

Dialogue

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THE LONDON SUMMIT REVISITED

Henry Owen: Remarks on Post-Summit Progress

Q. How would you summarize the goals and results of the London Summit? What did the U.S. Administration try to achieve, and what was the outcome?

A. I think the goals of the American Administration at the London Summit were the same as the purposes of most of the other governments present. I did not detect any marked difference in the purposes with which most of the seven national governments approached the Summit. They were anxious to try to concert their policies in areas where this made sense: *first*, domestic economic policy; *second*, the international balance of payments situation, international indebtedness, and related issues; *third*, the Tokyo Round trade negotiations; *fourth*, energy, both conventional and nuclear; and *fifth*, North-South relations. The participating governments felt that in these five areas it was useful to try to reach agreement on common policies or, at least, to concert their national policies.

As to results of the Summit: Under the first heading, domestic economic policy, the governments pledged themselves to achieve specified growth and stabilization targets; under the second heading, world balance of payments, they pledged themselves to support Mr. Witteveen's proposal for a new \$10 billion facility; third, under trade, they pledged themselves to achieve substantive progress in trade negotiations by the end of the year in certain specified areas; fourth, in conventional energy, they agreed to increase production, reduce consumption, and share the results of their R&D programs regarding non-nuclear fuels; they also agreed to launch the International Nuclear Fuel Cycle Evaluation Program, a search for means of meeting peaceful needs for nuclear energy without proliferation; finally, in North-South relations, they agreed on the need to provide larger resources for the World Bank, to increase their aid, and to adopt a forthcoming posture on commodity stabilization agreements.

Q. Which would you say are the most important of those commitments?

A. The two most important, in my view, are the commitments on domestic macroeconomic policies and the commitments on trade.

Q. One has noticed increasing disparities — in terms of trade, economic growth, and even political evolution — particularly in Europe and between the U.S. and some European nations. Aren't the London commitments threatened by these increasingly diverging developments among the countries concerned? (Continued on p. 2)



Henry Owen, a member of the Trilateral Commission Executive Committee, was Coordinator of U.S. preparations for the London Summit. Although he remains Director of foreign policy studies at the Brookings Institution, he oversees post-Summit follow-up for the U.S. Government. These are excerpts from a fall conversation with Mr. Owen.

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A. First, as far as *trade* is concerned, we are very much on schedule: A timetable has been agreed upon between the European Commission and the U.S. Special Trade Representative, Robert Strauss. I think at this point it is too early to say whether it is going to be fulfilled or not. But if it is, it will result in substantial progress by January 15. Certainly, at this point the three main actors, the European Commission, Japan, and the U.S., are strongly in favor of pushing ahead. Let me note that in the European sphere, it is not the national governments with which we negotiate, but the European Commission.

Second, on *domestic economic policies*, the three countries which have pledged themselves to *stabilize*, namely Italy, France and the U.K., have all fulfilled their commitments to carry out effective stabilization programs. On the *growth* side, the U.S. largely fulfilled its growth commitment of 5 percent; and the Japanese have just introduced a major expansionist program which may well result in the fulfillment of their 6.7 percent growth commitment, although it still leaves Japan with a large external surplus which does not seem to be coming down and which is very troublesome. Finally, Germany has recently adopted a major expansionist program; it is too early to estimate the effects of this program with any precision. In 1977, the German growth record will fall below the German commitment at the London Summit, it is too early to make a prediction for 1978.

Third, as far as *political developments* within these countries are concerned, the only early political development that could call into question one of these governments' commitment to Summit goals would be a major political shift in France in the March election. Failing that, it seems to me that the kind of commitments which we have discussed reflect a sufficient consensus within each of these countries so that major change in these commitments is unlikely — although, obviously, there will be inevitable delays and setbacks along the line.

Q. *It has been said that there exist wide differences in the interpretation of the London trade timetable among some European countries and the U.S. Europeans are often described as basically wanting to maintain a status quo, whereas the Americans clearly insist on moving ahead and view the so-called "organized free trade" theory propounded by the French as clashing with their classical, free market approach. How do you evaluate these differences?*

A. I think there are two issues here. One is on the question of timing: I am not aware that the European Commission had changed its mind since July when it reached an agreement with Ambassador Strauss about timing. There have been further meetings and there is always a risk that trade negotiations timetables will not be fulfilled — but I am not aware of any deliberate, purposeful effort by the European Commission to change the timetable or to avoid living up to it.

The second question is that of the French view (which is, of course, distinct from the European Commission's) concerning "organized free trade." The model which seems to attract France is the international Multi-Fiber Agreement, which provides for an orderly growth in fiber exports to the industrial countries but puts a ceiling on that growth, so that it does not produce overly rapid and abrupt change within the importing countries. Whether this view is a challenge to the philosophy of free trade depends, in part, on how it is applied: How many cases does one consider? What are the growth rates? What kind of agreement does one seek? Until we get a clearer picture of the French view on these issues, I would be reluctant to reach a conclusion about the policy implications of the French position. In any event, as I said, our negotiations are with the European Commission, not individual governments.

Q. *In the area of nuclear proliferation, how are the London decisions being followed up? Don't you see widening differences between the trilateral countries?*

A. No, I don't think so. The international studies known as the International Fuel Cycle Evaluation Program will obviously take quite a while, and at this point I do not have a clear position as to how these studies, which were discussed and agreed upon at the Summit, are going to come out, or how different countries are going to perform within these studies. I think it would be premature to try to reach any conclusions on that. But the studies are off to a good start. So I am hopeful that when we get down to the long-term issues in the International Fuel Cycle Evaluation Program, we will be able to devise some effective means of giving force to the international approach which several of the Summit heads of government have referred to.

Q. *What about Mr. Callaghan's statement last September that the London Summit was a failure?*

A. In effect, Mr. Callaghan said that Germany and the United States had failed in their role of "locomotives" — I think this was the charge that he made. As far as America is concerned, he was clearly wrong and I suspect this was a slip of the tongue: The U.S. is largely fulfilling its growth commitment. In the case of Germany Mr. Callaghan is clearly right: Germany will not have achieved in 1977 the growth rate which Chancellor Schmidt had pledged in London. But since Mr. Callaghan spoke, the Germans have introduced a major expansionist program which, even if it comes too late to have much result in '77, could have some effect in '78.

Q. *How do you see the Japanese performing in this combined locomotive?*

A. There is no doubt that the Japanese are a wonderful locomotive — the question is: Are they on the right track? With their new expansionist program they will

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The Federal Republic: A Report Card Six Months After London

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Where are we now, six months after the Summit conference of heads of state and government in London? What progress has been achieved by the big Western industrial countries in attaining their economic and social goals since then? How are we to measure this progress?

It is difficult to give an answer to these questions. A mere presentation of figures, statistics and prognoses can confuse more than it can clarify. The point of departure is already vague: the statement of May 8, 1977.

First of all there is the catalog of aims, which can hardly be ascertained on a national level. A national responsibility for the success is excluded. Improvements in these areas can only be achieved jointly.

The Aims of the Summit

These aims include a guarantee of an open system of world trade and avoidance of every type of protectionism; concrete steps in the plan for lowering tariffs, in the reduction of non-tariff trade barriers and in certain agricultural questions; the successful conclusion to the Conference for International Economic Cooperation; and finally, the constructive pursuit of the general North-South dialogue.

As far as the activities of the Federal Republic of Germany are concerned in this field, it has, on the whole, acted like its partner states. The Federal Republic — just as before the London Summit — strongly supports an *open world trade* and opposes every kind of protectionism. This behavior is only too natural for a country such as the Federal Republic whose existence depends on a free and properly functioning world trade. This is also true for the agreements on preferential tariffs, especially with the developing countries, to which the Federal Republic of Germany makes its contribution within the framework of the EC talks. Here too, however, changes which would accelerate or intensify developments have not resulted from the London Summit.

As no other concrete steps by the federal government towards completing these international tasks have become known, this question can be summarized by saying that the London Summit conference has produced no change in the prevailing policy of the federal government. Probably nothing else was to be expected.

We can now turn our attention to the second part of the London catalog of aims. These aims cannot be fulfilled solely as national responsibilities either, but progress can be measured on a national level. The catalog of these aims contains the creation of more jobs, particularly for youth, a further cut in inflation, a strengthening of eco-

nomie growth and stabilization policy, a reduction of discrepancies in balances of payment, measures for saving energy and increasing the production of energy, and finally, a decrease in the dependence on oil imports.

As the London statement itself does not contain any rules according to which developments in the above-mentioned spheres could be measured, possible criteria for judging the present situation are the status quo at that time and the prognoses then available. The fact that both aspects are important becomes clear in the passage of the London statement which differentiates between two different groups of countries: countries which are aiming for the expansion of growth; and countries which just want to follow a policy of stabilization.

The London statement did not say which country belongs to which group, although this point would certainly have been worth a definite clarification. However, it is possible to say that the Federal Republic of Germany, if only halfheartedly, lets itself be counted as one of the first group, a fact which is of decisive importance for the answers to the remaining questions. When the federal government decided to participate in the London Summit conference, it had harbored expectations which already had lost their actual basis at the time of the conference. Together with all the other conference members, the federal government had affirmed a general improvement in the world economic situation since 1975, a statement which seemed to be confirmed by German development in 1976.

After the gross national product had been increased in real terms by 5.5 percent in 1976, the annual economic report for 1977 was based on the following developments:

- a growth of the economy in real terms of 5 percent per year;
- a decrease in the number of jobless from 4.6 percent to 4 percent; and
- a limitation of the increase in consumer prices to under 4 percent.

Consequently, it could be recognized during the second quarter of 1977, that is, at the time of the London Summit, that these optimistic and ambitious goals — with the exception of currency stabilization — were already no longer attainable. The actual rate of growth of the gross national product had dropped down from 6.1 percent in the first to 5.3 percent in the second six months of 1976 and to a meager 3 percent in the first six months of 1977. The number of employed had decreased by 0.2 percent compared to the preceding year, to only 24,870,000.

Compared to the development the year before, economic growth nearly everywhere had slowed down in the first six months of 1977.

The German Performance

Already at the beginning of 1977, economic development in the Federal Republic of Germany had thus taken a course which had been predicted by the "pessimists." Whereas three of the five German economic institutes considered a relatively large increase in the total economic production of 1977 probable, the other two institutes regarded the economic situation following the revival in late 1976 as unstable. The minority referred to the fact that once again the economic recovery was halting — already at the beginning of the new year — that an effective recovery of investors' activities was not in sight, and that for future investments, too, impetus was lacking due to widely spread insecurity over future market and profit opportunities.

Most probably due to internal and party policy reasons, however, the federal government, in office only a short time after its successful reelection, was only too ready to follow the "optimists." They expected a heightened demand from abroad, an increase in private consumption and a stronger tendency to invest by business. Above all, they placed their hopes in the positive effects of a 16 billion DM program for future investments, even if only 3 billion DM from this program could be put into effect during 1977.

The federal government, however, did not stop at merely accepting the optimistic prognoses as its own but went on to strengthen them. With a growth target of 5 percent in particular the government stood completely alone. It obviously expected its wishful thinking to change reality according to the motto: If we really want something we shall get it.

The difficulty of such a policy — probably quite a sensible one for internal encouragement — was and is that some of the other countries took it at its face value and measured developments in the Federal Republic of Germany accordingly. With this background the result had to be disappointing:

- Instead of 5 percent *growth* in real terms, the Federal Republic of Germany will show a 3 percent rate of growth at the most. The actual increase in private consumption was only 2.5 percent in the first half of 1977. State expenditure stagnated. Although an increase of 6 percent was reached in the field of investment placing, public investments actually shrank by 1 percent.

- Nor was there any noticeable improvement in the *labor market*. The average number of unemployed during the first nine months of 1977 was 4.6 percent compared to 4.8 percent in 1976. In absolute figures this means that the number of unemployed on a yearly average sank by only 45,000, from a previous 1,089,000 to 1,044,000. Here, however, the fact must be pointed out that the

number of unemployed in September was only 4 percent or about 911,000. All the same, the desired target of a yearly average of "under 4 percent" can no longer be reached.

- The FRG proved to be relatively successful only in its fight against *inflation*. In all probability it will be possible to achieve the goal of limiting the increase of consumer prices to under 4 percent. Considering the immense importance which was rightly accorded to the fight against inflation at the London Summit, the result reached in the Federal Republic of Germany should certainly not be underestimated. For inflation is as much as ever the fundamental evil of Western industrial nations.

- To what extent, if at all, the Federal Republic of Germany can fulfill the *energy* policy goals it proposed in London cannot yet be said. We only know for a fact that at the time its goals were not unrealistic, and that a number of measures have been taken to reach these goals. In the meantime, however, the feasibility of these measures has become questionable. Against the erection of atomic energy plants in particular, considerable internal political opposition has formed with which large groups within the government parties, the SPD and the FDP, strongly agree. The federal government is therefore in the unfortunate situation of having an energy program with which the goals set in London could admittedly be reached, but which will most probably fail in its original form due to resistance on the part of the government parties. How much of its concept the government will be able to salvage will be seen during the next few months.

The situation can be summarized as follows: Five months after the London Summit, the federal government reached its goal only in the fight against inflation. There is even some hope that this success is not completely transient. On the other hand, the most disappointing fact is the failure to reach the growth target. The 3 percent growth rate actually obtained is not sufficient to stabilize employment lastingly and to noticeably reduce unemployment. This development, above all, is particularly worrisome to the Federal Republic because for some years to come there will be a bulge of young people commencing their working life. With such a small rate of growth it will be very difficult for them to find places as trainees, and later, jobs. The goal to which the highest priority was given in London is therefore especially jeopardized. Developments in the energy sector during the next few months will have to be awaited before reasonably reliable assertions can be made.

What the FRG Has Done

On the whole, this result is disappointing. It is therefore of interest to have a look at the political steps taken by the federal government to fulfill the promises made in London.

The catalog of measures is considerable. Only a few weeks after the London Summit, the federal government resolved on May 25, 1977:

- a 600 million DM program to assimilate problem groups among the unemployed;
- the appointment of an additional 1,600 employment advisors and agents;
- the extension of the regional program for public housing for one year (until the end of 1978). The funds available for this purpose are to be increased by 730 million DM, to nearly two billion DM;
- apart from this, the federal government considered shortening the time during which unemployment pay can be claimed from twelve to eleven months, whenever a reasonable job is refused or the unemployment is the fault of the unemployed person.

When neither the 16 million DM program to increase future investments nor this program had had a sufficient effect, the federal government decided on further "resolutions for the promotion of growth and employment" on September 14, 1977. The introduction to these resolutions explicitly says, "(t)he federal government thus strengthens its shared responsibility for the world economic development which it confirmed anew at the meeting of heads of state and government in London in 1977."

The resolutions of September 14, 1977 include ten points. Of particular interest are:

- The increase of federal expenditure (i.e., without the Länder and the communities) by a nominal 10 percent in 1978 and with a predicted nominal increase of the gross national product of barely 8 percent. State investments should have a nominal increase of 16.5 percent. The financial deficit is to be raised to 28 billion DM compared to 21 billion DM in 1977.
- The strengthening of the purchasing power of the population by tax relief. However, the only part of this plan which is in no way controversial is the increase of the Christmas allowance from the previous sum of 100DM to 400DM per employee. Other plans for reducing taxes are disputed between the government and opposition, the latter basing its claim to share in decision-making on this question on its role in the Upper House (Bundesrat) where it has the majority. According to the plans of the federal government, the effect of the various measures of tax relief would amount to 5.7 billion DM a year.
- The promotion of private investments with a higher rate of depreciations — namely, by an increase in degressive depreciation for mobile productive goods and the re-admission of degressive depreciation for industrial buildings and privately financed housing. The direct effect on the federal budget would already amount to 1.5 billion DM in the first year.
- Further points are: increased allowances for investments which are made in the fields of research and development, subsidies for energy-saving investments in buildings, and a program of increased aid for establishing new and independent businesses.

If this program and the measures already resolved upon

should come into full effect, then the additional budget expenditure plus the reduction in revenues would total 16 billion DM. All the same, the government is relatively isolated in its expectation that the total sum of all its initiatives could lead to a lasting expansion in growth and consequently to an improvement in the employment situation in 1978. The number of skeptical comments is increasing, and they are not restricted to the political opposition.

For instance, apprehension exists as to whether the planned measures could once again endanger the previous successes in consolidating the federal budget. Another disadvantage feared is that certain decisions could accelerate inflation in the number of public employees, which has recently been halted with substantial difficulty. Neither do the critics of the government program expect any significant progress from tax relief for private households. They refer to the fact that in 1977, private households have already spent more money than average, due to the release of savings which was legally encouraged. This additional amount will not even be compensated by the tax relief provided for in 1978. With regard to the increase in degressive depreciation for certain productive goods, it is criticized that this measure, too, will only be successful if the market conditions and, more importantly, the predictability of the economic conditions which are dependent on political decisions, improve. Many communities claim that they are not in a position to start on any large investment projects, whether with or without federal support, as they are already hopelessly in debt. And finally, some of the Länder are of the opinion that quite a considerable part of whatever the federal government resolves is no more than occupational therapy, from which no genuine economic growth can be expected.

This argument can only be decided by the successes or failures of the future. And the government — and not only the government — is in bitter need of the successes. For suspicion is deepening that these crises, these symptoms of paralysis in all spheres of the economy and society, have neither cyclical nor primarily structural causes. The question is whether economic recession, unemployment, inflation and so on are actually only symptoms of a social crisis, or more accurately, a crisis of the Western industrial nations.

There are doubtlessly enough criteria to show that our Western societies, some more than others, have gone through a fundamental change during the last decades. Personal freedom, self-realization, independence and individual responsibility have been increasingly displaced, in Western Europe in particular, by political objectives such as social well-being, state provision, and a safe and as-equal-as-possible share for the individual in the general prosperity. This, however, means that static principles have taken the place of dynamic principles. The resulting consequences would be exactly those which we can observe today. A speculation? We shall soon know the answer.

Translating Commitments into Practice: An Interview with Bunroku Yoshino

Q. It has been said that the London, May 1977, Summit Meeting was the most substantive of the three summits which have taken place so far, both in terms of the discussions that took place among the heads of government, and in terms of collateral meetings among high-level officials. You were in London in a central position in the Japanese delegation; could you give us your sense of the meeting in this respect?

A. I fully agree that the Downing Street Summit Meeting was a most substantive and frank exchange of views among the leaders present. One reason might be attributed to the participants in this Summit Meeting: Most of the leaders present had known each other already for a long time; in the case of Premier Fukuda, although he was a "new" member, he was known already by the other participants as a former Minister of Finance, a former Minister for Economic Planning, and Minister for Foreign Affairs. This has made the exchange of views all the more frank and easy. Another factor was, of course, the deepening sense of crisis in the world economy; accordingly, the participants had to address this situation "head-on" — hence the added seriousness of the meeting. A third factor was that we have already had two similar summit meetings in the past, and this accumulated experience taught us what to do and what should be done in the next discussions. In short, we built upon this past experience. I believe these elements have contributed greatly to make the meeting more serious, more productive and worthwhile.



**BUNROKU
YOSHINO**

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Q. What specific points did the Japanese government particularly want to make to the other governments and how did the others respond to them?

This interview was conducted by Charles Heck, North American Secretary of the Trilateral Commission, on September 5, 1977 in Tokyo.

A. Naturally, our basic concern — which is a common concern — was the troubled state of the world economy and the specter of a rising tide of protectionism which now raises its ugly head everywhere, especially in Europe. We were particularly aware of the dangers of this trend. Among other concerns was, of course, the rising foreign exchange surplus of Japan due to our surging exports, and also, collaterally, the increasing gap in terms of balances of payments between Europe and Japan, and between America and Japan. We are aware that we should do something about this — and the best way to do so is in the way of expanding trade both ways, while expanding our own economy internally. This is why our Prime Minister was very vocal about the necessity of expanding the Japanese economy and we clearly stated what our objective was in this area — the famous 6.7% growth-rate target.

Q. It has been argued on the American side that there were three key commitments made in London: One was the growth rates commitments made by Japan, West Germany and the United States — and the Japanese commitment was higher than the others. Second was the commitment to push forward in the current multilateral trade negotiations in Geneva; and third was the commitment to organize the International Nuclear Fuel Cycle Evaluation Program which is now getting under way. Is this a fair description of the most important London decisions from the Japanese perspective as well?

A. Yes, very much so.

Q. The Japanese commitment is to achieve 6.7% real growth in the Japanese fiscal year beginning April 1, 1977 and ending March 31, 1978. Hasn't the Japanese economy been somewhat more sluggish than hoped for so far in this period?

A. That is true. At the beginning of this fiscal year, we had a better prospect of attaining this target; but we seem to be now behind schedule, and the growth rate has been falling a little bit below our target, particularly in recent months. Accordingly, we are now trying to raise our average growth rate.

Q. Would you say that the Japanese government is strongly committed to reaching this rate?

A. Very much so. This was repeatedly emphasized by Prime Minister Fukuda at the time of the Downing Street Summit, and since then this was further confirmed during the recent visit of Mr. Fukuda to Southeast Asian countries, and on several other subsequent occasions.

Q. *What was the commitment in London with regard to the multilateral trade negotiations?*

A. First, we firmly committed ourselves, along with other participants, to attain the objectives of the multilateral trade negotiations as early as possible and, if not within this year, at least early next year. One of the elements of the timetable agreed upon in London is that we would agree within this year on the tariff-cutting formula, as well as on a formula to reduce non-tariff barriers. If we are able to fulfill the timetable and thereby agree upon a minimum of principles, the negotiations should be able to proceed smoothly and automatically from this. This, indeed, is our objective.

Q. *What is the major substantive problem area in these negotiations for the Japanese government?*

A. Japan, along with the European countries, is in a recession. As far as business and industries are concerned, in Japan and elsewhere they are very reluctant about such overall tariff-cutting negotiations. This is our main problem in the trade negotiations. However, our thinking is that precisely because we are in a recession, there is greater reason for us to promote such negotiations enacting greater freedom of exchange of commodities all over the world. And to do so, cutting tariffs or reducing the non-tariff barriers would give great impetus to such a greater exchange of commodities. We do appreciate very much the fact that the United States has finally taken the initiative of promoting this negotiation, and that Ambassador Strauss, the U.S. Special Trade Representative, has agreed with the Europeans on a concrete schedule for these negotiations. When Ambassador Strauss comes to Tokyo in the next few weeks, we will confirm a similar schedule. And if we are able to agree on this schedule, then we can move ahead and persuade other countries to join us. In so doing, we will gradually accelerate the pace of these negotiations.

Q. *How important is it that these negotiations succeed? What might be the consequences if they collapse?*

A. I think success is vital to the maintenance of free trade in the world at large.

I view tariff-cutting negotiation as a sort of symbol of our belief that liberal trade should continue and should be our main concern for the future years. Under the present floating system of currencies it is agreed that cutting the rate of tariffs may not be as important as it used to be. In fact, as far as Japan is concerned, the value of the yen has risen 10 percent since the beginning of this year — and this would also apply more or less to the German mark. Without our consciously trying to do so, the tariffs have therefore been undermined accordingly by floating rates. However, the mere fact that we did get together to review the whole tariff and trade system, and to try to do whatever is in our capacity to reduce trade

barriers, is important; and if we fail, it would be a bad omen for the future of world trade. We attach, therefore, great importance to these trade negotiations.

Q. *What is in your view the importance of the so-called International Nuclear Fuel Cycle Evaluation Program, established in London?*

A. This is a long story. On the one hand, we know that oil and other so-called fossil energy sources are being depleted; the sooner we are able to develop non-conventional energy resources, particularly nuclear energy, the better for mankind. On the other hand, we know the real danger of spreading the use of plutonium. On the one hand, therefore, greater and fuller uses of nuclear materials for energy purposes are very important — but on the other, we are running the risk of spreading the danger of nuclear war. Accordingly, we agreed at the Summit to promote the peaceful use of nuclear energy; above all, however, we decided to get together to formulate strong international regulations to avoid the spread of nuclear weapons. The fact is that Japan was somewhat hesitant regarding the details of these procedures. So were Germany, France and, to a certain extent, Britain. On the one hand, we agreed on the policy enunciated by President Carter, but on the other, an immediate and total negation of the so-called reprocessing of spent fuel was not acceptable. An agreement was subsequently reached for the temporary operation of the Tokai plant for two years, and on further cooperation between the United States and Japan regarding the operation of that plant after two years. Since this important step in Japan's nuclear development is now out of the way, I think that prospects are now good for a fuller cooperation with the United States.

Q. *As I understand it, the fuel cycle evaluation program itself is to take about two years, so it will be coming to fruition about the same time as the temporary agreement on Tokai-Mura comes to a conclusion. I suppose that is not coincidental.*

A. No, it is not. But the most important implication of this whole process for our country and for the United States is the following: We now know fully that we have to utilize nuclear energy, although we are ourselves rather allergic to the use of nuclear energy. We know that even our experimental nuclear transport ship has not been able to find its home port unless its nuclear fuel is removed. This shows, you know, at least psychologically, the resistance of some part of the Japanese people. But on the other hand, it is very, very important for Japan to undertake as soon as possible a nuclear energy policy. President Carter's policy was announced at a very critical moment, when Japan was at a crossroads in terms of its energy policies; that is why we were rather worried, at the beginning, by this policy. Now, however, it seems that this is behind us — at least, I hope so. ■

Italy's Prospects After the London Summit

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"An international economic summit could be useful," *The Economist* was saying last January, if it addressed the question of "how to get away from the starvation of profits and consequent low investment and creeping deindustrialization in countries like Britain, Italy and even France." More generally, the London Summit discussions last May focused primarily on the issue of unemployment and the risk of political instability which this involves. They also reflected the realization that inflation is not a remedy for, but one of the major causes of, unemployment — and that it is not possible now "to spend one's way out of a recession" by boosting government spending. How has the situation evolved since then for a country like Italy, where the link between public spending, inflation, profits, investment, employment and political uncertainty have been so visible, yet so intractable, over the past few years?

The Italian economy, considered fatally ill in late 1976 when the October cost-of-living index reached an astounding 43 percent increase on an annual basis, is again showing signs of vitality. This was recently reflected, for instance, by a substantial increase in industrial productivity, by the halving of the work hours lost in strikes, by an improving trade balance, and by Italy's ability to repay the International Monetary Fund and the Bundesbank a combined \$1.3 billion in initial installments on its outstanding debt. Yet for some, the gains in productivity have also meant an increase in unemployment; the improvement of the trade balance has also been influenced by a temporary slowing down of industrial production and imports; and the official debt's partial repayment was the indispensable condition for the maintenance of a credible international financial profile.

The Italian bumpy road towards an economic and political unknown continues year after year. Interpretations of the country's economic performance multiply, ranging from outright resignation to incredulosity and even to optimism in the course of a few months. In political terms, perceptions of present trends are just as ambiguous and oscillate between two views. According to one, the stability of the Italian government in the last year worryingly symbolizes the increasing de facto power and stabilizer's role of the Italian Communist Party (PCI) and is the prelude to its formal recognition as a government partner. Others, on the contrary, emphasize Prime Minister Adreotti's skill in using the PCI's support (in parliament as well as in the factories) to stabilize the economy and society without admitting it to the inner circle of power. Thus, the present situation is being inter-



preted alternatively as either the threshold of an inescapable and traumatic change or as one of the final phases of a skillful disengagement.

Yet the key to understanding the Italian complexity lies less in the short-term maneuvering of political parties and currents in relation to each other or in the use of scattered economic statistics, than in the extent to which the structural weaknesses of the country are understood. The key to curing them is a function of the ability of the political system as a whole, as well as of the major economic and social forces, to finally grasp their common responsibility in the country's troubled past and future — and to rise to the difficult, yet unpostponable, task of making the country a manageable entity.

The Good News of The Summer

Let us try to give some perspective, first, to the recent developments in the international position of the Italian economy. The picture is one of positive trends and important future opportunities; but in order for these to be confirmed, a continuous vigilance on the economy is essential. The balance of payments outlook is improving considerably. A payments surplus of about \$430 million during the month of June, and over \$1 billion during July, was recorded. Conservative estimates by the Italian Ministry of Foreign Trade forecast the payments deficit at only \$560 million for 1977, and the trade deficit at only \$3.3 billion for the same year (considerably down from last year's deficit of \$6 billion). These recent advances in both the trade and payments accounts need to be somewhat discounted in light of a record tourist season, a substantial increase in foreign borrowing and thus in available reserves, and a slowdown in imports. Yet one has to recognize the very solid performance of Italian exports, which this year are realistically expected to increase by 8 percent in volume. Although the foreign indebtedness of the Italian banking system is decreasing only slowly, it is the "real" side rather than merely the "financial" one, which constitutes the best indicator of the economic performance of any country.

In the international markets the country's industry is showing remarkable, if discontinuous, signs of vitality beyond the usual, recognized ability to fill the "changing interstices" of world trade (shoes, leather goods, fashion clothing, etc.). The apathetic Italian August was thrilled by the news of the serious possibility that Fiat might outbid Volkswagen, Renault and a big Japanese firm in building a \$2.6 billion car manufacturing complex in Algeria. What is even more remarkable, however, is that not only big firms like Fiat but an increasing number of small- and medium-sized firms are becoming active exporters of machine tools and complete industrial plants. Despite the skepticism of some influential foreign analysts, Italian industry is seriously, if silently, making a credible bid to conquer a respectable share of the world market of "key-in-hand" plants in the light manufacturing and engineering sectors, and of medium technology capital goods. In the first half of 1977, for instance, the Italian exports to OPEC countries (exports mainly of capital goods) have increased in value terms by 66 percent over the first half of 1976. This performance is all the more remarkable if one considers that the unit cost of Italian labor increased by 10 percent in 1976, following a 35 percent increase in 1975. These figures were, of course, largely influenced by the decline in the value of the lira. While the recent evolution of production costs has not been favorable to the country's export industry, the flexibility of its technology and of its application "in loco" by Italian exporting firms has made certain categories of Italian products increasingly competitive vis-à-vis U.S. and German products.

Yet Italy's international financial profile is still a factor in need of very close attention. Italy's foreign debt still amounts to about \$29 billion (including both official and bank debt), of which \$2.9 billion are due to the EEC, \$1 billion to the Bundesbank and over \$2 billion to the IMF. The July repayment of \$825 million to the IMF, and the September repayment of \$500 million to the Bundesbank, although a welcome sign of financial reliability, are still not enough to end concern about the 1978 bunching up of maturities (about \$5 billion) on official, nonbank loans to the Italian government. The next year will be particularly crucial for the country's international financial profile. While in the long run Italy's economic and financial credibility will depend on a rationalization of the domestic economy, in the short run this credibility depends on the country's ability to meet its international financial obligations. This, in turn, requires in the years ahead an even stronger export performance than in 1977 — which, in turn, requires the understanding of Italy's major partners.

Against this background of risks, opportunities and hopes, Andreotti's visit to Washington in late July has been a necessary and effective step in projecting a more solid image of Italy to the international community and on this basis, in inviting concrete pledges of economic assistance and cooperation by the U.S. government and

the international financial community. In particular, it was important for the Italian side to present convincingly two major cases: firstly, the economic and political necessity to let nations like Italy obtain a higher share of international trade (especially trade which originates from OPEC demands for products from industrial countries), in order to facilitate the financing of the oil deficit and the adjustment to high oil prices; secondly, the need for more selective instruments of financial cooperation, and loans tied to specific industrial development projects (in the nuclear energy sector, for instance), rather than the traditional reliance on maxi-loans for currency stabilization purposes. Both policy directions would indeed provide occasions to give some substance to the otherwise vague pledges of the London Summit's communiqué in the fields of international trade, energy and balance of payments financing. But it will be up to Italy's major social, political and economic forces in the next months to show the international financial community that Italy is capable of managing responsibly any additional external help and "understanding" the country may possibly get. Without solid signs of domestic responsibility, Italy's partners are unlikely to be convinced of the necessity of even more costly concessions in favor of the country's economic future.

All this points to the fact that the fundamentally good news of the summer, in terms of both the prompt repayment of official debt and the impressive performance of Italian export industry, are not yet definite evidence of recovery, but simply the indispensable base for initiating a slow process towards it. Given the "exposed" (i.e. externally dependent) nature of the Italian economy, improvements in external transactions must be continued well into the years ahead to avoid significant internal disruptions; but they must also be supported by a steady improvement of the domestic economy. And this is where most of the difficulties lie, since Italians are much more able to adjust their technologies and skills to the need to find new export markets, than to reconcile their multiple, often contradictory internal interests. The management of the domestic economy in Italy is particularly difficult. New policy dilemmas, similar to those in other industrial countries and originating from the coexistence of inflation and recession, are being added to old structural weaknesses which are peculiar to Italy's own way to economic development.

Domestic Dilemmas

The broad traits of the picture are well-known. The intense process of economic growth of the fifties and early sixties has been reversed by the tensions originating from the unbalanced nature of this growth, from the failure to build an infrastructure (both economic and social) which would smooth out hasty transitions to new economic activities, and from the massive migrations of labor away from agriculture. At the same time, as Guido Carli has

argued, at the roots of the present crisis is a major socio-economic inconsistency.* Italy is still less developed than several European countries in terms of indicators such as per capita income, the ratio of active to total population (36 percent), fixed capital per employed person, and aggregate productive capacity. Yet the expectations, in terms of wage and consumption levels, of the great majority of Italians are very high, a sentiment shared in other European countries (as the trade union leadership puts it, "il salario europeo"). This has in turn created pressures towards high costs of production, especially labor costs. But a country such as Italy, which has developed unevenly, cannot afford to apply these higher costs throughout the whole economic structure. The result has been a "dualistic" employment picture. High labor remuneration could, in fact, be possible only for part of the labor force — the part working for those often large firms operating at a high level of productivity and enjoying considerable market power because of their size. The other portion has had to settle for lower levels of earnings, the fruit of either independent work or of jobs in low productivity firms.

This Italian situation has been a result of three major, parallel trends. The behavior of the *trade unions* has, through the years, been a cause of substantial uncertainty. In their official declarations they have often endorsed a strategy aimed less at wage increases than at obtaining structural reforms and a role in national economic policy decisions. These themes, however, have rarely left the level of rhetoric. Rather, the unions have concentrated their efforts on demands for wage increases and reduction of working hours. This has generated privileges for the sector of the labor force which is organized and works in high productivity firms, but not for those employed in the least productive and more precarious multitude of decentralized, very small firms (to which large firms often contract work out), which pay lower wages than those agreed through sectoral collective bargaining, and which avoid paying full social security charges. The steep rise of the *public sector deficit* (to which must be added the deficits of local and regional authorities and nationalized industries) largely depends on the fact that public sector spending has been consistently manipulated (not by the Christian Democrats alone) according to the increasing necessities of multiple systems of political patronage. It has not been the counterpart of a vast program of economic and social infrastructure but has fed a large number of public or semipublic entities which often maintain ill-defined and promiscuous linkages with local and national centers of political power.

Private investment has not been sufficient to modernize the national economy, i.e. to renew plant equipment, increase the technological content and quality of products and/or improve the working conditions in the plants.

*See "Sopravviveremo fino al 1984," interview with Guido Carli, *Mondo Economico* (January 15, 1977).

The extent of this reluctance to invest is illustrated by the fact that in 1975, private industrial investment fell by 22 percent, and in 1976, in spite of better general economic conditions in Italy and the world economy, it fell by a further 2 percent. Indeed, since 1963 industrial investment in the Italian economy has been declining or, at best, been stagnant, due to the Italian investors' lack of confidence both in the general political situation and in prospects for profits.

Roots for Sociopolitical Tensions

The vicious circle produced by these trends is inescapable. The economic system is being pushed towards European wage and consumption levels while production, profits and investments are not at comparable levels. The matching can only be reached through inflation (temporarily), through a deficit in the balance of payments, or through a combination of both. In this situation, social dissatisfaction has increased as some groups benefit from near European income levels while others have to settle for much less. Since wages have been pushed to levels which the economic system as a whole cannot sustain, employment suffers — the youth and the aged being hit the hardest. Hence the situation of youth unemployment is much more intractable in Italy than elsewhere in Europe. Families try to overcome this state of affairs by making sacrifices in order to provide their children with a high level of education, thus aggravating even more the gap between a skilled labor supply and the real availability of socially satisfactory jobs. It is no wonder that this excess supply of labor has become a suitable habitat for the growth of sociopolitical unrest.

In its opening lines, the London Summit communiqué did in fact point to growing youth unemployment as one of the most worrying trends in the present evolution of the Western industrialized economies. The issue is clearly of common political importance to all governments, but it is unlikely that concrete solutions can be found at the international level. What is involved is the delicate mix between industrial and agricultural policy on one side, and education, social and cultural policy on the other — a relationship which in each country has peculiar and unique characteristics and requires very specific policy actions.

The same is probably also true, although to different degrees, for most of the other aspects of economic policy which the London Summit addressed. The post-Summit renewed acceleration of economic and social problems in many countries of Europe, despite the continuing pledges of mutual cooperation, suggests the need for a realistic reconsideration of what international cooperation, especially through traditional instruments of macroeconomic policy, can achieve. As Peter Kenen has pointed out,* in the troubled economic waters of the 1970's governments everywhere do and will find it difficult to subordinate

*Peter Kenen, "An Overall View," in Fabio Basagni, ed., *International Monetary Relations After Jamaica*, Atlantic Paper 4, 1976 (Paris: Atlantic Institute, 1976).

their national goals to their international obligations. The preeminence of domestic constraints in "strong" as well as in "weak" countries demands a more modest, inward-looking criterion to identify the effective scope for and domain of policy. While external factors are very important in aggravating or alleviating a country's position in a particular moment, it is the set of domestic structural policies, undertaken or neglected, which in the medium run determines each country's ability to follow a balanced and flexible course amid changing conditions in the world economy, as well as in its internal society. The path to recovery in Italy as in other countries begins at home in the search for a dynamic equilibrium between different internal socioeconomic and political pressures.

In the Italian case, the crucial factor in this search is to identify promptly certain policy priorities which can make the needed reforms subsequently possible. Some correct priorities have already been identified in the Italian economic policy debate, although the process of bringing them into practice needs to be greatly accelerated. Very high on this list is the problem of somehow disposing of the huge pile of debt of most semipublic and many private companies that hinder new plans for investment, and thereby employment. Under consideration by the Italian authorities is, for instance, a system whereby creditor banks, gathered in consortia, would see their loans transformed into equities to be resold to the open market in better economic times. An improved financial structure of Italian companies would make it possible to stimulate investment, the single most important factor in a self-sustaining economic recovery, and thereby increase employment with obvious benefits for social stability. Most other reforms need to be built on the basis of a rejuvenated industrial structure.

Yet the essential condition for a healthier, productive system largely rests upon the behavior of Italian unions, which are now finally confronted with the fundamental choice of either protecting wage gains and privileges of a shrinking industrial labor force or favoring the enlargement of the country's employment base — not a very easy choice since unions represent the interests of members rather than those of outsiders. The problem is also complicated by the fact that while leftist unions can somehow be influenced by the PCI in light of its own strategy of support for Andreotti's government, an increasing number of small but vocal "autonomous" unions escape any organized political tutelage and pursue simply the short-term monetary interests of their members, thus disrupting any possible austerity plan.

The possibility of having any effective austerity plan towards recovery depends largely on the extent to which these conflicting trends in organized labor can be brought into a continuing, unified plan of moderation. This is, of course, a function of: (a) the degree to which the PCI is capable of controlling and influencing the bulk of Italian unions to accept a broad conception of their interests

(one involving sacrifices in order to stimulate investment and employment); and (b) the evolution of the ambiguous relationship between the two major Italian parties, the Christian Democrats (DC) and PCI.

Which Political Compromise?

In the period since the June 1976 elections the "Bipartitismo imperfetto," which Giorgio Galli saw as the crucial long-standing feature of the Italian political system, has been brought to its most extreme and paradoxical phase. Since each of the two major parties still has considerable "negative" power on the other's actions and is not prepared to consider the other as a credible and legitimate government alternative, an Anglo-Saxon style "alternance" in government between DC and PCI is not likely. Thus, they have had to develop and systematize an informal "entente" in sharing parliamentary and government power. This complicity, however, has not greatly accelerated the process of formulating and implementing effective policies. After the June 1976 elections gave a strong mandate to both large parties (38.7 percent of the vote to the DC and 34.4 percent to the PCI), it has taken twelve months of political maneuvering to reach a broad agreement on a "common program" for government (in July 1977). This contained no major economic policy breakthrough, although it admittedly stabilized the general political atmosphere for a while.

This last result is by itself important. But this kind of "passive" political stabilization obtained at the cost of specificity of programs may mean, in the medium run, stalemate in policy terms, i.e. further decline of the economic and social fabric. This will be unavoidable unless hard choices are made by the major parties and a common direction is given to the presently incoherent pressures within the country.

Yet, should the formal recognition of sharing power within the government ("the historic compromise") be sought prematurely by either party (i.e. before a deep internal maturation of each is completed), the outlook would be dim. Called to specify openly the nature of their policy instruments and objectives by underwriting a coalition government's program, the two big parties would still find, down to their grass roots, a basic incompatibility in their long-run goals. The renewed sense of mutual repulsion they would then feel would radicalize again the Italian political system and perhaps irreversibly fragment internal structure of the DC.

If, on the other hand, the existing "creeping compromise" does not become "historic" (i.e. if it boils down to a skillful expedient used by the Christian Democratic leadership to buy political stability and time from the Communists in return for practically nothing, while waiting for the inevitable mutilation of the PCI's left wing induced by the PCI's simultaneous loss of purity and present inertia), then the outlook is for recurrent elections and eventually a complete rerun of the endless number of

basically impotent minority governments led by the DC, since, like it or not, the PCI is here to stay.

This is the dilemma which defines the Italian crisis primarily as a domestic management puzzle far more than one centered on the future foreign policy alignments of a PCI with a government role. The problem to be resolved, both in terms of Italian and European stability, lies primarily in the fact that both paths just mentioned present high risks of breaking the fragile state of political equilibrium which is providing some relief to the Italian economy and society.

All this of course leaves open Arrigo Levi's question — "What is an Italian Communist?"* But, as he pointed out, the question of the real nature and future behavior of the PCI (even in the event of a more visible government role) could be better answered if we forget the PCI itself for a moment and look at the complex forces, both domestic and international, which condition the PCI's perceptions, and in relation to which it calculates its actions. The single most important factor among these will be the evolution of the DC, which represents the sentiments of the bulk of traditional Italian society. Even

*Arrigo Levi, "Italy's 'New' Communism," *Foreign Policy* 26, (Spring 1977).

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probably reach the growth rate of 6.7 percent which Prime Minister Fukuda pledged at London for 1977. On the other hand, Japan is running a large external surplus. In addition to overall expansion, specific measures will be required to reduce this surplus.

Q. *How do you see, in practice, the follow-ups to the London Summit — in short: Where do we go from now, and what are the next steps?*

A. A meeting of the national delegations which helped to prepare for the Summit was held in Washington on September 30. This was the same International Summit Preparatory Group that met twice before the Summit and once during the Summit. The group prepared a report for heads of government on post-Summit progress, highlighting what more needs to be done. Within each national government, there is supposed to be one person who reviews these further Summit follow-up tasks and reports to his head of government on how they are coming. Obviously, these institutional devices are not going to produce perfection. But I hope that conscious and continuing examination of post-Summit progress will give us better performance in carrying out the decisions of the Downing Street Summit than was the case for the two previous summits. We've talked of macroeconomic policy, trade and nuclear proliferation. On other parts—strengthening the IMF, energy, and North-South relations — progress is also being made.

the PCI is well aware of the risk involved in any move which would endanger the unity of the DC, since this would generate a stronger and uninhibited contingent to the right of the center of the political spectrum, and certainly rock the fragile political boat. Hence the caution of both parties in their mutual relationship. The DC leadership, and Aldo Moro in particular, argues for a cautious, step-by-step approach in considering the relationship to be established with the Communist party. The long time required for this "historical meditation" called for by Moro, who will eventually prove to be the main craftsman of the Italian fate, is made necessary less by the need to check the PCI's slow evolution into a reasonably Western party than to let a process of consolidation (and mild transformation) within the DC run its full course, as a way to assure the cohesion of the party in the event of a coalition government with the PCI (or its endurance in the event of new DC governments excluding the PCI).

The Italian paradox stems from this balancing act. The immediate need of the country for clear and effective policies has somehow to be reconciled with the tacit common need of the two major parties not to be asked to make hard choices before they have both improved their grip on their own bases. ■

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Q. *In view of current economic and business prospects here, do you think the U.S. will continue to fulfill its locomotive role?*

A. Clearly the U.S. is going to achieve that role in '77. If we are talking about '78, I guess there are several variables. For example, what is going to be the rate of federal spending? What is going to happen to private investment? What is going to happen to consumer confidence? My own judgment is that if natural forces do not seem likely to produce a good growth rate in '78, the government will take needed expansionist measures — e.g., some form of tax cut.

Q. *Do you envisage another summit meeting in the near future and, if so, what kind of issues would you place at the forefront, drawing on the lessons from the London Summit Meeting?*

A. The industrial nations have had so far three summits — about one per year. It seems to me likely that these meetings will continue. As to what issues the next summit will focus on, I suspect that they will be very much the same as at the last meeting: domestic economic policies, trade, energy, and North-South relations. These are the heart of the matter. They don't change from year to year. ■

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.