials which, for Arab countries as well as for all developing countries, still make up the lion’s share of their export towards the industrial countries. Under the current world economic order, these prices continue to collapse in comparison with those of the industrial products exported by the advanced industrialized countries.

- Finally, there ought to be a foreign contribution to the financing of development projects.

In all these four areas, it comes out clearly that the prevailing international economic order dominated as it is by the industrial world, and by both its public and private economic institutions, is, in general, largely detrimental to the development process of Third World countries, including the Arab countries. I might even add that such an order is not only an obstacle to development, but also an obstacle to justice, based as it is on unequal relations between developing and developed countries. Relations which can be considered, to a certain degree, as an extension of the old system of domination which yielded maximum advantages for the industrial world and minimum — if any at all — for the developing world and which, by and by, led to an all but total subjection of Third World economies to the rule of industrial countries economies, with no consideration whatsoever of the long-term interests of the poorer nations. Of course, the mechanisms which used to underlie this system of domination have somewhat changed, if only on account of changing circumstances on the world's political, economic and cultural fronts. In fact, new devices were set up, which had been previously unknown, to replace or refashion those which had fallen into desuetude. One such device was the spectacular growth of multinational corporations in the aftermath of World War II and their paramount role on the international economic scene ever since: The strategies, policies and practices of these corporations are all designed, in one way or another, to impede the progress of genuine, sound development in the Third World, Arab countries included, and to divert it from its initial goals.

4) It is fitting to consider, if briefly, the way in which the relations between Arab countries and industrial countries are currently organized with respect to the four areas previously outlined.

At the technological level, the multinational companies monopolize, to a large extent, a considerable part of technological facilities and only dole them out to developing countries, including the Arabs, in the form of manufactured products. They oppose overtly or covertly any form of
cooperation likely to enable developing countries to have access to high technology for their development purposes, let alone the drastic financial conditions imposed by the multinationals for the simplest use by developing countries of these technologies and the refusal to allow the citizens of these countries proper training in this field. This might seem natural and acceptable for those who hold economic analysis to be a mere matter of profit. We do not reject this criterion, but we must ask about the time-scale allowed to achieve such a profit. Should it be immediate profit, as the multinationals would have it, or long-term profit, as they would reject it? I believe you share my view that it is in the long-term interests of industrialized countries to contribute to the promotion of Third World economies — including the Arab countries — if only to ensure larger supplies and sales of their own industrial goods and products. It is, therefore, obvious that cooperation between developed and developing countries is beneficial and necessary to both parties. For, through development, the less advanced countries could boost their revenues and, consequently, their demand for all kinds of products, including those of industrialized countries. There is no doubt that this presupposes a new approach to international division of labor whereby developing countries are enabled to specialize in some industrial sectors suited to their own production capacities. Unfortunately, the multinationals would not have it this way, and continue to deny any technology-transfer to the Arab world in particular. Whenever this question was put to the leaders of industrial economies, at the level of the Euro-Arab dialogue for example, they routinely answered that their national authorities had no power whatsoever to oppose the decisions of the multinational corporations. Allow me, however, to observe that we all know that when basic, long-term interests of industrialized countries are at stake, these countries are perfectly capable of deciding what rules and regulations are needed, and to see to it that these rules are duly complied with on the part of any economic agents operating in their territories.

As to outlets for Arab products on the markets of industrialized countries, mention must be made of the increasingly severe protectionist policy of these countries concerning exports from all developing countries, including the Arab states. Certain Arab countries have tried to overcome these obstacles by concluding special agreements with EEC countries in conformance with the articles of the Treaty of Rome on which the EEC was founded. But as far as Arab countries are concerned, much remains to be done in this area — let alone other, non-EEC industrialized countries whose markets are especially important for both Arab exports and Arab development. A new formula for the international division of labor must be worked out that will allow both sides to exchange their products on the basis of balanced and fair deals.

As for the prices of raw materials exported by developing countries, including Arab countries, and the relations between these prices and those of manufactured products exported by industrialized countries, it must be emphasized that all developing countries are of the opinion that the deterioration in the terms of trade presents a grave problem for development, perhaps even more serious than many other development-related issues. As a result of this deterioration, the volume of manufactured products which the developing countries receive in return for a fixed quantity of their raw materials has been decreasing steadily and a great part of the efforts of developing countries have been operating at a sheer loss. It follows then that development is becoming more and more expensive and developing countries are subject to ever-increasing expenses. This situation would have been tolerable if raw material prices on the international markets had been fixed without interference from industrialized countries’ trusts and monopolies. These trusts and monopolies have played an important role in downgrading the real value of raw materials. Here too, it is the responsibility of industrialized countries’ national economic experts to remedy this situation. If this deterioration continues, it will inevitably lead, in the long run, to a grave and continuous pauperization of Third World economies including those of the Arab world with all that that implies — namely a decrease in their capacity to import products from industrialized nations, much to the detriment of the interests of these nations. This is why it is in the interests of all to cooperate and put a halt to this deterioration. Methods and technical procedures to this end are many. All that is needed is political determination.
The relationships between the prices of exports from developing countries and those of advanced industrialized countries was discussed at length within the framework of the North-South dialogue. The former requested that the prices of their raw materials be in keeping with those of the manufactured products they import.

For its part, the Arab World accorded particular interest to this question during the Non-Aligned Summits held in Algiers at the beginning of the last decade and in New Delhi last month. And both meetings pronounced in favor of finding a valid solution to this problem.

This leads me to evoke the question of oil prices which have been fixed by oil-producing countries, including Arab countries, since 1973. What has taken place since has only been a readjustment in oil prices in conformance with the economic rules which govern product price fixing. In fact, these rules provided that among the factors to be taken into account for product price fixing, the most important would be the price of substitute products: coal, nuclear energy, etc. One can then conclude that what has been done with regard to oil prices must be considered as a clear expression of the determination of developing countries to see the prices of their raw materials fixed in a more equitable manner. All the more so as these products are neither ordinary nor renewable and constitute the essential wealth of certain countries. What is more important is that this raw material is depletable and each passing year hastens the exhaustion of proven reserves.

It should be mentioned that Arab oil-producing countries, even though they supply 60% of industrialized countries’ oil needs, do not exercise a monopoly as the mass media would have us believe. For a very short time indeed, they had found themselves in this position, until industrialized countries succeeded in organizing themselves. These latter stockpiled considerable quantities of oil products, to counter oil price increases and, ultimately, succeeded in lowering them.

Even the financial surpluses of oil-producing Arab States, evaluated at the end of 1980 at some $250 billion are, for the most part, invested in advanced industrialized countries — Western Europe and the U.S.A. — either in the form of investments or bank deposits. To this it must be added that if a large proportion of world crude oil reserves are found in Arab countries, it is the great industrialized nations who handle refining, transportation and marketing of this product.

It is clear that the advanced industrial world plays a considerable, even a formidable role in the oil sector. Let us say, openly and honestly, that due to this role, any price war will have profound negative repercussions, not only on oil-producing developing countries, but also on advanced industrialized countries and will seriously endanger world economy.

Taking advantage of the oil price war and of the relative decrease in oil price levels, it becomes, apparently, uneconomic to continue research on substitute forms of energy. Yet, it is in our common interest that these substitute energies be developed so that we can postpone for as long as possible the exhaustion of developing countries’ oil reserves and ensure normal and continuous energy supplies to industrialized countries and non-oil-producing countries. Hence the necessity of constructive cooperation, if we are to prevent price wars from breaking out, and ensure the stability of a speculation-free oil market. This can only be achieved if we have a clear vision of the future. Such cooperation is in our common interest and every individual who assumes his full responsibility in the area of world economy, its promotion, its progress and its stability, cannot but be aware of this.

I come now to the fourth part of my topic, that is, aid granted by industrialized countries to certain Arab countries in the form of participation in the financing of development projects. This question could give rise to a certain confusion and even perplexity.

It hardly seems normal that Arab countries need apply for credits from industrialized countries when oil-producing Arab countries dispose of considerable financial surpluses. In other words, the Arab nation on the whole is capable of meeting the credit needs of certain Arab countries. An objection may be made by stating that oil financial surpluses are, and have been since 1973, invested in industrialized countries mainly in banking institutions. And these financial bodies reinvest such surpluses and make use of them in the form of loans to other countries, including non-oil-producing Arab countries and other developing countries. This illustrates the dual aspect of financial relations
between industrialized countries and the Arab nation. The financial surpluses of certain Arab countries serve, on the one hand, to improve the balance of payments of industrialized countries because they are considered as credits advanced by oil-producing Arab countries. But, on the other hand, they also serve to strengthen the industrialized countries’ capacity to grant loans to developing countries, including certain Arab countries.

This emphasizes the necessity of cooperation among all parties for the establishment of financial reports whereby both borrowers and lenders, that is, those who request capital and those who grant it, profit by the transaction. It is obvious that such cooperation implies, first of all, that there be favorable terms and conditions for the credits granted to non-oil-producing Arab countries by industrialized countries. These terms must take into account the nature of the participation of these credits in the financing of the development process, that is, for long-term purposes.

Secondly, there must be economic and legal guarantees for both loans and investments granted by each party.

Unfortunately, achievements to date in the area of financing, no matter what the method used, have fallen short of requirements. The volume of credits accorded by industrial countries to non-oil-producing Arab countries is still inferior to what it should be. These credits are subject to certain economic strings whereby their service charges greatly surpass the estimated rate of interest. These have reached very high levels over the past years, levels imposed for the benefit of a few industrialized countries within the framework of a monetary policy adopted with a view to solving internal inflation problems. This has been carried out with no consideration whatsoever for the heavy charges thus imposed on recipient countries, including certain Arab countries.

Furthermore, investments and credits that Arab oil-producing countries have accorded to industrialized countries, just as those granted by these latter countries to non-oil-producing Arab countries, also require adequate guarantees so as to protect them and favor their continuity. It is in this area that the Arab states plan to conclude a general agreement with, in particular, Common Market countries within the framework of the Euro-Arab dialogue. Whether with regard to volume, terms, service charges on credits to Arab countries or guarantees on deposits and capital investment of one of the parties in the countries of the other, appropriate measures must be taken, in the interest of all.

5) It follows from what has already been said that, for the most part, relations between the Arab nation and the industrial world are confronted with complex problems and great difficulties which may hamper the development process of the Arab countries. I believe that these problems can never be solved by confrontation between the two parties, but only by cooperation. Confrontation will serve neither of the two parties. On the contrary, it will have a detrimental effect. Only cooperation can favor the two parties. This is what I have tried to emphasize throughout this paper.

If we were to elucidate a general philosophy for cooperation we would say that it is founded on a single idea: The creation of a new world economic order where relations are based on equality between the two parties and where well-balanced relations serve the common interest of both parties. A new order that will ensure quality, justice and progress for all humanity.

This kind of world economic order was recommended by the last Non-Aligned Summit held in New Delhi last March with the participation of the Arab states who adopted the decisions and declaration concerning this new world order.

6) An important fact must be emphasized when discussing the problems of development in Arab countries and their relations with industrialized nations. It concerns the heavy defense spending sustained by the Arab states, especially in the Near East, to protect themselves from the Israeli policy of aggression and expansionism, not to mention the savage attacks carried on against the factories, enterprises and scientific installations of an entire Arab city, Beirut. Considerable funds must be found for their reconstruction. When added to the already heavy spending in the area of defense, we are faced with immense expenses which may set the development process back considerably. Industrialized countries have a major role to play in this matter and the only way they can bring a constructive contribution is to support the development process in the Arab countries—regardless of other aspects of the question. Their role must be to use all their influence and available means to put a halt to Israeli aggression and
expansionism and to urge the international community to seize the opportunity offered by the Fez Summit decision which, although insufficiently stressed by political observers, constitutes a historical turning point and a basis on which a lasting and comprehensive peace can be established in the region. All the more so as President Reagan's peace plan could also prove to mark the beginning of a positive evolution in American policy towards the Middle East problem. Industrialized countries may think that it is their duty to protect Israel. We understand this. But what we do not understand is that these countries supply Israel with everything it asks for to demolish enterprises and cities, destroy life and stop the development process in vast areas of the Arab homeland. By using all their influence and available means, industrialized countries will not only participate in achieving peace in the region, but also by the same token support the development effort in the Arab world.

7) We come now to the nature of the relations which exist between Arab nation and developing countries. As I have already mentioned, the Arab nation is part of the developing world and lives the problems and difficulties, shares the aspirations and hopes of all those who are concerned with development.

What is striking, first of all, is the relative weakness of the developing countries' participation in the Arab nation's foreign trade — scarcely one-quarter of the total volume of exports and imports. This phenomenon is understandable when one considers the specialization that is imposed on developing countries, including Arab countries, and the relative weakness of their revenues which limit trade exchanges between the two groups.

But this situation must evolve in the interest of all. Increased trade between Arab countries and other developing countries would serve to open new markets for their products, favor development and reduce the problem of market exigency, a problem which all too often makes new projects uneconomic. None of these measures would contradict the basic principles on which modern world economy is founded, one of which is that countries with a similar level of development group together and combine their efforts in the fields of trade and development. But this is not easy as it requires carefully structured organization, perseverance and patience. Nonetheless, every effort made in this direction will find its reward. It must be noted that an increase in trade exchanges between developing countries, including Arab countries, favors their development and increases their national revenues. As a result, their demands for imported goods from industrialized countries, especially machinery, equipment and manufactured products which they themselves do not produce as yet, will increase. This too stresses the need for a new formula of specialization and international division of labor, as I have already indicated.

There is another aspect of the relations which exist between Arab states and other Third World countries. Arab states have granted non-Arab developing countries, especially in Africa and Asia, financial aid for the most part on very favorable terms. Aid accorded by oil-producing Arab states reached a rate which passed by for the 0.7% national revenue figure established by the U.N. in 1970. The lowest rate for the period 1970-1980 was 2.34% of national revenue. In certain countries, in certain years, it reached beyond 15%. This aid was granted on such favorable and discreet terms that the recipient countries were not even publicly mentioned.

Thus, the Arab states have assured Third World countries investments on favorable terms, very much the opposite of those high-interest credits with onerous and increasing service charges granted by other countries.

It is vital that a solution be found for this problem. Having to resort to delayed payments and installment payments in order to repay credits is not the answer. The logical solution would be to adopt an international order that would provide loans on favorable terms and at low interest rates to developing countries for development purposes. This development might, in itself, be a means of checking worldwide economic stagnation, and averting the risk of a formidable crisis, of which increasing unemployment in industrialized countries is a premonitory sign.

What is essential is that the factors which unite Arab countries to other developing countries are much more important than those which separate them. The similarity between the difficulties and the interests of the two groups prevails over the differences which separate them. In addition, their position with regard to a completely new world economic order is one and the same.
In the Host Country

Following the tradition of past plenary meetings of the Trilateral Commission, the first session of the Rome conference was devoted to a review of current developments in the host country — Italy. Reproduced below are excerpts from the opening presentations of the three speakers at this session: Professor Mario Monti of Bocconi University in Milan; Guglielmo Negri, Deputy Secretary-General of the Italian Chamber of Deputies; and Romano Prodi, President of IRI (Institute for Industrial Reconstruction).
Italy’s postwar economic developments may be summarized in three phases, with regard to the relative performance vis-à-vis that of the main industrialized countries.

**THE FIFTIES AND SIXTIES: HIGH GROWTH AND STABILITY**

This phase came to be known as Italy’s economic “miracle” and was particularly buoyant at the end of the Fifties, a decade characterized by an annual average growth in GDP of 5.8%.

Although with larger fluctuations, the growth process continued through the Sixties: The growth rate in the period 1961-70 was on average 5.7% for Italy against 4.7% for the EEC.

In spite of its more rapid expansion, Italy enjoyed in that period virtually the same price stability as the EEC (3.8% annual inflation rate vs. 3.7%) and a larger payments surplus on current account relative to GDP (1.8% vs. 0.4% for the EEC).

Of course, there was a two-fold structural problem, which to a large extent persisted throughout the growth process of the Fifties and Sixties: A structural unemployment (5.2% of the labor force vs. 2.1% for the EEC), concentrated mainly in the southern regions of the country.

**THE SEVENTIES: STILL GROWING BUT BUILDING UP DISEQUILIBRIA**

It is perhaps surprising, given its comparatively very high dependence on imported energy, that Italy managed to keep its growth rate somewhat above that of the EEC (3.1% in 1971-80 vs. 2.9% for the EEC) even when the international economy was hit by the two subsequent oil shocks of 1973-74 and of 1979.

To a large extent, this was the result of relatively more accommodating policies, particularly in the aftermath of the second oil shock. The adverse effect was of course a substantial increase in the inflation differential. In the period 1971-80, Italy had a consumer price inflation of 14.6% as an annual average, compared with 9.5% for the EEC.

At the end of the period, it had become clear that the relative performance of Italy was too unbalanced and therefore unsustainable. By 1980, the growth rate of GDP was 3.9% for Italy and only 1.4% for the EEC. The inflation rate had reached 21.2% for Italy while it had been kept to 12.3% for the EEC. The current account deficit was 2.5% of GDP (1.4% for the EEC).

This divergence towards a pattern of “more growth-more inflation” did not help to solve the unemployment problem. The rate of unemployment in 1980 was 8.0% and exceeded that of the EEC (6.0%).

**THE EARLY EIGHTIES: A RECESSION WITH COSTS AND NO BENEFITS?**

When it became evident that running excess inflation was of no help to employment, while it generated increasing problems with respect to eternal equilibrium and to the orderly working of domestic real and financial markets, the fight against inflation came to be considered the top priority not only by the monetary authorities but also by those political parties and social partners which did not precisely have an anti-inflationary record behind them. This unanimity on the goal — but to an unexpected degree also on the instruments to be used — has probably characterized Italy more than other industrialized countries in the last two or three years.

Several measures have been planned, and a number of them actually implemented, in the field of monetary policy, of government spending and taxation, of wage and income policy . . .

While the policy-mix may have differed, the general economic policy stance has not been substantially different from that implemented in most other industrialized countries. The results, however, seem to have been less favorable in the case of Italy.

To be sure, these policies have contributed to a recessionary phase everywhere, bringing about costs in terms of foregone growth and of unemployment. On the other hand, they have brought benefits in terms of reduced inflation and improved external equilibrium, thereby creating the preconditions for a new sustainable and (hopefully) non-inflationary recovery.
Italy has fully shared in the costs of this strategy. Its GDP has stagnated, or rather slightly declined in line with that of the EEC (-0.1% on average in 1981-82), while the whole of the OECD has experienced a modest increase (+ 0.3%). The rate of unemployment has increased to 9.2% at the end of 1982 (9.3 for the EEC, a figure which rises above 11% if account is taken of those workers who are subsidized by the “Wage Supplement Fund” while still being “employed”).

In face of these costs, the benefits have been quite modest. The decline of inflation did not go beyond a rate of 16.6% in 1982 (consumer prices, annual average) thus leaving wide differentials with respect to the EEC (9.9%) and with respect to countries such as Germany (5.3%), the U. K. (8.6%), the U.S. (6.2%) and even France (11.9%). Also, the current account situation improved, but the deficit recorded in 1982 still amounted to 1.6% of GDP, compared to one of 0.7% for the EEC.

Today’s Policy Dilemma

The limited evidence presented here, as well as the more complex set of indicators which could be shown by a more scholarly analysis, suggest that the process of “convergence” of the Italian economy has so far been negligible, although economic policies themselves have made considerable efforts to be less “divergent” than they had been previously.

Given this apparent failure, a state of frustration now leads some political figures to recommend a sort of reversal of priorities, with a view to stimulating the economy. The example most frequently cited is that of France. . . .

Another position holds that the success in bringing inflation down has been modest because Italian inflation, after a decade in which it never fell below 12%, is deeply rooted in the behavior and expectations of economic agents. It will take time to be eradicated. Until it is not, any attempt to stimulate the Italian economy in isolation, or even to join in the international recovery when it materializes, is bound to produce no benefits in terms of employment and growth but rather to increase external disequilibrium.

If I had to state my own views, I would basically share the latter position. With one variant, though. To me, it is even less surprising that the decline of inflation has been slow. Not only is inflation by now embedded in the fabric of the Italian economy, but it is my opinion that only too recently has economic policy really begun to modify some of the peculiar mechanisms that throughout the Seventies had both generated inflation domestically and sustained imported inflation above international levels. If this contention is true, then the results in terms of reduced inflation, and renewed room for expansion, may not be expected to be reaped before some time . . . .

International Conditions That Would Facilitate Italy’s Convergence

The next few months will be crucial for several issues of international economic policy, also in view of the Williamsburg Meeting of the Chiefs of State or Government of the seven most industrialized countries. It would be beyond the purpose of this paper to investigate those issues. It should not be forgotten, however, that the prospects of the Italian economy are going to be strictly conditioned by the international trends and policy decisions.

This is so not only in the obvious, yet very important, sense that the main economic variables of Italy will be strongly affected by international influences. But also in the perhaps even more important sense that what will be decided internationally will largely determine which of the alternatives described earlier as a “policy dilemma” will actually prevail in Italian economic policy. Should there be no progress in deciding a joint action to moderate at least the most volatile exchange-rate fluctuations and a somewhat greater coordination of macroeconomic policies than has been the case in recent years, it is likely that in Italy a position would prevail, out of frustration, aiming at stimulating the economy even in isolation. It will be clear from what has been said above, that I would consider such a policy ex-
Having analyzed the dynamics of Italian politics and the role of the main political parties, Professor Negri noted in his conclusion that "the lesser political parties have been putting more stress than in the past on the shaping of public opinion." He then proceeded as follows:

This development may well be one of the most important consequences of the trend towards self-education which has been introduced into everyday life under the influence of the media, and especially television. In a people already endowed with natural intelligence and a penchant towards reflection, this has produced greater maturity and preparation for experience. The intellectual and critical development which the Italian people have undergone in the last thirty years can be said without exaggeration to be the greatest achieved in its thousands of years of history.

The growing maturity, favored as well by the spread of systems involving local assemblies or councils in the schools, the social services, the trade unions, politics and culture generally, has produced a demand by the population for higher standards in government, more efficient administration, an end to the system of patronage and to corrupt practices, as well as a greater sensitivity to the values of personal freedom and dignity.

The consequences of this development, which is the most consoling factor in the whole Italian scene, are to be found in a constant wariness on the part of the electorate towards the parties, and this has shown itself in greater changeability in electoral choice. This is not only true of the center, but also of the right and left, areas where the degree of political immobility, and thus of blockage, was in the past very high indeed. The tendency towards greater openness has therefore begun to appear in almost every aspect of Italian political life, fanning out into the kind of pattern that Anglo-Saxon commentators have termed "broad-based parties." These are aimed at appealing to wide sectors of the electorate through generally acceptable ideologies and limited and realistic programs, which aim to interpret and rationalize the aspirations of the average citizen of our age towards the liberty and dignity of the individual, towards work and education for all, towards an egalitarian society but one in which promotion based on merit is present and operates automatically, and towards privacy — i.e. a private area of individual liberty which cannot be invaded or abrogated for any motive or interest.

In conclusion, we can say that Italy presents a picture of substantial democratic stability and social consistency, far more reassuring than would have been the case twenty or thirty years ago. Serious problems certainly remain, however, relating to governability on the institutional plane, both from the standpoint of the existing relationships in the party line-up between the parties of the governing majority and the Italian Communist Party, and within the Communist Party itself, over its relations with the European democratic left and with those communist parties which are closely linked either to the Soviet Communist Party or to that of China.

As has been the case in our country for the last hundred and fifty years, foreign policy continues to exercise a strong influence on the evolution of our political situation. This is true, as we pointed out earlier, because of Italy's strategic position at the center of the Mediterranean theatre and the oil routes; it is also true because of the high degree to which Italian parties react to international events — perhaps higher than anywhere else in the present-day world. Italy has overcome many quite serious risks in the last forty years: The risk of becoming either physically or politically a kind of European Vietnam; the risk of isolation in neutralist and ambiguous positions which would nevertheless still be susceptible to economic or military blackmail in any emergency; the risk of authoritarian regressions, first of all in relation to the high degree of social disparity which still characterized the country after the second world war, and then later with the more recent wave of political terrorism. All these risks
have been avoided by an internal process of political development in which the Italian parties, without any exception, have shown themselves to be politically intelligent and prudent. From this point of view the "Party State" and the parliamentary form of government have saved Italy from other trials which might well have proved ruinous to its independence and to the liberty of the Italian people. This historical merit is an ample compensation for both the slowness of some of the parties in acquiring a "governing mentality," and for the populist and demagogical phase which we passed through in the Seventies. It also compensates for the stage of party pressure on civil society, which some people have defined as a real "occupation," and still continuing today, but against which there is now a vigorous reaction from the "antibodies" of public opinion and the revolt of the intellectuals.

The Italian political system, then, has shown over these years an encouraging capacity for self-adjustment and improvement, even through wearisome and sometimes frustrating trials which have ultimately contributed to preserving the basic values and to promoting a general and widely diffused human and material progress within the liberty and independence of the nation.
that have occurred in Italy have been so far-reaching as to be without parallel, at least in the rest of Europe.

The geographic migrations and occupational mobility have generally acted as the channels for this mobility and change. More specifically, the main channels of mobility have been: a) politics, particularly where this was “rediscovered” after the fall of the Fascist régime, and also as a result of the establishment of the model of the mass political party (with its need for a large number of cadres, and the need to control as far as possible the channels through which economic resources are allocated, which is perhaps not only an Italian situation); b) education, which has made occupational mobility possible and enabled members of different generations and of the same households to move up socially; c) the spread of small firms.

What is most striking about these great demonstrations of mobility in Italian society (to which I have dedicated the bulk of this paper), is that the political system not only tends to be deadlocked because it cannot manage to replace its élites with new ones (since there is no possibility of alternating between parliamentary majority and the minority) but above all because it tends to reason and take decisions (when it manages to do so) on the basis of projects that are designed to ensure the stability of society and maintain the status quo.

When there is a conflict of interests, it is generally the traditional interests that are most likely to be safeguarded over new interests. Perhaps this is the reason why such a powerful innovative force as industrialization has to move along traditional lines which cause small upheavals, such as the small-sized business. Despite what the politicians say, their actions seem wholly designed to keep the existing equilibrium, and even the past equilibrium at times. Meanwhile, society continues to undergo far-reaching processes involving whole communities, as we have seen, but since the political system does not respond to them or interpret them, they look as if they are the result of individual initiatives, and they eventually evade all control.

The fact that this society which accepts mobility is out of step with the political system that is keen to maintain the existing equilibrium is reflected in another contrast: the contrast between the revival of “municipalism,” the vitality of the periphery of the economy, the consolidation of so many industrial districts (in the sense that Marshall intended), and the poor ability to govern on the part of the State and, more specifically, the political system itself.

One might echo Braudel’s interpretation of the rise of cities in Italy, Flanders, or Germany, and ask whether it is precisely because of the weakness of the central government that explains this new cycle of vitality through which these peripheral towns are passing. In the 11th century it was the towns which were the outright winners in the competition between the towns and the state, at least in Italy, Flanders, and Germany, whereby they became the organizers of the political sphere. Under today’s changed technical, economic, and institutional conditions, it is the weakness of the Italian state which enables Italy’s enduring “municipalism” to win and to carve out areas for its own initiatives and spheres in which to show its vitality (even though it cannot obviously reach all the traditional political spheres, such as minting coinage, or defending the country).

Whereas Braudel provides us with a historian’s interpretation, an Italian sociologist with an industrial background (Prof. Luciano Gallino) offers us another interpretation of these anomalies or incongruencies in Italian society, which I do not consider contradictory.

Gallino has studied the phenomenon of dual employment and made a thorough examination of the informal economy (which is largely where the second jobs exist, or where the non-institutional labor supply and demand is found). In terms of the dichotomy between the typical contemporary system of laying down labor regulations for the whole country,
and the typical pre-modern system of the "piecemeal" approach, Gallino concludes that, "in the informal economy there is general desire to evade generally established norms... and to return to privately established values and behavior patterns on the part of both producers and the public."

By avoiding a naive chronological approach to development, one can note and accept the idea of the persistence of pre-industrial social patterns. Indeed, it is "thanks to the inter-change with social patterns belonging to the modern era" that certain structurally pre-modern relations which "are not only found in the informal economy but also in the small business, the craft firm and the peasant farm, and in the small distribution unit insofar as they operate wholly within the framework of the formal economy" appear today "to co-exist compatibly with much higher levels of productivity and consumption than the long-distance age in which these pre-modern relations first came into being."

Once again we must notice the existence of anomalies, (de-centralized industrialization, the re-emergence of "municipalism," the dual labor market), but at the same time realize that in theory and in practice these anomalies have a rationale of their own, consistent with the long and tortuous history of this society.

Since my professional life has been devoted to industrial economics, I cannot refrain from viewing contemporary Italian society, and the features of that society, from my own specific professional viewpoint, even though I shall be extremely brief.

We have seen a number of features and anomalies, but we have also said that they are profoundly consistent with the social system.

From my point of view, Italy's most worrying feature is the low level of operational capacity of the state, and of the government in particular. It may be true to say that it is precisely because the state is so weak that Italian society is so alive and so innovative. But I am personally convinced that, if it is not in a position to propose large-scale projects systematically designed to upgrade production and transform the economy, and then to govern these projects, Italian society does not have a very promising future ahead of it; neither will it write much history.

Spontaneous vitality may lead to a great capacity to adapt, as indeed it has done in the past. Italy is an excellent example of what Gallino calls "social do-it-yourself." But without large-scale projects, without collective goals, without an enhancement of the system, Italy will increasingly remain an object of curiosity to historians and social scientists, and increasingly less a protagonist in its economic and political affairs (and will therefore lose its hold on its own future).

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tremely dangerous, for Italy as well as for the EEC.

I am in full agreement, on the other hand, on the guidelines indicated for Italy in the recent position paper produced by the Institute for International Economics: "Italy would benefit from a recovery of the world economy, which should enable it to limit the effect on output of contractionary actions that may prove inevitable. Reflationary action is at present inadvisable in view of the persistence of very high inflation, of the current account deficit, and of the severe financial problem posed by a large public deficit. Resumption of faster growth will not be possible until action has been taken to remove the inertial factors of domestic inflation, to bring the expansion of public expenditure under control, and to improve the supply conditions of some sectors." (Promoting World Recovery, Institute for International Economics, Washington, D.C., 1982.)

I hope that this brief analysis has highlighted some of the limited but not insignificant progress being made in the actions to remove the inertial factors of domestic inflation. They have to be continued and intensified. A favorable international environment would be of substantial help.
The draft reports of the two trilateral task forces discussed at the Rome meeting are presently undergoing final revisions and are scheduled to be published this summer. As is always the case, these reports engage only the responsibility of their authors and in no way purport to represent the views of the Commission as such.

FACILITATING DEVELOPMENT IN A CHANGING THIRD WORLD:
Finance, Trade, Aid
The authors of this report are Takeshi Watanabe, Japanese Chairman of the Trilateral Commission and former President of the Asian Development Bank; Jacques Lesourne, Professor of Economics and Industrial Statistics at the Conservatoire National des Arts et Métiers in Paris; and Robert McNamara, former President of the World Bank. The report's central thrust:

After almost three decades of impressive overall economic growth in the Third World, developing country economies are generally stagnant. The terms of trade for most of their commodity exports have declined substantially in the past few years; the expansion of commercial bank credit has slowed dramatically and official development aid declined in 1981, principally because of reduced U.S. disbursements. And while the consequences of economic stagnation are deeply distressing in the developing world, we in the developed world are also threatened: Nearly one-fourth (and the fastest-growing portion) of our exports are destined for the developing world, and more than half of our raw material imports come from these regions.

Restoring satisfactory development in the Third World requires two sets of actions. On the one hand, of course, the developing countries must accept primary responsibility for their own development. Even in the face of world recession, there is much they can do to advance economically. On the other hand, satisfactory development will also require complementary and appropriate actions by the trilateral countries.

In the realm of North-South trade, the main recommendation is that the trilateral countries should hold the line against further protectionist advances and move, over time, to a more open system. In formulating their trade policies, trilateral governments should take developing countries into account as much as they do their OECD partners.

As for non-concessional financing of middle-income developing countries, it is incumbent upon commercial banks to continue financing countries with major liquidity difficulties. It is not necessary that net credit outstanding increase at the rate of recent years, but it probably is necessary that it continue to increase at a modest rate. The International Monetary Fund must be put in a strengthened position to extend emergency assistance.

To increase the Official Development Assistance (ODA) levels, those nations in the Development Assistance Committee (DAC) of the OECD which are below the combined DAC level of 0.35 percent of GNP in 1981 should, even within the limits of their austere budgets, move as rapidly as possible to increase their share to at least this level. Every effort must be made to concentrate available ODA on low-income countries. The low-income countries of sub-Saharan Africa should receive priority attention. The implications of the "bankruptcy" of the International Development Association (IDA), the largest single source of ODA for low-income countries, deserves the attention of every Foreign Minister and Finance Minister in the trilateral regions.

TRILATERAL SECURITY:
Defense & Arms Control Policies in the 1980s
The authors of this report are Gerard C. Smith, chief U.S. negotiator for the SALT II talks and former Ambassador-at-Large for Non-Proliferation Matters; Paolo Vittorelli, President of the Italian Institute for Defense Research and former member of the Italian Chamber of Deputies; and Kiichi Saeki, Chairman of the Nomura Research Institute. Some of the report's main themes:

The security of the trilateral regions is indivisible: There is a trilateral community of security interests, and a trilateral approach to meet the dangers of the 1980s offers the best chance of success.

The heart of trilateral security will continue indefinitely to rest on strong, survivable nuclear deterrent forces. This fact must not be underestimated or depreciated. But in an age of nuclear parity,
with the credibility of the threat of first use of these weapons quite diminished, there is a need to improve conventional forces in order to reduce allied dependence on the use of nuclear weapons to meet a large scale Soviet non-nuclear aggression. With sufficient public support, trilateral governments can assemble the human and material resources needed to improve conventional forces. The goal should be to acquire non-nuclear forces of sufficient strength, as SACEUR has suggested, to shift onto the Soviets the onus for any decision to use nuclear weapons.

In spite of all the activity of recent months, the control of arms is still being given second place to their buildup. The only path to improved security requires a more balanced combination of defense and arms control. Pursuing either in isolation will not yield lasting security; pursuing both in an uncoordinated manner will also not succeed.

In the strategic arms negotiations, the United States should propose a U.S.-Soviet agreement which would place a ceiling on, and thereafter progressively reduce, the total number of nuclear warheads on each side (on delivery systems with unfueled ranges greater than 1,000 nautical miles). If it is judged necessary for the United States to develop a more survivable ICBM, a lighter single-warhead missile should be developed to provide for this requirement. On balance, the case for deploying the MX is not persuasive.

On the much agitated question of intermediate-range nuclear forces in Europe, assuming the European nations continue to favor them, deployment should proceed in parallel with continuing efforts to limit this class of weapons — perhaps by an interim agreement to be folded into Soviet-American strategic arms negotiations.
Prodi, Ortona—and hourglass
The Trilateral Commission was formed in 1973 by private citizens of Western Europe, Japan, and North America to foster closer cooperation among these three regions on common problems. It seeks to improve public understanding of such problems, to support proposals for handling them jointly, and to nurture habits and practices of working together among these regions.

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Triologue is a quarterly publication of The Trilateral Commission. 345 East 46th Street, New York, New York, 10017.

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