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ISSUES AT THE SUMMIT

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ISSUES AT THE SUMMIT

WEDNESDAY, APRIL 20, 1977

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 9:40 a.m., in room 6202, Dirksen Senate Office Building, Hon. Hubert H. Humphrey (vice chairman of the committee) presiding.

Present: Representatives Bolling, Brown of Ohio, and Brown of Michigan; and Senators Humphrey, Javits, Roth, and McClure.

Also present: John R. Stark, executive director; Louis C. Krauthoff II, assistant director; William R. Buechner, Robert D. Hamrin, Kent H. Hughes, Sarah Jackson, John R. Karlik, L. Douglas Lee, and Steve Watkins, professional staff members; and Charles H. Bradford, George D. Krumbhaar, Jr., M. Catherine Miller, and Mark R. Policinski, minority professional staff members.

OPENING STATEMENT OF SENATOR HUMPHREY, VICE CHAIRMAN

Senator HUMPHREY. I think we will proceed. Some of my colleagues will be with us. I should tell our visitors from other parts of the world that the Congress of the United States has a multitude of activities, and right at this particular time it's one of the busiest seasons that we have. So many of our colleagues are on two and three major committees, and they spend a little time here and a little time there. I have been to one committee meeting already this morning, I have a third one to go to after this. We have, regrettably, in the legislative body not the time for indepth understanding of some of the problems that we deal with. It's due to the nature of our system. But we do expect to have several of our colleagues shortly. What we are trying to do here is prepare a record and that we think we will be helpful.

In just 2 weeks, President Carter will leave for London and he will attend his first international economic summit meeting.

In anticipation of that meeting, the Joint Economic Committee, which is the economic advisory body to the Congress, is holding 3 days of discussions and hearings to explore issues likely to confront the participants in the London summit.

Today, we open the hearings by focusing on three major issues: One, the supply and cost of energy; two, the state of the world trading system; and three, the need for the coordinated stimulation of the major industrial economies.

If I had to choose one word that would be central to the coming summit it would be the one that the President will talk about tonight, and has been talking about this week—energy. The cost of it, the need for it, and the uncertainty about it are part of every economic problem confronting us. The payments imbalance, the debt problems of many developing countries, worldwide inflation and the sluggish recovery of the major industrial economies all reflect the widespread impact of high-priced energy. I suspect that uncertainty about future energy policy has helped retard business investment and slowed the pace of economic recovery in the United States and elsewhere.

On Monday, President Carter spoke to the Nation urging energy conservation, a greater reliance on coal and higher prices for scarce energy resources. But there is as yet no agreement among the major industrial countries on the future course of energy policy. The questions are many. I might add that yesterday we had Mr. Roy Jenkins, President of the European Economic Community here with us and we asked Mr. Jenkins if the European Community was trying to coordinate their energy policy. I gather there are some beginning steps being taken, but as yet the European Community, much like ourselves, has been without any basic overall plan.

There is as yet no agreement, in other words, among the major industrial countries on the future course of energy policy. The questions are many. Can any of us learn to live with the suddenly lowered growth rates, if that should happen? Might Germany return to coal, or can it rely on oil shipments from the North Sea?

Can the developing world maintain plans for future industrial development? Those are just a few of the questions that are so obvious.

International trade has played an important role in the rapid growth of the GNP throughout the industrial world, but the depth of the recent recession and the modest nature of the recovery have put considerable strains on the international trading system. Little progress has been made in the multilateral trade talks, although the parties at the Rambouillet summit meeting in November of 1975 had hoped to conclude the negotiations by the end of 1977. In the United States, the International Trade Commission has proposed higher duties on imported shoes and color televisions. More recently, the Customs Court in New York found that the rebate of sales or other indirect taxes for exports amounted to an export subsidy. If the ruling is upheld and extended to other goods, a vast array of imports would be subjected to offsetting or countervailing duties.

Part of the current trade controversy reflects the high rates of unemployment in most industrial countries. It is hard to promise an American worker retraining when more than 7 million other Americans are unemployed. Another difficulty is that the rapid increase of imports of a particular product can make adjustment difficult. For instance in the case of shoes, older workers in our factory towns are often faced with losing jobs, and seniority, and pensions, and even community ties.

At the same time, the developing world has continued to press for greater access to the already troubled markets of the industrial west. And I for one am all for them. Few things are more important than the eradication of world poverty. But when it comes to robbing the job of an American Peter in order to employ a developing country Paul, there is bound to be resistance in the United States.

At the London summit, the industrial world must work hard to preserve the obvious economic benefits of an open world trading system despite the pressures on their own economies. It will be a difficult task particularly so long as this relatively high unemployment hangs over the industrial countries. I gather I am correct in saying that the European level of unemployment is unusually high for those countries and those economies. In the United States unemployment has ranged between 7 and 8 percent for 2 years. The drag on our economic system has been tremendous.

As the industrial structures of the developed countries have become similar, so have the economic problems. High overall unemployment, few jobs for the young—which is, again, an international problem, not just a national problem—persistent inflation and falling levels of investment. Many of the trade and energy problems would be lightened by renewed world economic growth and that is going to depend on cooperation among the industrial countries. It may be too strong to say that we will all grow together or stagnate separately, but some type of concerted action is necessary. There has been some progress, fortunately, in this regard. Partly in response to their own needs and partly in response to President Carter, Germany and Japan have both announced fiscal stimulus plans. The question remains as to how much more they can do and what impact more rapid growth in the industrial countries will have on their own problems and those of the weaker industrial countries and the developing world.

There is one problem common to all the developed countries that demands immediate attention—because it is of social significance as well as economic significance—jobs for youth. Youth unemployment is a curse that could hobble an entire generation and even undermine the political stability of some of the world's democracies. Last month, 18 Senators joined me in sending a letter to President Carter calling for an OECD-wide conference on youth unemployment. So far, the initiative has met with favorable reception, both at OECD and in the Departments of State and Labor. We are just waiting for approval from the White House.

By the way, I was talking to the President about this and I know it is being given the most serious consideration.

To help cut through this collection of gordian knots, we have with us today a panel of international experts from around the world. Without exception, these are men of considerable learning and broad experience. As I indicated, we want to do a preexamination of the many issues that will be on the table at the London Economic Summit Conference. We felt a hearing of this nature, a discussion, a symposium a seminar, could be helpful to the President, could be helpful to those that are going to attend the International Economic Conference, and, needless to say, since this is a congressional committee, we were thinking primarily in terms of our own representation at the International Conference.

We are privileged to have Mr. Arsenis, the present Director of the New York Offic of UNCTAD. We are happy to have you with us. Mr. Arsenis is both a lawyer and an economist—this is a dangerous combination—and has held a wide variety of research posts in both the OECD and the United Nations.

Mr. Chairman, come right in, sir.

Representative BOLLING. Thank you, sir.

Senator HUMPHREY. Congressman Bolling, Chairman of the Joint Economic Committee.

From Germany, we have the good fortune to welcome Mr. Armin Gutowski, an international economist of considerable renown and the chief economic adviser to the German bank that funds domestic development and administers Germany's foreign assistance program. Mr. Gutowski is also a member of the German Council of Economic Experts that advises the German Government.

From Japan, we are very pleased to welcome Mr. Saburo Okita, a widely-respected international economist with broad experience in public service. In the past, Mr. Okita has served with a variety of international agencies and is currently the president of Japan's Overeas Economic Cooperation Fund as well as Special Adviser to the Ministry of Economic Planning; and I believe you are also a candidate?

Mr. OKITA. I have just resigned the position of the Overseas Economic Cooperation Fund. It is a conflict of interest.

Senator HUMPHREY. And a candidate for public office.

Mr. OKITA. Chairman of the Economic Research Center, sir.

Senator HUMPHREY. Thank you.

We are also happy to welcome George Poulin to the panel. Mr. Poulin has long served the International Association of Machinists & Aerospace Workers. In July of this year, he will take office as the general vice president of the Union of the International Association of Machinists & Aerospace Workers.

We are indeed also very fortunate to have with us Mr. Robert Roosa, an economist and banker who is currently a partner with Brown Bros., Harriman & Co. in New York. Mr. Roosa is well known to many of us on the committee or his outstanding service with the Kennedy and Johnson administrations as an Under Secretary for Monetary Affairs at the Treasury Department.

Alphabetically last, but by no means least, we are privileged to have Robert Schaetzel with us. I have known Mr. Schaetzel for a long time; he is a lawyer who chose to go into the State Department, and his career has been characterized by a high standard of public service ever since. Presently working as a writer and consultant in Washington, Mr. Schaetzel has been Deputy Assistant Secretary of State for Atlantic Affairs and more recently the U.S. Ambassador to the European Communities.

So we have a very distinguished panel here.

Gentlemen, I want to welcome you on behalf of the Congress and on behalf of the Joint Economic Committee. I know my chairman will permit me to do that, and now I am going to suggest that we proceed in the same order that I introduced you.

We will start with Mr. Arsenis. We have Senator McClure and Senator Roth with us, as well, and we will expect to have other Senators as they come in.

Gentlemen, if you could keep your statements brief and then we will get into what we call the give-and-take and the dialog here, which I think will be helpful. Mr. Arsenis, please proceed.

STATEMENT OF G. D. ARSENIS, DIRECTOR, NEW YORK OFFICE OF UNCTAD

Mr. ARSENIS. Thank you, Mr. Vice Chairman.

The forthcoming high level meetings in London and in Paris next month, will address themselves to the complex and difficult issues facing the international community. These meetings are seen as offering a unique opportunity for the international community to take decisive steps toward establishing stable conditions for worldwide development. They are also seen as a crucial test of the dialog between the industrialized North and the developing South.

With regard to the North-South dialog, Mr. Vice Chairman, a positive factor has been the increasing awareness, in the recent past, of a true interdependence of the economies in the North and in the South.

In the past, the concept of interdependence between North and South has been relatively limited. It was acknowledged that economic conditions in the North affect in a critical way the economic situation in developing countries.

In the earlier years of this decade, it has been recognized in addition that economic conditions and policies in the developing world do, in turn, affect economic conditions in the North. So we are approaching the high level meetings with a clear understanding of the interdependence between developed and developing countries.

It is in the context of this interdependence that I should like to touch upon four points.

First, the question of further reflation in the OECD economies.

Second, the need for avoiding trade protection policies worldwide and eventually proceeding with further liberalization in international trade.

Third, the need for effective solution of the instability in primary commodity markets.

Fourth, and last, the need for provision of adequate development financing in favor of developing countries.

With regard to the first issue, Mr. Vice Chairman, developing countries see with some concern the relatively slow pace of recovery in the industrial countries. Current indications are that the OECD economies, as a group, may not achieve a rate of growth in 1977 of more than 5 percent. True, a slightly better performance is expected in 1978 and current projections indicate that the aggregate rate of growth in the OECD countries in 1978 may be 5.4 percent. However, these growth rates are by no means full employment rates in the OECD, and consequently developing countries are faced with considerable shortfall in their export earnings because of the weakening of the markets in the industrialized North. It is natural, therefore, that recent discussions regarding the possibility of further reflection of the economies of certain strong OECD countries are being followed with great interest in developing countries.

A further reflation of the OECD economies, particularly of those economies with current account surpluses, would be helpful not only to developing countries, but to the adjustment process in the world economy as a whole. It should be recalled that the Committee of Twenty on the reform of the international monetary system emphasized that the adjustment process should be symetrical and consequently should involve efforts by both surplus and deficit countries.

Insofar as imbalances in the world economy are to be adjusted only through deflation in the deficit the countries there will be a deflationary bias in the adjustment process for the world as a whole. If, on the other hand, surplus countries are also to reflate their economies, the adjustment process would be more symmetrical; it would avoid excessive deflectionery bias; and would be more conducive to the development of the world economy.

In UNCTAD we have calculated that if OECD countries were to grow at higher rates, say 1 percentage point more than it is forecasted, the export earnings of the developing countries would increase by about $4 billion, and this is not an insignificant amount. But, perhaps, Mr. Vice Chairman, the most important contribution that reflation in the OECD economies will make, is that it will reduce domestic pressures on governments to resort to trade restrictions in order to protect domestic employment.

I think there is general agreement that Paul should not gain at the expense of Peter, but that both Paul and Peter should find employment. The solution to the problem will be found in strengthening the demand in domestic markets.

The problem that many industrialized countries are facing today is not due to excessive levels of imports from the rest of the world—after all, many of these imports are regulated by quotas—the problem arises because domestic demand has experienced stagnation or decline in the recent past. The solution, therefore, should be sought in measures to increase the levels of income rather than in retrenchment and trade restriction policies.

It would seem to me, therefore, Mr. Vice Chairman, that with respect to trade policies, the international community may consider three specific steps.

First, the OECD countries pledge to refrain from trade restrictions should be renewed.

Second, there should be a renewed political commitment to expedite the multilateral trade negotiations now underway in GATT.

Finally, the international community may consider steps that may be taken, after the completion of the MTN negotiations, toward evolving comprehensive and new "rules of the game" that will encompass not only commodity trade but also foreign investment and transfer of technology.

We are faced today with a rather compartmentalized approach to the problem of international economic relations. There are a number of subjects that are under negotiation in different form, dealing with the transnational corporations, with transfer of technology, and so forth and so on. I think the international community will again if all these negotiations are to be brought eventually under the aegis of a comprehensive trade institution.

Turning now, Mr. Vice Chairman, to the question of commodities, I should like to say that price instability affects not only the producing countries, which are mainly developing countries, but also the international community as a whole. In fact, the coexistence of wide fluctuations in the primary commodity markets and the relatively administered prices of manufactured products, has tended to accentuate the international propagation of business cycles. Moreover, this phenomenon has added to the inflationary pressures in the world economy since rises in commodity prices have been pressed on in the form of higher prices of manufacturers. On the other hand, during the downswing of the business cycle, prices of primary commodities tend to fall but prices of manufacturers do not. As a result, instability of prices of primary commodities, tends to add to inflationary pressures in the world economy. It follows, therefore, that solution of the commodity problem will be in the interest not only of the producing countries, but also of the consuming countries.

In UNCTAD, Mr. Vice Chairman, we have proposed an integrated program to deal with primary commodities. The program envisages a series of individual commodity negotiations with a view to establishing commodity arrangements for 18 primary commodities. The program also envisages the establishment of a common fund, which will underpin the individual stocking operations of the commodity arrangements. Negotiations on the establishment of the common fund, and negotiations with respect to individual commodity arrangements are now underway in UNCTAD, and it seems to me that this program is perhaps the single most important issue from the standpoint of the developing countries.

It would be difficult for me to visualize a policy package that developing countries would find acceptable that would not include a satisfactory agreement with respect to commodities, including in particular the establishment of a common fund.

Turning, Mr. Vice Chairman, to the question of the external financing of developing countries, I should like to note that the exceptional deficits on current account that have been registered in the recent years are not due to overspending or mismanagement of the economies of the developing countries.

There is a general agreement that the increase of the current account deficits of developing countries from about $13 billion in 1973 to about $35 billion annual average in the period 1974–76, is mainly due to world inflation and consequently deterioration of the terms of trade of developing countries and to recession in the OECD countries.

It stands to reason, therefore, that a development oriented policy would require that these deficits should be financed on appropriate terms and conditions, and that the developing countries should not find themselves in the awkward position of having to adjust their current account deficits by retrenchment.

In this respect, the existence of excess world savings in the form of structural current account surpluses of the OPEC countries could help oil importing developing countries in financing their deficits on current account.

The problem, however, is that the existing international financial intermediation for recycling the petrodollars from the OPEC surplus countries to oil importing developing countries does not match the liquidity preferences of the surplus countries with the terms and conditions of development loans that oil importing developing countries need if debt repayments are to be consistent with their long term debt servicing capacity.

To a large extent, the debt problems of the developing countries today are due to the short term structure of the external debt. There is a general recognition that official action may be required in order to help developing countries alter their debt structure from short term to longer term. This rearrangement does not require, by the way, widespread debt rescheduling. It could be done in a number of alternative ways.

I, myself, have been convinced for quite sometime that the solution of this problem should be sought in the establishment of a multilateral financing facility that will allow developing countries to pay back their debts and, at the same time obtain, under this facility loans on terms and conditions that would be consistent with their long-term debt servicing capacity.

It is gratifying, therefore, that recent press reports indicate that in Washington next week in the framework of the IMF interim committee, some action may be taken to that direction. The point, however, I would like to emphasize is that the terms and conditions of loans to be obtained through a balance of payments financing facility should be consistent with the development objectives of the recipient countries. In particular maturities should be on longer term than those obtainable from the private capital markets. Short-term maturities of official loans would simply postpone the debt servicing problem for a few years. The solution to the problem is to provide the developing countries with development financing with relatively long maturities, say about 15 years.

I should perhaps stop here, Mr. Vice Chairman, but I would be glad to answer any questions which you or your colleagues may have.

[The prepared statement of Mr. Arsenis follows:]

Prepared Statement of G. D. Arsenis[1]

INTERDEPENDENCE

Recent developments in the world economy have served to highlight the close interrelationship of monetary, trade and financial problems; they have also underlined the increasing interdependence of national economies.

While the interrelationship of problems in the monetary, trade and financial fields has received general acknowledgment, it has not found adequate recognition in efforts at international co-operation. In fact, decisions are still compartmentalized and remain largely unco-ordinated .Thus, there is danger that positive steps in one area may be offset by retrogessive measures in another. For example, restrictive policies in the trade field would tend to reduce the efficacy of exchange rate adjustment in securing changes in the balance on current account. Moreover, if payments imbalances are due to "structural" factors, correction would call for adjustment of the capital account through changes in international investment patterns rather than adjustment of the current account through exchange rate policies. For example, developing countries which, on the whole, have been faced with structural payments problems have emphasized that the traditional distinction between balance-of-payments finance and long-term development finance is unhelpful to their development process. Recently, the emergence of persistent oil surpluses has introduced a structural element in the payments of both oil-exporting and oil-importing countries and has demonstrated the need for considering correction of payments imbalances in conjunction with

[1] The views expressed in this statement are the author's personal views and not necessarily those of the UNCTAD secretariat.

measures designed to affect the pattern of foreign investment. Notwithstanding recognition of this interrelationship, the international community has yet to devise a mechanism which would allow decisions in these areas to be taken in a consistent manner.

The industrialized countries have been fully aware of the interdependence of their economies and over the post-war period have evolved consultative machinery within the OECD with a view to reducing conflicts in national objectives that may affect the smooth functioning of the world economy. On the other hand, economic relations between the industrialized North and the developing world were seen, by and large, as containing elements of dependence of the latter upon the former group. The international community recognized that acceleration in the pace of development of developing countries would require a series of measures in the fields of trade and finance in favour of developing countries. However, the severe recession in recent years, the strong inflationary pressures in the world economy and the massive payments imbalances that have emerged, have given rise to a re-examination of the factors contributing to world instability. An important conclusion that emerges from such reexamination is that the problems facing the world would require concerted action by both developed and developing countries. Seen in that context, the rationale of international policy measures with regard to the development of developing countries appears to have undergone a substantial change. For example, the question of provision of long-term capital flows to developing countries is not seen merely as a humanitarian gesture from the industrialized North to the developing South, but it is increasingly seen as an indispensable component of the adjustment process in the world economy. Similarly, stabilization of prices of primary commodities is seen not only as contributing to the stabilization of incomes of primary producers, but also as an indispensable measure to reduce instability in the world economy.

It is in the light of this new perception of an interdependent world, that I should like to comment upon some of the issues facing the world community.

THE ECONOMIC SITUATION AND NON-OIL DEVELOPING COUNTRIES

A direct consequence of world inflation and severe recession in the industrialized countries has been the dramatic increase in the current account deficits of non-oil developing countries. The aggregate deficit increased from about $13 billion in 1973 to an average annual deficit of about $35 billion during the period 1974/1976.

The fact that needs emphasizing is that this dramatic increase in the deficit has not been caused by domestic mismanagement or overspending. In fact, the deficits would have been significantly higher if developing countries were to continue their development process and import programmes at the same rates as in the past. In effect, the level of real imports of these countries has hardly increased in the past two years and there is evidence that, in many developing countries, the level of fixed investment has failed to increase. The level of deficit on current account appears to have been determined to a large extent upon the volume of external finance that non-oil developing countries could obtain from official sources and from capital markets. While net official flows have increased in recent years, the share of these flows to total long-term financing (in net terms) declined from 60 per cent in 1971 to about 50 per cent in 1976. On the other hand, private capital flows and particularly Euro-currency loans expanded rapidly.

Clearly, this situation cannot continue for long. If widespread development crisis in non-oil developing countries is to be averted, the volume of imports will have to resume its upward trend. On the other hand, it is doubtful whether net flows from private sources could expand at rates sufficiently high to finance a reasonable expansion in imports. It appears, therefore, that foreign exchange resources required to underpin the development process must be sought in expansion of the export earnings and official development finance.

I should like now to turn to possible international measures that have a bearing on export earnings of developing countries and on the provision of development finance.

REFLATION IN THE OECD ECONOMIES

While it is not possible to determine, in quantitative terms, the impact of specific factors on the increase in the current account deficits of non-oil developing countries, it can be said, with some degree of confidence, that the recession in the OECD economies has accounted for a major part of that increase. It is natural, therefore, that developing countries are concerned that the recovery in the OECD economies, as a whole, might be unduly slow. Present indications are that the GNP of the major 13 OECD countries would increase by less than 5 per cent in 1977. A slightly better performance (5.4 per cent) is forecast for 1978 but on present indications the OECD economies are not likely to reach full employment conditions by the end of the decade.

The conclusion that emerges from these forecasts is that developing countries cannot expect to recoup the shortfall in their export earnings before the end of the decade. Viewed against this background, recent discussions on the possibility that the "stronger" OECD economies might take the opportunity offered them of increasing their level of demand are of particular importance. It is estimated, for example, that if the OECD economies, as a group, were to grow annually by one percentage point higher than what is expected in 1977 and 1978, the annual export earnings of developing countries might be higher by nearly $4 billion.[2]

Clearly, reflation of OECD economies in balance-of-payments surplus would have a more pervasive effect than is indicated in the above figures. For one thing, it would introduce a more symmetrical adjustment process in the OECD economies and consequently it would tend to reduce the prevailing deflationary bias in correcting the imbalance in international payments.

TRADE POLICIES

The recent recession in developed countries has resulted in significant weakening of demand for many import competing products. It is natural that this situation is viewed with concern, particularly in view of persistent unemployment. It is unfortunate, however, that the focus of discussion appears to be shifting from the need to restore higher levels of domestic activity to demands for imposing trade restrictions. In this connexion, it should be noted that many of the labour intensive imports are already subject to quotas and that depressed conditions in domestic industry are not due to flooding of competing imports but rather to shortfalls in domestic demand. For example, the current agreement regarding textiles, permits countries exporting to the United States to increase their shipments by 6 per cent per annum, which would be equal to the expected rate of increase in the domestic market. In the event, the domestic market increased by half of its expected rate last year and consequently domestic producers had to compete for their share in a weak market. It stands to reason, therefore, that the solution to the problem is to be found not in renegotiation of the textile agreement but in strengthening the level of demand.

Apart from the inherent risks of setting forth a deflationary process of catastrophic intensity, restrictive trade policies tend to be of a discriminatory nature: since the main objective of trade restrictions in developed countries is to protect domestic employment, such restrictions tend in the final analysis to be directed against developing countries, for it is they that have a comparative advantage in labour intensive industries.

It is, therefore, a matter of utmost priority that developed countries renew their pledge to refrain from restoring to trade restrictions. It is also important to proceed with negotiations with a view to securing substantial removal of existing trade barriers. In this connexion, a firm political commitment to expedite the Multilateral Trade Negotiations in GATT is called for.

Perhaps the time has come to consider the steps that might be taken in the trade field after the conclusion of the MTN. A major issue that arises in this connexion is whether completion of the reform of the trade system might not require the establishment of comprehensive "rules of the game" that would encompass the complex economic relations in the areas of trade, investment and technology among countries of different stages of development and different economic systems. A related issue that deserves consideration is the possibility of gradual evolution of the relevant organizations into a Comprehensive Trade Organization.

COMMODITIES

Fluctuations in the prices of commodities are a source of instability of the current account balances of developing countries. Moreover, the co-existence of unstable commodity prices on the one hand and of administered prices of

[2] It should be noted, however, that the impact on the deficit on current account would depend not only upon increases in export earnings but also upon possible increases in import prices.

manufactures on the other, has served to intensify the international propagation of business cycles. Upswings and downswings in the developed world have tended to be accentuated by movements in the terms of trade between manufactures and commodities and by the parallel changes in the import demand of developing countries that follow such movements. This process has also tended to be inflationary since rises in commodity prices have, albeit with a lag, been passed on in the form of higher prices of manufactures: it is only to a much smaller extent that the reverse has been true for declines in commodity prices.[3] Thus, any jump in the price level of commodities has been manifested in a higher overall price level, and this has restrained governments from allowing output to be maintained at its maximum sustainable level.

The long-term consequences of commodity market instability for the continuity of supplies are equally serious. Adequate expansion of production is threatened on two counts. In the first place, the high degree of uncertainty associated with expected revenues in commodity production tends to slow the rate of new investment. Secondly, the fact that instability tends to depress the terms of trade of commodity producers further reduces the capacity to invest.[4]

It is thus in the interest of both producers and consumers that an effective solution to the instability of commodity prices be found.

In so far as fluctuations in prices of commodities come from the demand side, co-ordination of national policies designed to achieve stable demand trends will significantly reduce the instability of commodity prices. However, even relatively small deviations of demand from its long-term trend will induce large changes in commodity prices.[5] This is due to the fact that primary production is, with some exceptions, inelastic in the short-term. Further, price instability would still occur in the face of complete stability in demand trends because of short-term variations on the supply side. Thus stability of commodity markets cannot be assured solely through management of aggregate demand. Measures must be taken on the supply side.

The negotiations on the integrated programme of commodities which are being undertaken in UNCTAD are aimed at establishing a new international framework for the stabilization and improvement of commodity markets. The programme envisages a series of international commodity arrangements within an agreed time frame. The programme also contemplates a set of measures with stocking as the main instrument. The commodity arrangements are to be facilitated by the establishment of a Common Fund which provides the assurance of finance from a central source.

The developing countries perceive the integrated programme as a key element in the negotiations between North and South. It is therefore of vital importance that the package that will be finally negotiated should preserve the essential character of the programme and in particular the establishment of a Common Fund.

DEVELOPMENT FINANCE AND EXTERNAL INDEBTEDNESS

While acceleration of the rate of growth of OECD economies, improved access to markets and stabilization of prices of primary commodities will undoubtedly have a favourable impact on the balance of payments of non-oil developing countries, it is quite clear that they will not suffice in themselves to sustain significant expansion in these countries. Estimates prepared by the UNCTAD secretariat[6] indicate that in the absence of changes in the trend of net capital flows to non-oil developing countries, the growth rate for the remainder of the decade may be as low as 4.5 per cent per annum. Moreover, the annual growth rate in the MSA (Most Seriously Affected) countries might be only 3.5 per cent with many of these experiencing declines in per capita incomes. In my view, such an outcome would not be sustainable. It will not only threaten stability in developing coun-

[3] The responsiveness of prices of manufactures to increases in primary commodity prices appears to be more than three times as great as it is to decreases.

[4] Past deterioration in the terms of trade of primary commodities is significantly associated with current price increases. The measured elasticity of commodity prices with respect to the average rate of change of the terms of trade over the previous five years is of the order of —0.6, suggesting a substantial investment response.

[5] The elasticity of commodity prices with respect to aggregate nominal demand in industrialized countries is about 3.4.

[6] See Report by the UNCTAD secretariat "Trade Prospects and Capital Needs of Developing Countries, 1976–1980" (TD/B/C.3/134).

tries, but it would also have a serious and adverse impact on international economic relations.

If developing countries are to achieve the growth target of the International Development Strategy,[7] the net flow of resources to non-oil developing countries will have to grow rapidly during the remainder of the Decade. The required net capital inflow requirements are projected to reach the level of $119 billion in current prices, or $90 billion in 1975 prices. These flows are equivalent to 1.5 per cent of the projected GNP of industrialized countries in 1980.

Clearly, the magnitudes involved are of high order and serve to underline the fact that the efforts required are anything but marginal. On the other hand, the task at hand is not beyond the reach of the international community. As long as the oil exporting countries, as a group, continue to experience sizeable current account surplus, there will be substantial investible funds to finance foreign investment. Moreover, the industrial countries appear to be unwilling to accept deficits on current account commensurate with the current account surpluses of the group of oil exporting countries. An efficient way to resolve the problem would be for the industrialized countries to offset their oil deficits by developing a current account surplus *vis-à-vis* non-oil developing countries and finance such trade by redirecting their capital inflows towards these countries, in the form of appropriately long-term loans. Thus, the recycling of the so-called petro-dollars would contribute to both a better adjustment process in the world economy and financing development of non-oil developing countries.

To be sure, substantial amounts have already been recycled to non-oil developing countries. The problem, however, is that the kind of financial intermediation involved in the recycling may not suffice to serve the future needs of all developing countries. In the first place, the poorer developing countries do not have access to capital markets. Financial flows to these countries must continue to be in the form of soft loans. In this connexion, it needs emphasizing that a decisive step should be taken towards meeting the official development assistance target of 0.7 per cent. Debt relief on official debt could contribute to a speedy increase in net resource transfer to the poorer countries; it would also serve to improve the quality of assistance.[8] In donor countries in which legislative procedures do not allow a general commitment to provision of debt relief, equivalent measures such as provision of additional development assistance in the form of untied programme loans could be considered.

Secondly, countries that have had access to private capital markets may find it increasingly difficult to expand their borrowing at rates observed in the recent past.

Thirdly, even if the capital markets were willing to provide the required funds,[9] the terms of such loans would result in a precarious debt structure for many developing countries. It has been estimated, for example, that if one-half of the capital requirements of developing countries were to be financed by private flows in 1980, the debt service ratio[10] might reach the mark of 32 per cent in that year.

The upshot of these considerations is that the untapping of investible funds from private sources would require increased involvement of governments. This could take a number of forms but a particularly helpful measure would be to increase the capital basis of the multilateral development agencies so as to allow them to significantly expand their lending programme.

Substantial increases in development assistance from bilateral and multilateral sources will also contribute to the improvement of the debt structure of developing countries. However, changes in the trends of this soure of finance will affect the debt profile with considerable time lag. In the meanwhile, many developing countries will be faced with mounting debt-service payments which will tend to reduce their capacity to import.

In the recent months, public discussion has focussed attention on this issue and the debate has centered around the likelihood of widespread defaults. In my view, the question posed is unfortunate because the question is not whether developing countries would default—as a matter of fact, it is not likely that significant defaults will take place. The relevant question to ask, it seems to

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[7] The International Development Strategy set as a minimum goal an average annual rate of growth of real GDP of 6 per cent over the whole decade of the seventies.

[8] Annual debt service payments on official debts of the MSA countries amounted to about $1.1 billion in 1974.

[9] If it is assumed that the 0.7 ODA target would be met by 1980, net private capital flows would amount to about 0.8 per cent of the GNP of the industrialized countries.

[10] Percentage ratio of payments on account of interest and amortization to total export earnings.

me, is whether under present world conditions, the servicing of debt impinges upon the capacity to expand domestic output at a reasonable rate. The answer to that qustion, I think, is that a good number of developing countries are finding it increasingly difficult to service their debts and maintain a reasonable pace of development at the same time. The problem arises from the short-term structure of the debt. Many of these countries do not appear to be in need of concessional debt relief nor do they wish to engage in multilateral negotiations that would affect their continued access to capital markets. But these countries will clearly benefit from arrangements that would iron out the "bunching" of private debt over a longer period.

I remain convinced, as I have been for quite some time, that the solution to this problem lies in the establishment of a multilateral facility which would refinance—at market related interest rates but with maturities of, say, 15 years—the commercial debts of developing countries in need.[11]

Recent press reports indicate that there is now a possibility that provision for adequate balance-of-payments financing may be agreed. Insofar as this financing will be provided on a long-term basis and on conditions that would be consistent with the developmental objectives of the recipient countries, the practical effect will be similar to that of a debt refinancing facility.

Senator HUMPHREY. I think we will proceed down the line. Please keep your statements within reason. We can open it up for questions from our colleagues here if that is agreeable; and, hopefully, you will cross-examine each other as you go along, because, obviously, some of you may have a different point of view.

Thank you, Mr. Arsenis, for your productive and constructive contribution here.

Mr. Gutowski, would you give us your thoughts.

By the way, all the prepared statements that are summarized will be made a part of our record and I now ask that that be done so we can make sure that the prepared statement along with the oral presentations appears in the record.

STATEMENT OF ARMIN GUTOWSKI, PROFESSOR OF ECONOMICS, JOHANN WOLFGANG GEOTHE-UNIVERSITÄT, FRANKFURT AM MAIN, FEDERAL REPUBLIC OF GERMANY

Mr. GUTOWSKI. Thank you, Mr. Vice Chairman.

I appreciate being invited by this distinguished committee to express my views on international economic issues presently discussed all over the world which will also be the subject of the forthcoming conference of the chiefs of state of several leading countries in London next month.

Let me begin by saying that by far the biggest social and economic—if not political—problem in the world today is the high rate of unemployment. What the Western World needs most badly, if the free market economy is to survive, is to regain within a reasonable span of time a high and sustainable level of employment. This implies that also a higher rate of growth of productive capacities than the present one has to be achieved.

Although the so-called stronger countries like the United States, Japan, and Germany suffer from the same disease of unemployment, I have no doubt that they could and that they should assist the so-called weaker countries in overcoming their problems. But I doubt that there is an easy way or even a trick by which the stronger countries could

[11] For a discussion of this proposal see Report by the UNCTAD secretariat "International financial co-operation for development" (TD/188).

relieve the weaker ones from their problems, and by doing so could solve their own problems at the same time.

Mutual understanding, cooperation, and assistance can facilitate the process of adjustment. For some countries this might even be a necessary condition of regaining a high level of employment, balance-of-payments equilibrium, and an adequate rate of growth without having to stretch the dangerous period of agony for too long, but assistance from outside alone would not be sufficient for achieving these objectives.

Each country, the so-called strong ones not excluded, will have to make the effort needed to shift part of its absorption from consumption to investment and to limit consumptive absorption to what it can afford.

The first thing that comes to the mind of a trained economist if employment is far below the norm and if productive capacities are far less than fully utilized, is the Keynesian recipe of stimulating demand. Why should not at least the stronger countries do more in this respect than they have done already?

I shall not comment on what Mr. Arsenis just said, instead I shall confine myself to the German example because I feel that you are all interested in that case.

Senator HUMPHREY. Yes, sir.

Mr. GUTOWSKI. The deficit of the German public sector has run up very high during the last few years. It amounted to 5.9 percent of gross national product in 1975—4.2 percent in 1976—whereas in 1974 it had been only 1.2 percent.

Part of the deficit can here be neglected because it represents regular government borrowing which the economy is accustomed to. The bulk of the deficit, however, is due to much less than full employment tax receipts, and expenditures going beyond the share of the productive capacities—production potential, not GNP—of which the public sector avails itself even when capacities are fully utilized—a portion of this is, in fact, structural; that is, it will not vanish automatically even when the economy is again returning to full employment.

This is true, since part of the shortfall in receipts stems from tax cuts meant to be permanent and because some of the additional expenditure are products of the prodigal reforms from the euphoric period before 1973, and as such cannot easily be reversed.

Taking all this into consideration, additional demand stimulation by way of further deficit spending, be it new tax cuts—perhaps except those easing the tax burden of enterprises—be it additional public purchasing, might encounter skepticism of investors and even of consumers.

We have learned this from the events in 1975. When in the summer of 1975 the size of the public deficit became known, investors expected rising interest rates in the capital market. Some also feared that the rate of inflation would finally go up again. The actual interest rates rose because of these expectations.

The Bundesbank intervened in the public bond market, although this was a precarious venture because the preset monetary target was at stake. The Government hastened to announced a plan for consolidating the structural part of the public deficit.

So, the adverse expectations could finally be broken. It became clear, that at this level of employment the public deficit could be financed and at the same time long-term interest rates as well as the rate of inflation could be further brought down.

By now the cyclical upswing has gone on for a while. Additional deficit spending could again endanger this process. Investors might fear being crowded out if the public sector would not be able to reduce its demands for capital adequately and in a timely fashion. This could suppress their only slowly growing propensity to invest.

Consumers might take the announcement of more public spending as a sign of unfavorable developments which could endanger their jobs, and might therefore react, as they have done before, by saving more. So, the negative feedbacks on private investment and consumption could more or less compensate the positive fiscal impulse on demand. These are some of the reasons why the Keynesian drug of deficit spending has lost its effectiveness.

The prospects of using the other allegedly demand stimulating drug; namely, additional monetary expansion, are even worse in Germany. Since the system of fixed exchange rates was given up in March 1973, the Bundesbank has proved itself able to bring down the rate of inflation slowly but continuously.

Confidence in monetary policy could be reestablished which had been lost in the early seventies when inflationary expectations had run up high, wage demands had been excessive, profits were squeezed, investment had decreased, and the rate of growth of productive capacities had gone down. I have supplied a table in my prepared statement which shows these developments.

The unions had learned the hard way what a strict monetary policy can do to employment if wage policy is too aggressive. In 1975 and 1976, their wage demands were rather moderate. As an inheritance from the years before and from the unexpectedly sharp decline of GNP in 1975, the level of real wages is still too high and the latest wage demands are not as moderate as in the preceding 2 years.

The rather high level of real wages and uncertainty as to the future development of wage demands is one, if not the dominant reason for the reluctant behavior of investors. If the monetary authority were to loosen its course of policy and by so doing would open up room for prices to rise, the unions would be the first to raise new demands. For money illusion is gone; there is no trade off between unemployment and inflation any more as the famous Phillips curve suggested. This curve has turned out to be an illusion itself. More monetary expansion would accelerate inflation, but discourage investment and further slow down economic growth. This would neither help Germany nor the rest of the world.

As far as fiscal policy is concerned, my rejection of major additional deficit spending is based on forecasts by the Government, the Bundesbank, the Council of Economic Experts as well as by several research institutes who predict for 1977 a rise of real GNP by 4.5 to 5 percent.

If in the course of the next few months it becomes obvious that the most probable outcome will remain substantially under this rate, additional deficit spending would be appropriate. As yet, I do not see strong indications that this will be the case.

Therefore, additional spending would be premature. It could not be justified even on grounds of taking precautions. At least to a certain extent it has to be taken as competing with private demand, especially with private investment in the capital market where interest rates would be lower without, rather than with, additional Government spending. But private investment is what we really need because only this will also create new jobs which alone would give us the chance of achieving full employment over the medium run.

Although being aware of all this, the German Government has announced last month a new program of some 15 billion deutsche marks——

Senator HUMPHREY. Is that 15 or 50 deutsche marks?

Mr. GUTOWSKI. Fifteen million deutsche marks. As a matter of fact it is closer to 16 million deutsche marks, to be spent over several years, 4 billion deutsche marks of which is to become effective yet in 1977. It is called a program of precautionary measures for improving growth and environmental conditions. Time and again the Government has emphasized that this is not just another program to stimulate demand. But if one looks more closely at the projects included in this program, one finds out that most of it, although being public investment, will later enhance consumption of public goods like cleaner water and air, and that little will directly stimulate or complement private investment. I do not see how this program should be able to stimulate substantially the creation of productive capacities and new jobs.

Since investment is lacking, I personally would have preferred a program directed at stimulating supply rather than demand. Such a program had been recommended by the German Council of Economic Experts.

Again, I repeat, our main problem is a job gap for the next 5 to 10 years caused by lack of investment during the last 5 years, a gap which has to be closed by a substantial increase of job-creating private investment.

Even if there is a positive net effect of purely demand stimulating spending, which is doubtful for reasons mentioned before, employment and utilization of capacities will be higher only as long as the additional spending lasts But this would not solve the longer term problem of the job gap.

Besides, Government borrowing for consumptive purposes could not go on forever because of the accumulation of public interest payments which would increasingly burden the budget.

I do believe, many of the other industrialized countries are basically facing very similar problems. I do not deny, some of them are in a much worse position than Germany.

Although I have argued that the net effect of additional demand stimulation on GNP might not be positive let alone substantial, and that even if it were substantial it would be only temporary and might deteriorate the longer term prospects for growth, let us suppose just for the sake of argument that additional deficit spending would let Germany's real GNP grow by 1 or 1½ percentage points faster than otherwise would be the case in 1977, and would not adversely affect 1978's GNP rate of increase.

Suppose further we have a rather high income elasticity of Germany's imports so that these would rise by 2 or 3 percentage points more than otherwise. Still, the positive effects on the exports of our trading partners like Italy or Great Britain would be rather small.

Anyway, some relief of the balance of payments would be felt in these countries. But their overall economic performance will only improve if the gains from the additional exports will be used for additional investment. I doubt that this is the most probable outcome.

Instead it could happen that such a relief would lead to new wage demands and to their accommodation by economic policy, on which the pressures to follow a restrictuve course would have partly been taken off because of the improvement of the balance of trade. If this were the outcome, the chances would have been given away. The sacrifice of the "stronger" country in terms of its longer run prospects would have been in vain and the prospects for all countries together would have deteriorated.

There is another aspect which has to be considered. It has been argued quite often, and it has been argued here this morning, that the burden of the oil deficit imposed upon the oil importing countries by the quadrupling of oil prices has not been distributed equitably among nations.

Since the aggregate deficit cannot be reduced in the short run, those countries running a substantial surplus—or a rather small deficit—on current account should at least accept a larger share of this burden.

In its more sophisticated form this argument would not imply for a surplus country, say Germany again, to expand more than it wishes or to accept a higher rate of inflation. It only requires from such a country a shift of resources from producing traded goods to producing nontradeables in order to let imports go up and/or exports go down. But what would it actually mean if Germany followed this advice?

Deficit countries would probably not increase their overall production even in a situation of large unemployment, unless other changes would be made which possibly could have been made also without the deliberate shift of resources in the stronger country.

In other words: If Germany absorbed more of the savings of oil-exporting countries for domestic purposes, these means could no longer be recycled to those countries, who are in need of capital imports. This would really put a burden on the deficit countries. Not the deficits as such are the problem, but how the imported capital is being made use of.

If it were used for profitable investment instead of consumption which would employ a change in the underlying policies, there would be no problem at all. But this can be brought about only by endeavors undertaken in the deficit countries themselves.

After having tried to make a convincing case against further demand stimulating policies at the present time in the so-called stronger countries, especially in Germany, on the ground that it would probably not help the weaker countries and at the same time would weaken the stronger countries and by all that would deteriorate rather than improve the longer run prospects for world economic gowth and full employment, still an answer remains to be given what stronger countries like Germany could do, each by itself or in a coordinated effort, in order to assist weaker countries in overcoming their difficulties.

Let me at first remind you again that Germany is in a strong position only with repect to its balance-of-payments situation, to its foreign exchange reserve position, and to its price level performance.

It is weak as far as investment and growth of productive capacities are concerned. Because of that it might envisage an extended period of unemployment.

Having said this, what can Germany do that would be of immediate assistance to the weaker countries.

First of all, it can let the Deutsche mark float upward if the market commands it. Germany has done this already during the last few years. The weighted average of the external value of the German Deutsche mark has gone up from the end of 1972 to the fourth quarter of 1976 by 30 percent.

If one corrects the external value for differences in the increase of unit labor costs—or of unit export values—one gets a less spectacular picture. But taking a longer view back, one can see from those figures that I have supplied in tables 2 and 3 of my prepared statement, that the continuous appreciation of deutsche-mark in nominal terms has put producers of export goods and of import competing products under heavy competitive pressure from abroad.

The result can be read from Germany's import performance. German imports rose from 1974 to 1976 in value by 23 percent and in volume by 19 percent—the respective figures for the United States were 20 and 8 percent, for Japan 4 and −4 percent.

Even in 1975, when the volume of imports of all OECD countries declined by almost 7 percent, German imports rose by 2.6 percent. I believe that Germany does more for other countries' exports by letting its currency float than it could do by stimulating domestic demand.

This alone, of course, is not the solution of the weaker countries' problems. Some of them have been caught in an inflation-depreciation spiral often referred to as the vicious circle.

Once being caught in this circle, further depreciations would neither improve exports nor lower imports because any depreciation will be accompanied by at least an equal increase in the rate of inflation. If now the Government and the central bank of a country experiencing such a vicious circle try to apply restrictive policy measures in order to break it, but still everybody expects the inflationary process to go on, it may come to downward overshooting of the exchange rate.

The degree of domestic restraint which by itself would break the vicious circle, might lead to unemployment of an extent that turns out to be politically unacceptable. Therefore, the downward movement of the exchange rate has to be slowed down as soon as restrictive measures are adopted if they are to have a chance of success. This can be done only by interventions in the foreign exchange market. Such interventions would require the extension of credits by the stronger countries.

I feel that such credits should be granted even in generous amounts by coordinated efforts of the stronger countries. In my opinion these credits would have to play the key role in assisting weaker countries to overcome their difficulties.

Germany has already contributed substantially to such supporting credit arrangements in favor of Great Britain and Italy and should go on to do so. Of course, the main effort has to be made by the weaker countries themselves. They have to stick to the restrictive measures in order to bring about the necessary shift of resources from consumption to investment.

The credits should, therefore, be granted only under the condition that sound economic policies have been adopted and will be continuously applied.

I would suggest going even one step further. One could try to establish a new basic principle by which multilateral assistance for interventions in the foreign exchange market would be made conditional upon setting up and adhering to jointly agreed monetary policy targets.

Without going into the rather complicated details of this proposition I want to point out that, in my opinion, such a scheme designed to gradually restore stability in the participating countries would have a good chance of functioning because it would fulfill the main precondition of workability of those international agreements; namely, a balance between the burden of discipline—imposed by the monetary target—and the advantage from solidarity in terms of access to credit facilities under well-defined conditions.

I feel it would be worth our while to think more along the lines, in which ways and by which means solidarity and cooperation among nations could bring about the discipline in economic policies that is needed for assuring worldwide adequate growth and full employment instead of trying to put the blame on each others policies for our failing to achieve these objectives. Thank you.

[The prepared statement of Mr. Gutowski follows:]

PREPARED STATEMENT OF ARMIN GUTOWSKI

I appreciate being invited by this distinguished committee to express my views on international economic issues presently discussed all over the world which will also be the subject of the forthcoming conference of the chiefs of state of several leading countries in London next month.

Let me begin by saying that by far the biggest social and economic (if not political) problem in the world today is the high rate of unemployment. What the western world needs most badly, if the free market economy is to survive, is to regain within a reasonable span of time a high and sustainable level of employment. This implies that also a higher rate of growth of productive capacities than the present one has to be achieved. Although the so-called stronger countries like the USA, Japan, and Germany suffer from the same disease of unemployment, I have no doubt that they could and that they should assist the so-called weaker countries in overcoming their problems, and that this, if it is done in the right way, would make themselves better off in the longer run. But I doubt that there is an easy way or even a trick by which the 'stronger' countries could relieve the 'weaker' ones from their problems, and by so doing could solve their own problems at the same time. Mutual understanding, cooperation, and assistance can facilitate the process of adjustment. For some countries this might even be a necessary condition of regaining a high level of employment, balance-of-payments equilibrium, and an adequate rate of growth without having to stretch the dangerous period of agony for too long, but assistance from outside alone would not be sufficient for achieving these objectives. Each country, the so-called strong ones not excluded, will have to make the effort needed to shift part of its absorption from consumption to investment and to limit consumptive absorption to what it can afford.

The first thing that comes to the mind of a trained economist if employment is far below the norm and if productive capacities are far less than fully utilized, is the Keynesian receipt of stimulating demand. Why should not at least the "stronger" countries do more in this respect than they have done already?

Although I believe that the following considerations are also valid in principle, though not to the same extent for many of the other industrialized countries, I shall confine myself to the German example.

The deficit of the German public sector has run up very high during the last few years. It amounted to 5.9 per cent of Gross National Product in 1975 (4.2 per cent in 1976), whereas in 1974 it had been only 1.2 per cent. Part of the deficit can here be neglected because it represents regular government borrowing which the economy is accustomed to. The bulk of the deficit, however, is due to much less than full employment tax receipts, and expenditures going beyond the share of the productive capacities (production potential, not GNP) of which the public sector avails itself even when capacities are fully utilized. Not all of it was caused by the recession. Some of it was only brought to light by the sharp decline of national income and by the accompanying reduction of the rate of inflation; although also acting to mitigate the recession, this portion of the deficit is in fact structural, i.e. it would not vanish automatically even when the economy is again returning to full employment. This is true, since part of the shortfall in receipts stems from tax-cuts meant to be permanent and because some of the additional expenditure are products of the prodigal reforms from the euphoric period before 1973, and as such cannot easily be reversed.

Taking all this into consideration, additional demand stimulation by way of further deficit spending, be it new tax-cuts (perhaps except those easing the tax burden of enterprises), be it additional public purchasing, might encounter scepticism of investors and even of consumers. We have learned this from the events in 1975. When in the summer of 1975 the size of the public deficit became known, investors expected rising interest rates in the capital market. Some also feared that the rate of inflation would finally go up again. The actual interest rates rose because of these expectations. The Bundesbank intervened in the public bond market, although this was a precarious venture because the pre-set monetary target was at stake. The government hastened to announce a plan for consolidating the structural part of the public deficit. So, the adverse expectations could finally be broken. It became clear, that at this level of employment the public deficit could be financed and at the same time long-term interest rates as well as the rate of inflation could be further brought down.

By now the cyclical upswing has gone on for a while. Additional deficit spending could again endanger this process. Investors might fear being crowded out if the public sector would not be able to reduce its demands for capital adequately and in a timely fashion. This could suppress their only slowly growing propensity to invest. Consumers might take the announcement of more public spending as a sign of unfavorable developments which could endanger their jobs, and might therefore react, as they have done before, by saving more. So, the negative feedbacks on private investment and consumption could more or less compensate the positive fiscal impulse on demand. These are some of the reasons why the Keynesian drug of deficit spending has lost its effectiveness.

The prospects of using the other allegedly demand stimulating drug, namely additional monetary expansion, are even worse in Germany. Since the system of fixed exchange rates was given up in March 1973 the Budesbank has proved itself able to bring down the rate of inflation slowly but continuously. In 1974, after the quadrupling of oil prices, was the critical year. The trade unions demanded and received even higher wage increases than in the two years before since almost everybody expected a boost in inflation (cf. Table 1). Because of the consequent monetary policy the actual rate of inflation turned out to be much lower than the expected. Each year from 1975 on the Bundesbank announced in advance a target rate for the expansion of central bank money and kept to it fairly well. So confidence in monetary policy could be reestablished which had been lost in the early seventies when inflationary expectations had run up high, wage demands had been excessive, profits were squeezed, investment had decreased, and the rate of growth of productive capacities had gone down (cf. Table 1). The unions had learned the hard way what a strict monetary policy can do to employment if wage policy is too aggressive. In 1975 and 1976 their wage demands were rather moderate. As an inheritance from the years before and from the unexpectedly sharp decline of GNP in 1975, the level of real wages is still too high and the latest wage demands are not as moderate as in the proceeding two years. The rather high level of real wages and uncertainty as to the future development of wage demands is one, if not the dominant reason for the reluctant behaviour of investors. If the monetary authority were to loosen its course of policy and by so doing would open up room for prices to rise, the unions would be the first to raise new demands. For money illusion is gone; there is not trade off between unemployment and inflation any more as the famous Phillips curve suggested. This curve has turned out to be an illusion itself. More monetary expansion would accelerate inflation, but discourage investment and further slow down economic growth. This would neither help Germany nor the rest of the world.

As far as fiscal policy is concerned, my rejection of major additional deficit spending is based on forecasts of the government, the Bundesbank, the Council of Economic Experts as well as of several research institutes who predict for 1977 a rise of real GNP by 4.5 to 5 per cent. If in the course of the next few months it becomes obvious that the most probable outcome will remain substantially under this rate, additional public spending would be appropriate. As yet, I do not see strong indications that this will be the case. Therefore, additional spending would be premature. It could not be justified even on grounds of taking precautions. Additional defiict spending cannot be set equal to additional aggregate demand as long as we expect a reasonable increase of real GNP without it. At least to a certain extent it has to be taken as competing with private demand, especially with private investment in the capital market where interest rates would be lower without, rather than with, additional government spending. But private investment is what we really need because only this will also create new jobs which alone would give us the chance of achieving full employment over the medium run.

Although being aware of all this, the German Government has announced last month a new program of some 15 billion D-Mark to be spent over several years, 4 billions of which is to become effective yet in 1977. It is called a program of precautionary measures for improving growth and environmental conditions. Time and again the government has emphasized that this is not just another program to stimulate demand. But if one looks more closely at the projects included in this program, one finds out that most of it, although being public investment, will later enhance consumption of public goods like cleaner water and air or more comfortable and secure infrastructure for travelling and transportation, and that little will directly stimulate or complement private investment. I do not see how this program should be able to stimulate substantially the creation of productive capacities and new jobs. At best it will slow down the reduction of jobs in the construction industry.

Nevertheless, the program has been received quite well by the public, since the government has convincingly argued that the program will not interfere with its plans for consolidation of public budgets and that it will improve the structure of public expenditures by shifting them more to public investment. Because of this effect and because of the timing of the program which still leaves open how much of it will finally be additional spending, I do not fear that the program will suppress private investment if this were to increase for reasons not associated with the program.

Since investment is lacking, I personally would have preferred a program directed at stimulating supply rather than demand. Such a program which had been recommended by the German Council of Economic Experts would include measures reducing the risk of private investment, e.g., the legal permission for higher rates of depreciation during the first years after investment, reduction of profit-independent taxes, subsidies or tax credits for research and development expenditures on a larger scale, and so forth.

Again I repeat, our main problem is a job-gap for the next five to ten years caused by lack of investment during the last five years, a gap which has to be closed by a substantial increase of job-creating private investment. Even if there is a positive net effect of purely demand stimulating public spending, which is doubtful for reasons mentioned before, employment and utilization of capacities will be higher only as long as the additional spending lasts. But this would not solve the longer term problem of the job-gap. Besides, government borrowing for consumptive purposes could not go on forever because of the accumulation of public-interest payments which would increasingly burden the budget.

I do not pretend that programs stimulating supply rather than demand would be able to solve the problem of too little private investment and job creation. They can only help. The main point remains: since the level of real wages is too high, it has to adjust to the relative abundancy of labor. But because of the stickiness of real wages an adjustment is less difficult when productive capacities are growing and not stagnating; the process of growth would be facilitated by a supply stimulating program, whereas it might be even hampered by pure demand stimulation.

I do believe, many of the other industrialized countries are basically facing very similar problems. I do not deny, some of them are in much worse position than Germany. Some have not been able to cope with inflation, they have been struck by the abrupt oil-price increase before they had started stronger stabilization policies, their structure of production makes it difficult to reduce their current account deficits by exporting more. If there is any solidarity among western nations it should be self-evident that these 'weaker' countries have to be assisted in overcoming their problems by those nations which are 'stronger' as far as social and economic stability is concerned like the USA, Japan, and Germany.

Although I have argued that the net effect of additional demand stimulation on GNP might not be positive let alone substantial, and that even if it were substantial it would be only temporary and might deteriorate the longer term prospects for growth, let us suppose just for the sake of argument that additional deficit spending would let Germany's real GNP grow by one oder 1½ percentage point faster than otherwise would be the case in 1977, and would not adversely affect 1978's GNP rate of increase. Let us assume further a rather high income elasticity of Germany's imports so that these would rise by 2 or 3 percentage points more than otherwise. Still, the positive effects on the exports of our trading partners like Italy or Great Britain would be rather small. Anyway, some relief of the balance-of-payments would be felt in these countries. But their overall economic performance will only improve if the gains from the additional exports will be used for additional investment. I doubt that this is the most probable outcome. Instead it could happen that such a relief would lead to new wage demands and to their accommodation by economic policy, on which the pressure to follow a restrictive course would have partly been taken off because of the improvement of the balance of trade. If this were the outcome, the chances would have been given away. The sacrifice of the 'stronger' country in terms of its longer run prospects would have been in vain and the prospects for all countries together would have deteriorated. There are, therefore, even under the assumptions made above, good reasons for the 'stronger' countries not to allow their own positions to be weakened. Most probably this attitude will also be to the benefit of the 'weaker' countries, because they can expect help from the 'stronger' ones only as long as these succeed in staying relatively strong.

There is another aspect which has to be considered. It has been argued quite often that the burden of the oil deficit imposed upon the oil importing countries by the quadrupling of oil-prices has not been distributed equitably among nations. Since the aggregate deficit cannot be reduced in the short run, those countries running a substantial surplus (or a rather small deficit) on current account should at least accept a larger share of this burden. In its more sophisticated form this argument would not imply for a surplus country, say Germany again, to expand more than it wishes or to accept a higher rate of inflation. It only requires from such a country a shift of resources from producing traded goods to producing non-tradeables in order to let imports go up and/or exports go down. But what would it actually mean if Germany followed this advice? Of course, deficit countries would be relieved of part of their oil deficits. But, ceteris paribus, they would have to reduce consumption or investment or both in order to shift resources to the production of export goods and import substitutes. They would probably not increase their overall production even in a situation of large unemployment, unless other changes would be made which possibly could have been made also without the deliberate shift of resources in the 'stronger' country. In other words: If Germany absorbed more of the savings of oil-exporting countries for domestic purposes, these means could no longer be recycled to those countries, who are in need of capital imports. This would really put a burden on the deficit countries. Not the deficits as such are the problem, but how the imported capital is being made use of. If it were used for profitable investment instead of consumption which would imply a change in the underlying policies, there would be no problem at all. But this cannot be brought about by a deliberate reduction of surplusses in Germany or in any other country but only by endeavors undertaken in the deficit countries themselves.

Let me insert here, more as a footnote, a few remarks on the question of energy policy. It is of high importance to all oil-importing countries to reduce their dependency on OPEC-oil and by that also to decrease the overall oil deficit in the balance-of-payments. After the oil-exporting countries have reversed the cost determined order of exploiting the various sources of energy by abruptly raising the price of oil and since they are not likely to lower its relation to prices of other goods voluntarily, in my opinion the best way of handling the problem would be in principle to let the price mechanism work freely in order to achieve the necessary adjustments and at the same time to create incentives for the production of alternative energies and for reducing its cost. As a matter of strategy, this process might be accelerated by guarantees and subsidies apt to reduce the risk of investment and to stimulate research and development with respect to energy production and to energy conservation. On the other hand I feel, countries should abstain from measures that could prevent the emergence of a market price that reflects the scarcity of energy in regard of the artificial shortage of OPEC-oil.

Sometimes in the discussions the danger of newly arising protectionism in the world is related to the alleged lack of demand stimulation in the "stronger" countries. If a country's imports increase faster than its exports, if its current account deficit rises and it gets in danger of loosing its credit worthiness, if unemployment goes up because structural change does not function, this country might be tempted to resort to protectionist measures. Since import restrictions would also hurt the rest of the world, such a country might try to induce the surplus countries to adopt more expansionary policies by threatening that otherwise it would have to erect new trade barriers. Giving in to those threats by adopting ill-conceived policy concepts would remind me of a man who committed suicide because of his fear of death. All that the "stronger" countries can do in such a case is to offer further reduction of their own trade restrictions. This can best be done within the framework of GATT. If GATT negotiations were to come to a standstill this would mean regression. I, therefore, believe it to be highly important that the Tokyo-round of negotiations will finally be successful in further reducing tariffs and non-tariff barriers in all industrialized countries.

After having tried to make a convincing case against further demand stimulating policies at the present time in the so-called stronger countries, especially in Germany, on the ground that it would probably not help the "weaker" countries and at the same time would weaken the "stronger" countries and by all that would deteriorate rather than improve the longer run prospects for world economic growth and full employment, still an answer remains to be given what "stronger" countries like Germany could do, each by itself or in a coordinated effort, in order to assist "weaker" countries in overcoming their difficulties.

Let me at first remind you again that Germany is in a strong position only with respect to its balance-of-payments situation, to its foreign exchange reserve position, and to its price level performance. It is weak as far as investment and growh of productive capacities are concerned. Because of that it might envisage an extended period of unemployment. Only if Germany succeeds in pursuing policies which keep the rate of inflation down, which consolidate the budget of the public sector, which stimulate job creating private investment, and last but not least which keep wage increases within prudent bounds will it remain able to contribute toward helping other countries to regain their economic strength.

Having said this, what can Germany do that would be of immediate assistance to the "weaker" countries? First of all, it can let the D-Mark float upwards if the market commands it. Germany has done this already during the last few years. The weighted average of the external value of D-Mark has gone up from the end of 1972 to the forth quarter of 1976 by 30 per cent (cf. Table 2). If one corrects the external value for differences in the increase of unit labor costs (or of unit export values) one gets a less spectacular picture (cf. Table 3). But taking a longer view back, one can see from those figures that the continuous appreciation of D-Mark in nominal terms has put producers of export goods and of import competing products under heavy competitive pressure from abroad. The result can be read from Germany's import performance. German imports rose from 1974 to 1976 in value by 23 per cent and in volume by 19 per cent (the respective figures for the USA were 20 and 8 per cent, for Japan 4 and —4 per cent). Even in 1975 when the volume of imports of all OECD-countries declined by almost 7 per cent, German imports rose by 2.6 per cent. I believe that Germany does more for other countries' exports by letting its currency float than it could do by stimulating domestic demand.

This alone, of course, is not the solution of the "weaker" countries' problems. Some of them have been caught in an inflation-depreciation spiral often referred to as the vicious circle. If, for a while, depreciation of a currency has lead to price increases of tradeable goods and this in turn has lead to a rise of factor prices, especially wages, and by that the general price level has been pushed up, and if an expansionary monetary policy has accommodated this inflationary process, everybody will expect this to go on. In anticipation of the continuance of this process, enterprises will raise their prices and unions will demand higher wages in order to keep pace with inflation or even to be slightly ahead of it. Once being caught in this circle further depreciations would neither improve exports nor lower imports because any depreciation will be accompanied by at least an equal increase in the rate of inflation. If now the government and the central bank of a country experiencing such a vicious circle try to apply restrictive policy measures in order to break it but still everybody expects the inflationary process to go on, it may come to downward overshooting of the exchange rate. The degree of domestic restraint which by itself would break the vicious circle, might lead to unemployment of an extent that turns out to be politically unacceptable. Therefore, the downward movement of the exchange rate has to be slowed down as soon as restrictive measures are adopted if they are to have a chance of success. This can be done only by interventions in the foreign exchange market. Such interventions would require the extention of credits by the "stronger countries".

I feel that such credits should be granted even in generous amounts by coordinated efforts of the 'stronger' countries. In my opinion these credits would have to play the key role in assisting 'weaker' countries to overcome their difficulties. Germany has already contributed substantially to such supporting credit arrangements in favor of Great Britain and Italy and should go on to do so. Of course, the main effort has to be made by the 'weaker' countries themselves. They have to stick to the restrictive measures in order to break the expectations of accelerating inflation and finally to bring about the necessary shift of resources from consumption to investment. The credits should, therefore, be granted only under the condition that sound economic policies have been adopted and will be continuously applied. Especially the rate of monetary expansion and the deficit of the public budget will have to be cut down; to keep wage increases moderate at least for a while, adequate incomes policies would have to be introduced in order to complement restrictive demand management.

I would suggest going even one step further. One could try to establish a new basic principle by which multilateral assistance for interventions in the foreign exchange market would be made conditional upon setting up and adhering to jointly agreed monetary policy targets. For each country participating in such an agreement a target for its monetary expansion, e.g. in terms of an annual rate of increase of its high powered money, would have to be set at a level which takes into account the country's individual political and social situation. At the outset this rate would have to be determined mainly by two factors, the rate of growth of the production potential and the rate of inflation deemed unavoidable. A second rule would have to be stipulated by which this rate of monetary expansion is gradually to decrease year after year. On the other side, all countries participating would have to commit themselves to extend credits to any of them who has adhered to the monetary rules and whose exchange rate has moved out of a target zone corresponding to the differences in monetary targets. Without going into the rather complicated details of this proposition I want to point out that, in my opinion, such a scheme designed to gradually restore stability in the participating countries would have a good chance of functioning because it would fulfill the main precondition for workability: a balance between the burden of discipline—imposed by the monetary target—and the advantage from solidarity in terms of access to credit facilities under well defined conditions. I feel it would be worth our while to think more along the lines, in which ways and by which means solidarity and cooperation among nations could bring about the discipline in economic policies that is needed for assuring worldwide adequate growth and full employment instead of trying to put the blame on each others policies for our failing to achieve these objectives.

TABLE 1.—KEY ECONOMIC INDICATORS FOR THE FEDERAL REPUBLIC OF GERMANY

[In percent]

	1960	1970	1971	1972	1973	1974	1975	1976
Profit margin [1]	11.2	9.6	9.0	8.7	8.3	7.2	6.5	[2] 7.2
Gross fixed capital formation [3]	15.8	15.4	4.6	1.1	.8	−9.6	−3.1	[2] 6.8
Growth rate of production potential [4]	([5])	5.6	4.9	4.9	4.5	3.8	2.7	2.4
Increase in wage rates [6]	6.8	13.6	14.1	9.5	10.6	13.0	9.3	5.9
Labor costs per unit of production [7]	2.0	29.	9.7	5.8	8.7	8.7	7.7	1.4
Unemployment ratio [7]	1.3	.7	.8	1.1	1.2	2.6	4.8	4.7
Increase in the cost-of-living index		3.4	5.3	5.5	6.9	7.0	6.0	4.5

[1] Entrepreneurial and property income as percent of gross production value, manufacturing sector.
[2] Estimated.
[3] At 1962 prices, increase on previous year: enterprises (excluding apartment letting enterprises).
[4] National economy: calculated by the German Council of Economic Experts.
[5] Not available.
[6] Standard wages; national economy; hourly basis.
[7] National economy; increase on previous year.

Source: Federal Statistical Office of the Federal Republic of Germany.

TABLE 2.—EXTERNAL VALUE OF DEUTSCHE MARK

[End 1972=100]

	U.S. dollars	Against—Currencies of EEC countries	All currencies
Monthly average:			
1973 [1]	123.3	109.5	111.8
1974	124.7	116.7	116.2
1975	131.3	117.0	118.1
1976	128.1	129.9	124.0
1973:			
I [2]	114.0	103.8	105.3
II	118.0	106.6	108.1
III	134.7	115.2	118.9
IV	126.6	112.4	114.8
1974:			
I	118.8	114.6	113.3
II	128.8	119.3	119.0
III	123.5	115.2	114.8
IV	127.8	117.6	117.5
1975:			
I	137.9	119.1	121.4
II	136.9	116.7	119.8
III	126.3	115.8	115.8
IV	124.1	116.4	115.4
1976:			
I	125.2	121.8	118.6
II	126.0	129.3	122.8
III	127.3	131.0	124.3
IV	133.8	137.5	130.2

[1] March to December.
[2] March.

Source: Deutsche Bundesbank.

TABLE 3.—EXTERNAL VALUE OF DEUTSCHE MARK IN NOMINAL AND REAL TERMS IN RELATION TO THE 14 MAJOR INDUSTRIAL COUNTRIES [1]

[1962=100]

	Weighted nominal movement of exchange rates	Weighted real movement of exchange rates—	
		In terms of prices [2]	In terms of Unit labor costs
1962	100.0	100.0	100.0
1963	100.4	100.6	98.0
1964	100.7	99.7	95.9
1965	100.2	100.0	94.9
1966	100.3	100.4	94.6
1967	100.6	99.8	89.3
1967	100.6	99.8	91.6
1968	101.8	100.6	89.3
1969	104.8	102.2	90.7
1970	113.7	107.3	101.9
1971	116.9	109.7	106.2
1972	119.2	110.5	107.3
1973	130.8	113.7	116.0
1974	137.2	104.0	114.9
1974	137.2	107.0	115.9
1975	137.6	105.6	106.5
1976 [3]	146.1	(4)	105.8

[1] United States, Canada, Japan, EEC member countries (except Federal Republic of Germany), Sweden, Switzerland, Austria, Norway; weighted with the share of each of these countries in the Federal Republic of Germany's foreign trade turnover.
[2] Unit export values.
[3] Provisional.
[4] Not available.

Source: 1976–77 Annual Report of the German Council of Economic Experts; 1976 figures updated.

Senator HUMPHREY. Thank you, Mr. Gutowski. We may have some discussions on this a little later. Again, I want to say that we would like to get some dialog going, so if you can paraphrase as much as possible, it will help us.

Senator Javits, please come over here, Senator.

Senator JAVITS. Okay.

Senator HUMPHREY. Please proceed, Mr. Okita.

STATEMENT OF SABURO OKITA, SPECIAL ADVISER, INTERNATIONAL DEVELOPMENT CENTER OF JAPAN

Mr. OKITA. I am thankful of being invited to this hearing. You have my prepared statement, Mr. Vice Chairman, and I may divert from the written text and try to speak off hand.

Senator HUMPHREY. Yes, thank you.

Mr. OKITA. The position of the world economy we are facing now is very critical. One is the bipolarization of the industrial economies of the world. For one thing some of the industrialized countries are the stronger economies, and there are the other weaker economies. As a matter of fact, 5 months ago, economists from Europe, Japan, and the United States worked together at the Brookings Institution in Washington and produced a joint press communique, saying that the stronger countries, the United States, Germany, and Japan, should try to stimulate their respective domestic demand to cope with the worldwide recession.

This has become a very popular issue for the world, and basically I personally agree with the proposal that the stronger economies among the industrialized nations should stimulate demand internally and make adjustments of some type so the weaker economies will have an easier time.

Another problem of the world economies is the accumulating debt of the developing countries who are nonoil producing countries.

In some of the countries, as Mr. Arsenis stated, there is a need for changing the structure of debt, particularly in the terms of debt. Longer term conditions should help those countries to get over their short-term problems.

But for other countries, with the lower incomes, there is a need, not necessarily in the short term, but a long term need for the importance of having a transfer of resources to those countries.

I should follow Mr. Gutowski's example of giving some account of our own economy; that is, the economy in Japan.

I mentioned in the prepared statement that the three economies, the United States, Geermany, and Japan, are able to overcome oil crisis for different reasons and due to different circumstances. In the case of the United States, the shock of high oil prices was relatively small compared with other countries because of the rich endowment of energy resources within the country itself.

For Germany, the financial policy was such that adjustment was relatively easy.

In the case of Japan, we have had somewhat more difficult conditions compared with the other two countries, and that was because the oil prices, the crisis of 1973 coincided with other strong domestic inflationary pressures. We had about a 35-percent rise in wholesale prices in March 1974, to the spring of 1973; and we had some 32-percent rise of average wages to about a year ago. The Consumer Price Index for the spring of 1974 rose by 26 percentage points higher than a year ago. So in the further years we had to introduce rather strict domestic anti-inflationary policies. Somehow we have succeeded in adjusting the economy particularly in the balance-of-payments position and the domestic prices. In fiscal 1974 Japan lowered the rate of economic growth to zero. There was a 23.4-percent rise in wholesale price index that year and 21.8-percent increase in the Consumer Price Index. This compares to the years preceding the oil crisis, the 15 years, where we had 10 percent average annual growth rate and 5 percent annual consumer price rise.

There is another factor which other industrial countries may not have experienced in similar ways to ours in the adjustment process. Although the macroeconomic indexes such as the balance-of-payments position and the price movement have improved substantially, the microphase has deteriorated considerably. This is the question that we are facing at the moment. Also, the Government budget balance has deteriorated. In the fiscal year 1977 the Government budget has some 30-percent deficit over the total expenditures. This is much higher than the case of the United States or in the case of West Germany. This is one limitation to the case for further stimulating domestic demand by way of increased budget deficits. Japan had the rather sharp expansionary export trade levels in early 1976, and we have seen some leveling off over the past year, but in general we have had the process of economic recovery somewhat lead by the strong export trade.

This is a dilemma for our economy. The Japanese economy still has some competitive strengths and the export expansion is still a stimulus to the domestic economy.

But if we follow this course, this may create problems in other countries who are importing countries. We have some problem already as you realize in the European Community because of the sharp increase of Japan's export trade to that area.

But on the other hand, if you look at our global trade picture, we have a regional imbalance of trade.

In the Middle East our oil bill increased very substantially, and we have $10 billion in our deficit with that area because of the large amounts of imports of oil at higher prices.

We have also a structural imbalance of trade in Australia and Canada. Every year we have $5 billion deficit of trade with those two areas. So those three areas combined including the Middle East, Australia, and Canada, we now have about $15 billion deficit in our trade account.

What is now happening is that we have a surplus of trade with the United States amounting to about $5 billion last year, also a similar amount with EC countries and some surplus of trade with the rest of the world including Southeast Asia, South America, and Africa.

So we argue that we cannot argue much about the bilateral balance regionalwise, because we have a deficit with certain regions, we have surplus with some other regions in order to obtain a global balance of trade.

Now, we have a deficit in our invisible trade account of the size of $5 billion. However, the problems we see in Japan is that the balance, or even current account balance, should not be argued in terms of regionwise bilateral relations, but rather discussed in global terms and also in terms of the overall balance of payments including capital transfers.

However, we also understand that apart from the macro picture of the Japanese export trade with the outside world, we have certain commodities where export trade has expanded sharply and if such expansion is concentrated in certain areas with certain commodities then it will naturally have the effect on the import market. But basically this is a matter of the changing international competitiveness, changing international comparative advantage.

In the past we have had the period of the fixed exchange rate which had some favorable impact on Japan's export expansion but now we are under the floating rate system and as in the case of Germany, although we have had some varying levels, we have shored it up by 7 percent in the course of the past 6 months.

There is, therefore, some necessity in view of this trade performance, there is some necessity of further stimulating domestic demand in Japan. This has been the question that has been very much discussed among international as well as domestic concerns.

There may have been cautious actions in the past year or so in creating demand domestically; but as an economist I personally felt—and in fact I have advised in various cases—the Government should introduce more positive demand-creating policies. In view of the higher rate of inflation still existing in Japan as compared to the United States and West Germany, added to the traditionally cautious attitude on the part of the Government, and also the very recent experience of the rampant inflation which took place right after the oil crisis was such that the Government has taken a more cautious position, perhaps, than necessary when stimulating the domestic demand.

That was the reason the central bank was belatedly reducing the discount rate by 0.5 percent in March and again further by 1 percent in April.

We expect there will be some stimulating effect on the domestic investment with that. The Government has set a target of 6.7 percent for a yearly rate of growth, for fiscal year 1977 starting in April, and ending in March. Some of the forecasts indicate lower figures such as the one prepared by the Japan Economic Research Center—of which I am the chairman of the board—whose estimate of the growth is 5.1 percent instead of the 6.7 percent of the Government forecast. I personally feel, as presented in my prepared statement, there should be a kind of commitment by each government, particularly the governments with stronger economies, in the forthcoming summit meeting in London, that each government may commit to a rate of growth in their terms which the Government is intending to attain for 1977, and promise to the rest of the world that the Government will introduce necessary measures to attain more or less the target set by the respective government. This kind of announcement will give confidence for domestic industry in those countries and the countries all over the world as well.

The lack of confidence is a very important factor. It is preventing investment activity. In the case of Japan, the industrial activity is still at 3 percent below the November 1973 peak. Since then there was an expansion of the capacity of 16 percent, therefore, the industries are operating very much below capacity, and this has taken away the stimulus for private industry to invest in new equipment. Like in the case of Germany, we need some stimulus in the private domestic equipment investment. Thank you, Mr. Vice Chairman.

[The prepared statement of Mr. Okita follows:]

Prepared Statement of Saburo Okita

The State of World Economy and a Policy Prescription

I. A Diagnosis of the Present State

The world economy in 1977 is confronted by two problems. The one is a bipolarization of the advanced economies, and the other is the problem of the mounting debts of the non-oil producing developing countries. The Soviet Union and East European countries are also faced with the problem of increasing debts, but much less seriously than the non-oil developing nations.

To begin with the first problem, there will become increasingly perceivable in the world economy of 1977 a bipolarization into two groups of countries; the one composed of those countries which can be considered to have overcome the aftereffects of the oil crisis such as the United States, West Germany and Japan; and the other of those nations like Italy, the United Kingdom and France which will hereafter have to undergo a full-fledged process of adjustment. France is in a much better condition than Italy and the U.K., but will be necessitated next year to continue restrictive policies as strict as those implemented this year if the nation expects to give satisfactory results to the Barre plan which was adopted last autumn. Italy and the United Kingdom will have the need to implement stabilization policies more protracted and thoroughgoing than those to be adopted by France. Other European countries are also likely in 1977 either to be in economic condition worse than in 1976 or to continue economic growth at as low a rate as in 1976 with the sole exception of Norway.

There are two reasons why the rate of economic growth is expected to be generally lower in 1977 than in 1976. Firstly, it is attributed to the fact that there were in 1976 such factors for temporary recovery of the economies as the decline in fixed investment being halted, the demand for consumer durables recovered and housing construction hitting the bottom and picking up, whereas some of these factors have disappeared in 1977. Secondly, it is ascribed to the

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circumstances that in some countries stabilization policies have been given full play.

Then, why have the United States, West Germany and Japan been able to overcome the oil crisis?

In the case of the United States, the reason might be that the effects of the oil crisis were less serious thanks to the nation's endowment with natural resources.

In the case of West Germany it was due to the fact that after the failure of the concerted action (Konzierte Aktion) in the late 1960s the country, exceptionally among major nations, put in force strict retrenchment measures beginning with the early 1970s with the result that price upsurges after the oil crisis were comparatively moderate to make subsequent adjustment relatively easy.

Then, in the case of Japan, the nation was hit by the oil crisis when it was in the midst of inflation which had been caused partly by the so-called "plan for remodelling the Japanese Archipelago." This resulted in price upsurges after the oil crisis which were more serious than in any other countries and even surpassing those in Italy. Nevertheless, the Japanese government formulated an appropriate medium-term adjustment program ranging over the three-year period from 1974 to 1976, and implemented it as scheduled to realize successfully the normalization. Let us briefly introduce below this experience of Japan.

Japan in fiscal 1974 deliberately lowered the rate of economic growth to zero by means of strict restraining policies in order to cut off a vicious cycle of price-wage spirals. The result was a −0.2 percent growth of aggregate economy, a 23.4 percent rise in the wholesale price index and a 21.8 percent increase in the consumer price index. This was a result nearly corresponding to what has been expected in advance. These figures themselves appear quite discouraging. Nevertheless, they were the achievements which would guarantee a success of the subsequent stabilization policy. This is because, it might be said, a starting point was prepared in fiscal 1974 for subsequent implementation in fiscal 1975 and 1976 of the policies which were designed to raise gradually the rate of economic growth on the one hand and lower by steps the rate of price and wage increases on the other. To explain the actual performance of the economy in fiscal 1975 for reference, the rate of growth was 3.4 percent, the wholesale price index rose 2.1 percent, the consumer price index 10.4 percent and the compensation of employees increased 14.1 percent. In fiscal 1976 the rate of growth is expected to have been 5.7 percent, the wholesale price index and the consumer purice index climbed 5.8 percent and 9.4 percent respectively, and the employees' compensation increased 13.8 percent. Thus the Japanese economy took in fiscal 1975 and 1976 a pattern, as designed by public policies, that the rate of economic growth rose gradually on the one hand and the rates of price and wage increases fell by steps on the other with the actual figures having also nearly been what have been projected. Having thus finished adjustment to the oil crisis in the past three years, the Japanese economy is about at last to enter the path toward a stable long-term growth beginning with fiscal 1977. Judging from this experience of Japanese economy, it will in the late 1978 through the early 1979 at the earliest that stabilization policies in European countries will have their effects to give the economies an occasion to take direction toward expansion.

As regards the second problem of the mounting debts of non-oil producing developing countries, a combined current deficit of these countries increased from ¥9 billion before the oil crisis to ¥26 billion in the period from 1974 to 1976 on an annual average. A deficit of nearly similar size is expected in 1977. The latest outstanding debt balances of principal debtor nations are estimated at $30 billion for Brazil, $20 billion for Mexico and $10 billion for Argentine.

The real points at issue regarding these mounting debts of non-oil developing nations are the following two:

(1) There are no signs of slowing-down in the tempo at which these debts are growing; and

(2) A considerable part (40 to 50 percent) of these debts are financed by major private banks.

In order to cope with these issues, it will be necessary for those non-oil producing developing countries to strive for containing their domestic inflation through adoption of restrictive policies and also for some steps to be taken with respect to those debts which are said to become due after 1978.

In particular, in the light of the intensification of inflation in the non-oil producing developing countries in Latin Amerca, it should become the precondition for these countries to adopt drastic anti-inflation measures in dealing with the debt problems.

Belt-tightening policies, if adopted by non-oil producing developing nations would have, even if temporarily, contracting effects on the world economy.

With respect to the problem of mounting debts of the Soviet Union and East European countries, it doesn't appear to be of so great a concern when we take into consideration the facts that the outstanding debt balance is still not so large (less than $50 billion) and that the causes for the increase of these debts have not necessarily been unsound. Different from the market-economy countries which are based on private enterprise, these centrally-planned economy countries have not so much been affected by the oil crisis. In these countries, notwithstanding industrial output increased and imports expanded as a result, exports remained sluggish due to economic stagnation in the market economy nations. Their debts have increased as a consequence of these situations and not necessarily due to unhealthy factors. In case, however, repayments in the future are made by deliveries of goods produced by the imported plants, it cannot be denied that we may have the difficulties.

As observed so far, in the world economy in 1977 and forward, the possibility is great that both the industrially advanced European countries and the non-oil producing developing nations with the exception of the so-called "engine countries" of the United States, West Germany and Japan will show an increasing sign of stagnation.

Under such world economic conditions there will be an increase in the instances that measures to restrict imports will be adopted in those countries, among others, which are suffering deficits in their international payments. As a real problem, it will be many Japanese exports which are highly likely to become the objects of such import restrictions. Even if Japan may maintain its rate of foreign exchange at an appropriate level, it would be difficult to keep such individual commodity problems from arising because the differentials in comparative competitiveness will remain deep-rooted with regard to some commodities. How should we deal with this problem?

We cannot oppose to the proposition that under such prospect of world economy as above the so-called three engine countries of the U.S., West Germany and Japan take positive measures for stimulating their economies in order to help other nations implement easily their stabilization policies.

It is also a matter of urgency that these countries with collaboration of oil producing countries set up an international mechanism for recycling oil dollars, shouldering the cost according to their abilities.

II. MATTERS DEMANDED AS PREMISES IN FORMULATING POLICIES

It is considered natural that Japan should cooperate according to its ability in overcoming these difficulties with which the world economy is confronted.

Since, however, Japan's endeavor in this direction will naturally have only limited results, it is desirable that similar efforts may be made by nations other than Japan if Japan's efforts should have expected results.

For example, the Japanese government is giving 6.7 percent as a target growth rate of the nation's economy. As will be discussed later, however, this is a target which is doubtful to be realized under the present conditions. I am of an opinion, nevertheless, that it is an international duty of this country at this occasion to make efforts aiming at realization of this target. I am also of a belief that Japan should not hesitate to take additional action for bolstering its economy if it is necessary in order to attain this objective.

Meanwhile it is reported that economy has recently been recovering smoothly in the United States and West Germany which are our partner engine countries. And, therefore, there are apparently no discussions about the need of adopting new measures for stimulating economy in the above two countries. In the United States, the government has cancelled the plan of tax rebate which President Carter declared this January.

Considering, however, the expectation that the world economy will be faced by difficult problems as mentioned already, it is believed that in the forthcoming summit conference in London in May Japan should promise a realization of the 6.7 percent growth of its economy and the United States and West Germany likewise confirm their intents to attain the governmentally-targeted rate of economic growth respectively, and also that all three countries should declare to the world their intention to exert additional policy efforts in case the realization of these objectives becomes doubtful.

The Presidential budget message sent to the U.S. Congress in January this year assumed economic growth at a rate of 5.2 percent in fiscal 1977 and of 5.1 percent in fiscal 1978. The present Administration appears also to be expecting a growth of over five percent. It is desired, however, that the U.S. government make its attitude on this point clear at the summit meeting.

Many economic forecasts announced lately in the United States are generally optimistic; and we ourselves are desirous of things so developing. It will be helpful, however, in eradicating entrepreneurs' deep-rooted concern over the future that the government should confirm at the summit talks its intent of their materialization.

There are many reports that West German economy will grow at a rate nearer to the five percent which is projected by government than to the 3.5 percent which is forecasted by the OECD. This is also quite encouraging to us. It is desired, however, that the governmental intention to realize this target be reaffirmed when the heads of the States meet in London.

Furthermore, it is hoped that nations other than these engine countries, which are in economic plights make reappraisal of their past policies and make efforts to realize the normalization of their economies.

As regards recycling of oil dollars, while a de-facto recycling has been propelled on the Euro market and at other financial centers across the globe, multilateral agencies have not so far played an important part in the recycling. Such recycling by private financial institutions which are based on profit motives, however, is giving rise, as its consequence, to a problem of mounting debts in some countries. It will be inevitable that multilateral agencies such as International Monetary Fund and World Bank will expand their roles in the future. Furthermore, partly in order that the debt countries may stand on their own feet again, there will be the need for these multilateral agencies to give them appropriate advices.

Since, however, direct cooperation of the oil-producing countries is indispensable to the operation of these international institutions, it is desired that the understanding of this point of the part of these countries be obtained. Furthermore, in view of the fact that in the operation of the funds thus raised the landings to debtor nations by the financial institutions of particular nations constitutes a large proportion, it is desired that caution be exerted for avoiding misunderstanding that the operation of funds are apt to be swayed by the interests of these nations. It is felt that Japan should naturally be willing to collaborate in the operation. In this connection, with respect to the OECD's so-called "Financial Support Fund" plan Japan have already had it ratified by the National Diet. Therefore, it will be necessary for Japan to find out the appropriate relation of the roles of OECD's Fund and this new recycling device.

As things now stand, it is quite difficult to make a short- or medium-term projection of the world economy. It seems indispensable, however, to write a certain number of alternative scenarios if we do expect various governments including those of oil-producing nations to formulate appropriate measures to cope with difficult problems including the bipolarization of the advanced economies, the mounting debts of non-oil developing countries and so forth. In the present conditions we cannot help saying that there are available only partial projections such as OECD's Economic Outlook which is restricted both in time span and regions covered and that there is lacking, as a result, information which various governments need in deciding on appropriate policies. We would like to suggest correction of these defects and to establish worldwide economic projections by internationally sponsored institution or by an international organization itself.

III. JAPAN'S ECONOMIC POLICY AS IT OUGHT TO BE

The Japanese government sets the target rate of growth of the nation's economy at 6.7 percent for this fiscal year. It puts the balance of current international payments at a deficit of $700 million as corresponding to this projected rate of growth. While the government has set no target for the rate of foreign exchange, the yen is now traded at a rate appreciating nearly seven percent above the rate that prevailed six months ago. There is no likelihood of the rate depreciating below this rate at least for the time-being.

In the meantime, a projection by the Japan Economic Research Center predicts that the Japanese economy will grow at a moderate rate of 5.1 percent in fiscal

1977. It foresees that private fixed investment, inventory investment and personal consumption will all together increase at rates lower than the governmental projections.

Although the Japanese government is making such efforts as to raise the rate of increase in general account spendings to 17.4 percent (nominal rate of growth is 12.4 percent) by issuing national bonds amounting to ¥8,500 billion, or $31 billion (about 30 percent of the total revenue in the general account), it is still not enough to attain the 6.7 percent rate of growth.

According to a simulation made by the JERC, in order to raise the rate of growth of aggregate economy above six percent, it is necessary for the government to appropriate in the supplementary budget for the second half of the year additional ¥500 billion ($1.8 billion) for public works projects, expand the framework of Housing Finance Corporation loans to an amount enough to construct additional 50,000 residential units ¥225 billion or $830 million), slash the official discount rate again by one percent, reduce taxes by ¥1,000 billion or $3,600 million and so forth.

It is expected that the Japanese government will sooner or later adopt such measures for bolstering economy, though it depends on the future development of economic conditions. It cannot be denied, however, that apprehensions of price rises are making policy-makers hesitate to take bold actions, though this could be said about all of the United States, West Germany and Japan. It is only several years ago that in the United States the Nixon Administration made an experiment of incomes policy. It is felt after all is said that, as far as price problems are concerned, one cannot necessarily criticize cautious attitudes which various governments may take.

As regards the problems of international payments and exchange rates, it is true that Japan should not continue registering a surplus in current balance under the current serious situation. The nation should cope with the situation by raising the rate of economic growth and keeping the yen's exchange rate rather appreciated, and channelling any current surplus that may still arise into direct investment abroad, for promotion of bond flotations in Japan by foreign countries, for expansion of aid flows to the developing countries and other objectives.

Furthermore, there is a possibility of the move toward import restrictions and the intensification of other trade barriers; but it is felt that on this very occasion we should not forget the promotion o fthe "Tokyo Round" of international negotiations to lower trade barriers multilaterally in order to prepare for the future welfare of mankind.

Senator HUMPHREY. Thank you very much, Mr. Okita.

All right, Mr. Poulin, we look forward to your commentary.

STATEMENT OF GEORGE J. POULIN, GENERAL VICE PRESIDENT-ELECT, INTERNATIONAL ASSOCIATION OF MACHINISTS AND AEROSPACE WORKERS

Mr. POULIN. Mr. Vice Chairman, members of the Joint Economic Committee, as a layman I am honored to be participating in this discussion with such a distinguished group of panelists and this committee. I appreciate this opportunity to express some of the concerns which our members share with the President of the United States as he prepares to confer with leaders of other industrial nations on economic, trade and energy problems.

One of the issues which will receive special attention is the need for general economic stimulus among those nations which account for most of the world's industrial capacity. The leaders of these nations are concerned by the continuing stagnation of the U.S. economy. This is because, as someone said, when America sneezes the rest of the world catches cold. For some time the American economy has suffered economic malnutrition. The symptom which most concerns the working people of this Nation is lack of enough jobs to go around. For almost 2½ years the rate of unemployment has been ranging from 7 percent to more than 8 percent. And this does not include millions of workers who are unemployed or who have simply given up and dropped out of the work force. Many economists claim that true unemployment is closer to 10 percent than 7 percent today. No matter how unemployment is counted, the fact remains that millions of Americans are not functioning effectively either as producers or as consumers. As a result, the economies of other nations suffer along with our own.

Leaders of other nations who are affected by the health of the American economy may well wonder whether our current seige of economic stagnation is temporary, in which case no unusual response is needed, or whether it typifies a more serious, underlying condition.

Mr. Vice Chairman, I think that in going into these discussions the President must recognize that the unemployment which is weakening the American economy, and thus the world economy, is not a temporary phenomenon. Chronic unemployment has been creeping up decade by decade. There are those of us who remember that in the 1950's anything over a 4 percent rate of unemployment was cause for governmental concern. In the 1960's it became 5 percent. And, as I have indicated, it has been ranging between 7 percent and a little over 8 percent since November 1974. Moreover, there is no sign of significant improvement in the near future. In fact current trends indicate that unless something is done, unemployment will continue to grow. More than 2¼ million new jobs will have to be created in 1977 merely to absorb the increase in the work force. Another 2½ million jobs will be needed for those whose present livelihoods will disappear because of automation, technological change and general increases in productivity.

We believe the President would be better prepared to assure our friends and trading partners if he were more committed to a program of timely economic stimulation within the U.S. economy. The most direct way to do this is to create jobs. And I am not suggesting make-work or leaf-raking projects. There is much to be done to meet a long-developing residue of human need in our country.

May I point out that Federal, State, and local governments are now spending billions of dollars for welfare, food stamps, unemployment compensation and all the other direct and indirect costs of unemployment. The American labor movement has urged that at least $30 billion should be invested in a major Federal effort to accelerate public works, expand public service employment and ease the shortage of housing which has reached almost crisis proportions. To this $30 billion, I would suggest respectfully that there should be added the $11 billion which the President had previously earmarked for tax rebates, but which he has since withdrawn. Such a direct and dramatic application of Federal funds is needed to regenerate our economy. It would take people off welfare rolls and put them on payrolls. It would convert millions of welfare and unemployment compensation recipients—that is, tax recipients—into taxpayers.

Since our trading partners in Europe and Japan are admittedly affected by economic stagnation in the United States, we believe the President could, and should, make clear the ways in which they, themselves, are contributing to the erosion of America's industrial job base through one-sided as well as shortsighted trade policies.

Mr. Vice Chairman, the American labor movement has recently been portrayed as narrow and protectionist in its trade views. But I would like to point out and submit to you that over the long run, the labor movement as a whole has favored open markets and free trade in world commerce. American workers are not afraid to compete on a fair basis with goods produced by workers in other countries. As a result of the Smoot-Hawley tariff and the restrictive trade policies of the early 1930's, we learned that we cannot sell our goods to other countries without being willing to buy their goods in return. In 1962, when President Kennedy asked organized labor's support for general tariff reduction in what was called the "Kennedy Round," he received that support.

Since then, however, we have been getting a lesson in the realities of international trade. We have seen our manufactured goods shut out of foreign markets not by tariffs, but by such nontariff barriers as quotas, border taxes, unreasonably high quality standards and the insistence of other countries to coproduction rights. Many employers, shut out of the common market by such nontariff barriers, have jumped these barriers and opened up factories in Europe. When we point to the job loss of our members they tell us they are forced to move, not because of any lack of productivity on the part of the American work force, but because this is the only way they can get into the European markets. As the largest union of aerospace workers in the world, we have come to realize that many of the so-called sales of aerospace overseas, which look so good in the computation of trade balances, are really sales of technology. The much-publicized sale of F-16 fighter planes to the NATO nations, for example, was more a sale of plans than of planes. The NATO nations demanded and received the right to build most of these planes with their own labor. They also demanded and received the right to produce 10 percent of all future orders placed by the United States Air Force as well as 15 percent of all future orders by non-NATO countries.

If other countries want to trade with us we are more than willing to trade with them. But trade must move in both directions. Countries that expect to sell freely in our markets must not be free to keep our goods out of theirs. It seems reasonable for American workers to expect their President to demand reductions of the many kinds of nontariff barriers that have been erected against the goods we produce with our labor.

In addition to economic stimulus and other trade policies, the President and these other leaders will also be seeking to formulate a mutually beneficial position on energy. He will, of course, be speaking from a most precarious position. As the situation now stands, our major sources of energy depend upon the whims of various sheiks and shahs along the Persian Gulf. Their power to hold our economy hostage will grow to the extent that we continue to import more and more billions of barrels of oil with each passing year. It's been almost 4 years now since we were all sitting in gaslines during the winter of 1973. Almost 4 years have elapsed without any really serious steps to break our economic dependence on imported oil.

But now the American people recognize what has to be done. We know we have to conserve oil as well as develop alternative forms of energy. The feedback that we get from our members indicates they are willing to make these sacrifices if those sacrifices are shared on a fair and equal basis by all segments of the population. A policy which seeks to conserve oil by making gasoline prohibitively expensive through taxes and deregulation is considered to be anything but equitable by our members.

They know that even if gasoline sells for $1.25 a gallon at the pumps it will not stop the rich and the well-to-do from tootling around in gas-guzzling monsters. Another $10 or $20 a week on our gasoline credit cards will not make pedestrians out of you or me or anybody in the $50,000 a year bracket. But such an increase will have a devastating effect on the family budgets of working people. In my years as a union representative in the field, I was constantly amazed—and I am today—at the vast distances people must drive to get to their jobs. It is not at all unusual for our members to drive 40, 50, or 60 miles each way to get to and from work. And if you add $10 or $20 a week to their gas bills, they will have $10 or $20 a week less for groceries and other necessities.

Since we obviously have to cut oil consumption, let us conserve in other, more equitable ways. For at least 3 years the Machinists Union has been advocating a program of Federal loans for insulating homes and equipping them with rooftop solar heaters. We know this is both practicable and achievable. It has been done in such energy-short nations as Israel and in Japan. In fact, it was recently reported that 40 percent of all the hot water in Japan is heated by rooftop solar collectors. Since water heaters are by far the largest single energy-using appliance in mots homes, this could result in a significant reduction in the need for imported oil.

By setting out to equip every home in America with rooftop heaters, for both water and area heating, we would not only have billions of barrels of oil each year, but would also create millions of needed jobs in both the construction and manufacturing industires. Factories that now stand idle in New York and Cleveland and Chicago could be retooled and shifted into production of vital importance to the future of this Nation. Construction workers and industrial workers who are now working part time, or not at all, could once more contribute to, rather than draw upon, the Nation's resources.

The sooner we get started, Mr. Vice Chairman, the better. The sooner we stop the outflow of capital which is being caused by the artificial and astronomical increases in the price of oil, the sooner we can restore the health of our economy.

And the sooner the President moves to restore the health of our own economy, the better it will be for our trading partners among the other industrial nations of the world.

Thank you.

Senator HUMPHREY. Thank you very much, Mr. Poulin. I can see that we are going to have some good discussion here if our colleagues will keep these thoughts in mind.

Senator JAVITS. Can I say in response to one fact, there will be submitted to the Senate an amendment to the tax bill giving a major tax break to home solar heating and insulation, which you mentioned.

Thank you.

Senator HUMPHREY. Mr. Roosa, we welcome you again. It's like having old home week here.

STATEMENT OF ROBERT V. ROOSA, PARTNER, BROWN BROS. HARRIMAN & CO.

Mr. ROOSA. Mr. Vice Chairman, I enjoy this opportunity. Mr. Vice Chairman, it is home week: Mr. Gutowski and Mr. Okita and I shared in writing an article about 3 years ago on the aggravated energy problem, and we are still here talking about it. [Laughter.]

Senator JAVITS. I am afraid you will be for a while.

Mr. HUMPHREY. Looks that way, doesn't it?

Mr. ROOSA. I will submit my prepared statement for the record, which does touch on several of the implications of the energy situation and also on one of the major subjects that Mr. Arsenis discussed. I would like to indicate in a broad way where I find a measure of agreement and a very slight area of disagreement.

On the energy-related issues, I would like to distinguish in the various things we have been discussing here between those derived effects which are in some measure either temporary or for which the remedies that have been proposed are of a temporary nature, such as some of those you will be discussing tomorrow when you talk about the balance of payments, and on the other hand, some of the deeper, longer run aspects, many of which Mr. Poulin just mentioned. It is these latter where I genuinely believe we have up to now missed a very significant opportunity. The papering-over or at least improvising with the balance of payments effects of the impact of high oil prices, as important as that is, and as significant as we must continue to regard it, is not going to deal with the basic fundamental fact. What we have been presented with is a change in the real cost of energy as it enters into the economy of every country in the world.

That real cost is so decisive, the change is so much in the order of a mutation, that every country has a basic structural reorganization to go through; and that is what we are finally beginning to get here in the United States today.

This has occurred in other ways in other countries and much more has to be done in all of them.

But I think it is terribly important that we think—particularly now that the United States is about to make a major thrust forward—about the other aspects of the implications of this same problem for all the less-developed countries of the world.

So, many of them who have been borrowing and getting through—and who have been creating debt obligations that Mr. Arsenis says, rightly, are going to have to have some further funding pretty soon—are still not getting that long-term capital, that opportunity for restructing within their own economic order that will permit them to become viable in the long run. They can't be in the position of a business firm that is running a deficit every year and borrows and borrows to cover it, unless they are getting long-term injections of new capital designed to fit their own management capability that will increase their productive capacity to become viable in the long run, to pay off these debts. What they need is a long-term capital commitment.

For that reason, it seems to me that it is important as we think now about the various positions that the President will take and those that the Congress will be taking reinforcing his views, and perhaps contributing to them over the months ahead, that we try to think in terms here of really the two aspects. It is largely short term to think of the financing arrangements that are needed. I agree with everything Mr. Arsenis said there. I think we do have to have through the International Monetary Fund, as I say in my prepared statement, a second increase in quotas; the seventh round ought to get started before we have finished the sixth.

I think we also ought to consider the so-called Witteveen proposal and make it as large as possible. In addition, as a contingency plan against the continuing deficit which, on balance, the outside world as a whole is going to have to run so long as the oil price remains where it is, and I think we also ought to think in terms of supporting, from the U.S. side, the so-called safety net or financial support plan which the bulk of the OECD and other countries have already approved.

This sounds like laying it on pretty thick, but the nature of the shorter term problem for just bridging these remaining gaps, as one country after another suffers the larger burden of this year's deficit and next year's is very big. And it's very significant that the deficit now projected for this year, on largely the oil account is going to be as much as $35 billion for the OECD countries, and perhaps $20 billion for the LDC's. We are getting back to where we were in 1974 when the big deficit was in the developed, or relatively developed, countries with a still substantial deficit in the LDC's.

So there is a place for all of these proposals and I would hope they would all be kept under active consideration, and that the President will encourage affirmative discussion of all three that I have just mentioned.

But related to this, all of these provide time if we use the time. Underneath that there has to be much additional done to encourage and support the further development toward viability of the whole complex of less-developed countries. We won't do that in 5, 10, or perhaps even 20 years; but we do need much more active support of the whole array of institutions represented by the World Bank. It has to have more capital. The IDA needs more capital; the IFC is getting more capital. It may even be necessary to revive, to look again, at the proposal of Chuck Robinson in the last administration for an international resources bank.

That would be necessary in order that we have every facet that can support constructively and affirmatively the development of basic change in the economic configuration of every country, and the way in which they can perform, in order to meet the quadrupled or quintupled real cost of energy.

So I would like to stress the need for looking at the long term and, in this connection and along with my own testimony, I would just ask to have inserted in the record, two articles I have written or shared in writing earlier, if I may, Mr. Vice Chairman, do that?

One is on something I will say a word on, a proposal to stimulate the economy through action on energy, and that is exactly what Mr. Poulin described; and I simply say I fully agree with him.

We have an enormous opportunity here to generate jobs, to create growth, if we see the energy position of the United States now not only as sacrifice but as an opportunity. There is just a tremendous range that that can give us on the capital investment side—a new mutation which will leap us well ahead of the stagnating position Mr. Poulin has just described.

So I would like to put that in the record.

Senator HUMPHREY. Yes, fine. We will place that in the record at the end of your oral statement.

Mr. ROOSA. As a final comment, I would like to put myself in agreement with the principle of the statement Mr. Arsenis made about the other problem which will remain chronic and serious even if we do all we should in the areas I have just described. That is the problem of raw materials and other internationally traded commodities where the price fluctuations are so wide and varied, and the availability is so varied and so unstable, that there is a destructive, whipsaw effect on the world economy, let alone on the LDC's. I think what we really have to explore affirmatively is some approach to commodity agreements on a much fuller scale than we have yet experienced, reinforced by some use of a common fund. For that I also have a paper for insertion in the record.

Senator HUMPHREY. Good. We will place that in the record at the end of your oral statement.

Mr. ROOSA. I would like to say that I am encouraged that the administration does now seem to be taking an affirmative approach here, too; and I pray for the President's success in persuading his colleagues at the summit to join in. Thank you.

Senator HUMPHREY. I might add that I find myself in agreement with much of what you propose. I hope you are successful in having an impact on the Congress, sir.

[The prepared statement of Mr. Roosa and the two articles referred to by him for insertion in the record follow:]

PREPARED STATEMENT OF ROBERT V. ROOSA

Mr. Chairman, you have been very considerate in giving me an opportunity to join with several old friends in discussing the critical issues that will confront the heads of state at their meeting in London next month. Although the range of our discussion here will undoubtedly be wide, I would like to focus on three of the critical issues in this preliminary statement: (1) the IMF and financial arrangements for balance of payments support; (2) the energy problem, with particular reference to the opportunities it affords for stimulating structural change, not only within the countries represented at the "Summit," but also on the part of all the others, particularly the LDC's; and (3) the proposed "Common Fund" and international commodity arrangements.

Before turning to these particular issues, I would like to make a general observation concerning the U.S. stance on these and other issues as that stance seems to be observed from abroad. I detect widespread concern, even some measure of bewilderment, among foreign observers over an occasional appearance of American pressure for the acceptance of views already determined here, in contrast with a give and take approach leading to mutually agreed positions, mutually arrived at. Sensitivity to this widely prevalent view abroad would suggest, at this early stage of a vigorous new Administration, that any of our positions can best succeed if advanced as basis for exploratory discussion, rather than as preconceived conclusions. There is, of course, a great difference between the determination of an irreducible national interest (as designed for the confidential guidance of this country's own representatives) and the broader presentation of alternatives or flexible approaches, which enable us to learn as well as to propose in the various international forums. My own brief following comments are intended to suggest the outer reach of negotiating positions rather than the inner core of irreducible requirements to meet our own national interest.

1. THE IMF AND THE FINANCING OF BALANCE OF PAYMENTS DEFICITS

The sizable balance of payments deficits of many developed and developing countries since 1973 have been financed through a remarkably resiliant variety of market facilities, including direct commercial bank lending, borrowings in the Euro-currency markets, governmental loans, and assistance from the various international financial organizations. Whether or not the proportion represented by private sector credits (estimated at about three-quarters) may have yet become unduly large, there is little doubt in my mind that recent proportions cannot be continued much longer, while the aggregate deficits will probably continue close to last year's magnitudes for several more years.

It is in any event sound contingency planning to provide now for the most effective combination of supplemental arrangements through the IMF or other international institutions. The current increase in IMF quotas now underway is only a beginning. It should be hoped that the leading countries represented at the Summit can agree, along with many other members of the IMF, that the next succeeding round of quota increases (the Seventh) should be initiated promptly, and that it should be large, preferably at least a 50 per cent increase over the quota aggregate of about $45 billion that will emerge from the current round.

Such a further quota increase could not possibly come into effect, however, in less than two years, that is, probably by the end of 1979. Meanwhile, it seems to me the United States should support in its discussions with other countries both of the approaches to supplement available resources that are currently being considered. That is, we should support an ad hoc arrangement for appending a $10 to $15 billion special facility to the IMF, and at the same time should support the so-called "safety net" or Financial Support Fund proposed over two years ago.

An IMF special facility might be expected principally to serve early needs for balance of payments support by countries outside the OECD. The Financial Support Fund could provide additional backstopping, on a standby basis, for countries within the OECD—most of whom, with the exception of the United States, have already completed the legislative processes for activating this facility.

The IMF special facility should be composed of contributions, or lines of credit, made available in roughly equal parts by the OPEC countries and by the surplus or strong country members of the OECD. Decisions to activate these resources, and make them available for IMF use in extending balance of payments loans to non-OECD countries, should be subject to approval by a special body consisting only of those who contribute to the special facility, with each country voting in proportion to its financial commitment. Owing to the unusual nature of the continuing balance of payments strains, the special facility should not be intermingled with other IMF resources. Moreover, the maturity of advances can appropriately be longer, and the interest charges possibly higher, than those typical under the IMF schedule of charges. The setting of such terms, as well as the setting of principles of conditionality for initial borrowing or for interest repayment, should be dependent upon mutual concurrence between the body created to provide the special facility and the Executive Board of the IMF itself.

With respect to the Financial Support Fund, the simplest procedure would be to follow lines that have already been agreed upon among the countries whose legislatures have already approved commitments to the plan. So long as there is an assured harmony between the use of any such facilities and the overall surveillance which the IMF is expected to provide for each of its members, the actual administration of monies raised and distributed could be handled by the Bank for International Settlements. That is the operating facility originally contemplated for the Financial Support Fund. In the interest of speed in establishing this backstop arrangement—one which may never have to be used, but whose mere existence may provide the needed degree of reassurance—I would thing acceptance of the existing agreements would be far preferable to the extended delay that might be implied by attempting to start over.

2. THE ENERGY PROBLEM AND ITS IMPLICATIONS FOR STRUCTURAL CHANGE

The quadrupling of oil prices not only caused the distortion of balance of payments positions, it also created an entirely new configuration of energy costs for every nation. In order to begin accommodating to this structural change in the real cost of energy, most countries have had to run the sizable balance of payments deficits for which the facilities of the kind I have just described provide a form of bridging accommodation. But the underlying need is to redesign each national economy to fit these new requirements over the longer term; to produce new combinations of production and consumption that can become viable on their own terms eventually. It is the process of making these adjustments that can, once the initial stage of shock has subsided, provide an impelling opportunity for economic advance along new lines, or in new patterns. I tried to outline some of these implications for the United States in a talk that I gave here in Washington last November. To save time and space now, I would like to submit a copy of that for the record.

Paralleling these opportunities for the United States, there are similar potentials available in differing ways for every other country. And very roughly as a matching offset to the needs for capital investment that each country's adjustment will require, there is the huge accumulation of surpluses in the hands of some of the OPEC countries. It is these surpluses which can be called upon, at least in part, to finance the bridging of balance of payments shortfalls in the oil importing countries. But the surpluses can have another purpose as they become devoted to instead to long term capital formation.

There are many countries, of which the U.S. is a leading example, who can, in their present posture, readily attract some of these OPEC surpluses for investment in capital resources. But there are others who need an intermediary, both to mobilize the funds available from the OPEC countries and to assist in working toward the priorities that will assure optimum use of borrowed or invested funds on a long term basis. For them, the IBRD with its subsidiaries, the IDA and the IFC, as well as the various regional development banks, have a profound responsibility. In order to channel some of the OPEC surpluses into support of the structural change that many of the LDC's must bring about, if they are to become viable in the longer run, all of these international development institutions need larger capital of their own, in order to support larger borrowing. That is why the United States should be aggressively supporting proposals for the enlargement of capital in all of these institutions through the direct contribution of member Governments.

Moreover, there may be some question as to whether the complex of these existing banks fully covers the entire range of meaningful need. The previous Administration proposed an International Resources Bank with this kind of need in view. That project was never fully articulated and it met premature but resounding defeat at the UNCTAD meetings in Nairobi a year ago. But the concept of developing a capability within the IBRD complex to work in tandem with private and other non-World Bank efforts to assist specifically the longer term restructuring of the extractive, manufacturing, or distribution facilities of the LDC's, does seem to me to have real merit. Whether the adjustment in any particular case will be more toward increasing capacity for exports, or for import substitution, the needs are distinctly different from those which can be met by the IMF or comparable facilities which aim simply to tide over shorter or longer gaps in a country's balance of payments until a new position of overall balance can again be achieved. In a fundamental sense, it is this second kind of need—that for lasting structural realignment, that is even more impelling than the improvisations that can carry countries through their current shortfalls.

3. A COMMON FUND AND INTERNATIONAL COMMODITY ARRANGEMENTS

Just as the United States should indicate strong support for our readiness to engage cooperatively in the design of supplementary financing facilities of the IMF and the IBRD types, there is also another particular form of need which is not as closely related to the oil price change and the related restructuring of energy uses. This is the alternate flagellation and stimulation of the world economy and of individual nations that is created by wide fluctuations in the availabilities and the price of internationally traded commodities. To be sure, the IMF already helps to bridge short periods of lost earnings or unusually large outpayments, and the IBRD helps to strengthen productive capacity and storage facilities, particularly for agricultural products. But a glance at any chart of the leading fifteen or twenty international commodities will show that the oscillations in availabilities and price, often originating in natural causes, are so excessively exaggerated by the precautionary hoarding of short supplies or the speculative bidding of prices, that the incomes of the producing countries are subject to wide swings and the planning of consuming countries is frequently distorted by these same swings.

Although specific efforts toward commodity agreements have dotted the record of international negotiations for thirty or forty years, few have yet been successful, even if only for three or four years. In the urge to do something systematic and comprehensive, many of the UNCTAD countries have now come up with a proposal for what is called an "Integrated Commodity Programme" to be financed by a "Common Fund." While some proponents view this set of recommendations as a means of accomplishing a net transfer of income and resources from the producing to the consuming countries there is growing recognition that insistence on that objective would cause the breakdown of any attempted commodity agreements—the collision of interests becomes too great to allow any agreement a sustained life.

But if the aim is instead to find ways of applying within the commodity markets those influences toward orderliness and the modification of wide swings that are now being developed in the foreign exchange markets for various currencies, then practicable possibilities may lie ahead. It is most encouraging that the Administration has already indicated a fresh attitude toward this latter possibility. One of my colleagues and I recently prepared a paper on "An Alternate Common Fund Proposal" which I would again like to submit for the record. The details of that proposal need not be elaborated here. They do, however, help to explain why I would strongly urge that the Joint Economic Committee support the President in any initiatives he may wish to take toward discussion at the Summit on agreement toward new approaches for moderating swings in the availabilities and the price of many raw materials and other internationally traded commodities.

Mr. Chairman, your Committee has opened a very interesting avenue for what might be called a pre-exchange of views—with an eye toward the Summit, but from what my associates would probably agree is among those of us at the nadir. I certainly appreciate having an opportunity to share in this experiment and look forward to the discussion which will follow.

Action on Energy: To Stimulate the Economy Through Production

(Excerpts from remarks at the Georgetown University Bankers Forum on "What's Ahead for the Economy: A Post-Election Overview," Georgetown University, Washington, D.C., November 19, 1976, by Robert V. Roosa, Partner, Brown Bros. Harriman & Co.)

Immediate initiation of a massive energy program can, if designed creatively, help importantly to meet the national need for prompt action to stimulate the economy without aggravating the fear or the fact of greater inflation. Reliance on the recuperative power of natural economic forces over recent months has not been enough—business spending on plant and equipment is stagnating. Reliance alone on the consumer spending or tax cut formulas generated by computer models may be too uncertain. Something new must be added.

Urgent promotion of all practicable alternatives for the development and conservation of energy, as the principal new sources of the spending and investment needed for increased economic expansion, can capture popular imagination in the United States. Once underway, such a program could also become a unifying influence upon the groping and contradictory efforts of other countries to find some form of non-inflationary economic stimulation. Should that occur, it might help reverse today's threatening fragmentation of the international economic and political system.

It is becoming increasingly evident, whatever the original merits of the OPEC case might have been, that the mutation of energy costs which occurred in late 1973 has in fact drastically altered the "production function" of the world economy, apparently imposing a slower or lower gradient for overall growth than might otherwise have been attainable. And until comprehensive new energy policies are devised and implemented, here and abroad, the non-OPEC nations will continue for some years ahead to confront that real obstacle to higher growth, while also suffering the consequences of a disequilibrium in their trading relations with each other—even without another round of oil price increases. In these circumstances, while traditional monetary and fiscal tools will help further cyclical recovery, they may not be enough to sustain that recovery and are quite inadequate to repair the critical structural distortion that has occurred. Nor can conservation strategies by themselves provide an answer to the structural problem, unless we are willing to sacrifice even more growth and prolong unemployment. A full recovery requires that deliberate action of a far bolder character be undertaken.

PHASE ONE: THE TRANSITION PERIOD AND THE REMAINDER OF FISCAL YEAR 1977

The Federal Government's energy efforts today are in alarming disarray, in part because each actor involved is following a different script. The General Accounting Office, for example, has been opposed to Government fundisg of private projects while the Federal Energy Administration supports the concept; the Office of Management and Budget and the Treasury have been skeptical of the cost effectiveness of new technologies, such as coal liquification and gasification, while the Interior Department continues to press for their development; and Congress has rightly regarded the breeder reactor with a jaundiced eye while the outgoing Administration has actively supported it.

Starting with the work currently being prepared by the transition staff, steps should immediately be taken to consolidate existing studies and proposals. These can provide the basis for an Executive Order promptly after the Inauguration to establish a definite chain of command responsibility in the energy area, without waiting the six months or more that would be required for Congress to create the proposed new Cabinet Department of Energy and for the Senate to confirm a new Secretary. During Phase One, the top responsibility might be placed with the Secretary of the Interior, or the Secretary of the Treasury (if the President should follow precedent by designating him the chief economic officer of the Government). Indeed, the experience gained in mobilizing under new leadership the work of existing Departments and Agencies (as well as in drawing upon a number of university and private research organizations) can help guide the eventual design of a permanent structure of organization to be developed later, in Phase Two.

The aim of the initial consolidation effort should be a program to mobilize promptly new commitments to energy development and energy conservation by a cross-section of the American economy. For that, the private sector needs a clear guide to Government intentions, including an announced resolve to begin studying and rationalizing the effects of the current regulatory structure on energy use and development. To emphasize that these intentions are real, an immediate display of initiative is required. Existing facilities for the subsidy or guarantee of purely experimental pilot efforts in coal development and pollution control, coal gasification, tar sands, oil shale, and thermal and solar power, for example, should be fully utilized. Legislation awaiting Congressional approval, such as the Energy Extension Service and the Small Grant Program for Appropriate Technologies, should be accelerated and possibly expanded. And American participation in international cooperative investment efforts, such as the several experimental projects being contemplated by the International Energy Agency, should be activated with purposeful vigor.

Some authorized and appropriated funds are already available for an initial thrust of this dimension, including those of the Defense Department and the General Services Administration. Still more funds could be readily set in motion in the private sector through systematic promotion of energy saving investment, relying on the use of investment incentives to generate additional activity and employment. The total of additional Federal Government funds disbursed or committed during Phase One, for energy development and energy conservation together, would probably be well below one billion dollars.

Because of mounting concern over the safety, the economics, and the weapons potential of nuclear fission, preliminary consideration could also begin during Phase One of the many existing studies and projects related to the development of nuclear fusion. Plans should be started for determining the form and content of a "New Manhattan Project" to be set up during Phase Two with the aim of producing practicable results by, say, the year 2000.

Even though these initial undertakings would be but the tip of an iceberg of Government promoted activity, the multiplier effect of such spending would be great, spreading through a wide array of ancillary, supporting activities. The combined result in new orders and activity may, in fact, have a greater sustained impact on actual spending and employment throughout the economy than a multibillion-dollar permanent tax cut. At the least, the initial Phase One program could help shorten to a span of months, rather than years, the life of any emergency tax cuts which may prove necessary by next February. And by directly generating new productive activity, instead of merely spreading additional purchasing power in a broadcast manner, it will minimize the risk of adding to inflation. The lift to public confidence from this evidence of striking Government leadership should generate further responses through other sectors of the economy.

PHASE TWO: FISCAL YEARS 1978–80

Phase Two should involve the presentation of more detailed proposals to Congress, perhaps beginning as early as mid-1977, as well as the subsequent physical implementation of these proposals, as they receive Congressional approval, through the next three fiscal years. Throughout this period there will be a continuous need for an imaginative reach into wider scope for this program, with a heavy emphasis on research, experimentation, and exploration. Additional support for the more promising pilot projects initiated in Phase One will be required. There will probably also be opportunities for an integration of the U.S. effort with the programs that it may be expected to encourage in a number of other countries.

The budgets for Fiscal 1978 through 1980 will presumably contain increasing allocations (or reserve allowances) for future obligations in magnitudes of several billions of dollars. As the scale of projects increases, some will need the encouragement of "take-or-pay" contracts, or of Government guaranteed loans; but actual cash disbursements by the Government itself may prove to be surprisingly small. Possibly the Federal Financing Bank can play a role; or a new Development Finance Corporation. But whatever the size of any direct or contingent burden on the Federal budget, the parallel expenditures for capital, raw materials and labor by the private sector on its own account (once the shape of the program becomes established) can be considerably greater, not only directly in the energy field, but also in ancillary or related industries.

During this second stage, more precise evaluation of priorities will be essential, drawing on the experience gained from the initial across-the-board support or expansion of pilot projects. It will be important also to evaluate the appropriate structure of public regulation and private organization to be encouraged—finding an appropriate mix in each sector between the economic gains of large scale and the need for competition to assure optimum performance. A delicate balance will also have to be found between Government and private participation, with Government's role varying from sector to sector with respect to possible equity participation, direct lending, the extending of guarantees, the undertaking of take-or-pay contracts, the regulation of performance and pollution standards, the surveillance of pricing practices and the possible maintenance of stockpiles. In gauging the effectiveness of competition as a useful controlling force, traditional anti-trust criteria may have to be broadened to take into account actual or potential competition from concerns in other countries, instead of being defined more narrowly in terms of facilities located solely in the United States. A close look will be needed at the pros, as well as the cons, of both vertical and horizontal integration in the energy field.

PHASE THREE: FISCAL YEAR 1981 AND BEYOND

Phase Three might begin as early as calendar year 1980 and continue intensifying at least through 1984. This will correspond to the all-out production stage of a major war effort when the design of major projects can virtually be frozen while their scale is multiplied many times. While research and exploration should be aggressively continued, both in the private and public sectors, the greater scope for further innovation during this phase will probably be in the development of new processes throughout all industry, spurred by the availability of additional forms of energy. These derived results could conceivably be comparable to the spreading effects throughout the economy that have been generated during the decades of the '50s and the '60s by such technological breakthroughs as those in electronics, computers, and the jet engine. During the period of this third phase, the New Manhattan Project for nuclear fusion should also be reaching a point of widespread contract awards for additional scientific and engineering development. That effort presumably should continue, and provide a significant source of support for university science programs as well, through the remainder of this century.

The longer range results of diversifying the sources of energy can have far-reaching consequences for the entire production process. To combine that prospect with the possibility for immediate strengthening of the current cyclical recovery is a commanding opportunity. To summarize, the approach outlined with breathless brevity here has four compelling potentials:

(1) It can stimulate needed additional investment—and employment—now.

(2) This, in turn, will have the expected multiplier effects upon total spending (and thus upon employment) throughout the economy.

(3) The new projects initiated in the energy field will in turn call forth additional investment as the new technology itself evolves, requiring the inputs of new machines and products from other industries.

(4) The increased energy itself, once available from varied sources, and possibly available at declining costs as new production realizes some economics of scale, will eventually provide support and stimulation for many other kinds of energy using activity.

AN ALTERNATIVE COMMON FUND PROPOSAL [1]

(By Richard W. Fisher and Robert V. Roosa)

UNCTAD Secretary-General Gamani Corea recently visited Washington to present and discuss his organization's case for a "Common Fund" to finance an "Integrated Programme" of commodity arrangements. The writers of this note were invited to attend one of the nonofficial meetings with Mr. Corea. It appeared there that, as both consumers and producers have a vested interest in limiting the gyrations of commodity prices, agreement was easily reached on the need of some kind of stabilization initiative. But Mr. Corea's proposal for a common fund operating within the context of—and indeed "at the core of"—an integrated program, encountered resistance.

Stress was placed on the view that most of the previous attempts to establish multinational commodity agreements, regardless of how financed, have broken down. This has occurred because producing countries found that they could not hold to agreed production or stockpiling quotas, or because consuming countries found that they could not practicably hold to agreed purchasing formulas, or because of any number of other reasons related to the difficulty of maintaining a tight, cartel-like agreement among many diverse sovereign countries. It was therefore argued that until a new modus operandi for buffer stocks and other international commodity agreements is discovered, establishing a Common Fund at this stage would be a case of placing a cart before an unbridled horse.

Discouragement with past commodity agreements should not, however, encourage a retreat into the type of market that produces widely, often wildly, swinging prices for basic commodities for many producers (and indeed for many consumers). Ways surely can be found, while prices still move and supplies vary in response to underlying market forces, to avoid the whipsaw of harsh, violent swings in availabilities and prices. But to do so, somewhat less rigid conditions than those of the typical commodity agreement will have to be found for the participating countries. For binding terms as to price and production, as sought by UNCTAD through agreement among countries with divergent capacities and aims (not to mention differing commitments to private or to state-owned enterprise), are almost certain to be unattainable; or if initially attained, then unsustainable.

AN INTRODUCTORY SKETCH OF A DIFFERENT COMMON FUND PROPOSAL

There may, however, be a more flexible, pragmatic approach which the United States could introduce during the UNCTAD, CIEC, and other multinational negotiations which would not only set aside a pool of potential funding, but also stimulate the development of a new approach to commodity price stabilization. It would modify the procedures now being considered by the UNCTAD and other groups by setting guidelines that avoid the need for negotiated floor prices, or agreed production quotas, or commitments to hold internationally linked stock-

[1] Based on a draft initially prepared and given limited circulation for private comment early in February and published in this revised form by the Journal of Commerce on March 21 and 22, 1977.

piles. Paradoxically, such an approach may come much closer to producing a satisfactory moderation in fluctuations of price and income than the more complicated network of commodity agreements that must be reached if the current UNCTAD version of the Common Fund were to become operational.

The heart of this proposal lies in using guidelines developed by the same countries that might have been expected to enter into formal commodity agreements, but without the need such agreements would imply to reach precisely definitive conditions to which each producing (or consuming) country must adhere. That is, guidelines, once agreed, would be permissive, not mandatory, and the arrangements would function through inducements, not through reliance upon virtually unenforceable compulsion.

Moreover, instead of having to operate within the confines of an internationally integrated program that would acquire stocks of a particular commodity as production or prices reached predetermined levels, and would then later sell them at other set levels, the role of the Common Fund would simply be to finance, as requested, the carrying of stocks of commodities that remain in the possession of the producing countries. And each country would in turn be free to decide whether to bring its own stocks into a national storehouse operated by its government, or instead to arrange parallel financing with its own producers, permitting them to warehouse the stocks until changed conditions made sale of the stocks attractive to them. Indeed, countries in more prosperous circumstances might simply carry (and later sell) their own stockpiles with their own domestic resources, and need not resort to the Common Fund at all.

The essential feature of the new Common Fund proposal would be reliance upon certain "trigger points," determined in terms of recent trends in the quantities or the prices of standard units of each chosen commodity in the world market. Data on the total quantity of world production and on the world price for a standard unit of each key commodity, for several past years, would be kept continually up to date. All producer and consuming countries would be invited to join conferences held by the management of the Common Fund to determine the percentage by which world production might rise above trend, or world prices fall below trend, to reach the "trigger point" at which producing countries would be free to call on the Common Fund for financing to carry a portion of their own production in a buffer stock. The percentages above or below trend might be reviewed in the light of experience, at intervals, possibly every five years; but there would not be any scope for altering the guideline percentages to meet producer or consumer pressures in particular years or seasons.

Passing over for the moment any mention of the organization or the resources of the Common Fund itself, what might actually happen under such arrangements if the proposed Common Fund were in operation? A country producing copper, for example, or sugar, or jute, or any other key commodity would be free to call upon the Fund to finance the storing of part of its production if a trigger point were passed. By agreement, the trigger set by production of copper might be evidence that world output had reached or exceeded 5 per cent above the recent trend. But the trigger would not be activated if, for other reasons, copper prices were at the same time rising above their trend. The trigger related to copper prices would come at, say, 10 per cent below the price trend, provided the worldwide quantity of copper production was not at the same time dropping below trend.

For example, if world copper output in 1977 should exceed the trend (or, alternatively, the average) for 1972–76 by more than 5 per cent, while world copper prices were steady or declining, each copper producing country would be eligible to go to the Common Fund to borrow an amount of funds equivalent, at current prices, to the value of all of its own production that exceeded 5 per cent of its own average output for 1972–76—provided that that "excess' production was held in earmarked stocks by private firms or a government agency within that country. Contrariwise, if there were a slump in world demand for copper and world prices began dropping, while world production was steady or exceeding the recent trend, a trigger point activating Common Fund loans would be reached when the world copper price had fallen 10 per cent below trend. In those circumstances, a producing country would be eligible to obtain financing from the Common Fund for a value of stocks (at the prevailing lower price) equal to, say, 10 per cent of its current production.

No country would be required to stockpile; but it would have the right, whenever the trigger should be sprung, to accumulate stocks up to the amount indicated by the guideline and to draw an equivalent amount of usable currency from the Common Fund, adjusted possibly to provide a small margin between the current value of the stocks and the amount of the loan. It would pay a rate of interest on the currency drawn from the Fund, and would consequently not want to continue its indebtedness if demand and prices rose to permit sale at a profit above the loan value. For a country which used the external finance from the Fund as a sort of offsetting balance internally for what it may lend or pay to its own producers in local currency for the inventory being held, an internal pressure would be at work to induce sale as markets improve.

Meanwhile, however, each country would have control over its own inventory; the Common Fund would have a claim upon it only as collateral. The Fund's earnings would come from the interest payments received, or from liquidation of collateral in the improbable incidence of a default. But as an override to help cover operating costs, and assure an adequate return to the suppliers of Fund resources, the Common Fund might also contract to receive, say, one-fifth of any net profits received by a country on the sale of stocks that had been carried on Fund loans.

There will probably be some producing countries who simply want to maintain an "ever normal granary" on their own. They could accumulate stocks regardless of the guideline, and would be free to arrange their own financing, internally, or abroad, or both. They would not ordinarily need the Common Fund. But they would be expected to contribute information on their total production to the Common Fund secretariat, and would take part in discussions concerning the quantitative trigger-ratio to be considered appropriate for those commodities which they produce.

There is already, of course, a very modest program of buffer stock financing in existence at the International Monetary Fund. For reasons to appear shortly below, however, there may be persuasive reasons to shift this activity instead to a Common Fund devoted exclusively to this purpose. There is also an opposite kind of situation with which the IMF is already well equipped to deal, though indeed, there may as well be a case for making access to this IMF facility contingent on cooperation with a Common Fund. That is the condition in which a sudden natural or man-made calamity within a country causes its production to fall sharply, thereby creating a shortfall in needed foreign earnings. The IMF "compensatory financing facility" is intended for, and is already being heavily used to provide, bridge financing to help cover a country's balance of payments requirements over such periods of shortage—until a resumption of full production provides the means for repayment.

The essence of the approach suggested here is to moderate the tendency for cumulative price swings to occur whenever world conditions of supply or demand set off a change in the price of a world-traded commodity. The aim is to set the boundary conditions for access of any country to borrowing facilities in relatively simple terms, with a minimum of dependence upon solidarity of action among all of the producing countries. This design of arrangements would leave room, too, for the different needs and reactions of many of the more highly developed countries which also happen to be producers of one or more of the key commodities (and in some cases, major producers of those commodities). Nor would the usefulness of these arrangements depend upon assured cooperation by a high proportion of the consumer countries for any particular commodity. Perhaps this approach would fall short of an ideal result; but it would not depend upon an unrealistic conception of the sustainability of negotiated quotas for output (or storage) on the part of all producers (or consumers) of key commodities, within negotiated but fixed lower and upper limits for their prices.

THE ORGANIZATION AND RESOURCES OF AN ALTERNATIVE COMMON FUND

The present UNCTAD approach contemplates formation of a wholly new institution, funded by the voluntary contributions of interested countries. As currently designed, one-sixth of its initial $3 billion of capital will be funded by subscriptions from the developed countries (with roughly $100 million being solicited from the United States) and one-sixth from the LDC group. The remaining two-thirds would be raised in the international capital markets. Tentative capital subscriptions have already been offered by six countries and total $156 million. There is no reason under the proposed U.S. approach to forego these contributions; indeed many more can be solicited. But a case can be made for centering the new institution midway between the IMF and the IBRD, with a heavy claim upon each of them for resources as well.

For one reason, the total sum involved may at times reach a very large figure, perhaps the equivalent of $10 billion, or even more. Requirements on such a scale may well require a claim on the resources, the competence, and indeed the credibility of the two major international financial institutions. Perhaps the best solution would be to form a new international corporation, possibly named "The Common Fund," to which the major contribution of permanent capital would be made by the IBRD, and whose major source of borrowed funds would be the IMF. Such a Common Fund would also be empowered to accept capital subscriptions directly from any interested governments, and to pay dividends on all capital, if earned. It would correspondingly be equipped and encouraged to borrow working funds (including some with no fixed-date maturity) from other governments to supplement its drawing line at the IMF, and would pay interest at nominal rates.

Various formulas could be considered for determining the size and distribution of the capital. The direct IBRD subscription should probably be at least one half billion dollars. Individual governments might be expected to make a permanent contribution of capital in amounts equal to, say, 1 percent of their net official reserves during the year that operations begin, with additional supplements welcomed. The drawing line at the IMF could probably be fifteen times the capital, and countries in balance of payments surplus could offer demand loans to the Common Fund (with the Common Fund backstopped against withdrawals by unused IMF lines).

Questions of this kind require extensive study and negotiation, of course, but their resolution should not present a serious obstacle. Similarly, the composition of a board, and the definition of its powers, along with the role of the management and secretariat will have to be worked out in a multinational forum. It may be decided, for example, that the number of members on the board should be no larger than that of the IBRD or IMF, and preferably smaller. The boards of these organizations could each select, say, four directors (some of whom might be from LDC's), and other representative bodies such as UNCTAD might select say, seven—for a total of fifteen. The board's principal duties should be to select the management, and to make final determination of the terms of all capital contributions, borrowing contracts, and loan agreements, as well as to determine which commodities should be included in the arrangements, and (on the basis of recommendations by each "commodity group advisory committee") to fix the percentages that serve as trigger points for activating the accumulation of stockpiles to be carried by Common Fund credits.

The management in turn should select and administer a staff responsible for convening advisory committees on each designated commodity, for gathering and monitoring all relevant data, for making loans, vertifying collateral, collecting repayments, investing working balances, and for conducting all other operations. These are significant tasks, but none are insuperable.

CONCLUSION

To be sure, the foregoing proposal is but a most tentative outline for a new facility which, if it proves workable, would satisfy the third world's justifiable demands for a new approach to commodity price stabilization (and for a new institution). At the same time it would put into meaningful form the elements of free choice, and of national diversity, that some spokesmen for the previous U.S. Administration identified with "free markets," but without the implication of rigid interference with the basic determinants of supply and price which they associated with UNCTAD's Common Fund proposal.

The essential fact is that the less developed countries which produce raw materials for the world market need more orderly market conditions, less violent price swings, and the flexibility to develop their own economic policies within that framework. While their need is most striking, it is only in degree more impelling than the comparable need faced by most other countries—as producers and as consumers. The real challenge is to find practicable methods through the kind of positive effort among nations that can resolve difficulties, rather than acquiesce in disruption.

Senator JAVITS. Mr. Vice Chairman, could I have a minute before going to a markup?

I am ranking member on the Labor Committee and we are marking up the mine safety bill.

Senator HUMPHREY. Of course.

Senator JAVITS. I just wanted to say, Mr. Roosa, I would like to see and I hope you might know of the existence of any 5-year projections taking in the oil price at what it is today and adding in the inflation of 40–60 cents, and seeing whether the industrial production in the world and the world credit capabilities would be able to accommodate it; in other words, simply accept the deficit. I think it would give all the industrialized countries more hope in some authoritative way if there were acceptance of the fact that it will cost us $200 billion to indulge the Arab's political desires—I am not characterizing them at all—and yet we can make it and at the end of the road we will still be around and still be solvent. Is there any such thing made up?

Mr. ROOSA. I don't know of it, but I will try to find out. There has been so much effort expended in this area that there must be something that focuses in this way.

The overall question in longer terms, 10, 20 years, has been dealt with and it is my own conviction that we can make it; but we have loitered quite a while.

Senator MCCLURE. Would you yield on that point?

I wonder whether when you look at accommodating of Arabs, if you look at Nigerians, Venezuelans, Canadians, and others as well?

Senator JAVITS. May I just say that I have read Bob Schaetzel's prepared statement and I appreciate very much what you have said in those prepared statements, and I would like to thank, for one Senator, all the witnesses, especially our brethren from abroad, for their willingness to lend their wisdom to our deliberations.

Thank you, Mr. Vice Chairman.

Senator HUMPHREY. Thank you, Senator Javits.

All right, Mr. Schaetzel, we are looking forward to your commentary and immediately after that I will ask my colleagues if they want to prepare themselves for the questioning. We will set the groundrules; if a question comes from a Senator, any of you should feel free to comment.

STATEMENT OF J. ROBERT SCHAETZEL, CONSULTANT AND WRITER, WASHINGTON, D.C., AND FORMER U.S. AMBASSADOR TO THE EUROPEAN COMMUNITIES

Mr. SCHAETZEL. My contribution and the one most appreciated will be brevity. The role I see for myself in these brief remarks is to comment on the European scene and the European perspective as a part of the backdrop for the Summit meeting.

The thing that strikes me as I look on the European scene today, and I have spent a good deal of time there recently, is the contrast between crisis of the late forties and early fifties and the crisis today. Having had some responsibility in the Marshall plan days, it seems to me that that crisis was of great simplicity. You were putting together raw materials, putting people back to work; there was a large consensus or Europe, and that consensus was arrived at without too much difficulty in the United States.

The situation in Europe today, one of utter complexity, of economic problems where even the experts find it difficult to arrive at exact prescriptions as to what might solve the difficulties. Beyond that there is the extraordinary difficulty about arriving at any national consensus. One is therefore struck by the crisis proportions of the dilemma which confronts Europe today.

In an ironic way the success of the Marshall plan has really contributed to the situation that prevails in Europe. That is, you had steady growth for 2 decades of both gross national product and trade and an expectation that that growth would continue forever, and would therefore cover constantly expanding public expenditures, explosion of wages and related services; and that the deficits that were accumulating would be covered by future expansion. Then came the Yom Kippur war, the oil crisis and international recession. These expectations have obviously been destroyed.

As has been suggested earlier, the similarities among the European countries, with the exception of Germany, are striking. They have characteristic difficulty controlling public expenditures, steady wage increases and indexation in many countries, inflation which averages 10 percent, low growth, squeeze on the private sector, and balance-of-payments deficits.

I was going to talk a little bit about Italy, where I spent some time recently, as a case study, but again in the interests of time I will skip this. We can come back to this subject if you wish, for I think it illustrates so many of the difficulties which exist in Europe generally.

In that connection I know that you tried to get Mr. Carlie to testify. I remember meeting with him when he made a point which is crucial to my evaluation of the situation. He questioned whether democratic societies can cope with the kinds of economic problems which now confront the industrial democracies today.

I would like to make in passing a comment on the difficulties which the current economic situation in Europe poses for the process of European unity. You saw President Jenkins, as you said, Senator Humphrey. I am struck again by how some of the assumptions have been shattered by recent developments. One shattered assumption is that there would be broad, general growth and homogeneity of economic performance. Today, Europe is producing something which we are familiar with on the international scale, a "north-south relationship." There are rich and poor European countries with frictions and traumas coming out of that relationship. This diversity of economic performance has all sorts of adverse impact on the member countries of the Community and on European unity which we believe so essential to them and to us.

It was suggested that I might offer a word for your benefit, Senator Humphrey, on the Community agricultural policy. I will just add a couple of sentences.

Senator HUMPHREY. Not only my benefit. Since it is the largest American export in the eastern part of the United States that we must realize the importance of agriculture.

Senator McCLURE. Right on.

Representative BROWN of Ohio. Senator Humphrey is not the only farmer on the panel here.

Senator HUMPHREY. That's right, Michigan is a farm State, too.

Mr. SCHAETZEL. I will comment briefly on the common agricultural policy. In 1974, the European Community price level—intervention prices—were below world levels. The effect of the system was that the European farmer subsidized the consumer. Since then, as the European farmer sees it, when would prices fall below the intervention prices and increases in the Community intervention prices, his income failed to keep pace with the cost of the things he must buy. Consequently the European farmer feels he has been taken both times. This is not an unusual sentiment for the farmer.

Senator McClure. The American farmer feels somewhat the same way.

Mr. Schaetzel. That is right.

Now, going to the point of European Community, the Community buys five times more from the United States in agricultural goods than the U.S. imports of such goods from the Community. This is not an unimportant economic or political fact. In 1975 our exports were $5.6 billion and they continue to rise at a steady pace. At the same time the European Community is overlooked frequently in the United States as a major agricultural exporter: They export 12 percent of world agricultural trade.

This imbalance is something I want to emphasize, because it leads to my next point: The concern which the Europeans feel not only about the imbalance, but also about the restrictions which they see imposed on their prospects of entering this market in such areas as dairy products, or hams or beef.

This leads to my first conclusion. The crisis that we are discussing, which will be the heart of the meeting of the European summit, is essentially political. I suggested earlier a consensus has been developing very slowly on the kinds of economic policies that governments ought to adopt, among experts and at the June 1976 Council of Ministers Meeting of the OECD. This is still a loose consensus among experts or ministers; it is not necessarily a public consensus. The heart of the problem is the array of extraordinarily weak governments. Practically none of the governments has a strong position in Europe today. Some of them, Italy for instance, even have minority governments. None of the governments is popular and indeed the oppositions are not much more popular. What is general is public discontent with the people who have the responsibility for coping with these difficulties. As a consequence, the obvious reaction is for governments to seek to buy support from the interest groups as a means of staying in power or public acquiescence for programs considered necessary for basic economic viability.

The second point, as we look at the incredible number of problems which the world faces at the economic level, is to single out the keystones, the problems we should worry about most.

Having spent about 30 years of my life in the fields of foreign economic policy, I am struck by the fact that we are right back again with the trade issue. If we do not handle this trade issue wisely, everythink else is going to collapse on us. It is important on its own, but equally important are the side effects that mismanagement of this issue can create for our other interests.

Going back to Europe again, there is its vulnerability. These countries derive 20 to 60 percent of their gross national product from trade.

Therefore, maintenance of the generally open trading system is indispensible to their survival. They have been successful so far in resisting their own pressure groups. As most of these countries are in a worse economic position than we, their pressure groups urge restraints be imposed on foreign trade. European governments have successfully resisted this partly because they recognize the problem of retaliation, partly because they recognize their great dependence on the open trading system.

This leads to the third point, the United States interest and role. As far as Europe is concerned I will not recite again the security, political, cultural, all the other interests we have in Western Europe, which have underscored our relations since the end of the war.

Beyond that, there is the importance in seeing that the mixed economic system survives. If Europe's economic decline is not reversed there is a real question whether the system will survive. You see it in Italy; when the private industries come under pressure they are absorbed into the public sector. In the long run this has both economic effects and political effects.

Our role in preserving the trading systems seem to me to be absolutely essential. Partly this responsibility stems from our enormous position of strength and stability. I am convinced that the Western European concern with American protectionism, latent protectionism, is only part fear of the loss of the American market. I think it stems more from the essentiality of preserving the trading system.

Put simply, if the strongest and most stable country of the world goes down this road, what possible defense do the Western European countries have or their governments have against much stronger domestic pressures for similar protection?

The fourth point is to pick up what has been said before: To urge the vigorous pursuit of the multilateral trade negotiations. In this connection I want to call attention to a proposal which has been developed by the Atlantic Council called GATT-plus. It is a plan which would add to the GATT better rules, better procedures for consultation among the advanced industrial countries.

And my fifth point is to urge that the OECD be strengthened. I noticed in Bob Roosa's prepared statement that he makes a comment in his second paragraph to the effect that we are slipping into the role of unconscious American arrogance, offering the world "revealed truth" on a number of issues. I think we should consult about these matters rather than put them out as American prescriptions. To do so is more apt to strike a responsive chord among our friends as contrasted with the way we seem to be approaching these countries now. The OECD is a marvelous vehicle for this essential consultation.

My final point, and perhaps the most crucial factor, is as we develop our own economic policies, whether America has the maturity and wisdom to recognize and take into account the effects of our national actions on our allies.

Thank you, Senator.

[The prepared statement of Mr. Schaetzel follows:]

PREPARED STATEMENT OF J. ROBERT SCHAETZEL

I.—It is tempting to compare the current European economic crisis with that of the late 1940s and early 1950s. Yet the differences are striking. Even for those European countries most seriously afflicted today (Italy and England for instance) the impression is of vigorous activity, certainly of conspicuous consumption. No one had that impression in 1948. Another major difference is the change in the United States. Twenty-five years ago America, the preeminent economic power, was full of optimism, sure of its capacity to deal with both domestic and international issues.

Comparison of these two periods, just a generation apart, might best address the more subtle, complex and thus more dangerous aspects of the contemporary European scene. The European postwar crisis did not pose obscure problems of economic policy or call for complicated remedies; it was at bottom a matter of getting raw materials to idle plants, reconstructing devastated facilities, putting skilled people back to work. The basic questions were those of persuading America to mount the recovery effort and then organizing it.

Today, while a loose consensus on appropriate policies has developed among European experts and government officials, there is little public understanding or general support for these complex remedies, or confidence that proposed economic programs will achieve their purposes. To a striking degree the current European economic crisis is in fact political.

II.—Europe's current economic problems ironically are a direct result of the remarkable successes of the 1950s and 1960s. Spectacular rates of growth over more than two decades led to the conviction that such expansion was inevitable. In this atmosphere it was easier to accept than seek to restrain ever more costly domestic programs (wage increases and indexation, expanded social programs, etc.). Europe floated along on the comfortable expectation that the continued growth of trade and national product would cover the exploding costs of these programs.

After more than twenty years of subordination to the United States, Europeans thought in 1971 that there was a good chance of their becoming the world's dominant economic power. The American financial crisis of August 1971 seemed to confirm this possibility. In addition, the division of Europe was about to be healed with the success of the 1972 negotiations for British entry into the European Community. Talk among the Europeans of economic and monetary union no longer seemed fanciful.

These euphoric expectations were dashed by the oil and financial crisis which followed the Yom Kippur war and the subsequent international recession. With Germany almost the only exception, each of the European countries has had to face remarkably similar economic difficulties. Each carried the burden of extensive social programs; labor had come to expect job security and protection against inflation; unemployment grew rapidly and inflation for several countries ranged above 20 percent, with the European average at 10 percent.

Initially many governments tried to weather the storm through the tested techniques of budget deficits as they sought to placate domestic pressure groups. By the mid-1970s there were no strong governments. The pressures became even more intense to compromise in order to remain in power, to bargain in order to secure labor peace, to shore up sick industries, to avoid additional unemployment, to temporize where austerity measures were required.

Italy is a case study of the general European disease. Carli, former head of the Bank of Italy, has questioned whether democratic societies have the capacity to deal with the kind of economic storm which now batters Europe. The necessary economic policies impose burdens on each sector of society and at the same time alienate each sector. Efforts to cut back a bloated bureaucracy undermine the very foundation of the Christian Democratic Party. Wage restraint, efforts to moderate the noxious indexation formula, the "scala mobile," stir massive unrest in the labor movement. It is by no means clear that the leaders of the Italian Community Party, who support reasonable austerity measures, can control their ranks. Efforts to suppress inflation lead to high interest rates and deny investment capital to private industry. Efforts to reduce the flow of public funds to the sprawling government holding companies threaten to increase already high unemployment. Each European country sits in the middle of a similar dilemma.

III. The economic crisis has caused new tensions within the European Community. Up until the oil-financial crisis disparities in economic performance of the various member states had not been too significant. But by 1976 the gap between the strong (Germany and the Netherlands) and the weak (Italy, Ireland and Britain) was wide and growing. Europe had developed a rich-poor nation problem of its own. Pressures were continual to insulate domestic markets against competition from stronger neighbors. Insistent voices demanded special measures to assist first the steel industry, then aircraft, then shipbuilding. National programs to deal with depressed regions, such as the British Midlands, ran close to the point of being in violation of the Treaty of Rome.

A volatile world agricultural market created increasingly serious problems for the Community's Common Agricultural Policy. By 1974 world cereal prices were well above Community price levels and export levies were imposed. It can be argued that in this situation the farmers were subsidizing the consumers. But even when would prices fell and intervention prices rose above world prices, the income of the European farmer still lags behind the other sectors. His costs and the things he must buy have well exceeded incremental increases of the CAP price levels. He is also keenly aware that in 1975, for instance, the Community bought five times more farm products than it sold to the United States—$5.6 billion of agricultural goods. It is sometimes overlooked that the European Community is a major foodstuff exporter—12 per cent of the world's agricultural exports—and at the same time is the largest importer of agricultural produce, absorbing 35 per cent of all farm products traded on the international market.

It is not my purpose to defend Europe or European agricultural policy. It may be useful, however, in these hearings, to record European attitudes, to see things for the moment from their point of view. Farm exports from America to the Community rose by $3.8 billion from 1968 to 1975 while Community exports to the United States in the same period increased by only $700 million. In addition the Europeans complain about new restrictions, as Commissioner Lardinois did last year. "We have been kept out of your dairy market by a rigid system of quotas. We are being pushed out of the market for canned hams. We have been displaced almost completely in the beef market."

IV.—The result of these many adverse factors has been to reduce drastically the area of maneuver of European governments. They have no escape from the quadrupled cost of fuel which amounts to a heavy excise tax on already weakened economies. For an area uniquely dependent on exports the stagnation of international trade creates special problems. Inflation has led to higher relative costs with, for instance, hourly rates in Germany above those in the United States. Not only have American companies reviewed their investment strategies and decided to retrench in Europe while expanding in the United States, but European companies have arrived at similar conclusions.

The kinds of economic policies required to deal with these ills could hardly be expected to be popular. In addition to the adverse reactions from affected interest groups cited earlier, the European Commission and the several governments have recognized that the private sector needs help, that investment must be encouraged and to this end reasonable profits must be possible. This runs immediately into two problems. Any suggestion of increased business profits inevitably produces cries of rage from the unions which have been pressured to accept wage restraints. Secondly, subconscious Marxist economics, so much a part of the European intellectual scene, produce a reflex reaction against the profit component of the private enterprise system.

V. Today Europe is a troubled continent. While a general consensus has emerged on the economic policies which must be pursued, most governments lack the political strength to effectively administer these policies. All European governments are relatively unpopular; most have only the narrowest parliamentary majority. Opposition parties are hardly more popular, or promising. Whatever favor those out of power enjoy derives largely from the fact that they have no direct responsibility for the existing situation and have not been obligated to define precisely what alternative policies they would propose when and if they came into power. Even in France, where the left coalition swept the municipal elections last month, aided by the fratricidal inclinations of the Giscard government, the Socialists-Communists enjoy only 51 to 51 percent popular favor.

Preservation of an open international trading system is essential if Europe is to work its way out of this deep economic trough. The dilemma for Europe is that there is strong internal pressure for protectionist measures, but the governments have recognized that any unilateral imposition of restrictions would both provoke immediate retaliation and also lead to the breakdown of the very open trading system upon which their future depends. The European Commission has been a bulwark against these forces, insisting on adherence to the Treaty of Rome, negotiating with member states limited exceptions to the rules. They have been equally firm in their advocacy of an open trading system.

VI.—The continued importance of a viable Western Europe to every American interest—security, political order, the future of democracy and improvement of the conditions of the poor nations of the world—hardly needs restating. As one of the world's great production centers, as its largest market, the success of Europe's recovery program is also crucial to the preservation of the mixed economic system.

At this point the United States becomes the principal player in the drama. Looked at through European eyes America today is not only the economic giant, but an island of economic strength and political stability. The nervous attention Europeans give America's decisions regarding shoes, television sets or steel is only partially a worry about the immediate adverse economic effects on them of American protectionism. The concern is more basic. How can any European government, when all but Germany are in far worse shape than the United States, continue to resist domestic demands for protection if America concedes the point first: Indeed, beyond praying that Washington will resist imposing new barriers, they consider it logical that the economy which is recovering first should as a matter of course draw in additional imports and accept the economic logic of balance of payments deficits. A program of balanced restraint and stimulus was laid out in the Communique of the OECD Ministerial Meeting last June.

In this connection a word is in order about Germany's trade surplus and comparable responsibility. The Federal Republic has been an ally of the Commission in the battle against protectionist pressures. Germany's trade surplus has been falling. When services and private and public transfers are taken into account its current account deficit for 1977 is likely to be in the order of 5 to 6 billion D-Marks. The Germans are convinced that the 6.2 percent rise in the Federal budget for 1977, plus additional public investment programs over the next several years will provide appropriate economic stimulus. Germans, regardless of party or whether management or labor, are as one in rejecting any policy which threatens to produce additional inflation. There is a national consensus in support of the Federal Republic's present policies.

Returning to the role of the United States, another important contribution can be made. The multilateral institutions and procedure for consultation, which could be of singular value in this situation, have been allowed to languish. The OECD, with its membership of advanced industrial nations, should be central to the recovery effort. This will not happen unless the United States indicates its serious intentions, the evidence of which will be the degree to which Washington makes use of the organization for serious, high-level consultation.

In sum, it sems to me that we need to keep constantly in mind several basic points. As we have seen, Europe is caught today in a political-economic crisis different from but no less serious than that of the late 1940s. There is no readily apparent or politically acceptable mix of economic policies which promises to produce steady, noninflationary growth. American policies and behavior are critical in determining whether the Europeans have a chance of succeeding in this objective. By "behavior," I mean sensitivity to Europe's problems and the narrow tolerances within which each government exists. Perhaps the crucial factor, as we develop our own economic policies, will be whether America has the maturity and the wisdom to recognize and take fully into account the effects of our national actions on our European allies.

Senator HUMPHREY. Well, that is a splendid summation. I cannot help but think at this point of that when I came into what I might call my period of political consciousness during the 1930's. The London Economic Conference of 1930 was the great meeting that was supposed to stem the tide of what was the apparent breakdown in the economic standards of the trading world. All of us remember with considerable heartache and sadness the failure of that conference. The governments of Western Europe at that time were having great difficulty maintaining what you might call good strong majorities. There was considerable discouragement among the European people as there was in the United States—much uncertainty, dismay. There were these rising elements of extremism that they were the nondemocratic forces of Europe. We see some of that today.

It is a different kind. It is not the fascist mood. The United States was in a pivotal point even at that time because of our basic strength. Even though we were having bank failures and all we were still considered to be a rather strong economy. But the whole conference failed and we entered the inwardness of the Smoot-Hawley period. We paid a terrible price for it.

Gentlemen, just for a very few moments, I am going to be absent from this table because I have to deliver a little statement to another committee and I will be right back. However, our ranking member is Congressman Brown of Ohio, and he and I sort of managed to get along in this committee last year when I was the chairman and he was the ranking Republican member. I have asked Congressman Brown if he would preside and pose some questions to you. I have given some of my questions to my colleague in the Senate, Senator McClure, and I know he will present them for me. We also have another Congressman Brown from Michigan and I know he has definite concerns over trade policy in particular.

So, Congressman Brown of Ohio, if you take over, I will be back and I do not want this to be interpreted as a lack of interest or discourtesy. I apologize but I must take care of a constituent domestic matter, shall I say.

Representative Brown of Ohio [presiding]. Mr. Vice Chairman, thank you very much. I should note for the benefit of those of you not aware of it, the Joint Economic Committee, both Democrats and Republicans, have usually agreed on economic policy as it relates to our international views from this committee. As a matter of fact, traditionally we prepared single international economic reports and then had majority and minority views on domestic policy. Sometimes it is hard to relate those differences to a single international policy but suffice it to say across the party line, we have had more agreement than disagreement, I think, about what our international economic policies should be.

However, you have left now three Republicans to ask questions of you, and that is likely to stimulate a more diverse number of viewpoints than if we still had the balancing influence of Senator Humphrey and the Democrats to both unify us as members of the minority and, also, provide for the coordination of viewpoints on international economics across party lines.

It is our tradition that we let the first one to arrive for the hearing ask the first questions so I am going to let Senator McClure be the first one on the assumption that he is seated here close to the vice chairman because he got here first.

Senator McClure. Your assumption is correct. Let me dispose of an important but relatively lesser important question in terms of the total economic policies issue; that is on agricultural imports, the question that Senator Humphrey left and one in which I have great interest and I will just read it the way he left it so that I will not be guilty of any editing; while it is true that U.S. agricultural exports to Europe have increased in recent years and as you point out, that the balance of trade in these products heavily favors the United States, this may be only temporary.

The European agricultural policy has high price support levels aimed at obtaining self-sufficiency in most products; thus our booming exports to Europe seem to be related more to temporary factors such as poor crops there, high fertilizer and feed grain prices, and so on.

Apart from transitory situations such as the present one, aren't we likely to be shut out of the European market over the longer term unless we can get them to negotiate their agricultural policies?

I would seek perhaps of Mr. Gutowski, a comment on that and then others of you who have comments to make.

Mr. GUTOWSKI. I will do that although I do not feel that I am an expert in the agricultural field.

But it happens to be so that I am very much against the European agricultural policy. [Laughter.]

Senator McCLURE. I am glad I asked you the question. [Laughter.]

Mr. GUTOWSKI. I feel that we do not do ourselves a favor in pursuing this type of price directed policy. What I feel we should do in Europe is to have more of an income-directed policy which would mean letting the market determine the price and rather give income compensations to farmers instead of letting their income grow by a continuous upward adjustment of the administered agricultural prices. I believe that Senator Humphrey is quite correct, that self-sufficiency is reached for more and more products and, therefore, we are forced to export some of those products because we produce more than 100 percent of our own needs. This situation simply has to be changed. Indeed, part of the success of American export policies might be temporary because there is a built-in tendency toward self-sufficiency. This certainly means a further misallocation of resources in the field of agriculture. But let me add one sentence, if I may.

I am even less an expert in agricultural policy of the United States, but as I understand, there are also many incomprehensible measures applied which are similar to those in Europe; so I would believe that it would be to the advantage of both the United States and Europe, if we made the obstacles to trade disappear by mutual negotiations.

Senator McCLURE. Are there other comments?

Mr. SCHAETZEL. Could I make a couple comments on that, Senator? I think the direct answer to Senator Humphrey's question is "No." In other words, I would be astonished if there were any development over the foreseeable future which would see a closing out of that market to us. The question is whether the past astonishing rate of growth is going to continue. But even this is a function of general levels of economic activity more than agricultural policies because the bulk of the exports, soybeans, for instance, are bound. Beyond that, there is their self-interest in importing feed grains because of the structure of their agriculture and structure of consumption in Europe. Other major items are tobacco, again a product which has an essentially inelastic demand. These bulk items which make up so much of our agricultural exports are really not likely to be affected by the policies of the community.

Now, on top of that, I think you gentlemen would know better than anyone, are the kinds of pressures which affect national agricultural policies and the difficulties of bringing about what many people would see as sensible adjustments? The European Commission is taking the lead in this area. Indeed over the past several years the increments in the intervention levels have been below the rate of inflation in the communities. As I said earlier, the farmer has been the one who has suffered.

Now, the current Agriculture Commissioner, Mr. Gundelach, is proposing even more modest increases, despite the high level of inflation, which ranges somewhere between 2 and 3 percent. There is a suggestion, one I would concur in which would be to get at the distressed state of the agriculture community in Europe by income support. We know how hard it is to sell this idea to the farmer and to many legislatures and it is difficult to administer.

Finally, between the new Secretary of Agriculture, Mr. Bergland and Mr. Gundelach, you have two new people at this business. In the context of the mutilateral trade negotiations and because of the pressures which exist on the agricultural communities in Europe and the United States, it may be possible to work, perhaps slowly, but nonetheless work in the direction of a more rational agricultural relationship across the Atlantic.

Senator McClure. Let me make a couple other comments and get to another issue, perhaps more of emergency proportions. First of all, Mr. Okita, you mentioned that you were running trade surpluses with the United States and trade deficits with Australia and Canada. I would suggest that we could shorten up that deficit—buy more U.S. wheat instead of the subsidized wheat from Canada. I recognize it is more attractive for you to go to Canada.

Mr. Poulin, you mentioned that the trade union movement has been very much in favor of free trade and I recognize that support and commend you for it, but on the other hand, it was not that noticeable when it came to the grain shipments to Russia which might have been helpful if you had been consistent. With consistency, it is easier to demand of others than it is to achieve of yourself.

Mr. Poulin. Once in a while, our politics get ahead of us.

Representative Brown of Ohio. Would you yield there? I just went to a meeting of the steel industry union, and the position on free trade is not particularly consistent, let me say, because there are some feelings about specialty steels, and I understand that even some people who make shoes have some strong feelings.

Senator McClure. I think there was some kind of a deal made on steel when it came up to the Rhodesian question.

Mr. Poulin. You might find some individual differences, and I am sure you have, in dealing with the different unions, basically our policy is pretty uniform and some of our aims and our goals are. From time to time, we will be deviating as each international has a right to do as it views its own position. We differ even in collective-bargaining processes, also.

Senator McClure. I want to touch briefly on the question of energy because every one of us has looked at the question of energy as a major international economic fact. It has been pointed out that the United States could adjust to the problem that has been presented better than a lot of the other countries and other OECD's and Japan because we are more self-sufficient in energy, 50 percent or more of our petroleum is produced within the United States, 80 percent of total energy is produced within the United States in contrast to the nations in Europe and more drastically and graphically in contrast to the position of Japan.

Yet, we see now in the President's energy message—which will be coming to the Congress tonight—some very drastic reductions in U.S. consumption of energy which will very markedly slow economic progress and recovery in this country—at least is likely to do so.

That will dampen the opportunity for international economic recovery, although it will reduce the effects of oil price increases in the long run.

I would like to have whatever comment you may have on that and in connection with that, the likelihood or your view as to the likelihood of the European Community and Japan following the suggestion that has been made by the President that we cancel the plutonium fuel cycle in nuclear energy.

Mr. ROOSA. I would be glad to take a quick try at it, Senator.

On the slowing down aspects, certainly there will be some such initial impact. I say that without knowing the ingredients, only the press rumors.

I suppose to a modest degree, there will be some inflationary impact, which helps to account for some of the other actions the President has recently taken.

But it does seem to me the real opportunity here is to combine the proposals which now concentrate on conservation and thereby in a sense are restrictive or constrictive in the economy, with the other opportunities that the energy situation affords for tremendous amount of new investment; some of them were suggested by Mr. Poulin.

But on the question of the President's position, vis-a-vis plutonium and the fact breeder reactor, I happened to be in Russia all of last week and had considerable discussion of that as well as other questions in what I must say—at the present stage—was a refreshingly friendly atmosphere; and they are troubled. They have been closer to the United States—or the Carter position—than any other country; but they are clearly troubled because they do not see other countries in the West as yet lining up with the Carter position—which as I understand it is that we concentrate on uranium and the enrichment of uranium; what we try to avoid reprocessing and certainly the heavy capital expenditure for the development of the fast breeder.

And all of this is related to the very compelling fact that we want to avoid adding to the great dangers that are a byproduct of this; there is danger enough in producing nuclear energy in the ordinary way.

So it does seem to me we are at a critical point. Since we are talking about the Summit, I do feel that it is extremely important that, if the Congress so feels, that they would reenforce the President in his position in hopes this will gain greater concurrence among the others at the Summit because without it, then I am sure that the collaboration which has been remarkably good with the Soviets in this field will also be gone. They are not going to stand with us alone if they feel that the problem has been given away by third, fourth, and fifth countries.

Mr. SCHAETZEL. Could I add a point to that, Senator?

You asked about the reactions to the proposal with respect to plutonium technology.

I think it has to be put in the context of the energy crisis. We have tended to put the plutonium cycle problem primarily in the security context. I think it needs to be looked at from both points of view.

Representative BROWN of Ohio. The energy crisis nationally or internationally?

Mr. SCHAETZEL. Internationally. Europe and Japan are infinitely more dependent on imported fuels than we.

Going back to the Atoms for Peace program in the 1950's, we took the lead in urging the development of nuclear power and the use of American systems through licensing and other arrangements. These countries adopted our systems and are now dependent on a monopoly—

which happens to be the United States—for the supply of enriched uranium.

With their energy problems and reliance on our uranium, it is natural for energy reasons for them to move into this plutonium technology as a means of coping with the energy crisis. Therefore, they have to reconcile these two objectives: Solution of the energy problem, on one hand, and the security, on the other.

This leads to the most dangerous development; namely, the tendency of the United States to use its position as monopolist to achieve its policies on reprocessing or the breeder reactor or plutonium fuel elements.

I can't think of anything more harmful to the United States generally, in every area, than to end up by being a cavalier monopolist on something as vital as this.

This goes back again to what we were saying, the need to discuss and consult about these matters and find other ways of dealing with them than threatening to cancel contracts for fuel reactors for which our friends have made very heavy investments, to say nothing of the implications for general security of these countries.

We have a unique responsibility in this area which I don't think has been fully examined in the discussion of this particular problem.

Senator McClure. Mr. Okita.

Mr. Okita. I quite agree with this energy policy. In the case of Japan, about 87 percent of total energy consumption is imported, and there is very little prospect of increasing domestic production.

Anyway, we will have to import either petroleum, gas, or coal to meet energy demands.

And the policies of the United States will have far-reaching effects on the future life and course of the Japanese people in general. So I would very much like to see this Government, the United States Government, to carefully study the international implications of your energy policy, particularly on Europe and Japan.

We see the possibility of a decreasing supply of oil in the international market and we don't see any other supply of energy except nuclear power and probably coal.

Again, in the case of coal, we may have to depend very heavily on the supply from other countries; from the United States, the Soviet Union, or Australia, and we do not know in case we introduce restrictions on the reprocessing of used nuclear fuel, there could be alternative supplies of energy, say, of coal or uranium; otherwise, the prospect for Japan is dim. Reprocessing may give some hope. It is necessary to avoid an emotional feeling emerging that the United States is creating the pressure to stop the Japanese economy from growing.

So I would very much like to see this Government indicate the possible alternatives for countries with very serious shortages of energy resources.

Senator McClure. Yes.

Mr. Gutowski. I almost completely agree with Mr. Schaetzel as far as the German economy is concerned; it is highly dependent on the development of nuclear energy, at least for the medium-term period.

Maybe there are other prospects in the longer run for development of other energy sources, but right now I do not see how we could substitute for future nuclear energy. Take coal, for example: Even if we improved the exploitation of our coal mines, its share would probably go down. The share of natural gas could rise, but not sufficiently, because the sources are limited.

So we simply have to rely on nuclear energy and although I see the delicacy of the problem, of the security problem, I agree with what Mr. Schaetzel and Mr. Roosa have said.

Let me add one sentence to what Mr. Roosa said in his statement here.

I feel that in the field of energy we have a task before us, the tackling of which could even improve the overall performance of the economies in Europe as well as maybe here in the United States, if we give the right incentives for new investment in energy by letting the price mechanism work, and when I mentioned before that I would be in favor of a program which stimulates supply rather than demand, then one facet which I meant by that is that we should stimulate research and development, also in the field of new energy sources, in order to come up with new and more supplies.

We shouldn't look at the energy problem only as a burden, but also as something which could bring us some positive results with respect to growth and employment.

Mr. POULIN. Senator McClure, I have addressed myself to your question in my presentation. I wonder if you might give us your opinion on the question that you posed, and the other members of the committee?

I will be interested in hearing that. You get all of the input from us usually.

Senator McCLURE. Well, let me allow Mr. Arsenis to make whatever comment he has and then briefly I would express myself.

Mr. ARSENIS. Just briefly to support what Mr. Roosa said, that the energy problem may not necessarily lead the world economy to a new recession, or even to a slowdown of worldwide development. On the contrary, investment in alternative forms of energy may provide opportunities for a worldwide investment boom.

I should also like to point out that most of the developing countries are energy-deficit countries and these countries will be faced with two problems:

The first problem is the provision of technological know-how with regard to exploration or development of alternative sources of energy. The technologies involved may not be as sophisticated as those that are now considered for application in the industrialized north.

The second problem—and I think that Mr. Roosa touched upon it in his statement—is that we do not have as of now a systematic mechanism for providing long-term development finance to the developing countries in the energy field.

Senator McCLURE. Thank you.

Just briefly, because I have already used more than my share of the time, and I want to yield to the others, I agree with the statement that George Meany has made about the continuation of the fast breeder reactor and the recycling plant at Clinch River and Barnwell. I think we ought to continue development of that, and I think it is incredible of us to expect that our partners in the industrialized world are going to give away a very large energy option when they are so much more dependent upon foreign energy sources than we.

It is a very great risk for us and a tremendous gamble for us, but an incredibly greater gamble for them. I can't concede that our European trading partners or Japan are going to readily accede to our request that they greatly jeopardize their own national security and economic well-being simply because of our view from our perspective that there are unacceptable proliferation risks involved.

I could go back and discuss that and we will be talking about whether or not it really enhances the security of the world or whether it jeopardizes the security of the United States.

I think perhaps the cancellation on balance jeopardizes the security of the world, rather than enhances it.

Representative BROWN of Ohio. Out of fairness, I think we ought to move on to Congressman Brown of Michigan. I am sitting here itching to get into this discussion, but we have a 10-minute rule, and I don't mean to abbreviate your answers, because the discussion is what we are here for, but it now Mr. Brown of Michigan's turn.

Representative BROWN of Michigan. Let me make a twofold apology to you gentlemen.

First of all, for arriving late, and then I am going to have to be leaving early.

Now there are some very fine questions that have been asked, but one thing hit me particularly, one thing that you said, Mr. Schaetzel, that I would like to follow up on.

That is in your statement you suggest that to a high degree the current European economic crisis is in fact political. I would respectfully suggest that maybe not the crisis, but the economic adversity that the United States is facing is also political.

It just seems to me that we don't have any general citizens any more. We all are kind of micro-citizens or special citizens and we don't look at efficacy and hazard as an equation. Environmentalists don't look at the use of coal from the standpoint of its efficacy, but only its hazard. Labor doesn't look at imports from the standpoint of free trading, facilitating exports, but only the hazard of the import.

In short, I am rather pessimistic. Can we resolve this political-economic kind of controversy, or almost debacle we are in?

Mr. SCHAETZEL. If I may just make a comment on that. I tried to deal with it in my brief formal statement. It is something that preoccupies me as much as anything else, not only because of the greater evidence of this phenomenon in Europe, but because, as you say, it exists here.

The problem moves rapidly into the areas of psychology and sociology. I think all of us in the industrial democracies, have a problem: How do you develop a consensus on extremely complex questions? I have talked with some of your colleagues and asked how constituents can be persuaded to take steps one, two, and three to get to four, even when they know that they want to get to four.

The situation is more politically precarious in Europe. The greater the economic difficulties, the more difficult it is to put that consensus together.

Representative BROWN of Michigan. Are you suggesting that that then leads to autocratic systems that get rid of the necessity of electing every 2 years to resolve the problem?

Mr. SCHAETZEL. I think it can lead to that. Indeed, I was in Italy a few months ago at a conference, sitting next to Segre—who is the shadow Communist Foreign Minister in Italy—and we talked at length for 2 or 3 days about all these issues.

They fear that something like Chile could happen in Italy, with, first, an option to the left, but then a rapid reaction to the right. The far right is not the problem now, but whether it is far left or far right, I think one of the possible responses is an autocratic regime.

Representative BROWN of Michigan. You or Senator Humphrey mentioned the right of the 1930's, and right of the 1930's is a reaction to the left of the 1930's, or left of the late 1920's.

Mr. SCHAETZEL. That's correct. But in each case I think what you get are doubts raised about the efficacy of the capacity of the democratic process to cope with these issues. Whether the response is totalitarian or quasi-totalitarian on the left or right, you have more or less the same public impact.

But that doesn't help get at the answer to the question.

It does lead me to my major message: We as Americans ought to be particularly sensitive to the difficulties these countries face and help them reach a democratic answer. This means we may have to be patient with certain economic phenomena—we talked about plutonium, about imports—just because the stakes are so high.

We ought to try to help these democratic governments through this process and see if a consensus cannot be developed of the democratic nature which will resolve these issues.

Representative BROWN of Michigan. Yes.

Mr. GUTOWSKI. I was impressed with what Ambassador Schaetzel was saying about the European political scene, but I feel there are some promising developments underway, and although I would not understate the Italian and British political situation, I really believe that even those countries are coming to realize that this all is a consequence of the inflationary developments.

I can understand the unions that in this process of inflation they really try to get ahead of inflation after having been behind for quite a while. Now, in the phase of trying to reduce the rates of inflation, we face the problem of breaking expectations. The level of real waves is too high by now almost everywhere which means in economic terms that we have too high a rate of, in quotation marks, "natural unemployment," and I think the unions have realized that.

I think the European countries could help each other by granting conditional credit so that more of the income of Europe is devoted to investment rather than to consumption. This would imply, of course, wage discipline or a very strict incomes policy. Therefore the credits have to be conditional. If they were not, the weaker governments would be forced to yield to the wishes of unions and others. In this case credits could perhaps help for a very short time, but not in the longer run.

Representative BROWN of Ohio. Will you yield just for an observation?

Don't you see Prime Minister Callaghan trying to lead his labor unions into that realization?

Mr. GUTOWSKI. Oh, he does, yes. He should and he does, he tries.

Representative BROWN of Ohio. However, the concern is that the political result of that may be that Prime Minister Callaghan will be leading the minority side of the Government in Great Britain, isn't that correct, and isn't that one of the threats that he faces?

This is the instability that swings back and forth with the public sentiment.

Mr. GUTOWSKI. Right. But the stronger the conditionality of credits, the more he can say inside his country that he simply has to do this and that in order to get on, and if all realize that the opposition would be in the same position, then this might even strengthen his position.

Mr. OKITA. In the case of the Japanese political picture, I feel more optimistic than the case of Europe. We find a broadening understanding even including some of the leftwing politicians, about the need for maintaining parliamentary democracy and maintaining basically market economies. Although the one-party rule by conservative Liberal Democratic Party may end, there will be a possibility of understanding between labor and employers, and possibility of realistic approaches to international, as well as domestic issues.

I am not expressing this optimism because I am going to join politics recently. [Laughter.]

Mr. POULIN. I think the statements made concerning the union's position is a little bit oversimplified. While it is true we have been concerned about our constituency, particularly when a plant shuts down and it moves out, we do all we can to protect them and that source of jobs. We have gone beyond that and I think the conservationists have gone beyond that, we are looking at the causes and let me impose upon you for a couple of minutes and cite you one example which affects our union personally.

That is the manufacture of small aircraft, and our dealings with Brazil.

For many years all of Brazil's smaller aircraft were purchased in the United States, Brazil had no aircraft producing company. About 4 or 5 years ago, the Brazilians acquired in negotiations with Piper Aircraft the right to pick up some of the technology, and I won't bore you with the details.

The end result is that they are producing light aircraft in Brazil with their labor, our technology went down there through Piper Aircraft Co. in this case, and they have literally—this is what people tell me—they have no restrictions on selling those planes in our market in this country. Whereas we have all kinds of restrictions in their markets.

So we literally cannot compete against them in their own market in their own field. Yet they have free rein in ours. So we are looking at those things. Those are the things we address ourselves to in our own way to this committee today.

Representaitve BROWN of Michigan. My comment to Mr. Schaetzel is that I get the impression that you think it is better for President Carter to talk to Americans about energy than to talk to the world about human rights. [Laughter.]

Mr. SCHAETZEL. That is not a statement I could completely associate myself with.

No, I think——

Representative BROWN of Michigan. You don't have to respond. [Laughter.]

Mr. SCHAETZEL. You do provoke an observation. I am greatly concerned on the basis of a lot of contacts with the Europeans and Americans regarding the danger that each society is becoming excessively introspective, so concerned with domestic, political, and economic problems that we forget this is an interdependent world and we forget the impact of our discussions on others.

I want to say how much I agree with Bob Roosa, that in our enthusiasm for isolating problems and proposing remedies we cast these ideas out on the world as the way we must all proceed. I am absolutely convinced this is not the way to create a better world or maintain international viability.

Representative BROWN of Michigan. Thank you, Congressman Brown of Ohio.

Mr. OKITA. I have just one comment.

Representative BROWN of Ohio. Sure.

Mr. OKITA. In relation to the statement recently by President Carter, withdrawing the tax rebates. It should have been a controversial issue here, but it has had also some international repercussions. It has somewhat strengthened the hand of the conservative policymakers back in Japan not to expand domestic demands too much.

They say, look, the United States has now changed its position to give more importance for anti-inflationary measures rather than to stimulate demand. We should also be very careful in stimulating domestic demand in Japan to prevent inflation.

I personally do not agree with this view in Japan. For Japan, we need more stimulus to increase domestic demand, but there is so much strength in the conservative policymakers not to introduce bolder measures in stimulating domestic demand in Japan.

Representative BROWN of Michigan. If I can comment, I think a lot of us who didn't support the mechanism of a rebate would support tax reductions. We are not all Keynesians who think that the only improvement in the economy comes through emphasis on the demand side; you can do something on the supply side, too.

I would like to continue that point because there seems to be a rather specific difference of opinion between you, Mr. Okita, and Mr. Gutowski, on this point. Mr. Gutowski, if I understand your testimony, after having read it briefly, and I also apologize for being tardy, but I, like the Senator, had some parochial matters that while perhaps were not relevant to this discussion, were of great consequence to my district.

Your testimony seems to infer that what we need is a stimulation of supply and somebody else mentioned the fact that we ought to stimulate the economics of the world by seeking new energy sources, that that would be one way and that we need capital for that, and perhaps we ought to get the Government out of those businesses and let those be done as a private matter and, of course, one of the ways that you stimulate private capital is to reduce Government demands on that capital or reduce taxes.

Would you respond to that as a not only domestic philosophy for Germany and for the United States, but as a philosophy for various nations of the world, particularly the strong trading nations?

Mr. GUTOWSKI. I agree. I think the argument is valid, maybe not to the same extent in all countries, but to a certain extent, at least.

In Germany, it is particularly valid because the Germans are still very much in fear of inflation and the psychological feedbacks may be stronger than in other countries. In Germany, and I believe to a certain extent in other countries as well, the negative feedbacks from demand stimulation could be stronger, at least, in the medium run than the positive first round effects of increased deficit spending.

If countries take up such matters like new developments in energy and take other measures which make the productive capacities increase, instead of only raising the degree of utilization of existing capacities for as long as additional public spending lasts, that would improve the overall situation, including employment.

That is my main point.

Representative Brown of Ohio. Mr. Arsenis.

Mr. Arsenis. There is no doubt that in the long-run the expansion at the national and international levels has to take the form of expansion in productive investment, particularly investment in new areas. I think this is the main point that emerged from several statements today.

But over the period of the business cycle, in the short run, I think that there is no agreement as to how to bring about expansion. There are some economists, and I belong to this group, who believe that domestic markets should be stimulated. There is considerable excess capacity in many countries and stimulation of demand will help the recovery in these countries; it would also contribute to a better adjustment process in the world economy.

Now, I understand that Professor Gutowski is not opposing expansion in principle but he is opposing expansion through a particular form; namely, deficit spending.

Well, of course, economists disagree on this issue more or less on philosophical grounds and I don't think that we can settle the matter here. But I think that he mentioned something which is worth while to note, and which could perhaps provide a viable alternative with regard to a smooth adjustment process.

I think that Professor Gutowski is in favor of effecting a smooth adjustment in the balance of payments by operating on capital account rather than by operating directly through the current account.

In other words, the surplus countries could provide long-term capital flows to the deficit countries, which would enable the latter countries to finance their deficits and avoid further deflation.

This is something that is worth while exploring, not only in connection with OECD economies, but also in connection with the current account deficits of oil-importing developing countries.

I mentioned in my statement that the deficits in developing countries are not due to overspending but they are due to deterioration of the terms of trade and recession in the OECD economies.

So insofar as surplus countries are prepared to provide long-term flows to developing countries in the form of public assistance or private investment, this in itself may help a better and developmentally oriented adjustment process in the world economy.

So I would like to highlight this point on which it seems to me we are both in agreement.

Representative Brown of Ohio. That is a very broad-minded attitude for the countries that are surplus countries, and it seems to me it is easier to apply—easier for Germany to apply to Germany than for us to sit around the table and apply it to the Arabs. One has to have some support from the surplus countries to get the mission accomplished.

How do we get it—how do we get the Arab nations, which are surplus countries at this point, to agree to that rather generous application of their surpluses?

Senator McClure. Could I make a comment or rephrase it so that I perhaps can get the language in terms more directly understandable to me. But the suggestion is rather than reflation to help the lesser developed countries, you are suggesting an alternative possibility that there be long-term loans and lest we blanket all Arab countries as being currency surplus, there are some that are and some that are not. Some are in deficit as others that are non-Arab and nonoil producing. I think of Algeria as a country in that situation.

Representative Brown of Ohio. Strike Arab and read it as OPEC.

Senator McClure. They are surplus.

Representative Brown of Ohio. I embrace in OPEC perhaps a few years out, our friends, the British, who through the North Sea, may well be extracting money, whether it is deutsche marks or not, from the European countries to replace their own current capital problems.

But how do we get countries to adopt that as a matter of national and international policy?

Senator McClure. May I suggest this as something on which the panelists might make their comments; that is, where the countries have large surpluses, they may find that reflation is more tightening to their security than the prospect of making long-term loans that might be less than completely hard loans.

Representative Brown of Ohio. The "we" is what is the vehicle for doing that.

Mr. Roosa. There are two things, first, and this applies to Germany and Japan now, even greater attention must be given to developing their own imports; which is another way to use the surpluses.

But in the capital export sector this certainly applies to the surplus OPEC countries. They are already doing their best to import. Their harbors are clogged, and they can't spend all the money. A transition is occurring, however. It may seem slow because 3 years has elapsed, but much has already happened in terms of their getting their funds directed into capital markets.

They started out with very conservative views. They didn't want to have a maturity beyond 7 days, even with very large cash balances. And this, as it has evolved, has reached the point of their being willing to take risks with investment in equities in the United States, but not yet equities in many of the less-developed countries.

Representative Brown of Ohio. Would you yield at that point for this observation? In the Bedouin philosophy it is very hard to make a commitment beyond that period of time as a matter of personal philosophy.

Mr. Roosa. Yes, but it is already changing.

Senator McClure. It was tied to the threats to expropriate.

Mr. Roosa. Yes, and therefore they diversified. But what they are doing now is making much larger contributions both to the kind of temporary bridge financing arrangements that I mentioned briefly, and to the longer term structural investment opportunities that are possible through the World Bank and the other regional development banks. They are themselves making loans and are beginning to contribute to the capital of these international bodies. Most recently the Saudis—it is a small sum for them—but they have voluntarily walked up and said, here is $35 million for the IFC. This is the affiliate of the World Bank, as you know, which is specifically devoted to the development of private enterprise as a part of the World Bank complex.

It is going to take time, but I think a very large part of the surpluses can become available through international institutions. This will also include a supplemental facility at the International Monetary Fund as well as the more long-term kind of commitment through the World Bank complex.

I don't want to sound too Pollyanna about this;; I just stress that change is occurring and that it is this avenue that I think is most promising.

Representative BROWN of Ohio. That is an optimistic statement which doesn't respond to my question, which is, How do we get them to do it? What is the vehicle for it being done?

Mr. OKITA. As I said in my prepared statement on the last page, having begun the programs:

> It is true that Japan should not continue registering a surplus in current balance under the current serious situation. The Nation should cope with the situation by raising the rate of economic growth and keeping the yen's exchange rate rather appreciated, and channeling any current surplus that may still arise into direct investment abroad, for promotion of bond flotations in Japan by foreign countries, for expansion of aid flows to the developing countries and other objectives.

There is a savings surplus in Germany, Japan, and in the Arab countries while there are capital short countries in the world. And the transfer mechanism of surplus savings to shortage countries is not adequate. Maybe, as Mr. Roosa was saying, international institutions can be strengthened. The private capital market is not quite enough to accomplish this transfer from surplus countries to the deficit countries.

There may have to be some international arrangement for guaranteeing the risks, or reducing the risks or some kind of interest subsidy of a slight amount.

Representative BROWN of Ohio. By removing the risks, are you speaking about the risks of having your investment nationalized by the Government of the other country? Or should we have some international compact on that basis? If in fact that had existed and if it could be enforced in some way, the Arabs of course never would have shared in the oil exploitation of the Arab lands and there is a question in my mind about whether you could actually accomplish that kind of an international understanding.

Mr. OKITA. There may have to be a kind of an insurance scheme somewhat broader than just reducing the risk of nationalization.

Representative BROWN of Ohio. Is there a way to strengthen the World Bank in this area?

Mr. OKITA. I think so, yes, that is one possibility.

Representative BROWN of Ohio. Before I lose the ball altogether, since the vice chairman is back and I am outnumbered two Senators to one House Member, and because I have to leave, I would like to turn the issue back to energy for a moment.

You mentioned the British and the North Sea oil a moment ago, and I got the impression from some discussions I had with some of the leaders of the British interests in the North Sea that their concern about our slowing up nuclear development is not as great as perhaps that expressed by some of our participants in the panel this morning, simply because they apparently are going to have some oil that they can use for their own development; and also that they can use for trading advantages with particularly the European countries, where oil is short.

Tonight President Carter is going to lay out the specifics of a rather stringent energy program for the United States. The program is reported to propose higher gasoline tax, taxes on fuel-inefficient cars, wellhead tax on crude oil, higher natural gas price ceilings, as well as tax credits for such things as home insulation and solar energy use.

The tentative estimate collected under the program for 1979 would be somewhere between $20 billion and $45 billion. Either of them is a whopping amount to be offset by rebates.

Decisive U.S. action to cut energy consumption is needed if we are to forestall further OPEC price increases, and their disastrous consequences for the world economy. But stringent actions by the United States may soften current recovery and slow U.S. economic growth.

Such actions will almost certainly cause us difficulties in offsetting the economic hardships for individual groups of Americans, back to our parochial problems of domestic politics.

Can you give us the benefit of your insights to the current world energy situations as you see them, and relate them to the United States, and give me some indication of how we proceed?

It seems to me that we have a choice here between a free market approach which says let energy costs seek a natural level on the one hand, on an immediate basis which might have a severe economic impact immediately; or let's restrict them in some way and manage it through the national economy, which in effect makes for unrealistic pricing of energy to American consumers or to the American Nation as a separate entity from the world situation.

I am curious to know from those of you on the panel what you would recommend to us both in our own best domestic interest, but also in the international world interest in this field; and are the two mutually exclusive?

How is that for an easy question? Try to answer it briefly. [Laughter.]

Senator HUMPHREY [presiding]. As brief as the question. [Laughter.]

Mr. OKITA. My answer would be, my recommendation is your first alternative.

Representative BROWN of Ohio. Is what?

Mr. OKITA. The first approach.

Representative BROWN of Ohio. We ought to let the price of energy float the way we let the currency float?

Mr. OKITA. Yes.

Senator HUMPHREY. Let me just ask if there is any free market in energy? I mean, after all, there is a cartel. They set the price. It isn't competitive. The only free market you really will have is in commodities other than those that are outside the cartel. You have a free market in the price of eggs, but not in the price of oil.

Senator McClure. But oil is only one facet of energy. There are free markets around the edges of that.

Representative Brown of Ohio. With all due respect I notice the chairman is back, but I know your views—both of you. [Laughter].

What I have asked for is their views.

Senator Humphrey. But I thought your premise was screwy, that's all. [Laughter.]

Go ahead on that screwy premise; answer the question. [Laughter.]

Representative Brown of Ohio. Or you may take my screwy premise if you like.

Senator McClure. Or agree with it.

Mr. Roosa. It's just too big a question to answer in the time that we have, and I am sure that there will be no set of answers that will survive more than a few months before they have to be revised and altered or accommodated.

The basic fact that we have at present a cartel that controls the price of oil, and thereby sets the criterion on which all other energy uses can be gaged, means that every country is going to have to find a way of meeting that level of energy cost; and to adjust its own production processes and patterns in the way that it will still make it possible to pay its own expenses across its own frontier and balance its own accounts.

Every country is going to have to take a different approach. It will, I hope in each case, rely as fully as possible within each country on the market mechanism. But we know that that will have to be buttressed both in order to cushion the shock effect of some adjustments—and the shock we will probably get tonight—and also in order to get the time required to make the other compensating investments that are going to be needed.

And here, I think there is a real opportunity to get the OPEC surplus put to work.

You ask what is the mechanism—there are two steps: First, you have to have the institutions which you described.

The second is you have to have the salesmen to persuade.

I have spent a lot of time trying to do that, together with my colleagues here in our article a few years ago. There are dozens of American businessmen who are in the process of trying to develop their thinking along these kinds of lines both out of a sense of responsibility and out of a sense that, if they are going to own a large part of the world, they are going to want to make sure that it works better.

I think all of this is coming along, but it's a many sided process for which I am really afraid there isn't any answer that is as short as the question.

Representative Brown of Ohio. Mr. Gutowski.

Mr. Gutowski. A market economy is used to continuous marginal or incremental changes, but this was not an incremental change; so it's rather difficult to adjust, and therefore one has to find an optimal solution, it's really an optimality problem.

I agree with Mr. Okita, that we should in principle let the market determine the price, but one has to take into consideration that the Arabs by their decision have reversed the natural order of exploitation of different sources of energy. If you let the price adjust to the new market conditions, it might be too much of an adjustment to be asked for in one step. But I would not set limits to prices, I would rather try to do it in an indirect way by taking measures which stimulate energy conservation and, as those mentioned before, the development of new energy sources, taxing energy consumption and the like, in order to influence the supply and demand side of energy favorably for the longer run price of energy.

So one has to find some sort of compromise for the adjustment process, although in principle, I would like to see the market operate via prices.

Representative BROWN of Ohio. Mr. Arsenis.

Mr. ARSENIS. No, I would not add anything.

Representative BROWN of Ohio. I will return the ball to you, Mr. Vice Chairman, unless the other two gentlemen——

Senator McCLURE. That was supposed to be a screwy premise.

Senator HUMPHREY. It isn't as screwy as it sounds, I grant you. I tend to agree with the final part of what Mr. Gutowski had to say.

The point that impressed me the most amongst the testimony, the many things today, was when you said, Mr. Roosa, that the increase in energy prices has really produced most of the inflation in the world economy. It's now a different economy. It is the failure to understand that it is a different economy not only here, but worldwide. That is really at the source of much of our difficulty today. We are going around pretending that somehow it was just a small adjustment in the price, that you could work with within the market system that takes care of these adjustments.

Actually, it was a change that had political and economic repercussions of almost revolutionary impact. And we are still going around trying to put on bandaids in terms of our response and not getting at the long-term needs of development.

We have just finished marking up the international financial institutions requests legislation. To say the least, many of our agencies are upset with the amounts authorized. Yet you are right, just as the IMF finished its sixth replenishment of it and ought to be working on its seventh. The arithmetic of economics has changed drastically and this is what people can't understand. It is very interesting to see what this has done, for example, to a simple thing like asphalt for a highway. It has totally wrecked the economic base of the government in many townships where they tried to use hard-surface roads. I know of where I speak because the cost, the drastic increase in the cost of maintaining that highway is more than the tax base will provide for.

Senator McClure, did you have something?

Senator McCLURE. I was just going to comment that I suspect there will be a number of people who will accept the replenishment more readily if they realize that the replenishment is not going to also be matched with the relation as a solution. I think the comments made by Mr. Gutowski and the contribution of Mr. Arsenis, on that question may aid the discussion of the replenishment.

Senator HUMPHREY. One of the philosophical differences which prevails amongst public and private citizens, is on the issue of investment. As was discussed by Mr. Gutowski and Mr. Arsenis and others, there is still disagreement about whether you get more investment tax incentives or increased demand, to be frank.

Now, I have mixed views. For example, when the farmers got $3.50 to $4 a bushel for their wheat out my way, they maintained their buildings, bought new machinery, added to the barn, bought a new tractor; they invested; which I support. Despite the investment tax credit, which I support, they did not buy a thing. But the minute they got $4 for wheat, $10 for soybeans and $2.50 for corn, they started to invest.

Now, if you have enough people that work, you have demand and you are going to invest. If we run a little business and if I see, for example, that our volume is up and that my profits are thereby up, I am going to invest. But you are not going to get me to invest when I have a volume that is down and no profits. The guy has to have holes in his head unless he has a huge bank that he can draw on. But the independent small businessman employs 55–60 percent of the people in this country. Business with sales of $5 million or less employ a majority of the people in this country. Those people don't have large amounts of capital, they just don't have it.

When do they invest? When they see sales. That is when they invest. Yet I know also investment is necessary for productivity, and productivity is necessary to keep down costs, and you don't have a clear-cut line; but I know Mr. Gutowski was not for economic stimulus; he was for the investment policy. And of course this is a battle royal that we fight here in the Congress. Right now we have an issue in the Senate because the Finance Committee reported out a 12-percent tax credit at the same time that we dropped the $50 rebate.

Well, the political ramifications of that is one problem. But the other question is about the health of the economy. Mr. Carter, Mr. Blumenthal, Mr. Schultz, and others we have heard made a dramatic turn around in just 48 hours.

Senator McClure. I am glad you said that.

Senator Humphrey. Well, I might as well be the fall guy here, but we have the consumer purchasing up and GNP showing growth. That is simply better than we contemplated. Capital investment is up. Therefore, you can drop the $50 rebate because you don't need the stimulus that might also give you inflation, and if you want to scare children and old folks, you say "inflation"——

Representative Brown of Ohio. Some of us are middle aged. [Laughter.]

Senator McClure. Are you scared, too?

Senator Humphrey. Some are in my generation, too. But then why do you need the investment tax credit? Why don't you move in on that just for a moment—anybody?

Mr. Roosa. I would be glad to. I was involved in getting it first started. I had to make the first presentation of the administration to the assembled economists of the AFL–CIO when we first proposed the investment credit in the spring of 1961.

I have not recovered yet, but I am still in favor of the investment tax credit.

Senator Humphrey. I was one of those heretics, liberals that was for it. I have never forgotten. I still think it is a good idea.

Mr. Roosa. Yes.

As for the immediate situation, I think that appraisal of the underlying condition of the economy has a lot to do with the choice you make as to what kind of stimulus is going to be most effective. I feel that additional spending in this case will occur anyway as a result of the fact that there will be a somewhat larger budget deficit because the investment credit is made available. That generalized flow of additional purchasing power will exert a moderate stimulating effect.

But what matters is its injection point in the economy is clearly related to an addition to the productive capacity of the economy. There are times when I think the emphasis should be on that side. There are other times when, somebody invoked the phrase, you can toss the money out of the back of an airplane and it will be just generally good. But here we want to aim or target the injection point where we are sure of what is going to happen.

In the present setting, there is a lot of uncertainty as to what would happen with that $50 rebate and the uncertainty kept growing.

Senator HUMPHREY. Yes, that is my view of it.

Mr. ROOSA. And here there is a clear advantage of keeping the investment credit. I know the President decided to drop it but I argue the way I——

Senator HUMPHREY. He dropped the additional 2 percent.

Mr. ROOSA. Yes, but kept the 10 percent.

Senator HUMPHREY. Yes.

Representative BROWN of Ohio. There is another point, and that is the last part of the economy to recover has been industrial investment. They just have not moved and you do target it to an area that is not responding in that way.

Mr. ROOSA. Yes.

Representative BROWN of Ohio. I did not mean to interrupt you.

Mr. ROOSA. No, that is all I really had to say.

Senator HUMPHREY. We all recognize, I think, that investment is a very basic part of any kind of steady economic growth. You have to keep your plant modern, you cannot be competitive without it. And it is job-creating to invest. The question is, Do you do a better job of getting investment through tax incentives; or do you get a better job of getting investment by increasing demand? That is the old argument.

There are those of us of the populist school that say the best way to get it would be demand. I have never been impressed with people who decided to invest when there was not a market. I have always thought those were people you ought to have take you out to dinner but never do anything with the economy. So many people who made ridiculous investments have caused a lot of heartache in the country. But if you see a market, if there is a market for bubble gum, I think you ought to invest in it.

But if the kids quit chewing it, I do not care how many bubble gum factories you build, they will not buy the bubble gum. Do you want to comment? I know what Congressman Brown of Ohio's view is already. [Laughter.]

Mr. GUTOWSKI. I think we have to change the behavior of entrepreneurs. There is, of course, such a thing like aggregate demand but there is no market as such. It is not the task of the entrepreneur, to watch on the television, whether or not aggregate demand has been turned on again; rather they have to find out where the particular markets for those products are, which they are able to produce and to sell, and I am quite sure markets exist. But there is also the question of profitability, and problem, I think, can only be tackled from the investment side, without giving away too much money to the enterprises.

If one stimulates demand only, it could happen that the prospects for profitability do not change. Given the low utilization of capacities the entrepreneurs would certainly provide more bubble gums or whatever is in demand for those $50 tax rebate, but they would stop right away producing more, when this money has been spent. So if a tax reduction is not made permanent, it would not work, I guess.

Representative BROWN of Ohio. Could I go back to a question you raised earlier, Mr. Vice Chairman, because we came to it when you were out briefly and it is still gnawing at me.

That is the question about the governmental reaction in various parts of the world to this close balance that is political and relate that to the economic situation in not only those countries but the world.

It is sort of a philosophical question but are you suggesting or do you feel that we are at the time when we need a new social compact in the world not only between have and have-not countries but perhaps between labor and management in some of the countries, perhaps between the two parties in the United States or the multiple parties that exist in some of the countries which some of our friends here represent, that would address itself to the dangers of inflation and to the more equitable use of some limited resources? Is that too complex a question to ask for your comment on?

Mr. SCHAETZEL. I would be glad to make a quick comment. I think I invited this.

If you look at the countries which to a degree are succeeding—Japan, Germany, United States—you have something which approximates this consensus. In other words, you have a broad area of general understanding. Where you do not have it, there is a problem. I think one of the difficulties in France is the ideological difference between the opposition and the Government which wants to change the system. This is one of the problems that Callaghan has with his militant left, a minority which wants to change the system. Others are trying to search for solutions within the system, recognizing the difficulty of the problem.

I agree entirely with the form of your question, which is the necessity to broaden that area of national consensus and international consensus. If we do not, we are really all dead.

Senator HUMPHREY. Mr. Gutowski.

Mr. GUTOWSKI. We have what we call in Germany a "concerted action" which is a regular institution called in by the Minister of Economics, where unions, employers, associations, central bank and the council come together with government officials and discuss questions of mutual interest. There is no obligation whatsoever but it makes people understand each other much better; you might perhaps not know that a similar action has been tried out twice already within the frame work of the European Community.

The European Commission has arranged such a concerted action and gathered corresponding groups of representatives from all member countries. I do not know if it is still in an experimental phase. Its continuation might be helpful. If you take Great Britain, there exists for 2 or 3 years now a social contract which helped to turn the tide. Of course, it is now getting more difficult because the unions will have to step back for at least 1 more year and this is really hard to ask them for.

Senator HUMPHREY. Could I just finish up on a question and Senator McClure wants to ask some questions and I know you want to have lunch and I have to go over to the State Department.

Professor Gutowski, there is a significant difference in the forecasted growth rate of West Germany between West German domestic forecasts which range 4.5 to 5 percent and the OECD forecast which is 3.5 percent. Is it likely that the 5 percent targeted growth rate will not be met this year? What is your view?

Mr. GUTOWSKI. My view is that 4.5 percent is still the best guess, so to speak. Of course, it is possible that it could become lesser over the next few months. I would say the 4.5 percent is closer to the upper limit of the scale of possibilities and not right in the middle. By the way, the OECD corrected its forecast a bit to the optimistic side. I do not always go along with the OECD forecasts. At the moment, for example, there are countries who would like to see more demand stimulation in Germany; this might express itself in a rather pessimistic view on the German prospects for growth, because the darker the forecast is, the better is the chance for getting more demand stimulation.

Senator HUMPHREY. You may be interested in the headline that appeared in the business and finance section of the Post, "U.S. Plan To Bolster Worldwide Economy Quietly Laid Aside." It was a statement confirmed by Fred Bergsten. He said:

> Roy Jenkins, president of the European Common Market's governing body, indicated after meeting here yesterday with President Carter that American proposals to stimulate the world economy have quietly been laid aside.
>
> This was confirmed by a high official of the Carter's [sic] administration.

It is kind of hard for us to keep up with what is going on around here. [Laughter.]

Representative BROWN of Ohio. That's the way it is when you control the White House. We had that problem for 8 years. [Laughter.]

Senator HUMPHREY. I enjoyed it so much more sitting on this committee when you fellows were in charge. I could attack with ferocity, with reckless abandon, now I have to be much more restrained. Go ahead, Senator McClure.

Senator MCCLURE. I have noticed that.

Mr. ROOSA. You have to read the "Party Line" every morning in the newspaper.

Senator HUMPHREY. It is hard to keep up.

Representative BROWN of Ohio. You have the right paper for it.

Senator MCCLURE. There are many, many questions we would like to ask and I am not immune but I have three in the time that we have. One brief one, Mr. Okita, you said that the forecasts made in 1974 in your country rather adequately and accurately predicted the course of economic recovery including the rates of inflation.

Were the Japanese people informed and did they know what rate of inflation was going to be the result of calculated government policy before that policy was placed in effect?

Mr. OKITA. The fact was at that time there were many projections, Mr. Fukuda announced his idea of normalizing the economy in a 3-

year period. He gave some specific target for price rise which had some effect on wage demands. In the spring of 1974, the Consumer Price Index was 26 percent higher than a year ago and the wage rose by 32 percent. Fukuda set a target to reduce that price increase by the spring of the following year when the so-called spring offensive of wage demands as expected. He set the target of price rise at somewhere around 15 percent for the 1976 spring. He also set a target for the spring of 1977, 2 years ahead, that it should be below 10 percent. This has been what was attained.

Senator McClure. So it was predicted in advance but it was a prediction from a high level of inflation toward a lower level of inflation.

Mr. Okita. And it had the effects on wage negotiations.

Senator McClure. There has been some comment made about the financing of less-developed countries' debts by private U.S. institutions. There is at least some growing concern about the level of that indebtedness held by major U.S. banks and whether this effects liquidity or security of financial institutions. I suggest it is also raised by some as to whether or not it is going to effect their political judgments in regard to our position in the world and with regard to specific foreign nations.

There is another factor that really does concern me domestically that is related to that question and that is the real credit crunch, the lack of credit in the farm belt of the United States, the country banks are running out of capital. The tendency is for the capital to concentrate in capital markets in the country, mainly New York City. To the extent New York City is financing lesser developed countries, that capital is taken away from the farm belt of the United States.

Arthur Burns made a strong statement to the Carter administration about this problem, and the result has been more and more farmers and farm community businessmen who have had their credit terminated as a result not only of hardship but a growing number of bankruptcies and liquidations in the farm belt of the United States that may be directly related to the phenomenon of private institutions financing of lesser developed countries.

My question relates not so much to that side of it but to the other side of whether or not these lesser developed countries can continue to function as economic units with the tremendous burden of a debt which they will accumulate over the next few years.

Mr. Arsenis, in your prepared statement you say the debt service ratio may possibly reach as high as 32 percent by 1980 for the developing countries.

Can their economies actually function at that debt level and if not, what would be the impact on the private banks in the United States that have advanced the loans?

Senator Humphrey. If you will close this off, Senator McClure, I will appreciate it. I am due at the State Department.

Representative Brown of Ohio. I have to leave, too, I want to express my thanks and tell you how fine I thought the testimony was. Excuse me, Senator McClure.

And, I would just say that some of the things you have said here today have been very stimulative and I would agree to a good many of the comments made, and disagree with some. I would say personally to Mr. Gutowski that I liked several of the rights, you have the right name to succeed politically in my State so if you get out of the business you are in, we have a spot for you. [Laughter.]

Mr. OKITA. Could I leave now, I have an appointment.

Senator MCCLURE. Surely, any of you who have a time constraint, may leave. I appreciate the time you have taken to be here.

Mr. OKITA. Excuses me then, sir.

Mr. ARSENIS. The number that you have referred to; namely the debt service ratio of 32 percent by the year 1980 relates to a purely hypothetical exercise. We have carried out this exercise in order to examine the implications of certain trends.

I have emphasized this ratio simply to illustrate what might happen if a certain mix of external finance is assumed. I think that a debt service ratio of the order of 32 percent by 1980 would be too high for developing countries, as a whole, to sustain and at the same time, maintain a reasonable pace of development. But this is not a forecast, it is a hypothetical exercise to illustrate the point that the composition of external finance of developing countries will have to change and that the loans to these countries will have to be provided, on more concessional terms in relation to those prevailing in the international capital markets.

Now, the problem that developing countries are facing is that, for a number of reasons, they have not been very successful in breaking into the bond markets and consequently they rely primarily upon commercial loans of relatively short maturities. Helpful as these loans may be, they cannot do the things that they are not supposed to do; namely, to finance investment with very long gestation periods. It is because of this fact that I have emphasized in my statement that some official initiative is required in this area in order to transform the excess savings that are available in the world economy into long-term loans to developing countries. Now, this kind of transformation does not necessarily require budgetary appropriations in the form of a development assistance. There are other techniques such as the provision of guarantees, for example, that will enable developing countries to have better access to capital markets and obtain loans with longer term maturities.

That there is a lot of discussion in the market about the debt servicing capacity of developing countries and the possibility that certain developing countries may default on their debts.

I do not think this is really a fair question to ask because the question is not whether developing countries will default; the question is at what cost to their development process these countries are now servicing their debt. My own personal feeling is that, at least this year, that there will be no widespread defaults. On the other hand, debt servicing today impinges upon the capacity of developing countries to sustain a reasonable pace of development.

Senator MCCLURE. Any other comments?

Mr. ROOSA. Just quickly, the problem of accumulating maturities begins to gather strength next year. Many of the major loans made at the time of the initial impact of the oil shortage were for 4 to 5 years. I think these will be worked out, but it is going to be important that the International Monetary Fund be in a position to provide a kind of partnership relationship in the evolving of country-by-country arrangements, for the stretching out of some of these credits. I think

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I can say confidently that American banks are in general prepared to do that. But if they can do it in conjunction with action by the International Monetary Fund, it will make it a lot easier all the way around. But there is no general fear of default. There is a recognition that this convergence of maturities may become a technical problem that will need some assistance from the International Monetary Fund to help.

One of the people you will hear from tomorrow in these same hearings sat in the same meeting that I did yesterday with a number of bankers where this very subject was discussed so I think he can give you much more on that.

Senator McClure. Well, thank you very much. I think the time has come to pack up the meeting. You have all been very helpful despite the fact we have not solved all the problems in the world nor even explored all the questions.

Thank you all very much. The committee is recessed.

[Whereupon, at 1:03 p.m., the committee recessed, to reconvene at 10 a.m., Thursday, April 21, 1977.]

ISSUES AT THE SUMMIT

THURSDAY, APRIL 21, 1977

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 6202, Dirksen Senate Office Building, Hon. Henry S. Reuss (member of the committee) presiding.

Present: Representatives Bolling, Reuss, Long, and Pike.

Also present: Louis C. Krauthoff II, assistant director; G. Thomas Cator, Kent H. Hughes, Sarah Jackson, John R. Karlik, L. Douglas Lee, and Katie MacArthur, professional staff members; Mark Borchelt, administrative assistant; and Stephen J. Entin and M. Catherine Miller, minority professional staff members.

OPENING STATEMENT OF REPRESENTATIVE REUSS

Representative REUSS. Good morning. The Joint Economic Committee will be in order for its second in a series of meetings on "Issues at the Summit." Today we are discussing balance-of-payments financing and adjustment. The object of these hearings is to review the policy questions in London next month so that it may be possible to give our views to the President before he goes.

First, compared with previous years, in 1977 and 1978 commercial banks are likely to provide proportionally less balance-of-payments financing to weak industrial and advanced developing countries. At the same time these countries' deficits will probably remain at about the same size if not increase slightly. Are the assets of the International Monetary Fund and other multilateral financial institutions adequate to provide sufficient balance-of-payments financing? If not, how much should these resources be increased and through what mechanisms? Mr. Peter B. Kenen, professor of economics and International Finance at Princeton University, devotes his excellent statement primarily to these issues.

Second, how much adjusting should deficit nations be expected to do to reduce their external payments difficulties? What types of adjustment are preferable? Mr. R. S. Eckaus, professor of economics at the Massachusetts Institute of Technology, discusses in his statement the tradeoff between the benefits of financing payments deficits and the costs of the painful adjustments necessary to eliminate them.

Third, how are the surplus OPEC countries likely to invest their excess revenues in 1977 and 1978? Is it possible to change the distribution of these investments so as to increase international financial stability? Mr. William J. McDonough, executive vice president of the First National Bank of Chicago, will share with us his insights on how the surplus oil producing countries can be integrated more fully into the major financial markets.

Gentlemen, we appreciate the comprehensive prepared statements which you have prepared and which, under the rules, and without objection, will be received in full in the record at the end of your oral testimony.

Before proceeding, I have an opening statement of Senator Hatch, a member of the committee, who was unable to be present, to be entered into the record at this point.

[The opening statement follows:]

Opening Statement of Senator Hatch

Western countries such as Italy and Britain are not in trouble because of oil. They had deficits in the balance of payments and falling currencies before the OPEC oil price rise, during it, and ever since. The basic problem with Italy and Britain is deficit spending. They are trying to consume 103 percent of their income each year. The government deficit is partly covered by the inflation tax from printing money. The rest spills over into the rest of the world. It becomes a current account deficit in their balance of payments, and they have to borrow more abroad.

This illustrates an important point. If a country has a current account deficit, which means mostly a trade deficit, it has to run a capital account surplus and that means borrowing abroad to pay for its imports. Conversely, if a country has a current account surplus like Germany and Japan, it must have a capital account deficit, which means it lends abroad to others.

When we pressure Japan and Germany into inflating their domestic economies in order to eliminate their current account surplus, we are in effect asking them to eliminate their capital account deficits. The reduction in the current account surplus of Germany and Japan may translate into some benefit for Chile which will sell more copper to Germany and Japan and for OPEC which will sell more oil and for Bolivia and Malaysia which will sell more tin. But pushing Germany and Japan into capital accounts deficits means that they will cease being lenders or suppliers of funds abroad and instead will become borrowers themselves. This will make the situation of large debtor countries such as Brazil, Mexico, Peru and Indonesia more difficult and could even push them into default. In effect, this plan will simply benefit some "third world" countries at the expense of other "third world" countries.

Fortunately, Germany and Japan are not going to run the printing presses or start a deliberate program of domestic deficits. Their people would not put up with it. They will not follow other countries down the road to inflation and overspending, because once a country gets used to spending 103 percent of its income it is hard to stop. Fortunately, they will not pursue policies that could suck money into Germany and Japan from the rest of the world, bankrupting third world debtor nations in the process.

Third world countries are in trouble because they are trying to increase their share of world income through international redistribution, rather than by producing more income themselves. What the third world needs is a chance to diversify their economies and to industrialize, yet all we hear now is a call for price supports paid for by the West to encourage more production of the few commodities on which some third world economies are already too dependent.

Only a few countries really want this—those with the commodities. For the others it is mostly political rhetoric. What the third world really needs is freer trade and foreign investment. Those which have tried this have done well: Singapore, Ivory Coast, Kenya, Brazil, Venezuela and others. Uruguay has recently opened up a freer trade and investment and is showing remarkable progress in only a few months.

Why instead of working to increase trade are we working to help establish restrictions on prices and production of a few commodities for the benefit of a few countries at great expense to others? Quite frankly, I believe that this political rhetoric is a mask behind which hides the vested interests of the bureaucracies of the international organizations. The crises and hardships that these price fixing schemes will generate will produce a greater demand for their services and expand their clientele, their prestige, and their budgets.

On the international scene, just as on the domestic scene, income will be transferred from the poor to the highly paid bureaucrats. This is not the route we want to follow.

Representative REUSS. Mr. Kenen, will you start?

STATEMENT OF PETER B. KENEN, WALKER PROFESSOR OF ECONOMICS AND INTERNATIONAL FINANCE AND DIRECTOR OF THE INTERNATIONAL FINANCE SECTION, PRINCETON UNIVERSITY

Mr. KENEN. Thank you, Congressman Reuss. I should like to summarize the prepared statement I submitted to you.

The summit meeting 2 weeks from now will take place under happier circumstances than its predecessors. The economy of the United States is recovering more rapidly and robustly than was foreseen a few months ago, and a healthy American economy is vital to the health of the world economy.

The share of the United States in world output is smaller than it was in the 1950's, but the United States has become more heavily involved in world trade, investment, and finance than ever before. The oneway dependence of the early postwar era has given way to genuine interdependence.

Reciprocal vulnerability is, of course, the counterpart of interdependence. It is thus understandable, but nevertheless worrisome, that the economic trauma of the last few years have spawned an anxious, defensive nationalism in many countries. Hopes for further trade liberalization are dimmed by demands for additional protection. Proposals for synchronized policies to foster recovery are answered by protestations of impotence and professions of concern about the dangers of inflation.

Governments have not sought to export unemployment by competitive depreciations, but some are playing a game almost as dangerous. Pursuing cautious policies at home, they hope to be rescued by bolder neighbors, thereby to enjoy export-led recoveries combined with exchange-rate appreciations. Each is behaving like Alphonse, offering politely to follow Gaston.

Expectations that exchange-rate flexibility would insulate national economies, reconciling interdependence with national autonomy and permitting the pursuit of independent monetary policies, have given way to fears that flexibility strengthens the strong currencies and weakens the weak. It is now understood, moreover, that monetary policies must be coordinated as closely as they were when exchange rates were pegged, to minimize large exchange-rate fluctuations that destabilize domestic prices.

The problems of recovery and policy coordination are complicated by the fact of large imbalances in world trade and by the certainty that they will continue. The situation is less menacing than it was, or seemed to be, right after the increase in the price of oil. Imbalances are smaller, and the "recycling" of surplus funds has been accomplished with less damage to financial stability than was forecast when we faced for the first time the avalanche of money from the Middle East.

From here on, however, we face harder problems:

One, the imbalances resulting from the high price of oil will not go away. They may indeed grow larger in the next few years.

Two, the recycling of surplus funds can no longer be managed as it has been heretofore, largely by banks and other private intermediaries.

Three, none of the official financial institutions presently in place will be able easily to do the work that must be done in the next half decade.

Looking back and ahead, I draw three conclusions:

First, the imbalance in trade between oil exporters and oil importers will not vanish before 1980 and may last beyond 1985. There was a surge of optimism 2 years ago, when high-absorbing OPEC countries stepped up their imports and low-absorbing countries allowed their oil sales to fall in the face of declining demand. That optimism was short lived. There was an increase in the size of the imbalance in 1976, and it is projected to stay at or near $40 billion in 1977. No one can pretend to know what will happen in 5 years. But I would be less surprised by an OPEC surplus larger than $40 billion in 1980 than by one smaller than $30 billion.

Second, the problem of payments imbalances would not be solved even if the bilateral imbalance with OPEC were to vanish tomorrow. There would be no OPEC revenues to "recycle," yet the problem of financing imbalances would not be much different than it is right now.

The oil-exporting countries have chosen to employ most of their investable surpluses to purchase IOU's from the developed countries. They have taken first mortages on the strongest developed countries, and those countries have, in turn, taken second and third mortgages on weaker developed countries and on less developed countries. If Saudi Arabia decided tomorrow to purchase goods instead of IOU's, it would take them from the same strong countries that have been supplying the IOU's. There would still be need to lend to other countries, and responsibility would continue to reside with the countries that have carried it all along.

I do not mean to imply dissatisfaction with the way in which imbalances have been financed. On the contrary, I am very much more comfortable with the economic and political implications of the pattern of recycling that emerged in 1974–76 than with the alternative. I think it wrong analytically and unrealistic pragmatically to say that OPEC countries should be made to take their share of the second and third mortgages on countries in need of financing.

My third conclusion is related to the second. The distribution of current-account balances among oil-importing countries has not borne any intimate relationship to the incidence of higher oil bills. In fact, the amount of financing required depends in the first instance on economic performance and policies in the major developed countries, more so than it does on the price of oil or the OPEC surplus.

Looking more closely at the pattern of imbalances among the oil-importing countries, I find two regularities that need attention.

First, the deficits of the smaller developed countries, especially those of Mediterranean Europe, display a distressing stickiness. Yet the problems of these countries—Portugal, Spain, Greece, and Turkey—have been crowded aside by the attention devoted to the problems of the less-developed countries.

Second, cyclical fluctuations in the current-account balances of the United States. Germany and the countries whose currencies are linked to the deutsche mark have run surpluses year after year, and the Japanese surplus has been growing. In my judgment, these patterns testify to defects in the policies of the countries concerned.

Some of my academic colleagues disagree. Under floating exchange rates, they say, the sizes and patterns of current-account balances are determined by the market, not by national policies. But this refutation is ignorant of fact and theory.

It is ignorant of fact because it assumes that exchange rates float freely in foreign-exchange markets. They do not—not all of them. In 1975-76, Japan acquired more than $3 billion of reserves; the Japanese authorities intervened to prevent any significant appreciation of the yen.

The refutation is ignorant of theory because it assumes that domestic policies cannot affect exchange rates. Yet it is the chief lesson of recent work on exchange-rate theory that a larger government deficit financed by issuing bonds will stimulate domestic activity, reduce capital outflows, and cause the exchange rate to appreciate. The current-account balance will shrink.

Thus, I side with those who urge that the Japanese allow the yen to appreciate and that the Germans generate larger budget deficits.

In the course of the last 2 years, much has been said about the deficits and debts of the developing countries. These problems need to be put in perspective.

Developing countries ought to have large current-account deficits. Without them, there would be no transfer of real resources from the developed countries. By implication, an increase of deficits is not cause for grief if it results from an increase in the flow of aid and long-term concessional lending. Conversely, a decrease of deficits is not cause for jubilation if it reflects financial stringency and the adoption of growth-retarding policies.

The debts of developing countries do not threaten the stability of the international financial system. There is little likelihood of debt repudiation. There will perhaps be defaults, but they will be scattered across borrowers and lenders. Furthermore, the increase of borrowing by the developing countries has not burdened the debtors beyond safety.

Looking ahead, however, I find cause for concern. Official aid and long-term lending are projected to continue at or near the record levels set in 1976. But there will still be need for many countries to borrow from banks and other private lenders, and the gap will not be closed for years to come. At the same time, we are told that banks are becoming reluctant to lend to the developing countries. There is, then, the need to take steps that will sustain the flow of private credit and also to enlarge the flow of official credit.

Turning from deficits in prospect to debts already incurred, allow me to explain why I am not fearful of repudiation and why I believe that defaults will be few, far between, and relatively harmless.

Two years ago, the developing countries demanded debt relief and threatened unilateral repudiation. Egged on by a handful of radical governments, including some of the oil producers, they drove through the United Nations General Assembly a resolution that called for a conference of creditors and debtors to agree on ways of reducing debt burdens.

Since then, many developing countries have come to have doubts about the desirability of debt relief. The costs may be too high compared to the benefits. If countries receiving debt relief had to agree not to borrow anew or were shut out of capital markets, the reduction in debt-service burdens furnished by debt relief would not be large enough to compensate for losing access to new credits.

These days, then, most of the worrying is about the danger of defaults rather than the threat of repudiations. We are told that the debts of developing countries have made the banks illiquid. What would happen, it is asked, if the OPEC countries were to withdraw massive amounts of money from the banks, and the banks had to call in loans on the developing countries? We are also told that some developing countries will be unable to honor their obligations when they fall due. What would happen, it is asked, to the banks' earnings and solvency if the developing countries fell behind in their payments?

The first, calamitous scenario is not one that worries me. Let me answer the Cassandras' question by asking another. Where would the OPEC countries put the dollars withdrawn from the banks? Would it be impossible for the banks to borrow them back? I think not. And even if they could not do so, dollar for dollar, the banks could draw on their head offices, and they, in turn, could draw on the central banks. The central banks would not refuse to lend. Of that we have every assurance.

Turning to the less dramatic possibility—that the developing countries may fall behind—it is safe to predict that the banks will readily renew or extend the credits they have granted. This is what they have done before; it is what some are doing now; and it is what they will continue to do even if larger numbers of borrowers fall behind. You cannot foreclose on a country. To put the point differently, there will be de facto rescheduling.

At the start of this statement, I said that none of the official financial institutions now in place is able to handle the problems ahead. Aid and long-term leading have risen remarkably since 1973, and they must be sustained at present or higher levels. There is thus need to augment the capital of the World Bank, to complete without delay the replenishment of the International Development Association, and even to begin work on the next replenishment. But the jurisdictions and policies of these institutions do not and should not permit them to supply medium-term financing based on balance-of-payments needs.

Proposals to deal with these needs should focus instead on the role and resources of the International Monetary Fund. There are indeed three proposals under consideration. It has been suggested that there be a new distribution of special drawing rights. It has been suggested that the Fund negotiate new lines of credit to supplement its liquidity. It has been suggested that there be another increase in IMF quotas.

Each of these proposals is meritorious. As a matter of fact, they are not alternatives. An increas in IMF quotas is always asymmetrical in its effects on the Fund's liquidity; it enlarges the amounts that members can draw by more than it enlarges the Fund's holdings of dollars, marks, yen, and other strong currencies. As there have been very large drawings on the Fund in the last few years, and there will be more this year and next, the Fund may have to bolster its liquidity even if there is no further increase of quotas. It would most certainly have to do so if quotas were increased again.

An increase of quotas and credit lines, moreover, would not deal with a problem that may be getting serious. Even as inflation has reduced the real debt burdens of less developed countries, so also has it eaten into their real reserves. This trend is causing concern in the less-developed countries. It is, I believe, fair to conclude that some of them have been borrowing in order to build up reserves. Be that as it may, this much is clear: An increase in the reserves of the less-developed countries would most certainly help to allay the fears of private creditors and thereby help to forestall a precipitous decline in the level of new lending.

Putting these facts and arguments together, but allowing also for the fact that the increase of IMF quotas begun last year has not yet been completed, I recommend these steps:

One, no new increase of Fund quotas should be undertaken until 1979 or 1980, but the next one should be larger than the last, so that the two together would double the size of the Fund, compared to what it was in 1975. The effects of inflation alone would justify this large step.

Two, it is time to resume the distribution of special drawing rights. It would be sensible to start next year, and to increase the supply by no less than $2.5 billion per year for the next 5 years. At that rate, the stock of SDR would be larger by $7.5 billion 3 years from now, and this is the amount that would match the need arising from a further increase of IMF quotas. To put the point differently, an increase of quotas without new distributions of SDR could transfer the bulk of the existing supply of SDR from the Fund's members to the Fund itself. The SDR would be available for use in drawing on the Fund, but they would disappear from national reserves. This is hardly the way to make the SDR the principal reserve asset in the international monetary system.

Three, plans should be made immediately to increase the liquidity of the International Monetary Fund. This should not be done, however, by going hat in hand to Saudi Arabia to ask that it cough up surplus revenues. There is another way. Every time that Saudi Arabia deposits money with the banks it is making its main contribution to the financing of imbalances. It is the task of the Fund to mobilize that money. To this end, it may be time for the Fund to start issuing bonds, in denominations and maturities attractive to banks, and other private investors.

Four, finally, I would recommend an expansion of the credit lines already embodied in the general arrangements to borrow.

The steps I have suggested would enlarge the supply of financing available directly from the IMF and would bolster that Fund's liquidity. They would increase the reserves of the less-developed countries. And they would help to sustain the flow of medium-term bank credit to those countries by making them more attractive credit risks. But two more steps should be taken.

In my view, it is necessary that members be given more time to repay drawings on the Fund. This could be done by changing the rules that govern regular drawings. It could also be done by changing the rules under which members can draw on the Fund's extended facility.

It is also necessary to strengthen financial relationships among the developed countries, especially to increase the flow of long-term capital to the countries of southern Europe.

Two years ago, I testified before the Senate Foreign Relations Committee, urging ratification of the OECD Financial Support Fund. I have just been reading what I said then, and there is little I would change. To be sure, we have managed to get along without the Support Fund for the last 2 years, but the contingencies against which it was meant to defend us are less remote today than they were seen to be in 1974 or 1975.

Loans by the Support Fund, however, would not be large enough in volume or long enough in term to aid the economies of Southern Europe. To that end, I would like to make one more recommendation.

Much has been said in the last few months about the ways in which the United States can foster respect for human rights. I welcome the new emphasis on that goal. But there are two ways to pursue the goal, and we have latched onto the wrong one. We talk of punishing countries that do not live up to our standards. Yet our ability to do so is limited, and our willingness to do so is compromised too often by the necessities of national security. The other way seems to me to be more promising. It is to reward in all ways possible governments that do display respect for human rights.

We have learned to our sadness that many nations do not share our regard for human liberties. In pessimistic moments, we wonder whether democracies may be an endangered species. It behooves us, therefore, to give unstinting aid to domocratic governments wherever we find them.

It is thus my suggestion that we join with the countries of Northern Europe, the members of the European Community, to make a large, long-lasting commitment to the development of Southern Europe—a commitment to include the promise of long-term lending and the removal of trade barriers, especially barriers that impede the agricultural exports of southern Europe.

Egalitarians are sure to object that aid should go to the poor, not to the second-richest group of nations. In this case, however, our commitment to democratic values should take precedence.

Thank you very much.

Representative Reuss. Thank you.

[The prepared statement of Mr. Kenen follows:]

Prepared Statement of Peter B. Kenen

Issues at the Summit: Balance-of-Payments Financing and Adjustment

The summit meeting two weeks from now will take place under happier circumstances than the two that preceeded it, at Rambouillet and Puerto Rico, if only for the reason that the economy of the United States is recovering more rapidly and robustly than was foreseen a few short months ago.

The health of the American economy is vital to the health of the world economy, no less so than it was twenty years ago. True, the share of the United States in world output is smaller than it was in the 1950's and we can no longer boast of having the highest per capita income measured at current exchange rates. But the more rapid growth of other industrial economies, of Europe and Japan, is not the fact most relevant to judging the importance of the United States in international economic life.

In the last twenty years, but especially in the last ten, the United States has become more heavily involved in world trade, investment, and finance. Ours is now an open economy. Ten years ago, in 1966, merchandise exports accounted for only 3.9 percent of U.S. gross national product; in 1976, they accounted for 6.8 percent. More striking, ten years ago, exports accounted for only 8.0 percent of final goods production; last year, they accounted for 15.1 percent. The American economy does not overshadow others as it did in the decade following the Second World War. But the links between our own and other economies are closer than ever before.

During the last few years, we have come to experience what Marina Whitman has called the "dark side" of economic interdependence. Errors in our own economic policies were responsible in part for the worldwide inflation of 1973–74 and for the recession that followed. But our economy was punished by accidents, errors, and policies that were not made in America. There were crop failures in the Soviet Union and other countries that caused the world's demand for grain to focus suddenly on U.S. supplies. There was the sharp rise in prices of nonferrous metals and of certain other raw materials—a misfortune that was due fundamentally to the boom in the industrial countries but was exacerbated by uncertainties and speculation in particular commodity markets. There was the increase in the price of oil.

Reciprocal vulnerability is the counterpart of interdependence. It is thus understandable but nevertheless worrisome that recent economic trauma have spawned an anxious, defensive nationalism in many countries. Hopes for further trade liberalization are dimmed by demands for additional protection, even for agreements to freeze market shares. Proposals for synchronized policies to foster recovery are answered by protestations of impotence and professions of concern about the dangers of inflation.

Governments have not sought to export unemployment by competitive depreciations. They have learned, as we did in 1971–73, that depreciations and devaluations have large, widespread effects on domestic prices. But some are playing a game almost as dangerous. Pursuing cautious policies at home, they hope to be rescued by bolder neighbors, thereby to enjoy an export-led recovery combined with stable or appreciating exchange rates. Each is behaving like Alphonse, offering politely to follow Gaston.

Expectations that exchange-rate flexibility would insulate national economies, reconciling interdependence with national autonomy and permitting the pursuit of independent monetary policies, have given way to fears that flexibility strengthens strong currencies and weakens the weak. It is now understood, moreover, that monetary policies cannot be conducted independently. They must be coordinated no less closely than when exchange rates were pegged, so as to minimize exchange-rate fluctuations that destabilize domestic prices without contributing significantly to the elimination of long-term payments problems.

The problems of recovery and policy coordination are hugely complicated by the fact of large imbalances in world trade and by the virtual certainty that they will continue. The situation is less menacing than it was or seemed to be right after the increase in the price of oil. The imbalances are smaller, and the "recycling" of surplus funds has been accomplished with less difficulty or damage to financial stability than forecast by bankers and economists when they had first to contemplate an avalanche of money from the Middle East.

From here on, however, we face harder problems:

1. The imbalances resulting from the high price of oil will not go away. They may indeed grow larger in the next few years.

2. The "recycling" of surplus funds can no longer be managed as it has been heretofore, largely by banks and other private intermediaries.

3. None of the official financial institutions presently in place will be able easily to do the work that must be done in the next half decade.

Allow me to explain and also to qualify these three assertions.

THE SIZE AND DISTRIBUTION OF IMBALANCES

In the first year following the increase in the price of oil, the oil-exporting countries piled up huge surpluses. Even those we now identify as high absorbers, countries that are able to spend their oil incomes, could not step up imports fast enough to use their vast revenues. Thus, the oil-exporting countries as a group ran a $67 billion current-account surplus in 1974, and the deficits that were the counterparts of that enormous surplus appeared pervasively in the accounts of the oil-importing countries (see Table 1).

TABLE 1.—THE PATTERN OF CURRENT ACCOUNT BALANCES, 1974–77

[In billions of dollars]

Country group	1974	1975	1976[1]	1977[2]
Oil-exporting countries	67	35	44	42
Low absorbers	40	30	35	NA
High absorbers	27	5	9	NA
Major developed countries	−7	21	6	2
United States	2	15	2	NA
Germany and other EC Snake[3]	16	13	13	NA
France, Italy, and United Kingdom	−19	−1	−9	NA
Japan	−4	−1	4	NA
Canada	−2	−5	−4	NA
Other developed countries	−17	−18	−18	−10
Mediterranean Europe[4]	−7	−8	−7	NA
All other[5]	−10	−10	−11	NA
Less-developed countries	−30	−38	−27	−29
Latin America	−13	−17	−12	NA
South and East Asia	−10	−9	−4	NA
Middle East and Africa	−7	−12	−11	NA
Other, unallocated, and net error	−13	0	−5	−5

[1] Preliminary.
[2] Forecast.
[3] Belgium, Netherlands, and Sweden plus Switzerland.
[4] Greece, Portugal, Spain, Turkey, and Yugoslavia.
[5] Austria, Denmark, Finland, Norway, Australia, New Zealand, and South Africa.

Source: International Monetary Fund, annual report, 1976, and unpublished tabulations. Balances do not include official transfers (grants).

In 1975, the situation was different but far from satisfactory. The onset of recession in the developed countries reduced their demand for oil, even as the oil-exporting countries raised their imports at astonishing rates. The current-account surpluses of the oil-exporting countries were cut in half, falling to $35 billion. But recession in the industrial world, along with the sharp decline in prices of primary products caused in part by that recession, led to a dramatic redistribution of deficits. The current-account balances of the major developed countries improved by $28 billion, and those of the less developed countries worsened by at least $8 billion.

Last year, economic recovery stimulated oil imports, and there was a $9 billion increase in the collective current-account surplus of the oil-exporting countries. Correspondingly, the current-account balances of the major industrial countries worsened by $15 billion, and those of less developed countries improved by $11 billion. The latter enjoyed increases in the prices and quantities of their exports, but also adopted draconian, growth-reducing policies to reduce imports and curb deficits.

Looking back across the last three years and into the near-term future, I draw three conclusions.

First, the imbalance in trade between oil exporters and oil importers will not vanish before 1980 and may last beyond 1985. Projections of petroleum production and consumption, based on present prices and policies, are sobering. OPEC oil exports may be larger in 1980 than in 1974, before the recession, and may rise further by 1985 (see OECD, *World Energy Outlook*, Paris, 1977).

There was a surge of optimism two years ago, when the high-absorbing countries were gobbling up imports and the low-absorbing countries were allowing their sales to fall in the face of declining demand. That optimism was short lived. There was, as I said, an increase in the imbalance with OPEC in 1976, and it is projected to remain at or near $40 billion in 1977. No one can pretend to know what will happen five years from now. But I would be less surprised by an OPEC surplus larger than $40 billion in 1980 than by one smaller than $30 billion.

The high-absorbing countries are not far from balance, and some are even slipping into deficit. That is why those countries, led by Iran, press for a more rapid increase in the price of oil. They are selling almost all the oil they can lift and spending almost all the income they can earn. They can raise their revenues only by raising prices. But the low-absorbing countries will continue to run surpluses, and those surpluses may get larger. If, indeed, Saudi Arabia can impose its view that the price of oil should rise slowly, by adding to its own capacity and exports, an increasing fraction of the world's oil bill will be paid to countries that cannot pay it back in orders for imported goods and services.

If I may wallow in pessimism for a moment, there is a sense in which we will be had, no matter who wins the argument inside OPEC. If the high absorbers win and oil prices rise, the oil-importing countries, including the United States, will suffer a further deterioration in their terms of trade. We will be poorer for having to give up goods and services in increasing quantities to pay for oil. If the low absorbers win, we will be better off in real terms temporarily, but will have to go on living with the problems we face now—the need to "recycle" surplus revenues and to offset by domestic policies, especially by budget deficits, the deflationary drain of purchasing power that is the principal macroeconomic manifestation of the low absorbers' current-account surpluses.

The argument in OPEC will probably be compromised. In that case, we will face bits of the worst of all worlds—cost-inflationary pressures stemming from higher oil prices, the need to sell more goods and services to the high-absorbing countries, and the need to "recycle" and offset the surpluses of the low-aborbing countries.

My second conclusion may be less familiar. The problem of payments imbalances would not be solved even if the bilateral imbalance with OPEC were ended tomorrow. Pretend that Saudi Arabia decided to increase its imports by $35 billion in 1977. Saudi spending would probably be concentrated on goods produced by the United States, Germany, Japan, and a few other countries, and the current-account balances of the major groups of countries would look something like this:

[In billions of dollars]

	Amount
Oil exporting countries	5
Major developed countries	40
Other developed countries	—10
Less developed countries	—30
Other and unallocated	— 5

There would be no OPEC revenues to "recycle," but the problem of financing imbalances in trade and payments would not be very different than they are now.

The oil-exporting countries have chosen to employ most of their investable surpluses to purchase IOUs from the developed countries (see Table 2.) The United States has been the largest supplier of IOU's, bilaterally and through the Eurocurrency markets in which U.S. banks have come to play a major role. Thus, the oil producers have taken first mortgages on the strongest developed countries, and those countries have in turn taken second and third mortgages on weaker developed countries and on the less developed countries.

If Saudi Arabia decided tomorrow to purchase goods instead of IOU's, it would take them from the same strong countries that have been supplying the IOU's. There would still be need to lend to the weaker developed countries and to the less developed countries, and the responsibility would continue to reside with the countries that have carried it all along.

TABLE 2.—DISPOSITION OF FINANCIAL SURPLUSES, OIL-EXPORTING COUNTRIES, 1975–76

[In billions of dollars]

Item	1975	1976
Financial surplus	36	33
Investments in the United States	10	12
Bank deposits and U.S. Government securities	3	5
Other investments	7	7
Investments in Eurocurrency and other financial markets	9	11
Foreign-currency deposits, London	4	6
Investments in other financial centers	5	5
Credits and loans to international institutions	4	2
Other investments (net)	13	8

Source: Bank of England data summarized in IMF Survey, Apr. 7, 1977.

I do not mean to imply dissatisfaction with the way in which imbalances have been financed. On the contrary, I am very much more comfortable with the economic and political implications of the pattern of "recycling" that emerged in 1974–76 than with the one that is usually urged in its stead—that OPEC countries should be made to take their "share" of the second and third mortgages on deficit countries. I am merely concerned to emphasize the fact that imbalances would be large and difficult to terminate even if the OPEC countries ceased to have large surpluses.

My *third* conclusion is related to the point I have just made. The distribution of current-account balances among the oil-importing countries has not borne any intimate relationship to the incidence of higher oil bills. In 1974, when there was no time to adjust to the increase in oil prices, the vast majority of oil-importing countries were thrust suddenly into difficulty. A handful continued to run current-account surpluses (the United States, Germany, and a small number of less developed countries whose earnings were inflated by rising commodity prices), but their surpluses were smaller than they had been before. In 1975, the major developed countries dove into recession, reducing the oil producers' surpluses and shifting the current account deficits onto the less developed countries. In 1976, recovery and higher commodity prices, including higher oil prices posted in 1975, shifted the pattern again. With the significant exception of Japan, the major developed countries ran smaller surpluses or larger deficits, and the positions of the less developed countries improved.

In brief, the amount and pattern of financing required depends in the first instance on the economic performance and policies of the major developed countries, more so than it does on the price of oil or the size of the OPEC surplus.

I do not deny the importance of the point made by Robert Solomon in testimony before this Committee, that the oil-importing countries confront an "incompressible" deficit *vis à vis* the oil-exporting countries. It is assuredly incompressible at any moment in time, given the level of economic activity in the oil-importing world and the energy policies of the large consuming countries. I do mean to stress that its distribution among developed countries and its division between developed and less developed countries is not determined by the price of oil or other events beyond our control.

Invoking Solomon's own metaphor, the developed countries that are least successful in controlling inflation will most certainly be burned more often than others as the "hot potato" is passed from hand to hand. And the size of the collective deficit of the less developed countries will be determined largely by the policies of the developed countries. The problems of the less developed countries will be larger if there is stagnation in the developed world. They will be larger, too, if we fail to avoid an acceleration of inflation as we move toward higher levels of activity, since inflation will worsen the terms of trade of many less developed countries—those that do not enjoy an equal or larger increase in the prices of the raw materials they export.

Looking more closely at the pattern of imbalances among the oil-importing countries, I find two regularities that need attention.

First, the deficits of the other developed countries, especially those of Mediterranean Europe, display a distressing stickiness. They did not increase in 1975, during the recession, but neither did they decrease in 1976, during the recovery The problems of these countries—Portugal, Spain, Greece, and Turkey—have been crowded aside by the attention devoted to the problems of the less developed countries. But the rhetoric of North-South confrontation must not divert us from concern with the problems of others, especially of those who are striving to restore and sustain democratic institutions amidst economic difficulties.

Second, the cyclical fluctuations in the current-account balances of the major developed countries are dominated by fluctuations in the current-account balance of the United States. By contrast, Germany and the countries whose currencies are linked to the Deutsche Mark have run surpluses year after year. There was a $5 billion decline in the German surplus from 1974 to 1975, but some of it was offset by an increase in the Swiss surplus; and there was no significant change in the situation during 1976.[1] I have already mentioned the Japanese experience—

[1] It would at first appear as though there were sharp cyclical swings in the French, Italian, and British positions, but this is an accident of aggregation. The British positon has improved steadily; the current-account deficit shrank from $7 billion in 1974 to one smaller than $2 billion in 1976, and there is the promise of further improvement as North Sea oil begins to come in. There was a small cyclical swing in the Italian position from large deficit in 1974 to small surplus in 1975 and back to deficit in 1976, but the deficit in 1976 was smaller than the one in 1974. The biggest swing has been in the French position, from a $5 billion deficit in 1974 to a $1 billion surplus in 1975 and back to a $5 billion deficit in 1976, despite a substantial depreciation of the franc since 1974. This may be the most worrisome case for the next couple of years.

a steady strengthening of the current-account balance, reflecting in part continuing competitive success in world markets and in part the slow recovery of the Japanese economy.

I am apprehensive about the implications of these patterns. The deterioration of the U.S. balance is not dangerous in itself. The United States is the principal issuer of IOU's to the OPEC countries. In other words, there has been a large, sustained flow of foreign capital into the United States. Furthermore, the huge current-account surplus of 1975 was an abberation, and the recession of which it was a symptom had much to do with the difficulties of the weaker developed and less developed countries. Nevertheless, the influx of imports reflected in the recent deterioration is sure to intensify protectionist pressures in the United States. Equally important, the stickiness of the German surplus and the growing Japanese surplus suggest that Bonn and Tokyo have been too cautious in fostering domestic recovery.

Some of my academic colleagues deride this diagnosis. Under floating exchange rates, they say, the sizes and patterns of current-account balances are determined by the market. The balance on current accommodates itself to the balance on capital account. There is, then, nothing that Germany and Japan can do to alter the pattern of imbalances. This refutation is ignorant of fact and theory.

It is ignorant of fact because it assumes that exchange rates float freely in foreign-exchange markets. They do not—not all of them. In 1975–76, Japan acquired more than $3 billion of reserves; the Japanese authorities intervened to prevent any significant appreciation of the yen. (There was a similar increase of German reserves, but this reflected obligatory intervention to stabilize exchange rates within the EC "snake" rather than an effort to prevent the mark from appreciating against the dollar.)

The refutation is ignorant of theory because it assumes that domestic policies cannot affect exchange rates. Yet it is the chief lesson of recent work on exchange-rate theory that a larger government deficit financed by issuing bonds will do three things: it will stimulate domestic activity; it will reduce capital outflows; it will cause the exchange rate to appreciate. The current-account balance will shrink.

Thus, I side with those who urge that the Japanese allow the yen to appreciate and that the Germans generate larger budget deficits. (Bonn has gone some distance in this direction, but the Federal deficit was smaller in 1976 than it was in 1975, and it amounted to only 2.6 per cent of German GNP, compared to 3.5 per cent in the United States.)

THE FINANCING OF IMBALANCES

In the course of the last two years, much has been said about the deficits and debts of the developing countries. The problems need to be put in perspective.

Developing countries ought to have large current-account deficits. Without them, there would be no transfer of real resources from the developed countries. By implication, an increase of deficits is not cause for grief if it results from an increase in the flow of aid and long-term concessional lending. Conversely, a decrease of deficits is not cause for jublilation if it reflects financial stringency and the adoption of growth-retarding policies.

The debts of developing countries do not threaten the stability of the international financial system. There is little likelihood of debt repudiation. There will perhaps be defaults, but they will be scattered across borrowers and lenders. Furthermore, the increase of borrowing by developing countries has not burdened them beyond reason. Recall the point made by Irving Friedman in his recent testimony. The real debt burdens of developing countries have not risen as rapidly as levels of indebtedness; inflation has scaled them down almost as fast as new borrowing has enlarged them.

From 1974 through 1976, the developing countries ran current-account deficits totalling about $95 billion (see Table 3). In those same years, however, they received some $14 billion of direct investments and some $35 billion of official grants and long-term credits. Borrowings from banks and other private lenders totalled only $35 billion. Furthermore, the developing countries built up their reserves by $13 billion while drawing only $5 billion of balance-of-payments assistance from the International Monetary Fund. As a matter of fact, borrowings in 1976 were no larger altogether than the increase in reserves.

TABLE 3.—THE FINANCING OF LDC DEFICITS, OIL-IMPORTING COUNTRIES, 1973–77

[In billions of dollars]

Item	1973	1974	1975	1976 [1]	1977 [2]
Current account deficit	−11	−30	−38	−27	−29
Direct investment inflow (net)	4	4	5	5	6
Official grants and long-term loans (net)	11	15	18	20	20
Borrowing from banks and other private lenders (net)	4	12	12	11	8
Subtotal	19	31	35	36	34
Use of IMF resources	0	1	2	2	
Use (+) of reserves	−8	−2	1	−11	−5

[1] Preliminary.
[2] Forecast.

Source: Same as table 1.

Figures like these always conceal important differences among countries. Thus, some of the countries that borrowed heavily in 1976 were not the ones that built up reserves, and some of those that built up reserves were not large borrowers. India, for example, has not been a big borrower in international financial markets but, helped by good harvests and an increase of aid flows, India added $1.7 billion to its reserves and reduced its indebtedness to the IMF. But some that were large borrowers in 1976 and earlier were among the ones that built up reserves. Taking two countries whose debts have been discussed extensively in the press, Brazil borrowed about $5 billion in 1976 but added $1 billion to reserves, while Korea borrowed about $1.3 billion but added $1.4 billion to reserves.[2]

Looking ahead, however, there is cause for concern. Official aid and long-term lending are projected to continue at or near the record levels set in 1976. But many countries will still need to borrow from banks and other private lenders. And the gap will not be closed for years to come, even if there is faster recovery in the industrial countries and a more rapid increase in commodity prices. We are told, moreover, that banks are becoming reluctant to lend to the developing countries. On the one hand, their exposure is already large. On the other, the demand for loans from other customers will pick up with continuing recovery.

In my judgment, large numbers of developing countries could and should continue to borrow year after year. They can do so without working themselves into serious difficulty. A few, however, are already having trouble servicing their debts, raising the banks' apprehensions about others. It is therefore imprudent to suppose that private lending can continue to fill the gap between the developing countries' current-account deficits and the flows of aid and long-term lending that will be forthcoming from governments and international financing institutions. The gap will be smaller than it was in 1975, when developing countries drew on every available source of credit and ran down reserves to finance deficits. It may nevertheless range between $5 and $10 billion for the rest of the decade, and it may grow gradually on account of the increase of debt-service payments mandated by the borrowing that has already taken place.

The gap to which I refer, moreover, is not the only one with which we must deal. In each of the last three years, some of the developed countries have had to borrow huge amounts to deal with balance-of-payments problems, and some of the problems have not been resolved to anyone's satisfaction. There is every reason to expect an improvement in the position of the United Kingdom. There is less reason to believe that Italy has solved its problems. And France may seek financing too if political uncertainties lead to large capital outflows. More importantly over the medium term, the Mediterranean countries have run large deficits for the last three years, and I am skeptical of the forecast that those deficits will shrink.

[2] Here, new borrowing is measured by the sum of new bond issues and Eurocurrency credits plus the increase in liabilities to U.S. banks and other U.S. lenders. The former, reported by the World Bank, are gross borrowings and overstate the corresponding increase of indebtedness; the latter, reported by the U.S. Treasury, are changes in amounts outstanding and are therefore net of repayments. Incidentally, Table 3 may understate the volume of LDC borrowing in 1976. Bond issues and Eurocurrency credits exceeded $15 billion in 1976 (see *IMF Survey*, April 4, 1977, which says that net borrowing may have been larger than $11 billion).

Contrast the recent experience of, say, Spain with that of Brazil or Korea. In 1976, Spain borrowed more than $2 billion in the Eurobond and Eurocurrency markets, and Spanish liabilities to U.S. lenders rose by at least $300 million. At the same time, Spain's reserves declined by $800 million. Knowing little about the Spanish economy, I would not dare to recommend specific remedies. What I do know about the Mediterranean countries, however, tells me that it will not be easy, economically or politically, to reduce their deficits. Financing will be needed for several years, along with changes in the trade and agricultural policies of the European Community to make way for an increase in exports from the Mediterranean countries.

Turning from deficits in prospect to debts already incurred, allow me to explain why I am not fearful of repudiation and why I believe that defaults will be few, far between, and relatively harmless.

Two years ago, the developing countries demanded debt relief, and there were threats of unilateral repudiation. Egged on by a handful of radical governments, including some of the oil producers, they drove through the United Nations General Assembly a resolution that called for a conference of creditors and debtors to agree on ways of reducing debt burdens. Thereafter, the developing countries made an elaborate proposal in anticipation of UNCTAD IV that would have covered all varieties of debt:

Debt relief should be provided by bilateral creditors and donors in the form of waivers or postponement of interest payments and/or amortization, cancellation of principal, etc., of official debt to developing countries seeking such relief. . . .

Multilateral development finance institutions should provide programme assistance to each developing country in an amount no less than its debt service payments to these institutions.

Agreement should be reached to consolidate commercial debts of interested developing countries and to reschedule repayments over a period of *at least* 25 years. The consolidation of commercial debts and the rescheduling of payments would require the establishment of suitable financial arrangements or machinery. . . .

As you know, there was no agreement at UNCTAD IV, not even to convene a conference, but the threat to repudiate debts has not been heard recently. The reason lurks in the resolution I have just quoted, which refers to "countries seeking such relief" and to "interested" developing countries. The demand for general debt relief did not have the support of the largest debtors, and the threat of repudiation was more frightening to them than to their creditors.

Many developing countries have doubts about proposals for debt relief, even if negotiated. The costs may be too high compared to the benefits. If countries receiving debt relief had to agree not to borrow anew or were shut out of capital markets and turned away by banks, the reduction in debt-service burdens would not be large enough to compensate for lost access to new credits. Furthermore, debt relief would most probably be given in lieu of new aid and long-term lending by creditor countries. Finally, a rational calculation of costs and benefits must allow for the virtual certainty of inflation—a process that reduces real debt burdens even as it raises the need for new borrowing.

The benefits of debt relief could be large. A year ago, I tried to calculate the amounts by which debt-service payments would decline if relief were offered along the lines proposed in the resolution quoted above. Had there been a generous rescheduling of debts and a large reduction of interest rates, debt-service payments would have fallen by more than $5 billion in 1976, given the levels of debt outstanding at the end of 1975. Had there been in addition a partial forgiveness of debts owed to the governments of developed countries, the reduction would have been about $7 billion. (See P. B. Kenen, "Debt Relief as Development Assistance," in J. N. Bhagwati, ed., *The New International Economic Order: The North South Debate*, MIT Press, 1977.)

I have not brought these calculations up to date but have made best guesses based on my estimates of debts outstanding at the end of 1976 (see Table 4). By now, the most generous forms of debt relief would reduce annual debt-service payments by about $7 billion, and if it were coupled to partial foregiveness, it would reduce them by about $9 billion.

TABLE 4.—ESTIMATES OF LDC INDEBTEDNESS AND RESERVES, OIL-IMPORTING COUNTRIES, 1973–76

[In billions of dollars]

Item	1973	1974	1975	1976
Total long-term debt (disbursed)	71	88	110	138
To private creditors	25	35	45	58
Banks and financial markets	18	25	34	47
Suppliers and other	7	10	11	11
To public creditors	46	53	65	80
International institutions	12	14	19	24
Governments	34	39	46	56
Short-term debt to U.S. banks	6	10	15	17
	30	32	31	40
Reserves:				
Latin America	12	12	10	13
South and East Asia	11	12	13	18
Middle East and Africa	7	8	8	9

Source: Data for 1973 and 1974 from World Bank, "World Debt Tables," 1973 and 1974, and from U.S. Treasury, "Treasury Bulletin," various issues; data for 1975 and 1976 obtained by methods similar to those described in P. B. Kenen, "Debt Relief as Development Assistance," in J. N. Bhagwati, ed., "The New International Economic Order: The North-South Debate," MIT Press, 1977, pp. 72–76. Debt data here are not comparable with borrowing data in table 3; the former include debts of certain countries classified in table 3 as "Other Developed" and do not include all types of debt.

These are large numbers, compared to the level of new borrowing required to fill the gap between earnings on the one hand and aid and long-term governmental credits on the other. But if, as I said, debt relief were offered as a substitute for aid and new long-term lending, the net gains would be smaller.

These days, most of the worrying is about the risk of default rather than repudiation. We are told that the debts of developing countries have made the banks illiquid. What would happen, it is asked, it the OPEC countries were to withdraw massive amounts of money from Eurocurrency banks, and the banks had to call in their loans on the developing countries? We are also told that the developing countries will be unable to honor their obligations when they fall due. What would happen, it is asked, to the banks' earnings and solvency if the developing countries fell behind?

The first, calamitous scenario is not one that worries me. Let me answer the Cassandras' question by asking another. Where would OPEC countries put the dollars withdrawn from the banks? Would it be impossible for the banks to borrow them back? I think not. And even if they could not do so, dollar for dollar, the Eurocurrency banks could draw on their head offices, and they in turn could draw on the central banks. The central banks would not refuse to lend. They have indeed assured us of their determination to serve as lenders of last resort.

Turning to the less dramatic possibility—that the developing countries could fall behind—we must distinguish between two possibilities.

If borrowers fail to make interest payments when they come due, the lenders will suffer losses. That may worry bankers. It does not worry me. The banks are earning high returns on their loans to developing countries, returns that are rewards for taking risks.

If borrowers fail to make amortization payments, banks will have to reclassify loans and draw on reserves set aside against this contingency. They will not suffer insolvency. As a practical matter, the banks will have merely to renew or extend the credits they have granted. This is what they have done before; it is what some are doing now; and it is what they will continue to do even if larger numbers of borrowers fall behind. You cannot foreclose on a country. To put the point differently, there will be *de facto* rescheduling.

We have heard proposals for more formal arrangements, involving a debtor on one side and all of its creditors on the other, including governments and international institutions. In my judgment, governments should stand aside or deal separately with their debtors, as they have in the past. They should not bail out the banks by subordinating their own claims so that the banks can come out unscathed.

In too many instances, banks have beaten the bushes for borrowers, and flushed out some dubious prospects. Having seduced them into debt, they have no right now to cry rape. It is in fact my private, paranoid suspicion that some of the banks' laments and warnings about the dangers of default are calculated to disguise the mistakes they have made and to stampede governments into redeeming them. But public money for development is very scarce. It should be distributed according to priorities set by the governments and institutions to which it is intrusted, not in accordance with priorities predetermined by the errors made by private lenders.

ENLARGING FINANCIAL FLOWS

At the start of this statement, I said that none of the official financial institutions now in place is able to handle the problems that face us for the next several years. Aid and long-term lending have risen remarkably since 1973, and they must be sustained at present or higher levels for many years to come. There is thus need to augment the capital of the World Bank, to complete without delay the replenishment of the International Development Association, and even to begin work on the next replenishment. But the jurisdictions and policies of these institutions do not permit them to supply medium-term financing based on balance-of-payments needs.

The World Bank raises its money in private capital markets An increase in the Bank's capitalization is required to permit an increase in the level of Bank borrowing and thereby to make way for an increase in its lending. Larger lending will help to reduce the need for balance-of-payments financing. Furthermore, the projects the Bank finances will strengthen the economies of its clients, enhancing their capacity to service their debts. But the Bank's access to private capital markets is based partly on its reputation for prudence and project lending, and it might be a mistake to blur the markets' image for the Bank's mission by using its resources specifically for medium-term balance-of-payments financing.

The International Development Association has a different mission—to assist the least developed countries on concessional terms. It deserves the broadest support including support by the OPEC countries and the more prosperous developing countries. Making the same point in general terms, the burdens of assistance to development should be more widely shared, including the burdens of internal adjustment that will come with trade liberalization to foster development. It is time to ask countries like Argentina, Brazil, and Mexico to dismantle those of their trade barriers that stand in the way of an increase in exports from the least developed countries.

The International Development Association, together with national aid agencies, must do most of what is needed to help the poorest countries. It cannot and should not be asked to solve other problems—to sustain or replace flows of private credit to the more advanced developing countries and the less advanced developed countries.

Proposals to deal with this class of problems usually focus on the role and resources of the International Monetary Fund, and three such proposals are under consideration. It has been suggested that there be another increase in IMF quotas. It has been suggested that there be a new distribution of Special Drawing Rights. It has been suggested that the Fund negotiate new lines of credit to supplement its own liquidity—credit lines similar to those extant under the General Arrangements to Borrow.

Each of these proposals is meritorious. As a matter of fact, they are not alternatives. An increase of IMF quotas is always asymmetrical in its effects on the Fund's liquidity; it enlarges the amounts that members can draw from the Fund by more than it enlarges the Fund's holdings of dollars, marks, yen, and other strong currencies. As there have been large drawings in the last years, and there will be more this year and next, partly on account of the increase in quotas now under way, the Fund may have to bolster its liquidity even if there is no further increase of quotas. It would most certainly have to do so if quotas were increased again.

In 1976, drawings on the Fund totalled SDR 7.0 billion. Drawings in dollars, marks, and yen accounted for 45 percent of all drawings; drawings in the currencies of OPEC countries accounted for 19 percent; drawings in other national currencies accounted for 29 percent; and drawings in SDR accounted for 7 percent. At the end of February, 1977. Fund holdings of dollars, marks, and yen totalled only SDR 3.1 billion. Drawing fully on existing credit lines under the General Arrangements to Borrow, it could raise another SDR 3.5 billion. It is, I believe, commonly agreed that these amounts are too small to cope with prospective drawings.

An increase of quotas and credit lines, moreover, would not deal with a problem that may be getting serious. Even as inflation has reduced the real debt burdens of the less developed countries, so also has it eaten into real reserves. At the end of 1973, the reserves of less developed countries (other than members of OPEC) amounted to 37 per cent of their imports. In the course of the next three years, reserves rose rapidly, especially in 1976, but imports rose faster, largely on account of the rapid rise in world prices. By the end of 1976, reserves amounted to a mere 25 per cent of imports.

I do not attach much importance to this particular ratio. I do attach importance to the trend it describes, a trend that is causing concern in the less developed countries. It is, I believe, fair to conclude that some of them have been borrowing in order to build up reserves. Be that as it may, this much is clear: an increase in the reserves of the less developed countries would most certainly help to allay the fears of private creditors and thereby help to forestall a precipituous decline in the level of new private lending.

Putting these facts and arguments together, but allowing also for the fact that the increase of quotas begun last year has not been completed, I recommend these steps:

1. No new increase of Fund quotas should be undertaken until 1979 or 1980, but the next one should be larger than the last. The one begun last year will raise total quotas by SDR 10 billion, or 33.6 per cent. The next one should raise them by another SDR 20 billion, so that the two together would double the size of the Fund, compared to what it was in 1975. The effects of inflation alone would justify this large step.

2. It is time to resume the distribution of Special Drawing Rights. It would be sensible to start next year, and to increase the supply of SDR by no less than 2.5 billion per year for the next five years. At that rate, the stock of SDR would be larger by 7.5 billion three years from now, and this is the amount that would match the need arising from an increase of IMF quotas. Under the Amended Articles of Agreement, countries must pay into the Fund SDR (or currency reserves) equal to one-fourth of the increase in quotas. Thus, the two-step increase of quotas by SDR 30 billion I have proposed would call for them to put up 7.5 billion. As countries hold only 8.7 billion of SDR right now, an increase of quotas *without* new distributions of SDR could transfer the bulk of the existing supply from the Fund's members to the Fund itself. They would be available for use in drawings on the Fund but would disappear from national reserves. This is hardly the way to make the SDR the principal reserve asset in the international monetary system.

3. Plans should be made immediately to increase the liquidity of the International Monetary Fund. This should not be done, however, by going hat in hand to Saudi Arabia, as has been proposed, to ask that it cough up some of its surplus. There is another way. Every time that Saudi Arabia deposits money in the Eurocurrency markets, it is making its *main* contribution to the financing of imbalances; it is, as Robert Solomon said, a "necessitous" lender. It is therefore the task of the Fund to mobilize money already available. And the money in question will be *readily* available if banks are unwilling to lend directly to the developing countries. Hence, serious thought should be given to bond issues by the IMF in denominations and maturities attractive to banks and other investors.

4. Finally, I recommend an expansion of the credit lines embodied in the General Arrangements to Borrow.

The steps I have suggested would enlarge the supply of financing available directly from the IMF and would bolster the Fund's liquidity. They would increase the reserves of the less developed countries. And they would help to sustain the flow of medium-term bank credit to those countries by making them more attractive credit risks. But two more steps should be taken.

In my view, it is necessary that the International Monetary Fund allows its members more time to repay drawings on the Fund. This could be done by changing the rules under which members can draw on the Fund's Extended Facility.

It is also necessary to strengthen financial relationships among the developed countries, especially to increase the flow of long-term credit to the countries of Southern Europe.

Two years ago, I testified before the Senate Foreign Relations Committee, urging ratification of the OECD Financial Support Fund. I have reread what I said then, and there is little I would change. To be sure, we have managed to get along without it for the last two years, but the contingencies against which it was to defend us are *less* remote, not *more* remote, than they were seen to be in 1974 or 1975.

Loans by the Support Fund, however, would not be large enough in volume or long enough in term to aid the economies of Southern Europe. To that end, I should like to make one final recommendation.

Much has been said in the last few months about the ways in which the United States can foster respect for human rights. I endorse that goal, believing it to be the best way of uniting our Nation in support of vital foreign-policy goals tarnished in the 1960s by our involvement in Vietnam and by other mistakes.

But there are two ways to pursue the goal, and we have latched onto the wrong one. We talk of punishing countries that do not live up to our standards. Yet our ability to do so is limited, and our willingness to do so is compromised too often by the necessities of national security. The other way seems to me to be much more promising. It is to reward in all ways possible governments that do display respect for human rights.

We have learned to our sadness that many nations do not share our faith in democracy or our regard for human liberties. In pessimistic moments, we wonder whether the democracies may be an endangered species. It behooves us, therefore, to give unstinting aid to democratic governments wherever we find them. And we have just discovered a nest of them along the Mediterranean.

It is thus my suggestion that we join with the countries of Northern Europe, the members of the European Community, to make a large, long-lasting commitment to the development of Southern Europe—a commitment to include the promise of long-term lending, guaranties for private direct investments wherever they are welcomed, and the removal of trade barriers, especially barriers that interdict the agricultural exports of Southern Europe.

Egalitarians are sure to object that aid should go to the poor, not to the second-richest group of nations. But our commitment to democratic values has to take precedence here.

Representative Reuss. Mr. Eckaus, please proceed.

STATEMENT OF R. S. ECKAUS, PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. Eckaus. Congressman Reuss, may I first of all express my appreciation for the honor which you have done me by asking for my opinion on the issues before you.

In this brief oral statement I should like only to emphasize and elaborate on the arguments in my prepared statement. In the invitation to appear before this committee, I was asked to comment on several aspects of the balances-of-payments adjustment problems which will emerge over the near future. In particular my views were asked on three topics: One, the adequacy of the funds available in various international institutions in comparison to the requirements for balance-of-payments financing and possible alterative arragements; two, the conditions which should be attached to the assistance which might be given to the deficit nations; and three, the patterns of investment of the excess revenues of the OPEC nations.

In my oral statement and in my prepared statement I have concentrated on the first two issues. Moreover, I have dealt with the first in only a qualitative manner inasmuch as an estimation of the magnitudes of balance-of-payments deficits likely to emerge in the next few years requires a quantitative investigation which should be done on a systematic and careful basis and which I have not been able to undertake.

With respect to the magnitudes of balance-of-payments financing likely to be required by the weak industrial and advanced developing countries, I would emphasize that it is impossible to make short-term estimates without taking into account the long-term development programs of these countries and the extent to which these programs will receive international support. The rates and patterns of development of such nations will depend, in turn, on the amount of balance-of-payments assistance which they receive. Thus, the issue is not a short-term one of how much balance-of-payments support will these countries require to overcome current difficulties. The issue is a long-term one: of growth and development and the extent to which members of the international community, which have the means, will assist in that growth and development.

This reasoning suggests another major difficulty in estimating the requirements for balance-of-payments financing. Finance is fungible. That is, funds made available for short-run balance of payments financing can be converted indirectly, if not directly, into funds for long-term investment and development or other uses. For example, in some countries the balance-of-payments problem may have its sources in relatively high consumption goods imports induced by high rates of investment. Short-term balance-of-payments financing in this case is really a means of sustaining a high domestic investment level. No set of conditions short of extensive control of domestic and international expenditures can limit such fungibility of funds.

Without committing myself to particular numbers, I think that we should expect to see an increasing demand for longer term balance-of-payments assistance to the weak industrial nations and the more advanced developing countries as well as to the poorer among the developing countries. The weaker economies of Europe, Greece, Portugal, Spain, Turkey, and Yugoslavia will all try to accelerate their growth. The nations of the Mideast which do not have the good fortune to be major oil exporters nonetheless are pressing their development. It is too early to tell what the effect will be of the recent political changes on the Asian subcontinent, but it is to be hoped that India and Pakistan will resume the rates of progress made in the 1950's and 1960's. The problems of development of Latin America are by no means resolved and, in some ways, the many countries of Africa are just standing at the threshold of development.

In addition to the demand which will come from the push for development, some special events of the last several years, in particular the vastly increased cost of petroleum, have imposed burdens which have been particularly heavy for all the developing countries, including the weak industrial nations and the more advanced developing countries. In some countries, such as Portugal and Spain, the increased demands arise from political transformations toward greater civil liberties, popular participation and democracy. Assistance to these countries will help such transformations.

While it should be expected that there will be a larger demand for official assistance, it is a matter of some controversy as to whether the demand for commercial lending and the supply of funds from commercial banks will be reduced in the near future. There are national central bankers and international official bankers who believe that the growth of commercial bank lending to weak industrial and advanced developing countries and to the poorer developing countries is a source of considerable risk to commercial banks. There are other bankers and other economists who disagree. It is difficult to learn exactly what the facts are with respect to the magnitudes of commercial loans of this type, their distribution among the portfolios of the commercial banks involved in international lending and the magnitude of the arrearages which may exist.

However, it is probably true that the amount of commercial lending which will be undertaken depends in large part on the amount of official lending which is done. Rather than the one substituting for the other, the two sources may well be complementary. It would be understandable if this were the case because commercial banks are likely to think the prospects of any country are better than otherwise, if that country is also receiving substantial official assistance. Moreover, the point made above should be recalled, the amount of lending demanded by the countries under consideration is not a function of short-term difficulties, but of long-term development.

In this respect it may be noted that the role of the International Monetary Fund transcends the sizable loans which it makes. The Fund serves as the international rating service for loans by commercial banks to individual nations. The signing by a nation of the Fund's "terms of agreement" means that the nation has met the IMF's standards of creditworthiness and that serves as a validating signal for commercial banks.

Thus, the standards or criteria which the International Monetary Fund imposes as conditions for its loans are especially important for the developing countries as they determine the availability of an even larger flow of credit. But the conditions imposed on all international balance-of-payments financing are significant in the expectation of increasing amounts of such lending in the future. It is to the credit of this committee that these conditions should be made the subject of open discussion. While such conditions have been debated in the executive committees of the international lending agencies and occasionally by professional economists, they have not been treated openly, as they deserve to be treated, with recognition of both their technical and political implications.

Since the significance of conditionality as economic criteria is clear, allow me to dwell for a moment on the political significance of conditionality. It is sometimes claimed that international agencies take no political positions in their economic advice to countries applying for assistance. It is argued that, like medical doctors, they play the role of technicians who only specify what is required for the health of the applicants. Yet we know from experience with our own domestic economy that economic issues are seldom, if ever, so clear cut that they can be left to economic technicians to resolve. First of all, as everyone knows, the technicians cannot agree among themselves. Second, most economic issues have essential political aspects, which require political decisions for their resolution. These political aspects are, often, the real sources of the differences among the economic technicians.

Conditions imposed for balance-of-payments financing always have domestic political implications over which there is domestic controversy. When the conditions are proposed by an international agency, that strengthens some domestic groups and weakens others. There is no way of avoiding these effects.

Moreover, the international agencies themselves carry particular economic ideologies with them, though it is often thought not to be polite to mention these. If one looks at the conditions which have been imposed by the International Monetary Fund, for example, one finds over and over again a stress on monetary measures, monetary controls and what, in this country, would be considered conservative fiscal policies.

Typically the conditions which the IMF has set for access to its lending are conditions on the rate of credit expansion, the size of the Government deficit, the establishment of a realistic rate of exchange, the abandonment of quantitative restrictions on trade and payments and maintenance of adequate foreign exchange asset levels.

An examination of the conditions which the Fund includes in its terms of agreement also indicates the stress on achievement in the short term, that is in 2 to 3 years, of balance-of-payments equilibrium. For certain types of Fund loans the period may extend to the medium term, of 5 to 6 years. To my knowledge, in no case has the Fund considered the long-term development programs of a country and evaluated the current balance-of-payments problems in terms of that longer term perspective. Yet the longer term perspective is the appropriate one for the weak industrial nations and the developing countries generally. It cannot be expected that these countries will, within a relatively few years, achieve a maintainable, steady-state condition of viable independence in their balance of payments. The transformations of the economies of the weak industrial nations to strength and of the more advanced developing countries to modern industrial nations involve fundamental and far-reaching changes. The related balance-of-payments problems are different from those which arise from short-term and reversible commodity price fluctuations. No one should expect that major economic transformations can be accomplished within the space of a relatively few years.

Yet, from the information which is publicly available, the Fund does not ask of a country applying for balance-of-payments problems financing: "What are your long-term development goals? What are you prepared to do to achieve them? Are your current balance-of-payments problems an expected or unexpected part of your development program?" And the IMF does not ask of itself whether the goals and plans are consistent and feasible. Do the goals and plans require a realistically available or unrealistic amount of balance-of-payments support? Are the instruments of policy used by the country direct or indirect, more or less effective than the credit controls favored by the IMF?

Each of the developing countries, including the ones which already have traveled some distance along the road of industrialization, will have its own set of priorities and preferences for development patterns. That does not mean that each can make unlimited claims for international assistance. But it does mean, that in order to evaluate the current situation of these countries, it is necessary to take a long-range point of view.

A recent article in the Financial Times demonstrates the distinction between the short-run criteria of the Fund and the long-run criteria which are necessary for developing countries. The article in the Financial Times reported on the efforts in Mexico to develop their large oil reserves for production and export. Such development would substantially improve the Mexican balance of payments and Mexican development prospects. For this purpose, PEMEX, the Mexican National Oil Company should be and has been borrowing abroad on a large scale in order to finance exploration and development of the oil reserves in Mexico.

However, a recent IMF loan to Mexico put a ceiling on the total borrowing by Mexico in the near future. That ceiling on total borrowing may well constrain the investment by PEMEX. That is certainly counterproductive, because the more rapidly that PEMEX exploits Mexican oil reserves, the more rapidly the fundamental balance-of-payments position of Mexico will improve and the more rapidly Mexican development and economic growth will go forward.

This provides a typical example of how short-run criteria can be counterproductive when long-run criteria are appropriate.

If the International Monetary Fund intends to more explicitly participate in balance-of-payments assistance for developing nations, it will have to adopt criteria which are different from those of the past. As the Fund becomes known as a source of general balance-of-payments support for the weaker industrial and developing nations, it will receive an increasing flow of applications from these nations. At that point the Fund will have to face the problem of allocating limited resources among many competing claimants whose arguments for assistance will be different from the conventional short-term balance-of-payments problems with which the Fund has been accustomed to deal.

That raises the question as to whether the International Monetary Fund is, in fact, the international agency which is most suited to deal with the balance-of-payments problems of the weak industrial nations and advanced developing countries, not to mention the poorer developing countries for which it is also creating special facilities. It also calls into question whether the Fund should be the chosen instrument of the United States in supervising any consortium loans to such countries in which the United States may participate. The experience, the expertise, and the outlook of the International Monetary Fund are not those most directly relevant to long-term development issues. It is suggested that consideration be given to the use or creation of a new Fund facility or an institutional alternative to the Fund for the problems which are under consideration.

The International Bank for Reconstruction and Development certainly has had much more experience with development problems. It has established procedures for giving loans for general balance-of-payments support for industrial investment and production programs which take into account the production capabilities of the sectors and development goals and constraints. These are more like the kind of balance-of-payments financing required for the weak industrial and advanced developing countries than the short-term assistance with which the IMF has had experience. On the other hand, the IMF has shown institutional flexibility in the past and, perhaps, would consider further innovation to accommodate its structure, procedures, and criteria to a new set of responsibilities.

It is not my purpose here to advance a particular institutional alternative to the IMF. Rather I want to emphasize the change which is required, from a preoccupation with short-term stabilization questions which has been characteristic of the IMF, to a long-term development perspective.

I should also like to stress, that it is not my purpose to criticize the IMF, but rather to draw out the implications of constraints under which it operates. Given these constraints, it is, I think, appropriate to consider alternatives.

Representative Reuss. Thank you, Mr. Eckaus.

[The prepared statement of Mr. Eckaus follows:]

Prepared Statement of R. S. Eckaus [1]

Expansion Versus Contraction as Policies for Stability and Growth

I. THE BITTER MEDICINE OF AUSTERITY AND RESTRAINT

Just at this time in the world there are a number of low income countries with high rates of inflation, substantial balance of payments deficits, and large government budget deficits. In hope of receiving economic assistance in achieving their development goals, these countries are playing host to missions of international lending institutions. The diagnoses which are made and the advice given is often the same around the world: the inflation is due to the large government deficits and an associated high rate of expansion of the money supply; the balance of payment problems are the result of excessive demand expansion and unrealistic exchange rates which do not offset high levels of costs pushed up by rapid growth in money and real wages. These high wages are, in turn, associated with a low share of capital income in total income. The high wage share accounts for the low levels of domestic saving because of the associated high rate of consumption. The low savings rates, in turn, are the cause of low levels of investment.

The only way, "to put the house in order," according to these international missions is to cut government spending and/or raise taxes to reduce the government deficit, reduce the rate of expansion of the money supply, devalue the currency to eliminate the balance of payments deficit and, above all, "let markets work," to resolve the macroeconomic difficulties. The resulting unemployment, though seldom emphasized, is expected to restrain real wage increases, discipline workers and to both lower costs and increase the international competitiveness of local production. This is the bitter medicine of "austerity and restraint" now widely proposed. Its objectives are explicitly short run: to reduce external deficits and domestic inflation which is thought to generate such deficits. If a long run rationale is mentioned, the argument is made that the recommended austerity will encourage "resource switching" from consumption to investment.

II. WHEN IS THE BITTER MEDICINE INDICATED BY ECONOMIC CONDITIONS AND WHEN NOT?

Acceptance of the bitter medicine of austerity and restraint are the typical requirements imposed on nations by the International Monetary Fund as the condition for loans. Since the IMF acts as the major international institution determining the "creditworthiness" of borrowing nations, its authentication has an effect on the access of borrowers to credit which goes far beyond the substantial sums which the IMF itself may offer. Thus, it is important to examine carefully the prescriptions which the IMF typically proposes around the world and to ask whether they are the appropriate ones for each circumstance.

The "terms of agreement" which the IMF imposes as conditions for its loans are not made public. But the view in the developing countries is that the IMF prescription is a uniform one and tends to be both conservative and monetarist. It has been said, and the jest appears to have a germ of truth in it, that the only differences in the "Terms of Agreement" offered by the IMF are in the names of the countries entered in the documents and the precise numbers. But the substantive content—austerity and restraint—are the same around the world.

[1] The author is indebted for helpful suggestions to his colleagues, Professors N. Choucri, R. Dornbusch and L. Taylor.

They are the same terms offered to advanced countries as well. But certainly the requirements should fit the circumstances and the circumstances of the weak, industrial countries pursing long-term development goals are surely different from those of advanced countries attempting to achieve short-run stability.

The issue of "conditionality" when applied to the developing countries is really the issue of what economic criteria which will be used to judge their development.

This issue has been regarded as particularly complex and difficult by persons primarily concerned with the problems of the developing countries. Development criteria must assess the contribution of alternative policies to long term goals. The internal balance among the various producing sectors, the sources and uses of saving and the allocations of labor, the overall rates of growth and the relative improvement of particular regions and groups, international specialization and national economic independence must all be taken into account.

By comparison the publicly stated performance criteria for access to IMF assistance are relatively simple. With respect to assistance under the Extended Fund Facility, the stated intention is:

". . . support of comprehensive programs that include policies of the scope and character required to correct structural imbalances in production, trade, and prices when it is expected that the needed improvements in the member's balance of payments can be achieved without policies inconsistent with the purposes of the Fund only over an extended period. The Fund will pay particular attention to the policy measures that the member intends to implement in order to mobilize resources and improve the utilization of them and to reduce reliance on external restrictions, the time required for these measures to have the intended effect on the balance of payments, and other such factors as the Fund considers relevant to the member's circumstances." (p. 51, *Selected Decisions of the International Monetary Fund*, Eighth Issue, International Monetary Fund, Washington, D.C., May 10, 1976.)

With respect to the newly created Trust Fund, the criteria referred to in the *IFM Survey* of February 7, 1977 again appear relatively simple: eligibility is restricted to countries with per capital income of less than SDR 300 per year in 1973, and, "a need for balance of payments assistance, based on its balance of payments position, its reserve position, and developments in its reserves, and that are making a reasonable effort to strengthen their balance of payments position." (pp. 40–41)

While these are quite general statements of conditionality, it is clear that their emphasis is on relatively short-term balance of payments conditions.

Given the limited resources which are available for assistance to the developing countries, the use of some criteria for distribution of available assistance funds cannot be avoided. With respect to the weak industrial countries, the emphasis should be on long-term development goals and progress toward the individual country's. These are vague criteria also and can be made specific only by examining the particular circumstances of each country. However, equity requires that decisions with respect to the allocations to be made among the potential recipients not depend on the degree of their balance of payments crisis, on the one hand, or their adherence to conservative fiscal and monetary policies, on the other hand. If balance of payments crisis is made a condition for assistance, that would reward countries which live on the brink of such crises. If conservative fiscal and monetary policies are made a condition of assistance, that might well result in the rewarding of countries with relatively slow and inequitable growth.

Considerations of international equity and examinations of the long-term development programs of the low income industrial countries such as Portugal are foreign to the conditions and procedures of the International Monetary Fund. This is an important point in itself. Although the IMF is, increasingly, dealing with development issues, it approaches these issues from the unduly narrow point of view, of relatively short term balance of payments problems.

There is no rule for determining how much adjusting the developing nations should be expected to make as a condition of their assistance. Nor is their a rule for the choice of the preferred type of adjustments. Each of these nations is at a different stage in its growth process: each has different institutions, a different product mix with different supply and demand elasticities, and so on. Balance of payments difficulties may arise from different sources, have different expected degrees of persistance and different consequences. That is why it is a mistake to approach each of these countries with the same formula.

For example, the prescription of austerity and restraint, while it may never have been entirely appropriate for any single country, has been partially correct for a number of countries at various times and it is that which gives it a superficial appeal.

Among the development patterns of the 1960's there was the "Latin American model" in which saving was forced through high rates of investment financed by money creation. Add a fixed exchange rate, as was typical of the 1960's, and that creates a large part of the picture portrayed in the preceding diagnosis. In such circumstances perhaps part of the medicine prescribed was also warranted, though that was not always the case. Devaluation would not have been of major help to countries with a relatively small amount of foreign trade and for whose exports there was a low demand elasticity so that lower prices would not bring in additional revenues. High rates of inflation do generate distortions in resource allocation. Yet the resulting investment and growth based on saving forced in that manner may be worth the cost in distortions, inefficiency and, even, inequity by the countries undergoing the process.

In any case the circumstances in which the prescription for the bitter medicine of "austerity and restraint" are now being proposed are often quite different from the "Latin American model" of the 1960's. These differences make the conventional bitter medicine not only inappropriate but potentially problematic in their effects. The high rates of inflation now characteristic to some developing countries are to a large extent a reflection of inflation in world prices. So the inflation is partially imported. There is, in some cases, substantial unused industrial capacity and urban unemployment of workers who formerly had jobs. The latter aspect is hidden, however, in those countries in which layoffs are not permitted by law or union regulation so that "unemployment benefits" are paid directly by the employing firm in wages to underutilized labor.

This is a reasonably good, though not a complete description of several countries of which Portugal is an example. It contains important features of other developing countries, including Egypt. While unemployment is high in Portugal, its effects have been uneven. In the high organized industrial sector, wages were increased rapidly after the revolution of April, 1974. The real wage increases have been largely secured by the ability of the unions to threaten political instability. However, at the same time incomes in the unorganized urban and the rural sectors may have declined absolutely as well as in relative terms.

In the Portuguese case, and others like it, not all of the "bitter medicine" should be applied. Unlike the Latin American model of forced development, these economies are suffering from recession, which the inflation and a large balance of payments deficit should not be allowed to obscure. In these countries, typically, the limitation of imports by tariffs duties has been only partially successful, partly because tariffs have not been pushed as high as necessary. The attempts to stimulate exports by special credit facilities likewise has nto been markedly effective. In these circumstances a component of the bitter medicine, currency devaluation, may well be indicated, although that itself has contractionary effects which must be offset.

However, the most fundamental fact about Portugal, and some other of the weak industrial countries at this time, is that there is a large amount of open and disguised unemployment and substantial idle capacity in particular sectors. What is clearly necessary is policy which will stimulate recovery. The "bitter medicine" of across-the-board reductions in government spending and reduction in the level and growth rate of money supply is not called for in this case any more than it is called for in the U.S. economy when there is a recession. The contractionary effects of devaluation, through its reduction in real income, must be offset. The emphasis in economic policy should be on expansion not contraction.

For cases of the Portuguese type the most important lesson was learned long ago: when there is unemployment and idle capacity, investment is not determined by the level of saving; rather, saving is determined by the level of investment. It is true that savings are currently low and that consumption has risen. But it is not, in general, true that, if consumption, in general, savings would increase, and, therefore, more investment would be possible. In fact, if consumption were constrained, that would only create more hardship in the population, deepen the recession and discourage investment further. It will also activate latent political dissatisfaction and increase political instability.

Yet it is true that the scarce foreign exchange resources necessary for investment could be released if the consumption of imported goods could be reduced. But even here it is necessary to go carefully in seeking out successful policy paths. First of all, the price elasticity of demand of basic consumer goods is low so that raising prices will be relatively ineffective in restraining consumption. Thus, raising the prices by tariffs or taxes or reduction of subsidies on basic consumer goods, including such "luxuries" as tobacco and sugar, will not help much in reducing their imports. So that type of bitter medicine of austerity and constraint may well be impotent. Worse than that, the reduction in real income as staple prices rise, will reduce demand for other goods. So, again, if the bitter medicine is used, there must be an antidote to prevent it from depressing the economy.

In spite of protestations that the conditions which international agencies impose for assistance are non-political or a-political, there is no doubt that they have a differential appeal and attract differential support from various political groups within each country. Thus, the policies and actions of the international agencies effectively result in supporting those domestic political groups which argue that their programs are more acceptable internationally and capable of attracting international support.

Where political stability itself is important for development, the prescriptions of austerity and restraint are not helpful in when their consequences might well be to cause riots in the streets and bring down the government. It is all very well for outsiders to talk about the need for courage and foresight on the part of local leaders. But local leaders must be concerned with their own positions and are not willing to adopt policies whose objective consequence is political suicide. Thus, to apply the bitter medicine of austerity and constraint via a general reduction of consumption may not be politically feasible. International and national lending agencies which recommended this type of policy are often advising political suicide and, thus, may not receive attention, or, if their advice is followed, it may provoke political violence and/or a reactionary government.

III. ON FINDING MORE APPROPRIATE MEDICINE

In a sense the problem is an old one in development economics. It was originally formulated in terms of the difficulty of generating savings when there was generalized poverty and resource constraints. It was argued that the feasible path of development was to stimulate additional saving from additional income rather than to try to force down consumption to generate saving. It was also argued that international and natural agencies should make growth easier by providing additional investment resources. The new form of the old problem is that, for some countries, such as Portugal, there is both recession and a lack of development. It would be a major mistake to follow a policy of reducing consumption across the board in order to release some foreign exchange and, in the process, force a greater degree of recession on the economy.

What is feasible and desirable is to follow selective policies of mixing the bitter with the sweet. First of all, it is wrong to force a general contraction on the economy. Government budget deficits will often be desirable for investment purposes. "Resource switching" should take place by explicit programs for the stimulation of private and public investment to offset the contractionary effects of devaluation and any reductions in consumption. Secondly national and international lending agencies should support programs of stability and growth rather than impose contractionary and politically destablizing conditions for assistance.

If nothing else the recent Egyptian riots should have demonstrated the need to spread the burden of any reductions in consumption so that they are not borne fully by those groups who are most ready to take to the streets in protest. That will happen if there is not the appearance and the reality of equity in the imposition of austerity and restraint.

In summary, there should be a reorientation of conventional balance of payments stabilization policy for the weak industrial nations. The reorientation should emphasize a medium to long term outlook in creating the means by which a deficit country will be able to substantially finance itself externally through foreign exchange earnings long term capital movements. To set up that trade-oriented independence it is essential to leave the largest possible scope for investment programs. Such investment programs in the short run will require liberal external financing but they have the important advantage of coping with the short term problems of unutilized capacity and unemployment by creating domestic aggregate demand and the long term result of promoting growth. A recovery program linked to investment, including investment with a trade orientation, should have as domestic counterparts: (1) the containment of increases in consumption but should not attempt to reduce consumption through recession and unemployment and (2) government social welfare spending and transfers and taxes at levels consistent with domestic equity.

An investment oriented strategy inevitably is essential in another respect. The increases in real wages that are associated with political upheavals such as have been experienced in Portugal cannot be reversed. At present they are financed primarily by budget deficits, credit creation and reserve losses. This is patently impossible to continue indefinitely. The only escape is to validate those wage increases by investment that will sufficiently raise productivity to warrant the higher real wages.

Moreover timing is important! International missions like to have a complete package of policies implemented as demonstration of a commitment to the bitter medicine they recommend. They naturally feel uneasy with promises. Yet a large dose of medicine, which might cause a political explosion if forced down all at once, might be acceptable if spread out over time and mixed with policies which demonstrate equity and hold the promise of growth and development. That means that the international missions should expect to leave their host countries having only promises in hand. But that is better than leaving a burning city, or provoking political violence and/or a reactionary government.

Finally it should be noted that the aggressiveness of the International Monetary Fund in imposing conditions on the developing countries is not matched by its aggressiveness in imposing conditions on advanced countries. The exchange rate, balance of payments and overall macroeconomic policies of some of the advanced countries with persistent surpluses due to undervalued exchange rates are partial sources of the problems of the weak industrial countries. The full burden of correction of overvaluation of their exchange rates is placed on developing countries as a condition of assistance. However, the overvaluation of the developing countries exchange rates is, in part, an aspect of the undervaluation of the exchange rates of some of the more advanced countries. The counterpart of "over-expansion" in developing countries is insufficient growth in advanced countries. Rather than attempting one-by-one to induce the developing countries to correct their exchange values, it would be more efficient and would recognize a major source of the problems if the IMF were more aggressive in inducing corrections in those advanced countries with undervalued exchange rates.

IV. ON FINDING THE APPROPRIATE INSTITUTIONAL BASIS FOR ASSISTING THE WEAK INDUSTRIAL COUNTRIES

It is argued here that the balance of payments problems of the weak industrial countries are those of long term development rather than short term stability. If this argument is correct, then the appropriate institutional source of support should have its primary interest and experience in the problems of development. There is a real question as to whether the International Monetary Fund is such an institution, inasmuch as the experience and expertise of the IMF is mainly with short term probelms. By comparison the International Bank for Reconstruction and Development specializes in just those problems in which the IMF is relatively inexperienced.

Therefore, the question should be seriously considered as to whether the IMF should be the "chosen instrument" of assistance to the weak industrial countries or whether that instrument should be the IBRD. The World Bank, like any large institution with a long history, has its own set of foibles, but, at least, and most importantly, it is concerned with the right set of problems.

Representative Reuss. Mr. McDonough, please proceed.

STATEMENT OF WILLIAM J. McDONOUGH, EXECUTIVE VICE PRESIDENT, THE FIRST NATIONAL BANK OF CHICAGO

Mr. McDonough. Congressman Reuss, it is a pleasure to appear before the Joint Economic Committee to express the views of an international commercial banker on the three questions raised in your letter of March 22, 1977, about the world monetary mechanism.

In discharging my responsibilities at the First National Bank of Chicago, I am, of course, concerned with the credit-worthiness of the borrowing country as a whole and of individual credits and borrowers, including their commercial viability and the creditworthiness of both the companies and the appropriate governmental units. In addition, in assessing the overall credit position of a foreign borrower, the facilities available at official international financial organizations, such as the IMF, must be considered.

I turn now to the first inquiry raised in your letter: "Are assets of the IMF and other multilateral financial institutions adequate to provide sufficient balance-of-payments financing? If not, how much should they be increased and through what mechanism?"

The present world payments situation is dominated by massive current account surpluses of OPEC and of a few major industrialized countries and the corresponding deficits borne by the rest of the non-oil-producing industrial and developing countries.

The few surpluses of the industrialized countries seem potentially adjustable within a few years, and the surpluses of some OPEC members—such as Iran, Iraq, Venezuela, Nigeria, Indonesia, and Algeria—have either disappeared already or will do so within a few years. However, the surpluses of Saudi Arabia, Kuwait, the United Arab Emirates, and Qatar are likely to exist for the foreseeable future. These countries simply do not have the capability of adjusting their spending to equal the level of their income. They will continue to experience very large surpluses, which means that the rest of the world must have offsetting deficits.

The adverse impacts of the oil price increases have different implications for the less-developed countries that continue to run current-account deficits than for their industrialized counterparts. A few countries in each category are already running current-account surpluses or the deficits are small enough such that normal capital flows will offset the deficits without significant strain on their economies. Other countries are expected to make similar adjustments as world economic growth progresses—bringing increases in both the volume and prices of their major exports.

The locus of greatest concern rests with those LDC's and industrialized countries which are unlikely to be able to make the necessary adjustment. Although the greatest publicity has been accorded to LDC's in this group, of greater significance for the world economy is the group of industrialized countries that are experiencing great difficulty in adjusting to their current-account deficits. These industrialized countries are of greatest concern not only because the magnitude of their adjustment problem, and therefore their borrowing needs, is greater, but because their adjustment processes are potentially more disruptive to the world economy as a whole.

A larger role on the part of the IMF is necessary if the present international imbalance is not to seriously disrupt the world economy. The IMF must extend its effort, first, to seek a reduction in the deficits and, second, to expand its role as a buffer in order to finance temporary maladjustments.

Most countries with continuing deficits could do more to alleviate their own problems. The IMF currently has the potential ability to fulfill this role. As long as a country is exercising the necessary financial discipline, its credit ratings and borrowing capacity will maintain its access to private capital markets. However, if the country no longer is attractive to private lenders, the IMF should be available as a source of adjustment financing and discipline to encourage the necessary changes.

The IMF currently has available $9 to $10 billion of lendable funds under its existing facilities. In addition, plans to increase existing quotas and to implement a super-GAB will add substantially to this total.

The oil price increases caused serious disruptions for most oil importers: Energy-intensive productive capacity has been rendered obsolete, economic development has been stalled or slowed, and inflation has increased. The extent to which countries can be expected to rebound from the oil crisis varies widely—depending upon the extent and nature of the nation's resources, especially human resources, and upon the impact of nonoil factors in the deterioration of the balance of payments. The latter depends on one's assessment of the amount of payments deterioration that might be attributed to the 1974–75 economic slowdown, along with the related expectation of the extent of improvement that might accompany rising business activity in 1977 and 1978.

There are two different parts to this problem. That portion of the world's payments imbalance caused by nonoil factors should most appropriately be viewed as a temporary condition, a phenomenon of the world business cycle.

In contrast, portions of the international payments deterioration, primarily resulting from the oil price increases, that cannot reasonably be expected to be corrected by a rise in raw material prices and increased volume of exports should be corrected through basic economic adjustment; that is, by a combination of policies—fiscal, monetary, exchange rate, investment incentives for export, et cetera. No single type of policy need necessarily be relied upon to accomplish the desired objective. Indeed, excessive reliance on one approach could be overly disruptive to both the Nation adopting the measure and to its trading partners.

Another important factor to take into consideration in determining how much adjustment a deficit nation should undertake is the rate of economic growth that can be expected, and the resulting greater debt service capability. A nation with an outlook for rapid economic growth will be able to support a larger external debt than other nations, just as a growing and healthy firm can do. Allowance, therefore, should be made for this factor when determining required policy initiatives.

Our national policy has taken note of the fact that there also is an obligation of the surplus industrial countries to adopt policies that will narrow the currently existing world payments disequilibrium. Because payments deficits must be matched by surpluses, some of the responsibility for the correction of excessive imbalances also falls upon the surplus nations.

In this regard, the role of the U.S. Government and economy in this adjustment process cannot be overemphasized. As the largest, most energy-intensive and least energy-efficient economy in the world, this country bears a major share of the responsibility in reducing the present international imbalance. In 1975, although the United States ran a $24 billion deficit on oil trade, it ran an $11.7 billion surplus on its current account. Although the current account surplus disappeared, the oil deficit persisted.

In order to offset it, the United States must run large surpluses with the rest of the world. This obviously adds greatly to the current account deficits of those countries.

The United States must seek to reduce the current account surplus of the oil exporters. This it can do by reducing its own oil-import needs. As President Carter indicated earlier this week in this speeches to both Congress and the American people, the United States must reduce its energy wastage and seek nonoil alternatives for fuel. No other country has as much opportunity to improve the efficiency of its consumption. An American example on this issue will also serve as additional incentive for other oil-importing countries.

Now, regarding the disposition of OPEC surpluses, I anticipate that the amount of excess funds will be smaller than 1 or 2 years ago, and that the problem is gradually declining in importance as OPEC imports expand. Nevertheless, surpluses will continue to be large in 1977 and 1978.

OPEC surpluses in 1977 and 1978 will continue to be invested heavily in short-term marketable securities, but there is likely to be less reliance on this type of investment as OPEC imports expand and as more OPEC aid is extended to other Arab States. Increasing amounts of OPEC funds are going into Arab development projects and agencies. Additional amounts of OPEC surpluses could be used to aid non-Arab developing countries with payments deficits, but the outlook is not for a significant gain. In addition, more and more of the discretionary OPEC funds are being shifted into longer term investments in the major industrial countries. The scale of the accumulated surpluses is too massive to keep in short-term funds. Some of these longer term flows can either directly or indirectly be channeled to some of the deficit countries.

The surplus OPEC funds will continue to flow primarily into the major financial centers and especially into the major industrial countries. The investing governments' expectations of political and price stability will be major factors in their decisions. In general, they will prefer to continue to rely upon financial intermediaries.

Congressman Reuss, I wonder if I might expand on my prepared statement by referring to suggestions with regard to using the OPEC surpluses that you referred to in your speech in New York.

Mr. Karlik was nice enough to give me the press release [1] from your office and perhaps I could refer to the five key points stated therein.

Representative REUSS. I welcome your doing this, and I am going to ask our colleagues about the same question. So, proceed.

Mr. McDONOUGH. You suggested we should encourage the Arab surplus countries to establish their own bank to lend to the oil consuming countries. I think that is an excellent suggestion and it is beginning to take place.

The commercial banks formed by the Arab countries which are becoming most active in this regard are not only the ones in the countries themselves, but to a greater degree, the consortia banks they have established, usually with headquarters in Europe. For example, one in Paris,

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[1] See press release of Mar. 18, 1977, beginning on appendix p. 215.

normally known as UBAF, has recently joined in a syndicated bank loan to South Korea.

As these bankers become more accustomed to dealing in other parts of the world because of American commercial bankers like myself encouraging them to join us in various activities, they are in fact channeling funds from their major sources of deposit, which are the OPEC countries, into the recycling arena.

You suggest that we should favor increased involvement for the Saudis and the others in the IMF, and I think particularly that they be invited to join the new super general agreements to borrow.

I think that idea has great merit.

Representative REUSS. In other words, make a group of 13 or so out of the group of 10.

Mr. McDONOUGH. Ten plus whatever of those countries can be convinced to join.

Third, you suggested we should work for increased concessional lending, for greater participation of the Saudis in IDA and in the regional banks.

I think this idea has great merit, also. You suggested we should ask the oil-rich Arabs to develop their own societies as rapidly as possible.

I think they are doing that in a degree that is almost mind-boggling when one visits the countries involved, but there is a limit of the four countries mentioned earlier to absorb resources.

They simply do not have a large population, and although they are moving ahead on road construction and hospital construction, they simply can't do it as quickly as would be necessary to absorb very significantly larger amounts of resources than they are doing, although I think their motivation is certainly very strong to move in this direction.

You suggested finally that we should welcome further Arab investment in the industrialized countries.

As I mentioned in my testimony, I think that should be the case.

I think we should keep in mind that there is a very great difference between the wealth that an industrialized nation such as the United States has and the wealth of an oil-producing nation or any producer of a single commodity.

Our wealth has a tremendously broad base. Essentially, the marvelous farm lands that we have, the natural resources we have, but above all else, the vibrancy, the intellectual preparation, the experience and skills and governmental institutions of a very large and well-developed population.

In the case of the OPEC member countries, their wealth consists of one resource, which every day is pumped out of the ground and becomes unavailable in the future.

Consequently, they understandably are very conservative in what they want to do with the wealth that is being created as the result of the use of that resource.

They must look ahead, and if we were the political leaders of those countries, I think we, too, would have the idea that when the oil is gone they must have something in its place to continue to fuel their economies.

Consequently, the degree to which they are cautious and conservative, I think, is understandable, and encouraging them to go into a super GAO, and so forth, we must be understanding of their reluctance, at the same time that we do all possible to move them in that direction.

If only in a tactical sense, if one pushes too hard, the result is likely to be more negative than positive.

I believe also that that is the reason they wish to invest in the stronger developed economies, because this is in effect an act of faith in the democratic free enterprise system and its ability over time to provide the very valuable resource which will come back to them when the oil is no longer available to provide the wherewithal for their peoples.

Thank you very much, Congressman Reuss.

Representative REUSS. Thank you, Mr. McDonough.

[The prepared statement of Mr. McDonough follows:]

PREPARED STATEMENT OF WILLIAM J. MCDONOUGH

Mr. Chairman, it is a pleasure to appear before the Joint Economic Committee to express the views of an international commercial banker on the three questions raised in your letter of March 22, 1977, about the world monetary mechanism.

In discharging my responsibilities at The First National Bank of Chicago, I am, of course, concerned with the creditworthiness of the borrowing country as a whole and of individual credits and borrowers, including their commercial viability and the creditworthiness of both the companies and the appropriate governmental units. In addition, in assessing the overall credit position of a foreign borrower, the facilities available at official international financial organizations, such as the IMF, must be considered.

I turn now to the first inquiry raised in your letter:

Are assets of the IMF and other multilateral financial institutions adequate to provide sufficient balance of payments financing? If not, how much should they be increased and through what mechanism?

The present world payments situation is dominated by massive current account surpluses of OPEC and of a few major industrialized countries and the corresponding deficits borne by the rest of the non-oil producing industrial and developing countries.

The few surpluses of the industrialized countries seem potentially adjustable within a few years, and the surpluses of many OPEC countries (such as Iran, Iraq, Venezuela, Nigeria, Indonesia and Algeria) have either disappeared already or will do so within a few years. However, the surpluses of Saudi Arabia, Kuwait, Abu Dhabi, Dubai and Qatar are likely to exist for the foreseeable future. These countries simply do not have the capability of adjusting their spending to equal the level of their income. They will continue to experience very large surpluses, which means that the rest of the world must have offsetting deficits.

We anticipate that the price of oil will be little changed in the next several years—some increase in nominal price but a slight decline in the real price. Oil conservation and shifts in the use of energy resources almost certainly cannot respond sufficiently to avoid continued large current account deficits among some oil-importing nations.

The adverse impacts of the oil-price increases have different implications for the less-developed countries that continue to run current-account deficits than for their industrialized counterparts. A few countries in each category are already running current-account surpluses or the deficits are small enough such that normal capital flows will offset the deficits without significant strain to their economies. Other countries are expected to make similar adjustments as world economic growth progresses—bringing increases in both the volume and prices of their major exports.

The locus of greatest concern rests with those LDCs and industrialized countries which are unlikely to be able to make the necessary adjustment. The greatest publicity has been accorded to LDCs in this group. However, of greater significance for the world economy is the group of industrialized countries that are experiencing great difficulty in adjusting to their current-account deficits.

There industrialized countries are of greatest concern not only because the magnitude of their adjustment problem (and therefore their borrowing needs) is greater but because their adjustment processes are potentially more disruptive to the world economy as a whole.

If those funds which are accumulated from the current-account surpluses can be recycled satisfactorily, the consequent financing would, by definition, be adequate to the needs of the deficit countries.

A larger role on the part of the IMF is necessary if the present international imbalance is not to seriously disrupt the world economy. The IMF must extend its efforts, first, to seek a reduction in the deficits and, second, to expand its role as a buffer in order to finance temporary maladjustments.

Most countries with continuing deficits could do more to alleviate their own problems. The IMF has the potential ability to fulfill this role. As long as a country is exercising the necessary financial discipline, its credit ratings and borrowing capacity will maintain its access to private capital markets. However, if the country no longer is attractive to private lenders, the IMF should be available as a source of adjustment financing and discipline to encourage the necessary changes.

The IMF currently has available $9–10 billion of lendable funds under its existing facilities. In addition, plans to increase existing quotas and to implement a super GAB will add substantially to this total.

The basic need for IMF funds is to finance transitional changes. If the Fund adequately uses its persuasive power, the private capital markets will have the ability to finance current-account deficits—which will necessarily have been reduced as a result of IMF efforts, together with economic changes. The proposed increases in the IMF's resources which can be made available through its existing facilities should be adequate for foreseeable needs—if the Fund exercises its disciplinary role.

Turning now to the second inquiry posed in your letter:

How much adjustment should be made by deficit nations to reduce their external payments difficulties? What types of adjustment are preferable?

The oil price increases caused serious disruptions for most oil importers: energy-intensive productive capacity has been rendered obsolete, economic development has been stalled or slowed, and inflation has increased. The extent to which countries can be expected to rebound from the oil crisis varies widely—depending upon the extent and nature of the nation's resources, especially human resources, and upon the impact of non-oil factors in the deterioration of the balance of payments. The latter depends on one's assessment of the amount of payments deterioration that might be attributed to the 1974–75 economic slowdown, along with the related expectation of the extent of improvement that might accompany rising business activity in 1977 and 1978.

There are two different parts to this problem. That portion of the world's payments imbalance caused by non-oil factors should most appropriately be viewed as a temporary condition. World economic recovery would help to eradicate those shortfalls. Oil-importing countries such as South Korea, Argentina and Brazil, have already made such adjustments or are well along in their efforts. In some cases (*e.g.*, Argentina) these adjustments have been sufficient to even offset the impact of the oil price increases.

In contrast, portions of the international payments deterioration (primarily resulting from the oil price increases) that cannot reasonably be expected to be corrected by a rise in raw material prices and increased volume of exports should be corrected through basic economic adjustment (that is, by a combination of policies—fiscal, monetary, exchange rate, investment incentives for export, etc.). No single type of policy need necessarily be relied upon to accomplish the desired objective. Indeed, excessive reliance on one approach could be overly disruptive to both the nation adopting the measure and to its trading partners.

Tariffs, other import restrictions and uneconomic export incentives should be avoided, as well as extreme exchange-rate depreciation or deflationary measures.

Another important factor to take into consideration in determining how much adjustment a deficit nation should undertake is the rate of economic growth that can be expected, and the resulting greater debt service capability. A nation with an outlook for rapid economic growth will be able to support a larger external debt than other nations. Allowance, therefore, should be made for this factor when determining required policy initiatives.

Only a portion of currently existing payments deficits, then, should be viewed as requiring corrective adjustment action. The remainder can be expected (a) to be reduced as raw material prices and exports accelerate from recent recession levels, and (b) to be financed without extraordinary official support on the basis of above-average rates of economic growth, thereby supporting expanding debt.

Our national policy has taken note of the fact that there also is an obligation of the surplus industrial countries to adopt policies that will narrow the currently existing world payments disequilibrium. Because payments deficits must be matched by surpluses, some of the responsibility for the correction of excessive imbalances also falls upon the surplus nations.

The role of the U.S. Government and economy in this adjustment process cannot be overemphasized. As the largest, most energy-intensive and least energy-efficient economy in the world this country bears a major share of the responsibility in reducing the present international imbalance. In 1975 although the U.S. ran a $24.0 bn. deficit on oil trade, it ran a $11.7 bn. surplus on its current account. In 1976 this latter surplus disappeared. However, the oil-trade deficit persisted. In order to offset it, the U.S. must run large surpluses with the rest of the world! This obviously adds greatly to the current account deficits of those countries.

The U.S. must seek to reduce the current-account surplus of the oil exporters. This it can do by reducing its own oil-import needs. As President Carter indicated earlier this week in his speeches to both Congress and the American people, the U.S. must reduce its energy wastage and seek non-oil alternatives for fuel. No other country has as much opportunity to improve the efficiency of its consumption. An American example on this issue will also serve as additional incentive for other oil importing countries.

The final question of your letter asked how the surplus OPEC nations are likely to invest their excess revenues in 1977 and 1978.

I anticipate that the amount of excess funds will be smaller than one or two years ago, and that the problem is gradually declining in importance as OPEC imports expand. Nevertheless, surpluses will continue to be large in 1977 and 1978.

OPEC surpluses in 1978 and 1978 will continue to be invested heavily in short-term marketable securities, but there is likely to be less reliance on this type of investment as OPEC imports expand and as more OPEC aid is extended to other Arab states. Increasing amounts of OPEC funds are going into Arab development projects and agencies. Additional amounts of OPEC surpluses could be used to aid non-Arab developing countries with payments deficits, but the outlook is not for a significant gain. In addition, more and more of the discretionary OPEC funds are being shifted into longer-term investments in the major industrial countries. The scale of the accumulated surpluses is too massive to keep in short-term funds. Some of these longer-term flows can either directly or indirectly be channeled to some of the deficit countries.

The surplus OPEC funds will continue to flow primarily into the major financial centers and especially into the major industrial countries. The investing governments' expectations of political and price stability will be major factors in their decisions. In general, they will prefer to continue to rely upon financial intermediaries.

Mr. Chairman, I would like to thank you and the other members of the Joint Economic Committee for the invitation to present some of my views on the world monetary system. I hope that some of these remarks will prove useful to the committee. I would be glad to answer any questions.

Representative REUSS. I will pursue the point that we started.

You seem in more or less general agreement with the five points that were made.

Are there other additional approaches to the problem of how to deal with the fact that the OPEC countries, and particularly the Arabs, Saudi Arabia, Kuwait, and the Emirates, are likely to be generating surpluses of $40 billion a year and more for some time to come.

How do we take steps to best cushion this imbalance?

Mr. McDONOUGH. Well, I think the suggestions you made are rather inclusive, but again to go back to my testimony, I think it is very important for us to make sure that the surpluses become smaller rather than larger.

We must remember one is talking in real terms. The number of dollars may increase as the general level of world prices goes up. The same number of dollars is in fact a diminishing amount of purchasing power. We must do two things: Encourage these countries to become more and more members of the world economies, take on the role which is theirs as enormous net savers, to become bankers of the world economy, but we must, through our own conservation measures, make sure there is not an ongoing temptation to increase the real price of petroleum.

Representative REUSS. Let me now turn to the other two members of the panel and ask their judgment on whether the five courses of action that Mr. McDonough just reviewed make sense, whether you would criticize anything, or whether you have anything to add?

Mr. KENEN. Congressman Reuss, I have no misgivings about any of the five points which Mr. McDonough has just summarized on your behalf. In fact, suggested in my own prepared statement that it is time for the OPEC countries to make substantial commitments to concessional assistance through the International Development Association—assistance to countries whose income levels are lower than their own.

I do have misgivings, sir, about the tendency that has developed in some quarters to say that OPEC must somehow bear some fair or fixed share of the risk, or that there must be 50–50 participation by OPEC and non-OPEC surplus countries in the replenishment of the IMF and similar arrangements.

My reasons are two: First, such a rule would limit what we can do by what they are prepared to put up. If there is a 50–50 formula, and the OPEC countries say, "We are prepared to put up $3 billion but not $5 billion," then the commitments of others must be scaled down accordingly. We are in danger of that outcome.

Second, we labor under a misapprehension when we say that the OPEC countries must be made to bear the risks of lending to the developing countries, especially by way of the Fund and other international institutions.

As a matter of fact, if the OPEC countries put up money through an expansion of the general arrangements to borrow, or by some other supplementary financing device to enlarge the resources of the IMF, they will enjoy a guarantee, a guarantee issued by all members of the Fund, including the Government of the United States, which is a sort of 20 percent stockholder in the IMF, and would guarantee 20 cents on every dollar that the OPEC countries lent to the Fund.

They are actually bearing more risk now, with their money on deposit in commercial banks that are in turn lending to the developing countries.

I see no great advantage to us in conferring upon them the favor of a governmental guarantee in order to obtain more explicit OPEC participation in international financial arrangements. The success of those arrangements is not contingent upon this participation.

I would welcome their participation, but I would not pay a high price to obtain it.

If they are prepared to participate, so much the better, but we should not tailormake international financial arrangements that are not in our interest merely to meet their requirements, needs, or perceptions.

Their money is already in our hands. As I said, sir, our problem is merely to mobilize it.

Representative REUSS. Mr. Eckaus.

Mr. ECKAUS. I should like to comment briefly on these proposals.

Again, I, like my other colleagues, would endorse them. I think that your suggestions are eminently sound, and worth pursuing, so that if I now turn to a tone of skepticism, I should not like that to be interpreted as skepticism about the soundness of your proposals. Rather, I have a certain skepticism about the possibilities that the proposals in fact may be implemented.

I should like to give my own interpretation of the success of OPEC, which is that it derives its strength and stability from the common political and social and cultural interests in the Arab areas. Their common political, social and cultural interests, I think, will continue to dominate their outlook and the amounts and the direction in which they supply funds in the near future.

However, I think it is unlikely that the OPEC nations will expand their activities on a world scale in the ways which you would desire and I would desire. I think the information which we have about the Kuwaiti Development Fund and about the arrangements under which Saudi Arabia and the Emirates have made concessional lending in the past are that they are quite hardheaded in their lending in the sense that they continue to insist on relatively short-term criteria and exclusively project lending.

By comparison, if my interpretation is correct, what is necessary is program criteria in long-term lending, and there is relatively little evidence that the OPEC nations are ready to engage in that kind of financing.

I should like to reinforce Professor Kenen's answer or suggestions in this respect and what he has just said, about the importance of mobilizing the Arab nations' fund, which are already in the banks of the western world. May I also reinforce his suggestion that the IMF and the IBRD consider the floating of new kinds of debt instruments, perhaps directed mainly at the OPEC nations to raise additional resources.

Representative REUSS. Thank you.

Congressman Long.

Representative LONG. Thank you, Congressman Reuss.

Mr. Eckaus, I was particularly interested in your comments on Mexico's problems and prospects.

I gather that there are countries such as Brazil—well, you suggest that these countries can and even should continue to expand their debt to finance their growth.

What is the danger if they do expand their debt, because of the fact that they are so big, and because they are growing so fast, and because there is a limited amount of capital available, to all of these countries, that they will monopolize the available financing, particularly from private banks—which seems to me to be a different segment of the same problem—and thus leave the other LDC's in a bad position?

Mr. ECKAUS. I would like to be able to know enough to answer such an important question well. I think, however, that I must plead ignorance and suggest that I can comment on only certain aspects of it.

I think it is often very attractive for commercial banks to lend to the larger, more rapidly growing nations, and as a result, the dangers that you speak of, of a concentration of funds and lending in those directions, are real dangers. Yet, there is an offsetting effect as well to the extent that commercial lending is essentially project lending, project lending for purposes such as I mentioned in Mexico, the expansion of PEMEX's activities. So, to that extent there is a little danger, or less danger, that lending to large countries will forestall lending to other countries. Project lending in turn will result, within a relatively short time, in increased flows of funds. However, let me suggest that each country and the lending and borrowing by each country must be examined on a separate basis.

The recent problems of Mexico, and the borrowing that Mexico has engaged in recently, reflect different problems than are behind the borrowing which has been going forwad at a substantial rate by Brazil.

So that, again, I wish I could generalize more, but I feel unable to.

Representative LONG. But the fact that they are different types, and I well respect and understand that they are, really sort of begs the question, doesn't it? The fact that a limited amount of capital is available is the important point here, rather than the fact that there might be different types of loans being made.

Mr. ECKAUS. I think I am somewhat reluctant to accept the argument that the borrowing by Mexico and Brazil as examples will foreclose major additional borrowing from other countries.

I think that the short-term nature of such borrowing from commerical banks will mean that the loans from these countries will feed back into the financial markets at a substantial rate. If that lending in fact is justified by projects and growth in these countries, then within relatively short periods, that lending will in turn produce additional funds which can be reloaned.

Representative LONG. Let me ask Mr. McDonough a related question.

Mr. McDonough, the banks, whether in domestic finance or international finance, seem to me to follow the lead of the media.

If it is a news item to one network, it is an item to another. They call it the mass media.

My experience in banking, and as a corporation finance lawyer, before I came into Congress, led me to believe that if I could get credit from one bank I could pretty well get it from all of them. They tend to have the same trait, that while they have customers whom they generally service over a long period of time, in the international field, particularly, where a good many banks are dealing in unknowns more so than when they deal in domestic finance, they tend to follow fads. If Brazil becomes the fad, the attitude seems to be "Let's get in it and make a loan to Brazil," or, if Mexico becomes the fad, "Let's get into it and make a loan to Mexico."

As I suggested to Mr. Eckaus, this might result not only in nonavailability of credit to some other countries, but might also tend to make those countries that are the center of attention at the particular time go further, with respect to borrowing, than perhaps is the safe, prudent, and conservative financial thing for them to do at the time.

What is your comment about this, about how this works?

Mr. McDONOUGH. Well, sir, if I could refer to the last part of your question first, I do think that it is necessary for bankers, or for the private financial market participants in general, to make sure that they do not lend too much to a borrower, and therefore more than is in the borrower's best interests.

We must be extremely cautious, because we are using the funds of our depositors. Ours is a business which by definition should not be high risk. We should be cautious in making sure that the borrowing country in this case is following sufficiently prudent economic policies that we can be certain beyond reasonable doubt that the loan will be repaid.

Consequently, there is a tendency for the banks, especially the more sophisticated international banks, to be looking at the same creditworthiness criteria of individual countries.

So, if Brazil, let's say, at the moment is seen to be a particularly creditworthy country, it will be easier for Brazil to find banks which are willing to lend to it.

However, I think there is a limiting factor on this. Every banker, and certainly the head of every bank, must be very conscious of the spread of risks in his bank's own portfolio.

It would be extremely imprudent for him to allow his bank to have too much risk of any one type in the portfolio, and certainly that would be classically the case if there were too much lending to any one country.

Now, how much any one bank could lend would vary greatly with the size of the bank, of course, and I think would also vary greatly with its knowledge of the country with which it is dealing.

Representative LONG. Or at least how they perceive its credibility.

Mr. McDONOUGH. Yes, particularly with a country that is borrowing rather heavily and developing quickly, bankers must be cautious because the country can expand beyond the capability to support its debt, even when some of the individual borrowings might be used for a legitimate purpose, as has been given here as an example of development.

I think the country must be looked at as a whole, that the country's ability to support additional debt should be regarded carefully, the IMF and the various commercial banks dealing with this country should work together on requiring a certain set of economic policies which will enhance the ongoing creditworthiness of the country.

I mentioned that in my testimony. If this is done correctly, the IMF can back out of the situation.

Representative LONG. Mr. McDonough, is this basically what happened in Mexico last year when Mexico's borrowings had gone up at an alarming rate for a long period of time, or a substantial period of time? Then, when the devaluation came, and the flight of the capital out of Mexico came, the International Monetary Fund did have to step in at that time, as I recall it, and support some type of a stabilization program.

Mr. McDonough. Yes, sir. I believe it was clear in the course of 1976 that some adjustments must be made in the economic policy of the Government of Mexico.

Certainly, the present administration is very much aware of that, and has developed a program in cooperation with the International Monetary Fund.

I think that was necessary.

Representative Long. Mr. Kenen, does that in turn, though, really relate back to what you seem to me to be objecting to, of the bailing out of the bank?

Mr. Kenen. No, I don't think so, sir. Fund participation, on criteria that I would hope, like Professor Eckaus, would take account of long-run needs and development prospects, and not just the short-run banking condition of the country, would actually help the banks to stay in. It would not bail them out.

If the IMF says to a member country, "Your prospects look viable, and you qualify for drawing on the Fund; your economic and financial situation seems to us to be in good shape," the likelihood is that the banks will increase their commitments, whereas otherwise, the danger is that banks will try to cut back those commitments.

IMF participation does not constitute a bailout. It does provide reassurance, and this reassurance may be essential if the flow of credit to Mexico and Brazil, for example, is to continue.

Representative Long. Where would it reach the point you would express some concern?

Mr. Kenen. Only, sir, if the Fund and governments like the United States were to give in and to agree, directly or indirectly, to take over the bank's claims on these countries, and I don't see that coming. We are in no grave risk of underwriting with the taxpayers' dollars the mistakes that may have been made by some of our banks.

Representative Long. Mr. McDonough, I interrupted you in order to pursue this particular point. Do you have anything further to say on this?

Mr. McDonough. I would like to support Professor Kenen's view that the function of the IMF is not a bailout mechanism. In the private financial market, if the quality of the creditor is deteriorating, the ultimate tool is to withdraw credit.

In the Bretton Woods arrangements, it was decided that the international community really didn't want that to happen, and it set up a series of mechanisms, of which the IMF was one, that would allow the countries to go into a sort of rehabilitation center and to adjust their personal habits, if you will, in order to be able to go back into the private financial market, and become once again creditworthy.

Representative Long. You are putting them in the drunk tank?

Mr. McDonough. No, sir, I would think rehabilitation centers could include other problems.

Representative Long. Professor Eckaus, do you have any comment on this?

Mr. Eckaus. I would generalize the point that the activities of the internatinal official lending agencies and the activities of the private commercial banks are essentially complementary, not substitutable. The more the international institutions can expand their lending, then the more commercial bank lending we should expect to see.

Representative LONG. It encourages me that the three of you gentlemen are not more concerned about this than you are.

I really thought there was more concern in both the academic and in the commercial banking field than you have expressed.

Mr. Kenen.

Mr. KENEN. May I say, sir, that my concern is in a sense the opposite of the one you expressed in your question.

You asked if the Brazils and Mexicos of this world might crowd out other borrowers. My concern, as I put it in my prepared statement and in my summary this morning, is that the banks may now become too cautious in their lending to all developing countries, not because the supply of funds is limited, but because they feel overexposed and may not want to increase their lending on the scale that may be necessary to finance ongoing deficits.

Far from an orgy of lending ahead, I fear rather a stringency of lending that may place too large a burden on the official financial institutions.

Representative LONG. This resulted from at least a limited "lending orgy" in a few instances, perhaps Mexico being nearly an example of it. If it is not a situation where you have to throw them in the drunk tank, then you at least have to get them through some sort of a rehabilitation process. Perhaps the thing that adds stability to this, as it did in Mexico, is the support position by the International Monetary Fund. I think that would be what all three of you gentlemen would think would be a proper role for them to play: One to keep a "lending orgy" from existing; or second, the fear that Mr. Kenen has, to protect against the unavailability of adequate capital.

Mr. Eckaus.

Mr. ECKAUS. To some extent the rapid increase in lending by commercial banks to developing countries over the last few years is a reflection, on the one hand, of the liquidity of these institutions, and on the other hand the recession and the rather low demand for credit from the advanced countries.

If Professor Kenen's forecast is correct, and I think it is, that the advanced countries, of the Western Hemisphere and northern Europe are recovering, then we should expect to see an increased demand for credit from the commercial banks in these areas, and that may crowd out the credit availability to the less-developed countries.

Representative LONG. I well recognize that point, and I think it is a valuable point to make.

Mr. McDonough.

Mr. McDONOUGH. I wonder, Congressman, if I could make one brief comment.

I think earlier you suggested there had been a possibility of an orgy of lending in many countries. I don't think that is really the case.

I think that the international private capital market and particularly the commercial banks played an extremely vital role since the OPEC oil price increase, and during the 1974–75 recession, in fulfilling their functions.

This came to the attention of, especially, the media, and since it was a new phenomenon, since the numbers were rather large, people became alarmed about it.

I believe that rather than on the one hand having a situation in which one could say, "Well, everything is fine, don't worry about it," and on the other hand saying that chaos is about to take place, the truth is somewhere in the middle, as is frequently the case. What is really necessary is to look at the countries on an individual basis, and see which ones, based on reasonable criteria, are completely creditworthy and deserve the support of the private financial system, and those which need to have some adjustment to their financial system and their set of policies, because they have to adjust to the new realities of much higher energy prices.

Those countries, I think, need that combination of money and discipline that is provided by the International Monetary Fund and the continuing support it deserves from the private financial systems.

I would also like to say that the kind of hearings that you are conducting, which are, I hope, helpful to the Congress, but certainly educational to the American people, help to clarify this problem and hopefully remove some of the alarm from it. I think the recent scholarly remarks of the Chairman of the Federal Reserve Board of Governors will be very helpful.

Representative LONG [presiding]. Thank you.

Congressman Pike.

Representative PIKE. Thank you, Congressman Long.

Mr. McDonough, you mentioned the degree to which Saudi Arabia is already reinvesting their funds and seeking to expand their own economies, and I agree with you, and this gets me to something that Professor Kenen addressed, and I would like you to discuss the question—I would like all of you to discuss the question—of what benefit does Saudi Arabia get from keeping the price of their oil low, and what benefit do they get from continually increasing their production?

It is my own sort of gut feeling that if I were in charge of the things in Saudi Arabia, I would tend to freeze production right now, and would tend to go on with the increased prices that Iran is after, or go along with them, and I wonder why they don't, and I wonder what would happen if they did, both to the balance-of-payments problem of all the importing countries and to the stability and to the ability of the IMF to maintain that stability?

Mr. McDONOUGH. May I begin to answer?

Representative PIKE. Go ahead.

Mr. McDONOUGH. I believe that, based on statements made both publicly and privately by Saudi officials, the motivation they have for keeping prices lower than some other members of OPEC would like them to be—and of continuing to increase production as the tool that the law of supply and demand says they have to use in order to make their policy effective—is that they are trying to be a responsible member of the world community.

They believe that the oil price increase and the world recession which followed it created some rather serious problems in certain countries, including the democratically oriented countries of the Mediterranean, and that it is very important for the health of the world economy that this strain, or these strains, not be made greater or even continued.

Now, why would they want to do that? There must be some value judgments that they are making, if I am reading their motivation correctly, and I believe that their most essential value judgment is that, although they are still a kingdom themselves, they essentially believe in the value judgments that one finds in the United States and in Western Europe, and they are very particularly opposed to the atheistic value judgments made in the Soviet Union and the Communist countries.

I recognize that that points a rather glowing picture of their motivation, but I think in fact that that is what motivates them.

Mr. KENEN. I would be the wrong one, sir, to speak for Sheik Yamani. But I am not prepared to take him entirely at his word, and I am a bit skeptical of the reasons which Savdi Arabia has given for trying to keep the price from rising more rapidly.

I think we should say for the record, sir, that they have not tried to keep the price low. They have merely tried to resist a more rapid increase in a price that is already high.

Representative PIKE. There isn't any question in your mind, though, that they could have made it a lot higher?

Mr. KENEN. Yes, they could have concurred in the opinion of Iran that the price should go up by 10 or 15 percent.

Representative PIKE. And it would have.

Mr. KENEN. I quite agree.

It is true that the Saudis are concerned about the health of the world economy, partly because they are claimants on that economy. The funds they have invested with us are in a sense hostages. The health of the world economy is required to secure those funds.

But there are other reasons for their policies. First a more rapid rise in the price of oil would foster more intensive conservation measures in the consuming countries.

At some price, indeed, oil in the ground would cease to be worth more than money in the bank, for we would have learned to do without it. They are aware of that.

Second, they have motives, that are frankly political and far from altruistic. Iran is no longer running a large surplus in its balance of payments. It is using all of its oil revenues. The only way in which Iran can increase its revenues is by raising the price of oil. But a further increase of Iranian revenues, a faster development of the Iranian economy, and more importantly, a faster accumulation of weapons by Iran, are things that make the Saudis uneasy.

Iran is their political and economic rival in the Persian Gulf, and they do not wish to see Iran's power to increase further. Thus, one of their main motives in opting for a slower increase in the price of oil is to put Iran on a short tether.

Up to now, moreover, Saudi Arabia has been the swingman in OPEC. When world demand was low, as it was during our recession, Saudi production fell sharply, while some other OPEC countries shaved prices to keep sales high. The Saudis have indicated they are not prepared to play that role indefinitely.

They are particularly concerned that their share of the market should not erode indefinitely, and they do not want other members of OPEC to gain at their expense. I believe, sir, that this is a major motive in their decision to increase their producing capacity and their sales, and to keep the price of oil from rising rapidly.

It is in their own economic interest as a potential political competitor of other oil producing countries in the Middle East. This interest probably bulks larger in their thinking than any quasi-altruistic concern about the stability of the international economic system. But it may be, sir, that I am in a somewhat cynical mood this morning.

Mr. Eckaus. Let me again agree with Professor Kenen, as I find myself doing this morning, and add two more points.

Again, on the political side, I think that what was said by Saudi Arabia, in somewhat elliptical language, should be taken seriously. They expect a quid pro quo for their restraint with respect to oil price increases.

Part of the quid pro quo which they expect is, I think, fairly explicitly stated. They expect pressure from the United States on Israel for a Middle Eastern settlement which is more acceptable to the Arab nations. That is another illustration of the point I made previously, that in the OPEC nations there is an inextricable inter-relationship of economic and political policy.

Turning from this observation about the politics of the situation to the economics, I think we should also observe that the differences in the oil reserves make the position of Iran and Saudi Arabia quite different with respect to oil prices. Iran must expect to be out of the oil producing business on a large scale within, say, 15 or 20 years. Saudi Arabia is going to be in that business for a much longer time into the future.

Saudi Arabian interest, then, and I cannot say that this reasoning is exactly the way they think of it, but I would expect that they think in long-term terms, is in forestalling actual or potential competition for their oil.

Part of the competition would come from conservation within the United States, and part would come from other oil sources in other countries.

By keeping the oil price low, they are helping to forestall the more rapid development of that competition. It makes a great deal of economic sense for them, in this case, to act as if they were in possession of some degree of monopoly power, and to keep prices down to keep out the competitors.

Representative Pike. You have all given various responses. My own feeling is that I tend to go a little bit with Mr. McDonough on this, and I don't see the long-term benefit to Saudi Arabia in keeping the price down and increasing the production, no matter what happens to the price.

Iran is going to be out of the business, and they will be out of the business faster if the price goes up, will they not?

No?

Mr. Eckaus. I think that the interest of the Iranians is in maximizing their wealth within the next few years.

Representative Pike. I agree. Let's get to the other half of the question.

Let us assume that the Saudis did freeze their production, and did go along with the increase in price. What would that do to the whole balance-of-payments structure that we are talking about, and the needs of the IMF?

Doesn't it create a rather whole new ball game?

Mr. McDONOUGH. If I may suggest an answer, Congressman Pike, I think it is a rather similar ball game to what we have now, but a tougher one.

I believe that any real increase in the price of oil would be most unfortunate for the world economy, that essentially it would demand that countries already having to make rather serious adjustments to their standard of living over a period of time would have to do so to an even greater degree.

That would have a tendency to test the stability of those countries.

In the United States, none of us really likes to think that we might have to pay more for gasoline and have to reduce our ability to buy other things as a result; in other countries, people are very reluctant to make the sacrifices necessary.

One of the unfortunate things that that tends to do is test democratic principles. That is an unfortunate thing.

Representative PIKE. Not only institutions, but courage. [Laughter.]

Mr. KENEN. Could I perhaps carry that a little further?

Let us suppose for just a moment that the price of oil went to $15 or $16, exaggerating to make their point.

Suppose it did so immediately, and that Saudi Arabia did not allow its sales to fall much. In effect, I assume that recovery would continue in the developed world, causing the world to absorb almost as much oil as it does now. There would not be a sharp decline in demand immediately.

In sense we would then be in the worst of all situations. The Saudis' surplus would be larger, because they would be selling as much oil, and getting more for it, so that the deflationary effects of the low-absorbers' surplus would be larger than they are now.

At the same time, the world would be forced to give up more goods and services to countries like Iran, instead of paying for oil on credit, which is what we are doing now.

Finally, the goods and services would be sold mainly by developed countries like the United States, Japan, and Germany, those that supply capital goods and, unhappily, armaments of the sort that Iran would purchase with its increased revenues. Therefore, there would be little assistance to the weaker countries.

In brief, we would have a financial imbalance as large as we have now, coupled with the need to yield up additional goods for oil.

Mr. McDONOUGH. The people of the United States, if they conserve energy, would keep this from taking place. That is the only way to make sure that the crisis that you are speaking about will not happen.

Representative PIKE. I hope you were the chairman of the Bankers-for-Carter hearing in the last campaign. [Laughter.]

Representative LONG. Go ahead.

Mr. ECKAUS. I will comment only briefly.

Again, with respect to Professor Kenen's remarks, any increase in oil prices will result in a real transfer of wealth from the United States and other countries to the OPEC countries, and would have further deflationary effects.

I would find it hard to agree with Mr. McDonough that any likely and probable conservation efforts in the near future will do much to forestall an oil price increase.

Representative PIKE. I happen to agree with you on that last one, just because I don't think it can happen that fast, but that is why I am obliged to agree with Mr. McDonough that the thing the Saudi Arabians have been just a little bit—well, not a little bit but very altruistic in their statements, because what you and Professor Kenen both seem to envision as the result of these activities is certainly to our detriment, but I can't see it being anything but to their advantage.

Mr. ECKAUS. If I may respond, sir, it is, I think, a situation in which the interests of the Saudi Arabians rather narrowly defined are consistent with our interests, rather narrowly defned. While I am reluctant not to recognize altruism, and there may well be such altruism on their part, I don't think we need to resort to altruism to explain their actions.

Representative LONG. Thank you, Mr. Eckaus.

Mr. McDonough, if I may ask you a question, and then perhaps the members of the panel would expand on it.

Professor Eckaus suggests that the World Bank is perhaps a more appropriate institution than the IMF is to extend the medium- and long-term balance-of-payments type of financing to the developing countries.

Your reasoning, as I understand it, is that the bank seems to appreciate the needs and the objectives of these countries better than the Fund does.

By contrast, Professor Kenen argues that the operating guidelines that the Fund has established and used over a period of time might be altered to enable that institution to provide this longer term balance-of-payment financing, and otherwise the high credit ratings of the bonds of the World Bank might be, at least to some degree, compromised.

What is your opinion on this question, Mr. McDonough, from the commercial bankers point of view?

Mr. McDONOUGH. I think it is a question of a team approach. As I see it, the financing needs of the developing countries especially fall into a variety of categories.

There are some projects which are absolutely necessary for the ongoing and improving economic viability of those countries, especially in the areas of education and agriculture, which have very slow payouts.

They must take place over a long period of time, and I think that the World Bank does a superb job of making those kinds of loans. Its financial structure lends itself to that kind of lending.

Looking at it as a financial institution, one side of the balance sheet reflects well on the other.

In the case of the International Monetary Fund, it is going through a period of adjustment. For example, the present managing director and his very able staff are trying to move in the direction of longer standby periods, standby being the usual vehicle that they use in helping the country through an adjustment period.

Traditionally, those standbys are for 1 year. I think under the present circumstances that usually isn't long enough, and I understand the IMF staff would like to develop 2- or 3-year standbys.

If one takes a longer period, then one can recognize that an adjustment process in the economic policy mix of the country in a macroeconomic sense, cannot all be done in 6, 9, or 12 months. The Fund, with this slightly modified approach, is still the best vehicle to handle these particular problems, if only because its staff is the most expert in that area. If you diverted that job to the World Bank, what would happen is that a lot of folks would change their sweatshirts from an IMF shirt to a World Bank shirt.

Essentially this is because it is highly expert people who are able to put these programs together.

Then the private financial markets play their role. As the countries are creditworthy, and hopefully the more creditworthy they are, the greater the depth of the private market will be. They go into the commercial banks, for financing for projects with a shorter payout.

So, the present system has the various institutions and market participants well placed.

I don't see any need for a structural change.

Representative LONG. They correlate fairly well?

Mr. McDONOUGH. Yes, I think so.

Representative LONG. Mr. Kenen, do you have any comment?

Mr. KENEN. There are two issues here, one of which was raised by Professor Eckaus, and this time it is my turn to agree with him.

He expressed great confidence in the ability of the World Bank to make judgments about the appropriateness of the policies of developing countries, and while I am not quite as critical of the Fund staff as he is, I think he makes an important point. The criteria and expertise which we associate with the World Bank ought to be brought into play in judging the soundness of developing countries when they come in to borrow, whether from the Bank or from the Fund.

There is, next, the point made by Mr. McDonough, that we have to keep these institutions quite distinct, and there are reasons additional to those he has mentioned.

When you look at World Bank lending, you find something interesting. There is always a huge backlog of undisbursed loans on the books of the Bank, which the developing countries have not yet drawn down. This is because the Bank's lending is tied to projects that have very long construction periods, and countries draw down the loans as the projects are completed, just as one makes progress payments for work on a dam or any large project.

Long lags in disbursements are built into the way that the Bank operates, and its loans cannot offer immediate help to countries with balance-of-payments problems.

It is, of course, quite true that larger World Bank lending reduce the need for balance-of-payments financing. There would be less need for other kinds of funding.

There is one other difficulty that does perhaps deserve emphasis. Over the years, the Bank has succeeded in maintaining a relatively nonpolitical posture. Within the Bank, however, political judgments must figure in decisions. The Bank's management would have a great deal of difficulty with its membership if it had to devote a disproportionate share of its lendable resources to financing handful of large countries like Mexico, Brazil, Greece, Turkey, and so forth. The Bank has to spread its money around.

There are far clearer criteria for the allocation of IMF money within limits set by quotas, and the IMF may have more flexibility in coming to the aid of countries affected by balance-of-payments problems than the World Bank would have.

But I do agree with Mr. McDonough that, over the course of a quarter century, the Bank has done a remarkable job in projecting the image of an institution with a clear mission. In my own statement, sir, I emphasized the importance of preserving that image.

I would rather see the Fund go somewhat longer in its lending for balance-of-payments purposes, and I hope that we will put in place new devices such as the financial support funds and a new program of bilateral and multilateral lending to southern Europe that would reduce the demends on the Bank and the Fund and would spare us the need to blur their missions further.

Representative LONG. Professor Eckaus.

Mr. ECKAUS. I think on this occasion I must disagree slightly with both my colleagues here today, but agree in part, also.

It does not surprise me that Mr. McDonough should find the activity of the fund suitable and appropriate from his point of view. Commercial bankers deal with short-term loans and are essentially in the short market. That is where the IMF operates as well. The IMF, from the standpoint of commercial bankers is just kind of short-term credit validating institution that they want.

However, my point was that the problems of the weak industrial nations, and more advanced developing nations, are not short-term problems. They are problems of long-term growth and development and for those problems a different kind of credit is necessary.

Now, I do not want to be interpreted as an advocate of the IBRD in this respect. Perhaps, again, the most appropriate way to meet the problems of providing credit for the weak industrial nations and the more advanced developing nations is a new facility in the IMF. However, I would emphasize that by no means all of the IBRD loans are project loans. The IBRD has been consistently in the business of making program loans, loans for essentially balance-of-payments support, and they have in the past shown themselves to be able to move rather quickly on loans of this type, but on the basis of careful and long-term considerations.

For example, about a year ago, the IBRD made a substantial loan to Egypt which was essentially for the financing of increased imports to make it possible for Egypt to utilize unused productive capacity. That was essentially balance-of-payments support financing, and they moved very quickly on that. But they did it on the basis of surveys of the needs of Egypt, within particular industrial sectors.

I would suggest that the IMF, to my knowledge, has never made that kind of loan. Its expertise, its recommendations, have always been based, to my knowledge, on short-term macroeconomic considerations.

I agree with Professor Kenen that it would be difficult for the IBRD to get into the business, with the existing financing it has, of making large balance-of-payment loans to particular countries. They could do that only if, essentially, they had additional funds.

I don't mean to be an advocate of the IBRD in this respect. Rather, I want to be an advocate for the need for an alternative approach. in the Bank, or in the Fund, or some other institution which will explicitly take into account the long-term problems which underlie the balance-of-payments difficulties of many nations today.

Representative LONG. Congressman Pike, do you have anything else?

Representative PIKE. Yes.

Professor Kenen, Business Week of March 21 quotes you as having said that you sense an ingrained reluctance at this point on the part of the European and Japanese Governments to use trade policy to spur economic recovery.

What do you think trade policy should be doing, or how do you think trade policy should be used by these countries at this time to spur their own recovery?

Mr. KENEN. The difficulty, sir, of speaking with a very competent reporter very late in the day—on a long-distance telephone at that—is that one——

Representative PIKE. It is always allowable in the Halls of Congress to say, "I was misquoted."

Mr. KENEN. It is never allowable, sir, for a professor to say something as brief as that.

I wasn't misquoted. I was quoted out of context. I said that countries had not manipulated trade barriers, but I was expressing my relief.

I am sorry about the manner which some have used exchange-rate policy. In that interview, however, I was praising countries for displaying apprehensions about engaging in trade warfare as a device for stimulating their own economies.

Representative PIKE. I looked at your statement. You say that Bonn and Tokyo have been too cautious in fostering domestic recovery.

Since we have now dropped the $50 rebate proposal, and since it has been reported in the press that we are apparently quietly shelving our proposals for joint stimulation of the world's economy, would you add Washington to Bonn and Tokyo?

Mr. KENEN. To be quite frank, sir, I am not sufficiently acquainted with the projections for this year to decide whether we still need fiscal stimulus additional to what remains in the President's package.

I suppose it is quite possible for a professor to claim incompetence, and that is what I have to do.

Representative PIKE. On that very high note, and I do consider that one, I have no further questions.

Representative LONG. Thank you, gentlemen.

We appreciate your coming and all the work that went into the preparation of your statements and the very meaningful contribution you have made to this series of hearings.

This meeting stands recessed until tomorrow morning.

[Whereupon, at 12 noon, the committee recessed, to reconvene at 10 a.m., Friday, April 22, 1977.]

ISSUES AT THE SUMMIT

FRIDAY, APRIL 22, 1977

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 1202, Dirksen Senate Office Building, Hon. Gillis W. Long (member of the committee) presiding.

Present: Representatives Bolling, Reuss, and Long; and Senator Hatch.

Also present: John R. Stark, executive director; Louis C. Krauthoff II, assistant director; Richard F. Kaufman, general counsel; William R. Buechner, G. Thomas Cator, William A. Cox, Kent H. Hughes, Sarah Jackson, John R. Karlik, L. Douglas Lee, and Katie MacArthur, professional staff members; Charles H. Bradford, Stephen J. Entin, George D. Krumbhaar, Jr., M. Catherine Miller, and Mark R. Policinski, minority professional staff members; and Mark Borchelt, administrative assistant.

OPENING STATEMENT OF REPRESENTATIVE LONG

Representative LONG. Today's hearing is the third in a series conducted by the Joint Economic Committee concerning policy issues that will be discussed at a meeting next month of the leaders of industrialized nations.

Today's hearing will focus on issues that are part of what is commonly called the "North-South Dialogue"; that is, on that complex set of economic relationships between industrialized countries and developing countries.

These issues are being raised now, even though the developing countries will not be participants at the forthcoming summit meeting, because proposals will certainly be suggested at the summit which will directly affect the LDC's, and because many of the most difficult international economic problems directly involve the developing countries. It is clear that a broad range of issues remain to be resolved between the industrialized countries, the OPEC countries, and the nonoil exporting LDC's; the Summit meeting will provide an appropriate forum in which to hammer out an agreed upon set of views, so that perhaps we can begin to make some real progress when the North-South discussions resume.

I trust that we are all aware of our mutual economic interdependence in this increasingly complex world: the domestic vitality of most nations depends to a large extent upon a prosperous international economy. Obviously, then, the problems faced by the LDC's are neither exclusive to them nor unique; what happens in Gabon and Ghana, moreover, has an impact in Newark and New Orleans.

In a general sort of a way, I think most of us appreciate the nature of the economic difficulties faced by the LDC's. Many of these countries made substantial progress during the 1960's and early 1970's, but rising prices in food, rising prices in fertilizer, and especially rising prices in petroleum products, have recently combined with reduced demand brought on by the world recession to produce a severe economic strain on many of those oil importing developing countries.

As their economies tended to falter, many of these countries increased their debt burden in order to sustain development and to service their balance-of-payments deficits.

As our witnesses testified yesterday—and we had some excellent witnesses yesterday—some of these countries are now in danger of exhausting their credit for commercial bank loans.

Deficits, of course, are adequately described as mirror images of surpluses that exist elsewhere in the international economic order. Because of the continuing need for petroleum products, we can be confident that the OPEC nations, certainly for the foreseeable future, will continue to amass sizable surpluses. The question that remains to be resolved, though, is how the resulting deficits will be shared and divided among the industrialized and the developing countries.

An attempt to cope with trade deficits can produce a variety of alternatives, and it is altogether possible that some nations may attempt to solve their deficits in ways that are harmful rather than helpful to the international economy.

Our task, in my judgment, is to suggest and to explore better options that might be available, and to attempt to offer more substantial solutions.

Apart from seeking to build a prosperous international economy, the North-South Dialog concerns additional issues that have been on the international agenda for a number of years. Many of these issues center on the requests by the LDC's for changes that benefit them directly, such as increases in existing aid programs, and in financial flows. Among these subjects are proposals for uniform commodity stabilization programs, complete with buffer stocks, and a broad-gage transfer of technology from the industrialized countries to the developing world.

I have just returned from a meeting of the Interparliamentary Union in Canberra, Australia, at which 61 nations were represened, and the degree to which the developing countries aggressively want to explore the problem of technology transfer was something that I had not correctly gaged before I attended that meeting.

They are really very interested in this subject, more so than I had thought. But, it seems to me that too often these requests involve unilateral action. That is, a one-sided sacrifice designed to benefit just one side to the detriment of the other. Perhaps a case can be made in equity for such resource transfers, but I think that, realistically, we have to look at it in a different way. All of us operate in a political spectrum, as well as in an economic order, and such requests for unilateral policy alterations can result in substantial opposition from the developed nations.

Any meaningful solution to these problems, in short, must be conducted with mutual respect, and must work to the mutual advantage of all of the parties concerned.

A more realistic program, in my opinion, would seek solutions that would benefit both sides. I do not suggest that a quid pro quo is necessary, but I do suggest that the LDC's, as well as the developed States, must recognize the policy constraints that inevitably arise.

Our witnesses today bring a broad range of experiences to bear on this complex set of questions that we hope to address.

Mr. Ramphal, the head of the Commonwealth Secretariat in London, is a former foreign minister to Guyana.

Mr. Lewis, who is the professor of economics and interational affairs at Princeton, was previously the director of the U.S. Aid Mission in India. He is also a member of the United Nations Committee of Experts on Development.

Anne Krueger, we are particularly pleased to have with you with us. Ms. Krueger is a professor of economics at the University of Minnesota and specializes in trade policy questions, particularly as they relate to development in developing countries.

Finally, Mr. Lawrence Krause is a senior fellow at the Brookings Institution, and has been studying international problems for a number of years.

As I mentioned, the meeting of the Interparliamentary Union in Canberra was extremely interesting. Various committees were formed, and I had the pleasure of serving on a committee on economic and social affairs. Also serving on that committee was our distinguished colleague, Congressman Claude Pepper, who is also a former U.S. Senator from Florida. Congressman Pepper presented a statement to the conference of the Interparliamentary Union, and since it relates to the activities of this committee, I would like at this time to make that statement a part of these proceedings and a part of the record at this point.

[The statement follows:]

STATEMENT OF HON. CLAUDE PEPPER, A U.S. REPRESENTATIVE IN CONGRESS FROM THE 14TH CONGRESSIONAL DISTRICT OF THE STATE OF FLORIDA, AT THE 64TH INTERPARLIAMENTARY UNION CONFERENCE, CANBERRA, AUSTRALIA

Subject: The contribution of the developed countries to the establishment of mechanisms of cooperation among the developing countries.

The United States delegation is pleased to join in discussing the highly important topic of cooperation among developing countries and wishes to treat both its major components, namely, economic cooperation and technical cooperation. The general concept, of course, has a long history and is firmly based in the current Decade of Development, under which the United States and other developed countries agreed (in paragraph 40 of the International Development Strategy) to support regional cooperation among developing countries through financial and technical assistance as well as commercial policy.

Subsequent resolutions of various international forums have sought to assure concrete application of this principle. Within the last year alone it may be recalled that UNCTAD IV combined a number of specific proposals into that conference's Resolution 92 on economic cooperation among developing countries, and the subsequent meeting of the Trade and Development Board in October went on to establish a special committee for further consideration of the matter.

The 31st General Assembly also adopted a resolution on December 13, 1976, reviewing past action in this field and welcoming formation of the special committee. The United States intends to cooperate fully in the work of that body when it meets in Geneva next month (May 2–6).

Reference to previous resolutions, however, should not be interpreted as meaning unqualified U.S. support for all of the many detailed recommendations which have been made in this field. In this respect even the stated topic of "establishment of the mechanisms of cooperation" may be misleading, for this conference (and other for considering this issue) should examine the more effective use of existing mechanisms as well as creation of new ones. In addition, consideration of the "contribution of the developed countries" should not obscure the fact that cooperation among the developing countries must originate with them and that support from others can prove effective only to the degree that a program is well conceived and fully agreed among the nations immediately involved.

With these qualifications it should be emphasized that the U.S. Government already extends extensive support to regional cooperation and economic integration in two forms, (1) direct bilateral technical and capital assistance to regional projects and/or institutions, and (2) support of regional financial institutions which in turn fund integration projects or activities (e.g., the IDB, ADB, etc.). The United Nations regional economic commissions, particularly those for Latin America (ECLA), for Asia and the Pacific (ESCAP), for Africa (ECA), and for Western Asia (ECWA), have been active for many years in the promotion of economic cooperation among the developing nations. The United States is a charter member of both ECLA and ASCAP and hence has been actively involved in these efforts for almost 20 years. It participates also in ECA and ECWA in an observer capacity.

An important new concept in the field of cooperation among developing countries is that of technical cooperation. While this idea in various guises has been practiced for a long time, the concept is being given new emphasis as the needs of the developing world grow, the resources of the industrialized nations become limited and the capabilities of some advanced LDC's improve.

Technical cooperation among developing countries or "TCDS", as this approach is labeled, is seen as an additional means of mobilizing untapped and appropriate resources and capabilities—those within developing countries themselves—for the benefit of the Third World in general. Rather than a separate program, it is to be viewed as a dynamic process of development through mutual sharing which should permeate all multilateral activity, especially as carried out in the United Nations system. This recourse to indigenous skills and production should at one and the same time enlarge the world reservoir of resources for development assistance, refine and expand the human and material resources within the developing world and encourage that self-reliance which promotes independence and human dignity.

The principal catalytic element in the realization of TCDC is the United Nations Development Program. Acting upon resolutions passed in the UN General Assembly and by its Governing Council, UNDP has cosponsored meetings on TCDC in each of the four regional economic commissions and has developed an information referral system as a catalogue of skills and products available in the developing world. A year from now, UNDP will co-sponsor with the United Nations a world conference on technical cooperation among developing countries.

The United States has been involved with development of the concept of TCDC from its inception. It was largely at our urging that the Information Referral System was set up. We have participated actively in each of the regional meetings on TCDC and are assuming an appropriate role in the preparations for the world conference. In short, the United States is committed to this additional means of involving the developing countries in all aspects of developmental assistance.

In forthcoming meetings of UN organizations as well as in the present conference the U.S. representatives will be ready to review existing mechanisms of cooperation and to explore new means of assisting the developing nations in their mutual efforts to achieve progress. We look forward to useful discussions on practical issues and to the formulation of rational programs of action through which the concepts of economic and technical cooperation can contribute to enlarging and improving delivery of development aid in the Third World.

We in the United States know that the Cooperation which shall exist in the future between the developed and the developing nations will affect the health and happiness of a large part of the human race found in the developing nations and will not only give a deep and justified sense of satisfaction and Justice to

the developed Countries but in the long run will make them stronger and more secure as well. Hence the United States is pleased to continue to cooperate in such a program.

Representative LONG. I would like to ask you, Mr. Ramphal, if you will, sir, to lead off for us this morning, to be followed by the others in the order in which you are sitting.

Perhaps, Mr. Krause, you could go before Ms. Krueger. If each witness could limit his or her oral statement to 10 or 12 minutes, by summarizing your prepared statement, it would be helpful.

We will, of course, make your prepared statement a part of the record. You have all gone to a great deal of trouble and performed a great deal of work in preparing your testimony, and I assure you that it will be studied by the staff and by the members of the committee.

If you will restrict your statements to 10 to 12 minutes, I think that everybody's time here today can be better used by having an exchange of views and by having an opportunity for questioning following the presentations.

OPENING STATEMENT OF SENATOR HATCH

Senator HATCH. I want to make my statement here.

A person does not have to be very long in Washington before he ceases to be surprised at the way crises, causes, and arguments are invented and used by special interests.

I am surprised, however, to see self-serving designs that harm the interests of the schemers.

The scheme to establish price supports for the Third World commodities will cause a wasteful misallocation of their scarce resources into the overproduction of the price supported commodities at the expense of their economic development.

The scheme to reflate the domestic economies of the United States, Germany, and Japan will turn these net suppliers of international loans into net borrowers of international loans.

To dump the United States, Germany, and Japan into the already crowded international market for loans will only make the financial situation of Third World, large debtor countries more difficult.

Already Italy and Britain have trade deficits, and to cover them they have to compete against Third World countries for international loans.

If we pressure Germany and Japan out of their trade surpluses and into trade deficits, they also will have to compete against Third World countries for international loans.

Every country cannot be a debtor country. The economically underdeveloped Third World countries need to be debtor countries, because they need to import investment. Therefore, some countries elsewhere must have trade surpluses in order to be able to supply loans.

Germany and Japan cannot simultaneously have trade deficits and supply loans except by transferring their foreign exchange holdings as gifts to the Third World.

This would require flexible exchange rates to be abandoned and the German and Japanese central banks to peg the foreign exchange rates of the mark and the yen.

Otherwise, there would be an excess supply of these currencies in the world market that would force down the exchange values of the mark and yen, thereby increasing German and Japanese exports and eliminating their trade deficits.

If the Third World and their allies want grants, why not ask for them outright instead of concocting inefficient schemes that will reduce their economic development prospects?

Congressman Long, the so-called North-South dialog is nothing but an assault on the United States and other industrialized countries by lands whose economic opportunities are largely foreclosed by the nature of their political and social systems and by the absence of extensive and secure private rights to property.

Since none of the prepared statements in these 3 days of hearings have mentioned the real nature of the confrontation that is underway, and since few representatives of the American people other than Senator Moynihan are even aware of the confrontation, I would like to have printed in the hearings an article by one of the leading economists and thinkers of our time, Mr. Karl Brunner, professor of economics at the University of Rochester and, also, at Bern University in Switzerland.

The article is titled "The New International Economic Order: A Chapter in a Protracted Confrontation," and it is from the spring 1976 issue of Orbis, a journal of world affairs.

I ask unanimous consent that this be printed in the record.

Representative LONG. Without objection, so ordered.

[The article follows:]

THE NEW INTERNATIONAL ECONOMIC ORDER: A CHAPTER IN A PROTRACTED CONFRONTATION

by Karl Brunner

For a century Marxian literature predicted the collapse of capitalism. It outlined the process ultimately destroying a social system organized by markets and based on "private property in the means of production." But most propositions made by Marxian writers that permitted some assessment were falsified by events. They were of course suitably reinterpreted *ex post facto* in order to save the language required for the "revolutionary purpose." Among the adjustments appeared a new recognition of the role of the intelligentsia and the instrumental use of mass education facilities. The attention of the "socialist struggle for human liberation and the termination of pre-history" gradually moved beyond the "industrial proletariat." Political conception addressed and incorporated other social institutions or groups.

The crucial function of intellectuals in the erosion of capitalism was fully understood by Joseph Schumpeter. The doctrine of the "march through the intellectual institutions" emerged in Germany almost two decades after Schumpeter's prophetic analysis. His account of the role played by "professional articulators" in the evolution destroying capitalism still offers remarkable insights and many stimulating suggestions for contemporary readers. The intelligentsia's role also explains another phenomenon that cannot be subsumed under the standard Marxian scheme. The socialist assault on capitalism, apart from the entrenched and well observed aggressive hostility of the communist bloc, is spearheaded in recent years by the Third World. We owe some recognition of this circumstance to Daniel P. Moynihan's searching examination in a widely and properly acclaimed article.[1]

The exposure of intellectual elites in the Third World to the influence of Western intellectual traditions expanded the range

[1] See "The United States in Opposition," *Commentary*, March 1975.

Karl Brunner is Professor of Economics at the University of Rochester, New York, and at Bern University, Switzerland. Among his publications is *A Selected Survey of Monetary Theory* (Stampsli, 1971).

of the "Schumpeterian process" over noncommunist regions outside the established industrial nations. The socialist rhetoric cultivated by representatives of many "new countries" can hardly be missed. Socialist conceptions, moreover, are unmistakably revealed by the trend in economic policy and the prevalent forms of economic organization. This evolution may have affected the position of the United States in some respects. For many years the world's intelligentsia has nurtured an anti-American attitude and expressed political sympathies adverse to our long-run interests. As the leading capitalist country, the United States is a major affront, or possibly obstruction, to socialist aspirations. Still, without the vast institutional apparatus offered by the United Nations Organization the evolution sketched above would probably have minor significance for the United States. The infiltration of this apparatus and its exploitation give leverage to the power of the socialist onslaught. The United States thus faces a serious and protracted conflict bearing on the fundamental issues of a society.

The evolution of the United Nations Organization offers a good example of the "institutional weapon." Institutions, once created according to some well-meaning intentions, determine incentives guiding their use and development in very different and unanticipated directions. Over the past fifteen years the UN has increasingly suggested or approved ideas involving coercive transfers of wealth from the "developed" to the "developing" countries. This bias confronts the United States increasingly with a fundamental conflict concerning the future of American society. The institutional facilities of the UN are systematically used to launch persistent and wide-ranging assaults on the "injustice and oppressiveness" of U.S. capitalism which contrasts so sharply, it appears, with the glowing "justice and liberation" achieved in "socialist countries."

One wonders whether the media and our representatives understand the seriousness of the challenge. The traditional bureaucracies or diplomats in the State Department seem either unwilling or unable to cope with the situation. Any forceful attention to the challenge violates the traditional pattern of diplomatic procedures, and this may explain the blandly uncertain stance cultivated on many occasions by U.S. representatives.[2] Such uncertainty

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[2] The report published by the correspondent of the *Neue Zürcher Zeitung* in August 1975 on the occasion of the UN-Conference on Crime Prevention held in Geneva is most revealing in this respect. It summarizes the onslaught on Western countries and the United States in particular and notes the silence among Western representatives,

may also be conditioned to some extent by institutional incentives that determine an overlapping range of interests for national and international bureaucracies and operate to weaken the attention devoted by some national bureaucracies to *national* interests. It also explains the reaction of bureaucracies and old-line European diplomats to the major exception in our government. Moynihan apparently understood the nature of the challenge and the prospects of the confrontation. Substantially more than bland acceptance of a socialist rhetoric condemning our society is involved in this failure of U.S. administrations and representatives. The rhetoric accompanies persistent attempts to expand the institutional apparatus of international organizations. Moreover, such expansion would gradually impose, at least in explicit intention, increasing constraints on our domestic arrangement. The "march through the international institutions" thus becomes one of the means to eventually overcome U.S. capitalism and to transform American society to the levels of "justice, equality and liberty" to be achieved according to the socialist theories guiding many representatives of the Third World. Even if the rhetoric were just an instrument encouraging the U.S. intelligentsia's supply of guilt feelings designed to foster transfers of wealth, such transfers require institutional arrangements modifying the longer-run nature of our society.

II

The general pattern governing UN institutions may be exemplified by two resolutions adopted by the General Assembly on May 9 and 16, 1974. On May 9 the Assembly adopted the "Declaration on the Establishment of a New International Economic Order" designed "to eliminate the widening gap between developed and developing countries." The declaration recognizes that "remaining vestiges of . . . colonial domination . . . and neocolonialism in all its forms" are among the "greatest obstacles ot the full emancipation and progress of the developing countries." It also asserts that an "even and balanced development" was impossible to achieve "under the existing international economic order," and emphasizes that the inherited economic order "is in direct conflict with current developments in political relations." It is thus postulated that developing countries participate actively, fully and equally "in the formulation and application of all decisions that concern the international

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stating specifically that they refused to respond to the barrage in order "to avoid polemics." This attitude reveals a serious failure to comprehend the new international reality, or a serious misjudgment concerning our strategy to meet these onslaughts.

community." And so we read that "international cooperation for development is the shared goal and common duty of all countries." The "broadest cooperation of all States, . . . whereby the prevailing disparities in the world may be banished," should be respected; and likewise, "full permanent sovereignty of every State over its natural resources and all economic activities."

A week later the General Assembly of the UN launched itself on a supplementary resolution introduced as a "Programme of Action on the Establishment of a New International Economic Order." Colonialism and neo-colonialism are again properly exorcised and condemned. The actions proposed are subdivided into ranges covering trade and raw materials, transportation, the international monetary system, regulation of multinational corporations, and an array of means strengthening the UN system in the field of international economic cooperation. The provisions under the first item should assure larger real revenues from exports, more aid and financial contributions in one form or another. Transportation costs should be lowered (somehow), at least for the developing countries. In the range of international monetary problems, developing countries wish to be "fully involved as equal partners" in all decision-making. Return to a system of fixed exchange rates is mentioned with some emphasis. This proposal requires supplementary attention to the provision of international liquidity that would be linked to financial grants offered to developing countries. The "link" is thus naturally tied to the restoration of a fixed exchange rate system. The last section of the action program lists an extensive schedule utilizing or expanding UN institutions and in this manner raising the leverage to be exercised by Third World countries.

In case some innocent reader of the UN resolutions misses the meaning of the exercise covered with beautiful phrases about justice, peace, equality, liberty and humanity enunciated by representatives of a large assortment of minor or major tyrants, we may fortunately refer to the useful interpretation supplied by a self-styled moralist. On March 17, 1975 Gunnar Myrdal delivered a Nobel Memorial Lecture on "The Equality Issue in World Development." Myrdal's world view opens with the old "colonial empires" neglecting or possibly exploiting their less developed regions, which "stagnated in poverty." The spreading independence of the post-war period encouraged an awareness of the inequality between developed and other countries. A moral issue emerged which should dominate our attention. Myrdal acknowledges that some aid was given over the years, but he finds such aid thoroughly inadequate and usually given for the wrong motives (except, of course, by Sweden). Both morality and rationality, in his view, demand the establishment of a new world order. This new world order should be designed to remove inequality and introduce an egalitarian justice.

The egalitarian principle immediately reflects the appropriate morality, and rationality is expressed by Myrdal's judgment that substantial reductions in Western societies' consumption levels are "in the best interests individually and collectively," of all members of these societies. Implementation of such moral rationality requires national planning to achieve lower levels of consumption in order to release resources for transfer to the developing countries. He notes in particular that the United States would have to be prepared "to initiate and cooperate in planned intergovernmental action in a way pointing towards 'a new world order' asked for by the underdeveloped countries, which in turn would necessitate the rational restriction of our lavish utilization of resources." The new world order thus introduces a system of "integrated national planning" for the sole purpose of effecting a massive transfer of wealth from the industrialized nations to the majority of members of the United Nations Organization. Myrdal understands quite clearly that this "new order" cannot be realized without vast institutional changes covered by the expression "national intergovernmental planning." He observes in passing that an economic organization relying on markets seems not to be conducive to "rational actions" bearing on consumption demands.

The issue confronting the United States is thus clearly defined. We are addressed by a majority of members of the UN and "intellectual or moral leaders" to accept in essence and initiate a transition into a socialist world and a socialist society. It may be appropriate at this point to clarify our use of the term "socialist" as applied in this discussion. Two closely associated characteristics of social organization crucially determine important aspects of human life: the extent to which allocation and use of resources are guided by prices formed on markets, and the range or content of private property rights. There is no society without markets and some price-guided activities, and similarly, no society without private property rights (or entitlements) to resources or use of resources.[3] It is

[3] Observers of the German Democratic Republic note that janitors at the Leipzig Trade Fair charge about $80 for "private use right" to a toilet for the fair's duration. Speedier access to medical doctors requires side-payments; so does more rapid attention by automobile mechanics. Along with the official and formally decreed system, an informal market system has emerged based on de facto entitlements of the janitor,

important in this respect to understand the nature and consequences of an "entitlement structure"; consequences vary substantially with the range, explicitness, predictability, stability and tradeability of the entitlements.

Socialist programs essentially lower the various dimensions of private entitlements and also lower the range allotted to market mechanisms. This description implicitly rejects the Lange-Lerner conception of a market-oriented socialist society. Their notion is certainly possible, but it should also be recognized that it possesses little empirical relevance. The erosion of private entitlements to resources and their use is usually accompanied, as a matter of empirical fact, by replacing markets and market-determined prices with a political-administrative allocation mechanism. This attrition of private entitlements, according to socialist literature and rhetoric, forms a necessary condition for the transition from "prehistory to human history" — a necessary condition to assure human dignity and a "meaningful level of the quality of life."

This view has infiltrated the discussion at UN conferences on a wide range of issues, be it population, food, pollution or crime. It is also clearly reflected in the documents emerging from UNCTAD, UNIDO or the General Assembly bearing on the New International Economic Order to be established. The challenge confronting the United States should be fully recognized and accepted. We should also unhesitatingly accept the criteria advanced for judging a social organization, viz., criteria stated in terms of "human dignity and the quality of life." Although these terms are vague, somewhat ambivalent and require some further circumscription for adequate analysis, this is hardly the purpose of the current discussion. It is sufficient here to emphasize most decisively that the case for capitalism should not shirk these standards. On the contrary. Usefully formulated in a non-evasive mode, they should be fully embraced as the relevant standards of our judgment.

In this respect there is indeed a moral issue in the choice between social organizations, and it subsumes a cognitive obligation to analyze with reliable means the *comparative* operation of different institutional structures. This analysis extends to the human patterns fostered by different arrangements, the attitudes reinforced and the values permitted. It is in these very terms that the case for capitalism should and can be made. But so far we see little evidence

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the medical doctor, mechanics, and others. They all control *some* dimension of resource use which determines opportunities for transactions.

that U.S. representatives at international organizations and conferences understand the nature of the challenge or find it useful to fit the confrontation into their accustomed political game. Their neglect is in my judgment not entirely harmless for our long-run interests. The onslaught on our social system is a persistent and pervasive fact reflected by the verbalism and phrasings incorporated by UN documents.

iii

A dominant and basic theme expressed by many formulations encountered in the rhetoric offered by the Third World centers on the Marxist-Leninist idea of "exploitation." The Leninist extension of Marx's original notion to international relations explains the difference in wealth between Western industrial nations and the Third World in terms of a colonial history, or more generally, in terms of subtle and pervasive forms of political coercion. Western exploitation impoverished the Third World and enriched the Western nations. The story is impressionistically plausible and has influenced public attitudes substantially beyond faithful members of the Leninist branch of the Marxist church. One frequently encounters the assertion that the colonies and politically dependent territories stagnated in poverty, with progress occurring only after independence. Myrdal's Nobel lecture elaborates on this theme, and the rhetoric of the above-mentioned UN resolutions clearly reflects this view.

"Decolonization" is introduced as a necessary and primary condition of economic progress. Such progress seems impossible to achieve under a colonial regime. But it also appears that abolition of colonialism is not sufficient. The socialist doctrine claims that exploitation continues in new forms, covered by the term "neo-colonialism." Neo-colonialism emerges whenever private transactions occur between "developed" and "developing" nations. It occurs in particular whenever private corporations do business in developing nations. In a sense the label is attached to every transaction proceeding with the expectation of a *quid pro quo*. Abolition of neo-colonialism thus involves by definition the desired transfer of wealth to the Third World — a flow of real resources without a *quid* for the *quo*.

One should easily recognize a sense of rationality in these notions. They offer opportunities to justify an extraction of wealth. They also offer to established elites and bureaucracies in the Third

World opportunities for enrichment.[4] These opportunities are partly conditioned by the somewhat bemused responses encountered among members of our intelligentsia. The basic theme likewise justifies the claim to "reparations" made on developed countries as a compensation for the "obvious damages" wrought by colonialism and neo-colonialism. The flexible definition of "neo-colonialism in all its forms" and the claim for reparations embodied in the UN resolutions define an open-ended invitation with pervasive incentives to use expanding UN facilities for an unending stream of action programs raising political pressures on Western governments. The persistent demands also maintain the attention of Western media and professional articulators.

These prospects of a protracted confrontation suggest that the socialist rhetoric with its apparently substantive claims should not be blithely disregarded in the manner cultivated by U.S. representatives at UN happenings. It seems important that the claims and the associated rhetoric be forcefully and explicitly contested. One wonders occasionally whether Western representatives are sufficiently aware of the dubious case underlying the standard rhetoric. Some general indications of the weakness inherent in the socialist claim seem appropriate in this context.

We should note first that "exploitation" occurs according to socialist doctrine *by definition* whenever resources (means of production) are owned privately. The extent of "exploitation" can be measured by the portion of national income absorbed by ownership of resources. All transactions occurring under capitalist arrangements are thus necessarily "exploitative." It is important to recognize that this language has a motivating purpose directing moral-political actions. It is used to assert that abolition of "private property in means of production" liberates the working mass and generally raises economic welfare and human dignity. But the Marxian story, while plausible as are many other stories, fails precisely in its most vaunted virtues. Marxian writers emphasize the superior insights into crucial social relations summarized by the *Produktionsverhältsusse,* the relation between men determined by men's relation to productive resources. But the Marxian account misses completely the important entitlement structure shaping the political, social and economic process and therefore fails to offer

[4] The reader may wish to refer to Omotunde Johnson's instructive investigation into "The Economics of Corrupt Government," *Kyklos,* vol. 28-1975-Fasc. I.

any systematic account of political-economic events or processes under socialism.

It is not a matter of chance that socialist writings and the rhetoric about the socialist state barely penetrate beyond some essentially metaphorical or metaphysical elaboration mixed with a touch of the Nirvana approach. Neither is it a matter of chance that Marxian, and more generally socialist, literature cultivates a "Karamasov fallacy." One notes instances of injustice, frustration or unhappiness advanced as evidence against capitalism. One also notes that in a socialist country specific groups of the population enjoy more decent housing than before the "socialist liberation." This is suggestively used to convey that the whole pattern is generally improved. Such comments and observations are a useful ploy in a political struggle. However, they provide little information bearing on a systematic assessment of alternative institutional arrangements and economic organizations. Such assessment is not possible under Marxian or socialist conception. The doctrine offers no intellectual handle and no analytic perception about the working of socialist institutions; no understanding of the incentives emerging under these institutions and the resulting nature of the social process. It therefore usually fails to offer any relevant interpretation of the problems typically arising under socialist organizations. The permanent agricultural crisis in the USSR offers a good example of the general situation.

Attempts by Marxian philosophers to struggle seriously and honestly with the institutional workings and mode of behavior determined under socialist regimes reveal in explicit detail the flaws of Marxian sociology. The sociological model of man used in this literature obscures reality and prevents intellectual access to men's responses to incentives inherent in different institutional arrangements. It is unable to explain the system of side-payments and "unofficial or private" transactions arising under socialist institutions, the patterns of corruption dictated by these arrangements, the power structure or the nature of political competition, and similar problems.[5]

[5] An examination of this sociological model may be found in a paper prepared by William Meckling for the Second International Interlaken Seminar on Analysis and Ideology, held in June 1975. The paper will be published in 1976 by the *Schweizerische Zeitschrift für Volkswirtschaft und Statistik*. A full session of the Third International Interlaken Seminar on Analysis and Ideology will explore the issue still further with papers presented by co-authors Gerard Gäfgen-Hans Georg Monissen and by Willi Meyer. Among the serious writings by Marxian philosophers are some published by the group at the University of Belgrade—with specific reference to Stojanovich.

IV

A semi-religious attitude or commitment, which frequently replaces the necessary analysis and evidence, is scarcely conducive to a useful and rational assessment of alternative social systems. But such an assessment over a broad range determines the essential case for capitalism. It is not a case based on guaranteed and uniform justice, happiness, liberty, and the like; rather, it emphasizes the circumstance that a system based on wide-ranging private property rights diffuses arbitrary power more effectively than any alternative social organization. While "justice, liberty and equality" are not guaranteed, it offers more opportunities, and more persistent opportunities, for justice at a lower cost (i.e., than forfeited or sacrificed human values). It also offers more alternatives at a lower cost than the institutional arrangements typically imposed by a socialist regime. In particular, a broader range of alternatives for work and to express a variety of lifestyles erodes patterns of servility and subjection.

The "open institutions" of capitalism do not assure "equality," but they loosen established and inherited inequalities to a larger extent than "closed institutions" of socialist societies that are justified with an egalitarian rhetoric. Moreover, the private cost of dissent — expressed in terms of opportunities sacrificed by political, intellectual, moral or artistic dissent — is certainly positive in *any* social system ever realized or still to be realized. This circumstance frequently encourages a peculiar blindness revealed by absolutist assertions that freedom or liberty is equally missing in most social systems. But the occurrence, even under the best of circumstances, of positive private costs of social dissent should not blind us to the large differences in these costs. Their magnitude is systematically associated with the prevailing pattern of the entitlement structure, and they tend to vary with the range, content and reliability of private property rights. A persistent erosion of such rights eventually raises the cost of dissent and nonconformist behavior in politics, morals, literature and the arts.

Lastly, the greater opportunities and wider range of alternatives available at lower cost to the average man under a system of private property rights assures better protection of human dignity than can be expected under an essentially political-administrative apparatus. The manifest preference of established bureaucracies and intellectual elites in the Third World for socialist arrangements should be quite understandable, for the attrition of private property rights and the replacement of markets with political-administrative institutions raises the power of both bureaucracy and elite. An extensive reliance on markets erodes such powers and lowers opportunities for wealth transfers and enrichment via political activities. Some members of the elite and the bureaucracies recognize the potential for large rewards — at the cost of the average citizen — under socialist arrangements.

A suitable and highly articulated rhetoric obfuscates the transfer of internal wealth to established elites and bureaucracies. It is also an important instrument in the intellectual offensive directed at an international wealth transfer. Under the circumstances it is vital to understand precisely the human achievement of the social organization covered by the "capitalism" label. We will undoubtedly find pockets of oppression and injustice in capitalist economies. The world's intelligentsia has persistently emphasized the evils perpetrated in Chile, in Greece under the military junta, in Rhodesia, South Africa, Spain, and possibly also in Brazil. One can indeed observe oppression in these countries, and the cost of dissent is probably higher than elsewhere in Western Europe or the United States. But the hysterical rhetoric of the world's intelligentsia has apparently abandoned a sense of proportion in judging the human situation. The cost of nonconformist behavior in these countries is substantially below the level prevailing in countries accepting the Marxian faith or in numerous socialist countries claiming membership in the Third World.

This observation justifies no complacency about our own institutions or acceptance of the social patterns in the above countries, but it needs some emphasis. It reminds us that a wider range of private property rights is not sufficient to remove a substantial imposition of political constraints on individual activities. Yet these countries also offer useful elaborations on our theme. For one thing, within them an important area of daily life associated with one's work and economic activities remains free from detailed coercion and harassment. Political discussions within small or private groups are to a substantial extent feasible at little risk and very small cost. There is intermittently even a measure of public discussion of nontrivial social or political aspects. Moreover — and this is a crucial point — the persistence of a diffused range of private and reliable entitlements lowers the survival probability of the confining political system. The pervasive property rights prevent an "institutionalization" of the political system and thus raise the chance of transition to a political-social organization with greater freedom, i.e., entailing a smaller cost for nonconformist behavior.

We notice some serious discussions and a hopeful expectation about Spain's emergence from the ossified forms of a Falangist dictatorship. Similar developments in Chile and Brazil are not entirely improbable. Does anyone seriously contend that Yugoslavia will "open its institutions" after Tito's death, or that the Soviet Union will let "a thousand flowers bloom" after Brezhnev's death? The answer is obvious, and the difference in opportunities and prospects is anchored in the prevailing entitlement patterns. We are eventually led to realize that a *Gulag Archipelago* typically emerges under a socialist regime and with it develops the systematic use of arbitrary terror to browbeat citizens into well patterned conformity.[6]

It seems important to stress that patterns of subjection and servility fostered by vast political-administrative machineries lower access to alternatives over a wide range of life. A trend to the emergence of such machineries is implicit in Myrdal's program. His authoritarian position is clearly revealed by his peculiar conception of "rationality" — meaning that his judgment and the judgment of a peer group of his friends should prevail. The average consumer "needs to be told what's good for him." Myrdal effectively exemplifies the group of professional articulators who fail to appreciate that most people have a definite idea concerning the quality of *their* life. Many prefer life-shortening consumption habits to the chance of experiencing senile uselessness. Many prefer skiing, mountain climbing, car racing or flying to a safe, stodgily "rational" existence. Myrdal focused on a central issue of our time by pointing up the arrogant claim of "intellectual and moral leaders" to control the fate of our societies. Proposals to institute a comprehensive administrative control apparatus are a natural consequence of this claim

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[6] A short comment should be added apropos of Rhodesia-Zimbabwe and South Africa. That apartheid involves a wealth transfer to the white population was clearly recognized by the South African labor unions in the 1920s. At the time, the market operated toward gradual integration, and this occurred most particularly on the "marriage-market." But recognition of the internal wealth transfer implicit in apartheid should not blind us to the fact that the economic welfare of the blacks in South Africa, on the average, probably exceeds the levels reached (or descended to) in any other African country.

One should also note the intriguing statement made in Mozambique by one of the black leaders of Rhodesia-Zimbabwe. Making clear that a rigid socialist regime will be instituted in Zimbabwe, he warned particularly that it would have no room for assorted competing black politicians whose socialist ideology is suspect. A comparison of future patterns in Mozambique, Zimbabwe and Angola with the life patterns feasible in "oppressive white Rhodesia" or apartheid South Africa will certainly be interesting.

and the supporting view that most people are ignorant and incapable of addressing their own interests.

V

In this context the "colonialist theme" so ardently cultivated by the Third World deserves our particular attention. It determines the moral fervor and offers a justification of the claim for a New International Economic Order, but the rhetoric of "colonial" or "neo-colonial" exploitation by Western industrial nations is a legend substantially falsified by historical events. According to the standard exploitation thesis, poverty and economic stagnation should increase in relation to the density of transactions with capitalist economies. Yet we systematically observe the opposite. Over the past hundred years regions with the least commerce, the smallest exposure to capitalism and only marginal transactions with Western nations have remained the poorest and most truly stagnating areas (e.g., Ethiopia, Afghanistan). Almost without exception the colonies experienced substantial economic progress under colonial status and benefited from a net flow of real resources from industrial economies. The dramatic expansion of population, the improvement of life expectancy, the appearance of public transportation and modern cities resulted from economic relations with the West. Western investments raised real income beyond the levels that would otherwise have been achieved.

This description holds regardless of the regular repatriation of certain profits earned on these investments. Similarly, the use of exhaustible resources contributes to raise real income, at least over time. And with suitable reinvestments of savings accruing from raised levels of real income, real income could be raised permanently. The issue can be stated most effectively in the words of Peter Bauer, who has studied the problems confronting developing economies for many years. Referring specifically to Africa, he says:

All the foundations and ingredients of modern social and economic life present there today were brought by Westerners, almost entirely during the colonial era. This is true of such fundamentals as public security and law and order; wheeled traffic (sub-Saharan Africa never invented the wheel); mechanized transport (transport powered by steam or gasoline instead of muscle — almost entirely human muscle in Black Africa); roads, railways, and man-made ports; modern forms of money (instead of barter or commodity money, such as cowrie shells, iron bars, or bottles of gin); the application of science and technology to economic activity; towns with substantial buildings, water, and sewerage; public health and hospitals and the control of endemic and epidemic diseases; and formal education.

In short, over the last hundred years or so, contact with the West has transformed large parts of the Third World for the better. Southeast Asia and West Africa provide well-documented examples. For instance, in the 1890's Malaya was a sparsely populated area of hamlets and fishing villages. By the 1930's it had become a country with populous cities, thriving commerce, and an excellent system of roads, primarily thanks to the rubber industry brought there and developed by the British. Again, before the 1890's there was no cocoa production in what is now Ghana and Nigeria, no exports of peanuts or cotton, and relatively small exports of palm oil and palm kernels. These are by now staples of world commerce, all produced by Africans, but originally made possible by European activities. Imports, both of capital goods and of mass consumer goods designed for African use, also rose from negligible amounts at the end of the 19th century to huge volumes by the 1950's. These far-reaching changes are reflected in statistics of government revenues, literacy rates, school attendance, public health, infant mortality, and many other indicators, such as the ownership of automobiles and other consumer durables.[7]

We conclude that there is little merit in the well publicized idea that Western countries effected a transfer of wealth from the colonies to their own economies, a transfer impoverishing the colonies and enriching the mother-countries. The remarkable economic progress of capitalist economies over the last 150 years seems to support the exploitation thesis, but only if one fails to recognize the parallel development in the colonies. When real income per capita in Western economies rose persistently, in spite of Marxian predictions to the contrary, this economic progress also benefited the colonies. In any case, all the relevant indicators show an increase in economic welfare for these regions. In contrast to some popular beliefs, trade *is* mutually beneficial. Moreover, decolonization often produced economic stagnation and even economic decline. The sub-Saharan region, Sri Lanka, Burma, Uganda, Bangladesh and Pakistan are outstanding examples of this. Other countries may fare a little better, but even those like Algeria or India show little progress in comparison with previous phases of their economic evolution, whereas a colony like Hong Kong has continued to thrive.

These divergent patterns exemplify the irrelevance of colonial status and decolonization to economic progress. Such progress is crucially conditioned, instead, by the trend in policies and institutions developed. The comparative stagnation following "decolonization" in numerous cases resulted from a pronounced shift

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[7] Peter Bauer, "Western Guilt and Third World Poverty," *Commentary*, January 1976.

to "socialist programs and institutions," or from a rapid increase of political instability and uncertainties about the "social rules of the game."

A notion evidently cherished in UN resolutions refers to a member country's right, in order to be respected by others, to "sovereignty over its resources." One might respond with a shrug of the shoulders and easily assent to an obvious meaning. But the phrase involves a rather specific meaning subtly associated with the exploitation thesis. "Sovereignty over resources" is realized by "nationalization" and suitable ownership by "government." Moreover, "determination of one's own economic fate" is exercised by a system of political-administrative controls over the size and allocation of (nonhuman and human) resources. The rhetoric cultivated by the UN resolutions thus refers to a concentration in de facto entitlements to the use of resources among a ruling oligarchy, its articulators and bureaucracies. "Sovereignty" and "determination" involve the establishment of a socialist economy with eroded private property rights and a political-administrative machinery replacing markets over a wide range of activities. Acquisition of "sovereignty over resources" and active "determination of a nation's economic fate" subject the vast majority of inhabitants to the political machinations of a ruling oligarchy using these means to foster its political position and enrich its patronage and clientele.

Still, the notions appeal to wide circles which find it difficult to grasp that a developing economy could hardly advance its welfare better than by letting foreigners buy its natural resources and thus involve their active interests in economic development. Whether this inflow of foreign capital necessarily leads to political influence and domination depends very much on the prevalent institutions. Foreign business firms will invest in political influence and manipulations only to the extent that such investments are expected to bear returns. The "relative density" of government in society is the crucial factor. In face of a comparatively small government sector and modest regulatory powers, investment in political manipulations brings little return and remains on a small or even vanishing scale. The political problem posed by foreign business firms operating in a developing country results essentially from the established and pervasive influence of bureaucracies and government officials. It increases with a socialist trend in policy and institutions, becoming an "endemic disease" of such institutions as the operators of the government's administrative machinery find it advantageous to exploit opportunities determined by their position.

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Yet such (illicit) transactions probably raise general economic welfare above the levels achievable in the context of a rigid "sovereignty over resources" and a militant "determination of economic fate."

The exploitation theme also shapes the issue raised about terms of trade. It is occasionally asserted that Western industrialized nations manipulate the terms of trade to their advantage and impoverish the raw material-producing Third World. But the terms of trade of primary producers were, according to Sir Arthur Lewis, much more favorable in the 1950s than for the previous eighty years, and they improved even further in the late 1960s. The overall picture covers a diversity of experiences for different parts of the developing regions. Moreover, deliberate manipulation of the terms of trade by industrial nations for their benefit would require rising export tariffs on manufactured goods in conjunction with rising import tariffs on raw and primary materials. Yet we find no such pattern. There remains the obnoxious fact that the United States, Australia and Canada are major suppliers of some primary commodities on the world market. Under the circumstances "manipulation of the terms of trade" should be dismissed as a politically useful fabrication. Bauer's comments are again noteworthy in this connection:

> When changes in the cost of production, the greater improvement in the range and quality of imports, and the huge increase in the volume of trade are taken into account, the external purchasing power of the exports of the Third World in the aggregate is now very favorable, probably more so than ever before. This in turn has made it easier for governments to retain a larger proportion of export earnings through major increases in royalty rates, export taxes, and corporation taxes.[8]

VI

The conflict regarding the foundations of social and economic organization cannot be exorcised with pious platitudes. We may prefer tranquillity, serenity, undisturbed quiet with all contentious engagements far removed, but the issues bear on our life and the prospects of our society. What should the position of the United States be on these issues? Certainly it would be desirable for Washington to re-examine the trend emerging in recent years in various UN organizations. We should seriously question the wisdom of blandly following this trend with some muted reservations. But what may be a feasible alternative to a thoughtless accommodation? An alternative action program expressing the long-run interests of the

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[8] *Ibid.*

United States, in my judgment, involves five major strands, as follows:

The U.S. economy forms a vital center of the world economy, and the consequences of American domestic policies are felt throughout the world. Financial instability in the United States contributed substantially to the emergence of world inflation in the late 1960s and early 1970s. Financial policies pursued in the United States also determined the final breakdown of the system erected at Bretton Woods and eventually produced — reinforced by the massive transfers of wealth engineered by OPEC — the "stagflation" observed in Western economies. Such economic vagaries and uncertainties impose severe adjustment costs on many countries. Restoration and maintenance of financial stability is thus the first obligation U.S. policymaking should accept. This means that Washington must evolve a set of policies and institutions assuring stable monetary growth at a noninflationary level, and a controlled budget with at most a modest deficit. Restoring a reliable pattern of financial stability would require a major political effort and a substantial break with recent and current trends.

The second and third strands of a positive program would be directed toward a substantial opening of our economy. All trade barriers should be removed or drastically lowered. Import quotas of any kind and obstacles to imports should be systematically abolished — this action including the reduction and removal of tariffs. The elimination of trade barriers would offer other countries opportunities to sell their products and acquire the means to finance an increasing range of imports while substantially helping to expand their real income levels. The same policies would also contribute to a more efficient use of resources in the U.S. economy and would in the longer run benefit U.S. residents. Moreover, the systematic removal of trade barriers should be supplemented by a removal of all barriers to private investments in foreign countries or obstructions to private loans made available to foreign businesses and residents. The flow of capital would depend to a large extent on conditions in foreign countries and particularly on the predictability and stability of the rules of the game applied to foreign business and foreign investors. The policies and institutions of the Third World would thus form a major determinant of the capital flow and the contributions made by industrial economies to the rate of development.

As for the fourth item on the program, it is imperative that the United States formulate a coherent conception of the conditions relevant to economic growth and rising welfare. Uncertain growth and "stagnating poverty" are not the result of a colonial history or the consequence of "neo-colonialism in any of its forms." Over the postwar period most developing countries settled on a course of policies and a pattern of institutions systematically obstructing or retarding their economic development. In a growing number of countries economic reality has been sacrificed to the rising demands of ideology. Representatives of the U.S. government should learn to argue a coherent case for alternative programs and policies that would release the shackles imposed on developing economies. These programs and suggestions should be formulated with the full acknowledgment that members of the Third World have the right to proceed according to their own lights. But their insistence on policies and institutions obstructing their development and lowering their welfare sets no moral obligation on the Western nations to bail them out with a massive transfusion of resources. The manifest failure of government-offered economic aid revealed it to be wasteful and inefficient.[9] All aid should be replaced by voluntary transactions executed on open capital and credit markets.[10]

Attention to policies emphasized in the previous paragraph introduces the last item in a positive agenda. U.S. representatives (and hopefully even some intellectuals) should forcefully contest socialist claims in the world market for ideas. The case for capitalism as a set of flexible institutions best designed to assure a continuous striving for human dignity and human achievement requires some impassioned articulation. We should not hesitate to offer a vision of our humane potential, though this may involve some radical changes of established procedures and well entrenched habits, as revealed by the first press conference of Ambassador Moynihan's successor reported in the European press. According to these reports, Ambassador William Scranton emphasized that no fundamental issues of principle leading to a confrontation exist between the United States and major portions of the world. This

[9] See Peter Bauer's "Politicization of Knowledge: Development Economics," prepared for the First International Interlaken Seminar on Analysis and Ideology in June 1974, and subsequently published in the *Schweizerische Zeitschrift für Volkswirtschaft und Statistik, 1975.*

[10] The pervasive concern about a permanent food crisis should stimulate U.S. representatives to present alternatives to the established agricultural and land tenure policies of the Third World. Tanzania recently accepted the Soviet model and collectivized agriculture. The resulting effect on her agricultural output is predictable. Subtler ramifications bearing on agricultural output and population emerge from other land tenure systems. Arthur DeVany demonstrated, for instance, in an interesting study using Mexican data (prepared for the April 1976 Carnegie-Rochester Conference on Public Policy) that the ubiquitous usufruct system creates incentives lowering output and raising the average family size.

view may simply represent the standard verbalism of a "diplomatic bureaucracy," but the fact remains: we *are* confronted with a serious challenge and a severe test of our understanding of fundamental issues of social organization. Why U.S. representatives persistently fail to recognize or to admit the existence of an underlying confrontation, therefore, is a puzzlement. Perhaps, since our own domestic trend has veered sharply in the direction implicitly advocated by the New International Economic Order, many politicians and professional articulators may respond sympathetically to the socialist rhetoric supplied by UN organizations and the Third World. But the longer-run cost measured in human values will be high on this road. We can still learn and delineate a vision of human opportunities to be offered to the world.

Representative LONG. Thank you very much, Senator Hatch. We appreciate your views.

Congressman Reuss.

Representative REUSS. I would like to hear the witnesses. Thank you.

Representative LONG. Please proceed, Mr. Ramphal.

STATEMENT OF HON. SHRIDATH S. RAMPHAL, COMMONWEALTH SECRETARY-GENERAL, LONDON

Mr. RAMPHAL. Thank you, Congressman Long.

I shall endeavor to keep within your constraints, and in particular not to cover ground covered in the prepared statement.

I serve, Congressman Long, a 36-nation Commonwealth which might have been 37, save for certain events in Philadelphia, 201 years ago.

All the more, then I do acknowledge the honor and privilege of your invitation to address the committee. I speak of the committee, of course, without any connotation, however remote, of speaking on behalf of any of our 36 member governments; but, it is perhaps relevant that the Commonwealth itself has no graver issue on its agenda than that of international poverty; and this, really, from a commonwealth point of view, cannot be otherwise.

Of the Commonwealth's 1,000 million people, 89 percent are from developing countries, representing 44 percent of the total population of the developing world; and of the 950 million of the "absolute poor" with annual per capita incomes of less than $200, 80 percent are in the Commonwealth.

Accepting this invitation, therefore, as one to open another window on the global scene I shall try to help you to see contemporary problems through the eyes of those on whom the contemporary system bears hardest; and to see them more in terms of human needs than abstruse economics—since I am not an economist by training—I am encouraged by the fact, however, that there is a range of economic expertise on my left which will make up for my own inadequacies.

I assume it to be unnecessary to document for you statistically the reality of international poverty; that our human society in global terms presents a pattern of pervasive and constantly enlarging disparities in the human condition.

The RIO report, restructuring the international order, produced recently under Professor Tinbergen's editorship and the auspices of the Club of Rome, encapsulates the contradiction thus:

> The inequities in the international system are of tremendous significance. They have given rise to essentially two worlds and the disparities between them are growing.
>
> One is the world of the rich, the other the world of the poor, united by its heritage of common suffering. A poverty curtain divides the worlds materially and philosophically. One world is literate, the other largely illiterate; one industrial and urban, the other predominantly agrarian and rural; one consumption-oriented, the other striving for survival.
>
> We have maldistribution of the world's resources on a scale where the industrialized countries are consuming about 20 times more of the resources per capita than the poor countries.
>
> We have a situation where, in the third world millions of people toil under a broiling sun from morning til dusk for miserable rewards and premature death without ever discovering the reason why.

Congressman Long, none of this is new; it is just more familiar because daily more generalized and better articulated.

But, familiarity also induces a kind of numbness and can engender, certainly in the listener, an attitude of resignation. But the world's sufferers cannot be resigned.

This is why, for example, they will insist that concern for human rights worldwide must not limit itself to civil and political rights but extend with no less intensity to the diffusion and realization of social and economic rights globally, that human rights must have as much to do with the right to work, as with the right to vote; with freedom from starvation as with freedom from oppression; with the right to a roof as with the right to privacy; with the right to be literate, no less than with the right of dissent.

Whether such a concern for the human condition, which is what human rights in all their plenitude are about, is allowed to infuse the flagging international economic dialog with a new vitality and urgency, is, I suggest, the greatest challenge facing the developed world at the Economic Summit ahead.

If that challenge is not accepted, if in London and Paris next May and in the continuing debate thereafter, human rights are seen as relevant only to the dialog of détente, not to the dialog of development, the third world's skepticism, if not downright mistrust, should surprise no one.

And what is also new is the awareness, certainly among the world's disadvantaged, that this task of securing social and economic rights worldwide cannot be accomplished through superficial changes in human relationships or minor modifications in international arrangements; that a new world community will not emerge from minimal shifts in the international status quo; that the change that is needed is a change in the structure of international economic life, change sufficiently fundamental to permit a new international economic order to really help us create a new planetary community.

This is where I think we are, at the highest levels of perception. But generalized perception is not enough.

The world has now made a kind of verbal commitment to a new international economic order on the basis of the conclusions of the sixth and seventh special sessions of the General Assembly in 1974 and 1975.

But it is on the implementation of a program of action that rests the principal hope for relieving humanity of these intolerable conditions. So, what about the mechanisms that alone can fulfill this promise?

There has been no shortage of discussion. Within the year and a half since the seventh special session, New York has been followed in turn by major economic consultations, some fully international, some caucuses of the rich and the poor separately, in Paris, Kingston, Nairobi, Vancouver, Colombo, Mexico City, Manila, and Geneva. London and Paris lie ahead in the next few weeks; and, thereafter, Geneva again.

Yet, in all honesty, we must recognize that at the present moment the hard won consensus of the Seventh Special Session is in grave and present danger of being dissipated. The world is moving back to the angry confrontations of 1974.

In the eyes of the poor, the rich seem to have used the time in between to secure the commanding heights of the world economy, through recycling the OPEC surpluses, while indulging a dialog they never expected to succeed, and are now about to dictate, via the Economic Summit and Paris, the parameters of future, more limited, consultations fashioned to preserve the status quo. It is bad enough that this is believed; it would be disastrous were it true.

We will make no progress if the most extreme demand becomes the norm of third world positions and if the most entrenched and reactionary response becomes the norm for the developed world.

I think the relative weakness of their negotiating position alone will insure that the former does not prevail; but there are more and more signs that within the councils of the developed world collective response is agreed at the level of the lowest common factor of agreement to change, and this is so whether at the level of region as in the EEC, or at wider levels as in the OECD.

There is much hope—and, I am sure, Congressman Long, you would have encountered it in your interparliamentary meeting in Canberra—in the Third World that United States positions no longer occupy that lowest level of response.

There is great need, if that be so, for these positions, however incipient, not to be pulled back by less positive responses among the rich.

The world's future would be altogether much more promising if the United States could bring to the cause of international economic restructuring, enlightened leadership of the quality President Roosevelt once gave to the world's establishment in the cause of decolonization.

The commodity problem, of course, typifies current frustrations. Exports of primary commodities provide the developing world with almost 60 percent of their export earnings and are their primary generator of employment.

Given the prevailing regime in commodities, the operation of cause and effect between extensive reliance on commodity exports and chronic poverty is all too real.

Yet at UNCTAD IV in Nairobi, major developed countries including the United States, opposed the essentials of the Integrated Program for Commodities mainly on ideological grounds; that it interferes with market forces.

But within their domestic economic systems, these same countries practice wide-ranging intervention in the field of commodities operating at the national and sometimes, as in the EEC, at the regional and multinational level, to support prices and the incomes of their own commodity producers: As in the U.S. farm and oil policies.

The developing world finds it difficult to understand why the concepts of social and economic justice that justify these arrangements must halt at national frontiers—why these arrangements are not for export.

As long ago as UNCTAD I, in 1964, there was general agreement in the world that commodity prices were too low and falling.

Our own calculations in the Commonwealth Secretariat show that the prices of commodities exported by developing countries have fallen in relative terms by more than 40 percent over the least 20 years.

This is a perverse transfer of income, some $17 billion, from the developing to the developed countries, from the poor to the rich.

But the experience of the individual countries confirms the deterioration better than any kind of statistical data that I can give you. In my work, I meet with the leaders of all Commonwealth countries, and therefore, with the leaders of many of the world's developing states.

Theirs is the authentic voice of despair which I wish you could hear.

Were President Nyerere of Tanzania here, for example, he would tell you, as he said elsewhere, that:

> Tanzania was suffering from the present economic system before 1973; oil prices are just an extra burden, although a heavy one.
>
> In 1965 I could buy a tractor by selling 17.25 tons of sisal. The price of the same model in 1972 needed 42 tons of sisal. Even during the much talked about commodity boom of 1974 I still needed 57 percent more sisal to get the same tractor I did 9 years before.
>
> And now the sisal price has fallen again, but the tractor price has gone up still further.

And so, Congressman Long, the sisal which in 1965 bought an entire tractor in 1977 now buys just some of its parts.

Despite these persistent inequities, the developed world continues to be resistant to change. Discussions on the Common Fund at Geneva have once more ended in disagreement—not on financial grounds, but, certainly in the eyes of the developing world, on grounds that continue to be related to ideology and vested interest.

And is it not that same kind of resistance to change that prevents the world's international monetary system from being reformed to end the disorder that currently prevails to the particular disadvantage of the poor?

If the international dialog is to continue, it needs to be sustained by results, however modest, and by resulting action. It cannot subsist as a process by which despair is piled upon frustration.

Were it taking place as a domestic dialog within western societies, there would be, I think, no lack of awareness that such persistent frustration and deepening despair among a deprived majority was not consistent with national survival on any tolerable basis.

There would be no need of special insights to warn, as President Kennedy once did, that: "If a free society cannot save the many who are poor, it cannot save the few who are rich."

Yet such insights seem to escape the rich countries at the level of the global community, as if we still lived in an age when nations could pull the shutters down on the world and ignore and be secure from the wretchedness without.

The perception of interdependence comes a good deal easier when it reinforces commitments we seek, such as supply, than when it prescribes change we would rather resist, such as prices.

But it is interdependence not self-sufficiency, that is the reality; and a hardheaded self-interest no less than moral precept should motivate the rich countries in favor of change.

It is my case that over the long term, the improvement of living standards in the developing countries is not only consistent with, but necessary for, the preservation of high standards of living and continuing improvements in the quality of life in the developed world.

Moreover, I submit that if the industrialized nations, of whatever idoeological persuasion, seek a continuation of present policies that confine the developing countries to their current state of poverty they will be putting at risk the very high standards which they seek to safeguard and improve.

Nor should this be strange here in the United States where enlightened opinion has been long convinced that the way to larger profits, higher incomes, and greater social and political stability at the national level lies through satisfying the basic needs and legitimate demands and enlarging the purchasing power of the great mass of the people.

Why do these perceptions stop at national frontiers?

Almost 75 percent of the population of the world, excluding the socialist states, live in the developing countries.

In 1975 they earned less than 20 percent of its income. Their purchasing power is therefore low and the markets which they create for the manufactured goods which the developed countries produce is similarly lower than it could be—impressive though it already is.

In 1975, 32.3 percent of all North American exports of manufactured goods went to developing countries. For the EEC, it was 19.8 percent and for Japan, 42.6 percent.

In all cases this represented an increased share of total exports of manufactured goods over preceding years. In the case of North America, 38 cents out of every additional dollar of exports of manufactured goods, over 1969 imports, was earned from exports to developing countries. For the EEC, it was 26 cents and for Japan it was 44 cents.

The increases in the incomes which the developing countries would earn from the dismantling of trade barriers and other obstacles and from a sustained expansion of their export income from primary commodities and from manufactures, would be spent, and spent quickly, on imports from the industrialized countries, which now account for 84 percent of all imports of manufactured goods by the developing countries.

In a very real sense, in terms of growth and jobs, the economic well-being of the developing countries is material to the economic condition of the developed.

What the Third World is seeking should not be seen as a redistribution in its favor of a static world income, with its implication of a diminished share for the developed nations.

The higher incomes sought by the poor, through improved commodity and credit arrangements and through better access to rich country markets, would not be a mere transfer of existing resources from the rich to the poor, but an integral part of significant growth in world economic activity, with the poor nations sharing, but sharing more equitably, it is true, than hitherto, in the increment to world incomes that such activity creates.

In short, my proposition is that there is a quickening symbiotic relationship between development in the poor countries and continued growth in the rich.

Traditional economics have tended to emphasize the one-way flow from the developed to the developing.

I suggest that the reverse flow is equally important for sustaining employment levels in the developed world, and it is becoming more so. I have talked to the American labor movement in these terms.

The new contract which the Third World seeks with the first world and the second, is not aid oriented; it does not rest on the concept of charity or even on the valid one of humanitarianism.

It rests firmly and securely on the premise that the dependent relationships of the past have served the world badly; that isolationism is not an option open to even the most powerful of countries; that a world order dominated by concepts of sovereignty and founded on an adversary system is irrelevant and inimical to contemporary human needs and must be dismantled; that interdependence is the only valid basis for a human strategy of survival; and that in this kind of "planetary bargain" its short-term problems notwithstanding—and they are real—there are no losers.

If, at the Downing Street Summit, the North can bring itself to an acknowledgement of these contemporary realities, the necessary mechanisms of change—in commodities, in credit, in manufactures, and in resource transfer—will all become easier to negotiate with the South; and there will be hope for the human condition worldwide.

If, however, such realities continue to be ignored and policies proceed on other premises, the vistas of human betterment which unfold at the Summit will be for Northern eyes only.

The South will remain blanketed in the fog of mistrust, despair and rising anger that now enshrouds it. There will not be a better chance for the new U.S. administration, with the support of the Congress, to fulfill its promise of enlightened leadership.

Thank you.

Representative LONG. Thank you very much, Mr. Ramphal.

As I said earlier, we appreciate all the work that went into your prepared statement. It is most comprehensive, and we are indebted to you.

[The prepared statement of Mr. Ramphal follows:]

PREPARED STATEMENT OF HON. SHRIDATH S. RAMPHAL

NORTH-SOUTH ISSUES: PERCEPTIONS OF INTERDEPENDENCE

For most of the first three-quarters of this century international poverty has been as national poverty was throughout most of the eighteenth century—a matter on the periphery of the concern of the rich. It was a cause that touched the hearts of good people everywhere—but it was all too easily put off by the affluent as a subject for Sunday reflection. It did not obtrude into their workaday national life; it did not seem to bear on the quality of that life or to have any relevance to sustain enrichment. For the developed world, international poverty was, indeed, an external issue. It did not affect the price of bread; it did not influence, yet the price of pertrol; it did not threaten the value of currencies; it did not hurt.

These are not criticisms, merely; they are reflections on realities of yesteryear with relevance for decisions we must take in the last quarter of this century—in years that have already begun to witness basic changes in these realities. The simple fact is that in 1977 the issue of international poverty has become a matter of domestic importance to the rich no less than to the poor. It can no longer be relegated by developed countries to the periphery of national concern; it is not a matter for Sundays only.

THE MORAL IMPERATIVE

This is not to say that the case for action lacks a moral imperative. On the contrary: North-South issues are, in their most fundamental sense, a dimension of the struggle for the enjoyment of human rights world-wide. The rights of all persons deriving from their humanity and directed to the satisfaction of their basic needs are at the very heart of the global effort to eradicate poverty and to preserve the human condition at tolerable levels everywhere. Concern for the full realisation of human rights the world over is therefore directly pertinent to the dialogue of development—at least as pertinent as it may be to the dialogue of détente. Human rights have as much to do with the right to work as with the right to vote; with the right to a roof as with the righ to privacy; with freedom from starvation as with freedom from oppression; with literacy as with dissent. Yet there is a real danger that these fundamental truths may be forgotten or ignored amid the technicalities and complexities of the international economic dialogue. Abstruse economics has a tendency to divert us from human needs. It is essential to ensure, therefore, that the issue of fundamental change in the world's economic arrangements is always seen in these basic terms: to remember, and never to forget, that it is the human condition that provides the moral imperative for a new international economic order.

There are other imperatives, also: some more directly rooted in the national interests of rich countries; and with these, this paper is essentially concerned. But the principles which helped to found the United States and to mould its traditions provide a special justification, if not a mandate, for United States leadership in recalling the world to the moral imperative for structural economic change. Our world still holds in bondage its "huddled masses yearning to be free". For them, however, no new world beckons with promise of release. Their "New World" must be in this one—in this one made new.

THE OLD ORDER: A RECORD OF DISSERVICE

Why made new? Is it not true (as Dr. Kissinger once asserted) that the international economic system "has served the world well?" The old economic order has perhaps served some nations well; it may have served the United States well; but it is indisputable that it has served many countries ill, and among these are the poor countries whose present circumstances derive in large measure from the working of this system. And of course, it was a system they had no hand in shaping. Despite the countervailing processes of decolonisation it was a system that carried over into the post-war world with refinements embodied quintessentially in the Bretton Woods Agreement.

No global economic system can be judged satisfactory that fails to serve the basic needs of the people of this planet—their needs for food, for shelter, for health, and for the development of the intellect that marks them out as human. But what is the reality of the working of this old economic order? What will be, for them, the record say, by 1985? After a monumental effort by the developing countries themselves; at the end of three decades of international action devoted to development; on the basis of nearly four decades of the working (or non-working) of the Bretton Woods and GATT regimes—the result by 1985 is likely, we know, to be an increase of $50 per capita in the annual incomes of the poorest group over 1965 incomes compared with an increase of $3,900 per capita for those of the richest—who were already, in 1965, 3,000 per cent better off. By 1985, the poorest developing nations would have grown still poorer when compared to the richest developed countries: they would, by then, be 4,500 per cent worse off. The gap would have widened.

Today, those whom Fanon described 20 years ago as "the wretched of the earth"—nearly 1 billion of the world's poorest—subsist on incomes of less than $75 a year (less than 15 pence per day) in an environment of squalor, hunger and hopelessness. As the President of the World Bank, Mr. Robert McNamara, said recently at the 1975 meeting of the Board of Governors of the Bank:

"They are the absolute poor, living in situations so deprived as to be below any rational definition of poverty. Absolute poverty is a condition of life so limited by illiteracy, malnutrition, disease, high infant mortality and low life expectancy as to deny its victims the very potential of the genes with which they are born. In effect, it is life at the margin of existence."

An even more vivid contemporary commentary, on the effects of the system is given in the RIO Report—a report for the Club of Rome on the 'Reshaping of the International Order' produced by a group of the world's most distinguished men and women working in the area of international economic relationships from a wide cross section of the human family and under the co-ordination of Professor Tinbergen, the Nobel Prize economist of the Netherlands. It is a Report directed to the creation of a new international order in which a life of dignity and well-being becomes the inalienable right of all. It is a notable contribution on the way forward toward the removal of the manifest injustices endemic in the present system of relationships between nations and peoples. It is profound in its analysis. Amid its many forthright observations is the following on the contradictions of our current global condition deriving from the prevailing system:

"The inequities in the international system are of tremendous significance. They have given rise to essentially two worlds and the disparities between them are growing. One is the world of the rich, the other the world of the poor, united by its heritage of common suffering. A poverty curtain divides the worlds materially and philosophically. One world is literate, the other largely illiterate; one industrial and urban, the other predominantly agrarian and rural; one consumption-oriented, the other striving for survival ... We have today about two-thirds of mankind living—if it can be called living—on less than 30 cents a day. We have today a situation where there are about one billion illiterate people around the world, although the world has both the means and technology to spread education. We have nearly 70 per cent of the children in the Third World suffering from malnutrition, although the world has the resources to feed them.

"We have maldistribution of the world's resources on a scale where the industrialised countries are consuming about twenty times more of the resources per capita than the poor countries. We have a situation where, in the Third World, millions of people toil under a broiling sun from morning till dusk for miserable rewards and premature death without ever discovering the reasons why".

This is the reality of the Third World. These are the people whom the old economic order is said to have served well. The old economic order has not served them well. The old order has not served them at all. It was not designed to serve them well, or to serve them at all. And the fault lies not in its workings, but in the system itself.

WHY A NEW ORDER?

The system assigned to states and peoples pre-determined economic roles and predictable economic fortunes. It was designed essentially to support and advance the economic growth of the industrialised countries but was premised upon the supportive role of those states and peoples that were primary producers mainly. For those subordinate players, hope was supposed to rest in processes by which the wealth of the rich would trickle down to the poor. It was the preservation at the global level of a system of relations long since rejected by the West as a basis for their own domestic social organisation. The system promised order, stability and growth for the industrialised countries, for those who already wielded economic power; but it implied disorder, insecurity and deprivation for those who did not. Upholders of the system take it for granted that some countries are rich and others are poor and assume that by helping the rich to become more rich we will help the poor to become less poor.

The developing world, however, is convinced by hard experience that international poverty is not a mere aberration of international economic relations which minor adjustments can correct, but the unspoken premise of the old economic order. However, different may be the prospects from other casements, this is how the old economic order looks from a Third World window.

The advantaged do not readily see what is wrong with the world; the scene from Washington is not the same as that from a jute plantation of Bangladesh. But this view of the world in the sight of the two-thirds of mankind that is disadvantaged is itself one of the realities of the contemporary scene. If it is at least acknowledged as such it will become easier to understand why the developing world calls for a new international economic order.

Nothing about the reality of poverty and inequality is new; what is new is the level and intensity of the awareness of its root causes throughout the developing world and the emergence of an enlightened recognition in many parts of the developed world not only that these perceptions are right, but also that the interests of human society in general demand that the inequities they reflect must be righted. What is new, is an appreciation that the task of creating a just and equitable world community cannot be longer deferred; and that this task cannot be accomplished through superficial changes in human relationships or minor modifications in international behavioural patterns. The recent study done for the United Nations on "The Future of the World Economy" (the Leontief Report) has confirmed that a new world community will not emerge from minimal shifts in the international economic status quo. The change that is needed is a change in the structure of international economic life—change sufficiently fundamental to permit a new international economic order to help us create a new planetary community.

While this awareness is not yet universal, it is at least diffused. There is no community of thoughtful persons anywhere on our planet that does not now include many who possess this awareness and are ready to articulate it. There is no capital anywhere from which this awareness is altogether blotted out, though there may be many in which its acknowledgement is muted or, for tactical reasons in terms of international negotiations, even its validity publicly and officially discounted. There may be differences of opinion of the specifics of change and there are many on the details of timing. Nice distinctions may be drawn between 'a' NIEO and 'the' NIEO of the resolutions of the Sixth Special Session; but the compelling need for a fundamentally new approach to international economic relations—to a reshaping of the international order—is now not truly an issue.

The Commonwealth Experts' Group, whose Interim Report was an input into the work of the Seventh Special Session, formulated this awareness particularly well:

"Our own analysis of the development prospects and need of the poor countries indicates the necessity for fundamental changes in the world economy, involving a progressive re-distribution of economic activity in favor of the developing countries. This will demand bold and complementary action on several fronts to accelerate and deepen the processes of agricultural and industrial development in the developing countries. It will also require a substantially different structure of international economic relations than has been in existence up to now.

It is clear therefore, that it is nothing short of wishful thinking to suppose that solutions to global poverty could be found in case-by-case adjustments of an essentially marginal character. In coming to terms with the tasks with which it is confronted in this field, the international community has to demonstrate a new resolve for urgent and imaginative action."

When today, in the North/South dialogue in Paris or in Nairobi or in Geneva, we talk of development, it is about responses to this awareness that we are speaking. To ignore this or allow it to be blurred, would be to succumb to distraction and to stray from the main pathway along which human endeavour is now obliged to travel. The Third World will not easily succumb to such distraction: there is little danger of their straying this way. The real danger is that uneasiness about change in the developed world, sensitised by elements clutching vested short-term interests in the status quo, may blur the reality of the true long-term interests which their own societies have in a new economic order negotiated through dialogue and installed by consensus. If those counsels prevail over any significant period in significant areas of the developed world, humanity could, indeed, be "shaken to pieces" through its failure to respond to the question which Fanon saw looming on the horizon 20 years ago—the need for a redistribution of wealth.

Addressing the Seventh Special Session of the General Assembly of September 1975,, the Secretary-General of the United Nations spoke for the world community when he said:

"Many new nations, having won political independence, find themselves still bound by economic dependency. For a long time it was thought that the solution to this problem was aid and assistance. It is increasingly clear, however, that a new international economic order is essential if the relations between rich and poor nations are to be transformed into a mutually beneficial partnership. Otherwise, the existing gap between these groups of nations will increasingly represent a potential threat to international peace and security."

RECONSTRUCTION: THE AMERICAN TRADITION

Much earlier than all this, John F. Kennedy, as President of the United States counselling his people of the need for economic justice and the eradication of poverty, gave expression to these same concepts of interdependence and of the mutual interests of all men in social and economic justice, when he said:

"If a free society cannot save the many who are poor, it cannot save the few who are rich."

The President was speaking, of course, in a national context: but I am sure he would have agreed that these perceptions cannot stop at national frontiers.

Yet, today the United States is in danger of emerging as one of the nations least committed to change. I say "danger" because such a reaction to change, particularly change that has as its objective the enlargement of human equality, is alien to the traditions of this great nation which remains rightly proud of its revolutionary beginnings 200 years ago. And it is not only freedom from colonialism, but also the very structure of American political life and the character of its federal constitution which derive from a tradition of racial change. One of the great arguments of the Convention of Philadelphia was whether tinkering with the Articles of Confederation could fulfill the demands of the new nation or whether an entirely new instrument of government was required. The Convention was determined to have a new constitutional order—proceeding on the reasoning that Hamilton later put in the "Federalist" essays:

"A full display of the principal defects of the Constitution [would show] that the evils we experience do not proceed from minute or partial imperfections, but from fundamental errors in the structure of the building, which cannot be amended otherwise than by an alteration in the first principles or main pillars of the fabric."

The American constitutional system owes its existence to the fact that these bold but rational arguments prevailed. The case for fundamental economic restructuring at the international level proceeds on essentially similar lines. It demands a similarly enlightened response as that which the Founding Fathers gave at Philadelphia.

Henry Steele Commanger, in his Declaration of Independence drafted on Benjamin Franklin's turf in commemoration of the Bicentennial, offers such a response:

"Two centuries ago our forefathers brought forth a new nation; now we must join with others to bring forth a new world order. . . .

We hold these truths to be self-evident that all men are created equal; that the inequalities and injustices which afflict so much of the human race are the product of history and society, not of God or nature; that people everywhere are entitled to the blessings of life and liberty, peace and security and the realisation of their full potential; that they have an inescapable moral obligation to preserve those rights for posterity. . . .

To establish a new world order of compassion, peace, justice and security it is essential that mankind free itself from the limitations of national prejudice, and acknowledge that the forces that unite it are incomparably deeper than those that divide it—that all people are part of one global community, dependent on one body of resources, bound together by the ties of a common humanity and associated in a common adventure on the planet Earth.

We can no longer afford to make little plans, allow ourselves to be the captives of events and forces over which we have no control, consult our fears rather than our hopes. We call upon the American people on the threshold of the third century of their national existence, to display once again that boldness, enterprise, magnanimity and vision which enabled the founders of our Republic to bring forth a new nation and inaugurate a new era in human history. . . ."

THIRTY YEARS OF TINKERING

Two Development Decades have yielded bitter disappointment; four UNCTADs have institutionalized frustration; and nearly 30 years of post-war internationalism has seen the political equality of states guaranteed by the Charter almost totally nullified by pervasive economic inequality between the world's people. What is surprising, perhaps, is that the challenge to the system which preserved these economic inequalities should have come so late. In fact, it could not come before. In the early post-war years when the old order itself was reinforced by the Bretton Woods and GATT regimes the Third World for the greater part was a voiceless captive of the colonial system, powerless to influence the decisions being taken about the kind of world they would inherit. It was only in 1947 that India became independent, marking the start of the process of decolonization. It was only in 1956 that the dismantling of the French empire in Africa began, and a year later that the first of Britain't colonies in Africa attained freedom. Over more than a decade and half since then the developing countries have been almost excessively patient in their trial of prescriptions for development that in retrospect served merely to mask the basic ailment and, indeed, to worsen the prospects for a more equal world society.

Take aid, for example: the World Bank has projected that the United Nations target of 0.7 percent of GNP of the industrialized countries in official development assistance could be reached were they willing to commit to ODA a minor fraction of no more than 2 percent of the incremental wealth—2 percent of future growth—which they can expect to receive in the second half of the decade. Despite this, ODA relative to GNP is steadily falling: from 0.42 percent in 1965 to 0.36 percent in 1975 to probably 0.30 percent by 1985.

In trade, the record is no better. Produce more, sell more, earn more: that was the simple formula. With major effort, developing countries produced and sold more; but their net earnings, their terms of trade, steadily declined. The amount of cotton, or sisal, or sugar, or bauxite they had to produce and export in order to buy, say, a tractor, or antibiotics, or an irrigation pump, kept increasing. Despite all their effort, they grew relatively poorer. They were developing on a basis of diminishing returns. And there were other problems when they tried to diversify their economic base—efforts to industrialize, to process their raw materials and produce simple manufactured goods, led them to high tariff walls, differential freight rates and administrative obstructions to trade, all frustrating their entry into the markets of the rich countries.

When the new reserve assets, the SDRs, were created, developing countries asked for a link between SDRs and development finance. What was the result? As one Minister of Finance wryly remarked at the 1975 meeting of the IMF and the World Bank: "We asked for the link and we got a Committee". Aid a mirage, trade a cul de sac: the poor getting poorer and the rich getting richer. For the poor, to use the words of Santayana, life was not a spectacle or a feast, it was a predicament.

THE TRADE UNION OF THE POOR

In seeking release from this predicament, it is to many Third World countries a maddening contradiction that some developed states refuse to accept as legitimate at the international level mechanisms they have themselves employed, indeed devised, for advancing some of the most noble objectives within their own societies. Built into the ethos of Western democratics are the right of workers to establish trade unions, the legitimacy of collective bargaining, and the strike weapon—the collective withholding of labour. Yet when the poor of the world adopt similar methods to redress economic injustice at the international level, some developed states dispute their reasonableness or even their legitimacy.

How else would the societies of Europe have moved away from feudalism and privilege, how would American labour have moved the United States towards a just economic society, save through the collective effort of the deprived? How shall we ever move toward a just world community unless through organized effort of those now condemned to international poverty? How else, save by collective action, can they effectively challenge a system their experience compels them to reject as unjust?

To secure more effective negotiation in place of the imposed decisions of the developed states has become a basic quest of the trade unions of the poor countries. The basic objective is to negotiate a new deal with the rich nations through the instrument of collective bargaining. This is why solidarity is so essential an element of Third World action. It needs to be understood. A new order involves change—fundamental change in international economic relations. That change can be achieved by agreement, by a process of consensus, or it can be secured by compulsion, by confrontation and the clash of contending strengths. The solidarity of the Third World is often assailed as a posture of confrontation. If this means that the Third World seeks imposed solutions, the assertion is wide of the mark; for few developing countries would put high the prospect of success thus pursued.

But consensus between contending interests is not achieved through moral suasion alone—it is more often rooted in a balance of strength that itself compels reason and reinforces morality. It is to the creation of such a strength that the solidarity of the Third World is directed—a strength which is real enough to command respect and to encourage genuine dialogue and ultimate consensus. Seen thus, the solidarity of the Third World is not the posture and intent of confrontation, but an essential catalyst of consensus. It is not merely a legitimate tactic of negotiation but a necessary element of global harmony and development.

What OPEC has done: what other producer associations (or an association of producer associations) may, but only may, succeed in doing; what Third World solidarity in the Non-Aligned Movement or in the Group of 77, or in the ACP Group of States, is seeking to do, is to create conditions for more effective negotiation—to obtain greater equality of opportunity; to secure the right to sit as equals around the bargaining tables of the world. Take prices, for example, with rare exceptions, prices of primary products, whether of minerals or of agricultural products, have not in the past been the subject of effective as distinct from notional negotiations. Prices of manufactures are often not negotiated at all, merely invoiced. In both cases, prices are controlled by the developed states—whether as consumers or as producers. To make real negotiation in this area possible is surely not to seek confrontation—unless the developed world is implacably opposed to any change in the basis of human economic relations.

As is so perceptively stated in Harlan Cleveland's "The Third Try at World Order.":

"It is in the interest of the industrial democracies to be negotiating with a "trade union of the developing countries" that can clearly analyze and skillfully defend its abiding interests. The alternatives are much less attractive: a rash of "wildcate strikes" or a disguised re-enactment of the colonial relationship in which benefits to the developing countries depend more on our analysis of their interests than theirs. That is too fragile and corruptible a relationship on which to build a planetary bargain."

What is true is that confrontation becomes possible as strengths become more equal—but so, too, does consensus. Confrontation has always been within the armoury of the developed countries. It is perhaps now within the armoury of the oil producing states. It is still a long way from being within the armoury of any others. The option for confrontation is essentially an option for the developed states. It is only the opportunity for consensus that is available to rich and poor alike.

More specifically, the Commonwealth Experts' Group has urged:

"that the positive characteristics of producers' associations should be acknowledged and indeed encouraged, particularly in undertaking research and development; in evolving new methods of production and utilisation of a commodity; in providing a forum for the exchange of economic, statistical and technical information between member countries, and in enabling balanced negotiations to take place between the owners of the resources and the multinationals wishing to acquire them."

EQUALIZING MECHANISMS: WHY NOT GLOBAL?

The analogy with national conditions is valid, also, in relation to many of the equalizing mechanisms actually employed at the national level. Within every major industrial country and regional economic community it is now accepted that the unrestricted operation of free market forces can lead to results out of tune with prevailing concepts of a just national or regional society. The operation of the market often fails to achieve an equitable distribution of income among peoples or of activities among regions. And the market is vulnerable to manipulation through the exercise of unequally distributed market power.

Recognition of these failings has led to corrective intervention. Many developed countries have devised mechanisms for transferring income from the relatively rich to the relatively poor within their societies. Some of these mechanisms involve direct transfers. Others involve direct intervention in the market place. Thus freight rates and food grains are subsidized, minimum prices for agricultural products guaranteed, and marketing controlled.

Such intervention results in some redistribution of activities within regions, and it has often been supplemented by machinery designed to stimulate and assist the development of human and natural resources in lagging regions. The United States has elaborated stiff anti-trust and anti-monopoly measures in an effort to curb overweening economic power; farm policies and oil policies interfere with market forces in the interest of social and economic justice at home. And across national boundaries, within the European Economic Community, the Regional Development Fund, designed to implement a policy of balanced growth, transfers community resources from rich regions to poor.

Developing countries find it difficult to appreciate why these national mechanisms are not also available at the international level to redress international poverty and global inequalities. In 1974, the UN General Assembly adopted a Programme of Action for the New International Economic Order. Its essential features are not so different in kind from measures already accepted within developed states. Their adoption within the international community would not of necessity lead to chaos and disaster. What is needed is not an act of intervention but an act of will, to carry these perceptions of economic justice, of balanced growth, beyond the frontiers of developed states.

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It may be objected that in the international community, unlike the nation-state, there is no supreme authority capable of enforcing balanced development. But have the equalizing mechanisms of all developed states really derived from the exercise of sovereign power? Canada, for example, has created machinery for transferring resources, so that each Provincial Government has an acceptable minimum financial capability. This has been achieved within a federal system, not by constitutional litigation or amendment or by an imposed federal will, but by negotiation and consensus using the techniques of international diplomacy. Is this not an object-lesson for the international community? Is is for just such an approach to equity that the developing world contends and organizes.

WHAT THE SOUTH MUST DO

An important element of the new awareness of the realities of international poverty is the acknowledgment by the developing world that self-reliance, both at the national level and at the collective level among developing countries, must be an essential feature of development. Self-reliance is not autarchy, nor is it isolationism; it is not a vision of detached self-sufficiency. It is a conviction that development must come from within each society—conditioned by its history and its social, cultural, and economic strengths, founded on its resources, including its human resources, and committed to the national well-being. Self-reliant development is based not on what the world can do for us, but on what we can do for ourselves. It strives to ensure the provision by national effort of the essentials of national subsistence—of food, of habitat, of health, of education. And it seeks fulfilment by exploring new frontiers of co-operation between developing countries themselves.

It is, above all, development committed to the creation of just societies; for there is no rational basis, there is no morality, in the demand for a more equal world community, unless it implies the facilitation of more equal national societies. It is a model of development, therefore, that condemns privilege within developing countries as rigorously as within the world community of states. The Third World must articulate these perceptions of development and be zealous for their translation into reality. It must demonstrate both by precept and by example a commitment to national and collective self-reliance; to the dismantling of feudal structures; to the dispelling of pretences of privilege which are even more grotesque in the midst of poverty than they are in conditions of affluence. And it must prove by these advances that the creation of truly just societies, in which basic human values are respected and man's humanity is allowed to develop its potential, is the true fulfilment of the promise of development.

For some developing countries this process is well advanced. For others, it has yet to begin. But whether we are dealing with the one or the other it is wrong, and it is unhelpful, for developed societies to yield to the too easy temptation to escape responsibility for creating conditions of growth within the Third World by pointing to imperfections which at one time or another have been features of their own national development. The Third World does not divide up as easily as some would have us believe into "the deserving and the undeserving". It does not do so any more fairly than did the Victorian poor, castigated by their overlords for their indolence and indiscipline.

THE CENTRALLY PLANNED ECONOMIES

In the evolution of a new internal economic order a major responsibility rests upon industrialized Western countries. Jan Pronk, the Dutch Minister for Development Co-operation, has rightly observed:

"The new order required by the poor countries will be within easy reach when the United States and the Common Market agree it."

Together, they dominate world trade, international finance and industrial prodution. But obligation does not rest on them exclusively. All developed countries, of East no less than West, share in the obligation for eradicating international poverty. It is not enough for the centrally planned economies to plead, as was said recently at the Seventh Special Session, that they had no responsibility for the colonial exploitation of the Third World. It is not merely a legal issue of restitution or reparation. It is a moral issue that concerns the quality of life of a large section of humanity; it is fast becoming, for all nations, culpable and blameless alike, an issue of global survival.

FROM THE NORTH: AN ACCEPTANCE OF CHANGE

If these, then, are the realities, what are the prospects for advance toward the promise of the new order? Developing countries have no option but to seek an end to poverty and deprivation. For them, the analogy of the poor within the nation-state is apposite. The Third World, or at least a major part of it, has nothing to lose but its poverty. It has a world to win. It is important that the developed world understands this psychological reality of the human condition among the poor of the earth.

The way forward must surely lie in a change of attitude on the part of the developed world. Developed states must frankly acknowledge that the need is pressing for fundamental change in international economic relations; that the choice is not between an old order or a new but between a new order or sustained disorder. They must abandon petulance, and cease to deceive themselves that serious demands stemming from deep resentment of pervasive injustice are mere rhetoric. They must acknowledge that, together with the developing states, there is a mutuality of interest in change. Above all, in working for consensus on the nature of change, the developed world must be prepared to give a good deal more by way of compromise than the developing can be expected to yield—accepting Aristotle's time-hallowed teaching that as between unequals progress towards equity demands unequal inputs.

A ROLE FOR THE PEOPLE

The new order will not be installed in its entirety overnight, it has no more emerged full-blown from a constructive Seventh Special Session than it did from the unpromising Sixth. The conclusions of each were important; but what is needed if the peoples of the world are to be made equal in their economic destinies is not so much the outvoting of a rich minority or their passive acquiescence in the promise of change, but the conversion of that minority to the need for change and to the urgency of its imperative. Such conversion cannot be expected from the processes of United Nations action only; other fora, other forms of diplomacy, other machinery for dialogue that possess a potential for promoting such conversion must render service to the cause of change.

This implies, of course, a particular emphasis on reaching the people of the developed world whose governments, however enlightened, need informed popular support if they are to take the decisions involved.

That support must come from the labour movement—the workers of the West—who must see in the struggle for real development at the international level a reflection of their own successful struggle for social and economic justice at the national level. It must come from the consumers—convinced that there are gains in a new system which does not deprive them of access to the products of the Third World at prices uninflated by artificial barriers. It must come from the businessmen and industrialists—understanding that their long term interests, both in terms of access to materials and their capacity to sell, lie in the restructuring of the world order and that they would do well to make an investment in it now.

It must come from the political parties and political movements impressed with the urgency of bringing governmental policies into line with human needs and their own basic principles. It must come from the many ordinary citizens whose instinct of goodness tells them that the present system does not serve their own countries well and who are searching for the values and concepts of a just global society. And it must come from the youth to sustain them in their rejection of the invalidity of contemporary human relationships and the economic structures directed to perpetuate them.

The people can themselves help to ensure that the responses made on their behalf are indeed enlightened; for, whatever their perception of their own relative position, they face unrivalled prospects that their personal wants will be satisfied. It is more than likely that if the consequences of the system from which they unconsciously benefit were made truly apparent to the peoples of the rich countries they too would reject it. It is heartening to see how much is being done within many developed countries by individuals and associations and institutions in this regard. The effort, however, has barely begun and current economic difficulties—some, themselves, the aftermath of the collapse of the old order—do not create an altogether propitious climate for drawing attention to international poverty, even on a basis of enlightened self-interest. All the more reason, therefore, for a sustained attempt to alert the people of the rich countries to the predicament which international poverty implies for rich and poor alike, and to convert them to the cause of change.

IN THE PLANETARY BARGAIN: NO LOSERS

In that process of conversion it is an important factor that the planetary bargain which the Third World seeks involves no losers. In such principal areas under negotiation in the North/South dialogue as commodities, credit manufactures and a transfer of resources this mutuality of benefit is clearly demonstrable. At the heart of such mutuality in these specific areas is the reality of interdependence—nowhere better illustrated than in the field of international trade.

Contemporary economic experience shows that although there has not yet been a substantial change in North/South roles—the developing countries still in the main supply essential raw materials and fuels to the industrialised countries and purchase manufactures and capital goods from them—the part the developing countries play in supporting growth in key areas of the economies of the industrialized countries has become increasingly significant.

The following data show the contribution of the developing countries in supporting trade of the principal industrial countries:

TABLE 1.—PERCENTAGE SHARE OF DEVELOPING COUNTRIES IN DEVELOPED COUNTRIES' EXPORTS AND IMPORTS

		Manufactured goods				Primary products	
	Total trade	All	Motor vehicles	Engineering goods	Textiles	Total	Oil
(a) North America 1969–75 share of:							
1969 exports	22.8	23.9	13.6	28.4	35.2	19.7	12.8
1975 exports	29.3	32.3	20.5	38.0	31.3	23.3	7.4
Increase in exports, 1969–75	33.1	38.0	25.8	43.3	28.7	24.9	6.1
1969 imports	21.2	9.6		4.7	37.9	49.7	68.7
1975 imports	33.7	13.5	.6	12.1	55.4	65.2	79.4
Increase in imports, 1969–75	41.2	16.5	1.0	16.9	75.1	71.2	80.8
(b) EEC 1972–75 share of:							
Exports in 1972	13.4	14.6	13.3	18.9	8.2	8.6	4.0
Exports in 1975	18.1	19.8	22.9	25.0	9.0	10.6	5.1
Increase in exports, 1972–75	23.1	25.7	35.0	31.2	10.4	12.5	5.8
Imports in 1972	17.8	5.2	.1	1.4	12.7	37.7	70.8
Imports in 1975	22.6	5.7	.3	2.2	16.9	44.7	70.8
Increase in imports, 1972–75	27.7	6.4	.7	3.2	22.5	50.6	70.8
(c) Japan 1969–75 share of:							
Exports in 1969	39.2	38.4	36.1	37.4	49.0	52.2	80.0
Exports in 1975	42.9	42.6	31.6	37.8	62.6	54.1	77.3
Increase in exports 1969–75	44.4	44.3	30.7	38.0	86.4	55.9	76.5
Imports in 1969	41.3	18.8		2.7	35.0	50.5	73.9
Imports in 1975	53.4	21.8		11.3	51.2	61.3	81.5
Increase in imports, 1969–75	57.6	23.6		17.0	54.1	64.6	82.5

Source: Data derived from GATT reports on international trade; 1975 data are provisional.

The data demonstrate the increasing importance of the developing countries in supporting production and jobs in the industrialized countries. Merely by way of illustration, it is clear that:

(i) the role of the developing countries as markets for manufactured goods is far from marginal and has been growing. This growth reaches its highest level in the case of Japan where developing countries now account for more than 44 percent of the increase in Japan's exports of manufactured goods. This assumes additional significance in view of the fact that the increase was from a substantial base and that manufactured goods provided 96 percent of the increase in Japanese exports over the six year period; the figures for North America (38 percent) and the EEC countries (26 percent) are themselves substantial;

(ii) in engineering goods, which are of considerable importance to employment and exports in the industrialized countries, the markets provided by the developing countries have been large and increasing, being 38 percent for both Japan and North America in 1975;

(iii) trade among the industrialized countries, and between the industrialized and centrally planned economies, together still accounts for the larger share of the industrialized countries' export trade; but this share has been declining.

It is significant that this relative decline in intradeveloped country trade has taken place during a decade in which "the people of the developed countries have enjoyed per capita incomes in real terms that rose in absolute terms (over the 10 years 1965–1975) more than in any other comparable period in history". [McNamara 1976, p. 4]

The role of the developing countries both in supporting the level and increasing the size of the export trade of the industrialized countries becomes even more meaningful when it is noted that, with 50 percent of the world's population, the developing countries earned only 13 percent of the world's income in 1974. Looking to the future, it is now clearly inevitable that these countries will exert a significant influence on the expansion plans and prospects of the industrialized countries; they provide a potential new frontier for generating expansion in the world; but it is a potential which only development can activate. This shows up the long run harmony between development in the developing countries and employment of the tremendous physical and human capabilities in the industrial societies. It answers more clearly than any other argument the question—why should the industrialized countries become more involved in supporting an accelerated increase in the income of the developing nations. Conventional wisdom has continued to view the situation from only one perspective; that of the effect of developments in the industrialized countries on the experience of the developing countries. Inevitably, such a view arrives at conclusions which take no account of the dynamics of the recent past. But, as the data given above indicate, the conventional view is not only a partial view; it is becoming increasingly a wrong view. The dynamics of interdependence and mutuality of interest must shape the approach to future international economic policy of the industrialized countries. They must condition the responses of the North in the specific areas under negotiation; in particular, in commodities, credit and manufactures. Such mutuality of interest will be seen to lie in the detailed changes sought in these three areas.

COMMODITIES

It is inevitable that a major preoccupation of the developing countries should be with a new regime for international trade and other arrangements for commodities. Commodities dominate the export trade of most developing countries as the following data show:

TABLE 2.—DEPENDENCE OF DEVELOPING COUNTRIES ON COMMODITIES FOR MERCHANDISE EXPORT EARNINGS

	On all commodities		On 18 IPC list [1]	
	Number of countries	Population (millions)	Number of countries	Population (millions)
Over 75 percent	46	396.6	20	115.2
50 to 75 percent	27	912.4	23	335.3
25 to 49 percent	11	123.0	32	996.4
24 and below	10	120.5	19	105.6
Total [2]	94	1,552.5	94	1,552.5

[1] Agreed list of 18 commodities included in UNCTAD integrated program of commodities.
[2] Nonoil developing countries only.

Included among the 46 developing countries which depend for more than 75 percent of their export earnings, are countries with only a very narrow economic base; some (like the Gambia and Lesotho) have few discernible sources of foreign exchange earnings other than from the export of one or two commodities. The earnings from these commodities determine their ability to purchase essential imports such as drugs, spares for power and water systems, and fuel for transportation.

The violent fluctuations in commodity prices hurt these countries very badly; and the secular deterioration in the real relative prices they receive results in an unwilling transfer from the poor countries to the rich countries.

The experience of individual countries describes more dramatically than bare statistics can depict the frustration which the existing regime for commodities causes. President Nyerere of Tanzania stated in 1975—

"Tanzania was suffering from the present economic system before 1973; oil prices are just an extra burden—although a heavy one. In 1965 I could buy a tractor by selling 17.25 tons of sisal. The price of the same model, in 1972, needed 42 tons of sisal. During the much talked about commodity boom of 1974, I still needed 57 percent more sisal than I did 9 years before. And now the sisal price has fallen again, but the tractor price has gone up still further".

But the loss inflicted by the existing regime for commodities on developing country producers (deterioration in real relative prices of commodities exported by developed countries has been 40 percent lower than that recorded for commodities exported mainly by developing countries) is not to the unmitigated gain of all groups in the importing developed countries. The industrialized countries have long recognised the importance of avoiding excessive fluctuations internally and have introduced measures to safeguard the real incomes of their primary producers. The application of these principles internationally could yield important gains for the world economy.

In the producing countries, uncertainty over price expectations erodes the incentive to invest; it discourages new investors from entering the field; it frustrates the switch from the production of commodities facing declining demand to commodities for which the world may have a long term need. The secular decline in purchasing power, aggravated by sharp price fluctuations, reduces the capacity of the producing countries to contribute more substantially to sustaining export demand in the industrialized countries.

In the importing industrialized countries the fluctuations in prices and the uncertainty over supplies, worsen inflationary propensities through entrenching a ratchet effect on costs and prices; wages and related costs move up with the commodity prices peak, but not down with the prices trough. Consumers in the industrialized countries therefore do not gain significantly when the prices turn down, but lose when the prices turn up. When the price trough of commodities comes, and it occurs in the downswing of the business cycle, the reduced receipts of the producers curtail their demands for manufactured goods which the industrialized countries supply. This is not a surmise. Sir Harold Wilson has pointed out "before the War, Sir William Beveridge and I produced evidence that every industrial slump in Britain, every increase in unemployment for the previous 100 years, was associated with a collapse in primary prices in countries from whom we imported much food and raw materials". [World Economic Interdependence and Trade in Commodities; HMSO May 1975 p. 3.]

It is therefore to the benefit of both exporting and importing countries that a new regime for international trade in commodities should be introduced. A new regime must address itself to the underlying problems with the same comprehensiveness and directness that national systems, or multinational systems (such as those introduced by the European Economic Commodity) have done. It must take account the interests of both the producers and the consumers in the way that US farm and oil policies have done. An acceptable new regime should fulfill at least three basic requirements—

(i) yield prices remunerative to producers and fair to consumers, which avoid the wild fluctuations that now prevail;

(ii) provide adjustment assistance for producers to overcome unforeseen difficulties and adapt to changing requirements either through upgrading or phasing out production; and through these and other measures,

(iii) stimulate investment and new production to satisfy future consumer demand at reasonable prices.

An approach which does not meet at least these desiderata will be ineffective.

Enlarged compensatory financing facilities which will maintain the real import capacity of the exporters in times of unforeseen difficulty, and which will not impose burdens of repayment which are considered harsh, are a necessary part of any comprehensive approach. But they cannot be a substitute for arrangements which will yield reasonable assurances of remunerative price. It is inequitable to require a producer to borrow what he should be allowed to earn. Assurance of financing facilities alone does not deal with the problem of investment, and new investment is necessary to ensure increasing supplies and stable prices in the long term. For at the heart of any investment decision is the judgment that, based on expected prices and costs, a project will earn enough to repay its costs and yield a return for risk.

Additional investment funds for commodity production, provided by a bank or a similar financing agency, are also necessary. But price expectations must be right if the availability of credit facilities are to result in new investment and eventually new production.

Such a comprehensive approach, which recognized the need for greater intervention by national and international authorities in the production and marketing of commodities and in the financing arrangements that support them, has informed earlier proposals to deal with the commodity problem.

In 1942, Keynes, putting forward what was then a British proposal for the stabilization of primary commodity prices, pointed out:

"For many years the orthodoxy of laissez-faire has stood in the way of effective action to fill this outstanding gap in the organization of production. Nevertheless there are many signs that the world is ripe for change. Is not centralised international action capable of effecting a vast improvement of system, at any rate in the case of the great staple raw materials, most of which can be readily stored without serious deterioration? The details of any scheme must be governed by the special problems and requirements of the individual commodities. . . . Any buffer stock plan must be capable of adjustment to meet different requirements. Nevertheless, certain general principles can, it is suggested, be usefully prescribed and agreed."

The important point is that both past and contemporary analysis has recognised that a global approach is required to deal with the commodity problem; it must deal with prices and receipts and it must cover, directly or indirectly, a large number of commodities of export interest to developing countries as it is these latter who are hardest hit by the aberrations of the existing system.

The package of proposals now under negotiation, following their acceptance in principle at Nairobi, provides for a wide range of commodity agreements, negotiated within a short period of time, integrated by a central financing facility and supported by enlarged and liberalized compensatory financing facilities; and provides also for increased processing of commodities in countries of source. It is a most significant attempt to deal with the issues in a comprehensive manner. It is important that the package be negotiated as rapidly as possible, including the fixing of appropriate base price ranges for commodities, and that the essential integrity of the approach be retained.

In assessing the package of measures for commodities, as indeed in reviewing proposals for economic change in other fields, it is necessary to avoid the aid syndrome which conditions the approach which many tend to adopt in appraising international economic change. A new international regime for commodities is not a mechanism for aid. A few net importing developing countries may require assistance to cushion any adverse effects which its introduction may have on them; but a new regime for commodity trade is not and should not be seen as an instrument for providing international economic aid.

The regime proposed is not inflationary. The elimination of the wide swings in commodity prices would remove the ratchet effect on wages and costs, and greater stability in import capacity of commodity producers should assist in imparting greater stability to prices in industrial countries. In these two respects therefore the proposed regime is anti-inflationary and could assist in reducing the swings in the business cycle. Further, even under full indexation, as long as the prices of manufactured goods do not increase, the indexation coefficient remains unity; it therefore has no autonomous propensities for inflation. If, on the other hand, autonomous forces operate in the industrialised countries, or in other areas (e.g. oil prices), to cause prices of manufactured goods to increase, then indexation would be triggered. But to seek to do otherwise would be the epitome of exploitation by the rich industralised countries of the poor commodity producing countries; for these latter would be then required to absorb the cost of inflation in the rich countries by reducing even further standards of living which are already unacceptably low.

The outcome of the negotiations for commodity trade has implications for the whole question of North/South relations. The economics of the proposals are based on the concept of interdependence and on the imperative of demonstrable mutuality of benefit from an improved trading system. As we have seen, its operative mechanisms have long been advanced by the industrialized countries in relation to programmes designed to secure "improved labour standards, economic advancement and social security for all" [the Atlantic Charter]. Their efficiency has been tested by years of experience in the industrialised countries themselves.

What is new in the proposed arrangements, and what is at stake, is the possibility for the developed and the developing countries to share, more equitably than hiterto, the management of international commodity trade under arrangements in which both producers and consumers will have a substantial voice in determining the arena, the game and the rules. In the words of the RIO Report, "the commodity problem is (thus) one of establishing an equitable and harmonious basis for the joint management of asymmetrical economic interdependence [RIO P3–22]. The arrangements concluded will reflect the level of political willingness to establish this joint basis of management. A refusal to agree to a system containing the essentials of a mutually reinforcing programme for commodities can only imply that the industrialised countries are determined to maintain a monopoly control over decision making at all levels, at some substantial cost to themselves (a cost which their current high standard of living enables them to absorb), but mainly to the continued impoverishment of the developing countries, for many of whom commodity exports provide the sole lifeline.

INTERNATIONAL CREDIT

No attempt to shape the world's institutions and arrangements to suit the needs of contemporary reality, and the projections of a more humane and less unequal system, can leave the international credit system in its present state of disrepair. The reformation of the system of providing short term credit, and the refurbishing of the institutions providing long term finance, must occupy an important place in the world agenda. In introducing changes in this area, the international community must avoid being deluded into believing that the multiplication of special facilities, each having limited effect and requiring much scarce human resources to manage and to use, can be an effective substitute for fundamental change.

Credit is the central lubricant of any economic system. An adequate flow at the right time and at acceptable cost is required to enable output to grow, jobs to increase and costs to fall. This is why one of the primary goals in new international economic order which the developing countries now seek, is an international credit system which would be responsive to their development needs, be international both in scope and management and obviate the excessive obtrusion of the requirements of internal economic management of particular countries.

The deficiencies in the existing system of international credit creation and distribution are well known. The work of United States and other experts have clearly documented them. The IMF, established in 1948 as a main source of international credit for an expanding world trade, is required by its rules to make most of its credit facilities available to countries which do not and will not use them; they also require the Fund to take little account of the needs of those countries which require and will use the facilities. The patchwork of changes in the Fund, which has been introduced in the place of the more fundamental, even though moderate, reforms proposed by the Committee of Twenty, has not significantly improved the system. Indeed, most analysts are agreed on the ineffectiveness of the modifications recently agreed by the Interim Committee in the "Jamaica Package" [see Essays in International Finance No. 115, April 1976—Reflections on Jamaica, Princeton University]. Ad hoc changes introduced from time to time, including those currently under examination, provide some temporary relief for short periods, but the crisis which they are intended to avert will recur.

The international community must take fully into account the changed circumstances of the world since the time of Bretton Woods—when the primary focus was on the reconstruction of a war ravaged world; the needs of the now developing countries were for all practical purposes ignored. Now, due account must be taken of these needs in their own right. And account need also be taken of two of the more significant developments of the 1970s:

First, the very high levels of inflation in the 1970s: current price increase show signs of abating, but levels in 1976 were some 88 percent above 1969. It is very unlikely that prices will ever fall back to their levels of the mid-1960s; this has implications for costs and credit needs.

Second, the change in the balance of payments deficits which the non-oil developing countries face.

These changes require corresponding structural changes in the financing facilities to cover them. Prior to 1973, the deficits of the non-oil developing countries were in the region of \$9bn–\$10bn. It is true that, during this period, growth rates were low, yielding an increase in per capita incomes to the poorest developing countries (measured in 1975 prices) of barely \$2 per year. Nevertheless, the deficits were accommodated by normal aid flows, supplemented by international credit from the international agencies and private capital movements. Inflation and the movements in the terms of trade have changed the total picture. Even at equally low, in some cases reduced growth rates during the last three years, the deficits of the non-oil developing countries were between \$28bn and \$37bn. However, aid from DAC countries has shown no return to pre-1970 rates. The IMF quotas, which comprised 15 percent of world trade in 1948, have been allowed to decline to only 4 percent of trade in 1977. Instead of a substantive change in IMF quotas, a patchwork of ad hoc responses has been introduced, which, while being time consuming to negotiate, have had little more than a cosmetic effect in enabling the world community to finance the requirements of world trade. The IMF oil facility provided barely \$3bn to the non-oil developing countries during its two years and other ad hoc changes in Fund facilities have been of only marginal significance.

Under the arrangements currently operative, even if the developing countries had been prepared to accept all the conditions which attach to the use of credit from the IMF under its several facilities and had drawn all that could have been available—and this itself would have been impossible in view of the time required to negotiate the use of these facilities—the total sums available would have amounted to barely 10 percent of the deficit which they experienced: and would have been provided under conditions which many developing countries consider to be contrary to their requirements for satisfying the basic needs of their population in a reasonable period of time.

In the circumstances, the international comercial banks have had to be relied upon to provide a substantial part of the credit which the non-oil developing countries required. The scale of borrowing involved has pushed the total of indebtedness of the non-oil developing countries to over \$180bn, much of it relatively short term; and the consequent heavy debt service burden which these countries have to bear has begun to cause some concern both to the commercial banks themselves and to certain national authorities which superintend commercial banks activities.

In looking to the future, it would be futile to ignore the likelihood that the deficits (using World Bank projections) of the non-oil developing countries could reach \$50bn by 1985. This could be the outcome even though, on the basis of growth rates assumed, the poorest developing countries will secure an increase in their real per capita income of only \$3 per year. To obtain a larger increase would mean a larger deficit; to require a smaller deficit could mean stagnation, and in too many cases starvation. This defines the role for the machinery for meeting the balance of payments deficits of developing countries.

If the international community is to discharge the commitments it assumed at the Seventh Special Session and elsewhere, it must install arrangements which would permit the deficits of the non-oil developing countries to be covered in a satisfactory way. An essential step in this regard would be to reappraise the machinery for recycling surpluses to deficit countries. This is a function which the international commercial banks have been required to play, in a very large measure, over the past three years. They clearly could also play a significant role in the future. But unless the capability of the international agencies is substantially enlarged and made more flexible in the future, the commercial banks may, paradoxically, find it necessary to be more selective and restrictive in the kind of role they play in financing balance of payments deficits in the future. The truth is that the strengthened international credit machinery which the developing countries seek would be supportive of a continuing important role for other private credit institutions in the developed world.

In the long term, the international community will probably have no alternative but to create an agency which would perform for itself the services undertaken in a national economy by a central bank. It may very well be that the issues which will have to be negotiated in the establishment of such an institution will take some considerable time. However, there is more than adequate justification to take certain initial steps in this direction now and to strengthen the capability of the IMF to provide a major part of the international liquidity required for the continuing expansion of world trade. This strengthening should come about not merely through the establishment of new ad hoc facilities but by increasing the inherent capability and improving the flexibility of the IMF itself.

Two steps in this direction should command early agreement. First, there should be a substantial increase in IMF quotas, with a firm understanding that IMF quotas will in due course, be made to bear the same relationship to world trade as they did at the time when the Fund was set up. Second, the agreement already reached to make the SDR the principal reserve asset, should be made operational; this should be done through a selective allocation of SDR's, based on the needs of countries and not on the basis of the quota which they hold. This is a variant of the Link mechanism which has been extensively discussed over the past decade. These two measures could together assist in defusing the explosion of currency reserves which has been a feature of the recent inflationary past and which holds dangers for both national and international monetary management alike.

While the refurbishing of the machinery for meeting the balance of payments needs of countries in deficit must continue to occupy a considerable part of the world's attention, the enlargement of the capabilities of the institutions providing long term finance cannot be ignored. The decisions taken by the World Bank to freeze the level of World Bank lending and to increase the cost of its loans had little justification either in relation to the development needs of the non-oil developing countries or in the potential of the regional development banks. Such a step could possibly have been justified only if there had been a major expansion of bilateral and multilateral aid to finance both infrastructure and direct production facilities. For it is facile to assume that private capital inflows, through the medium of the transnational enterprises of other forms, is a relevant alternative to funds provided by the development finance institutions. Indeed the reverse is more likely; i.e. an increased flow of resources from the development finance institutions could create greater opportunities for productive cooperation between the transnational enterprises and the developing countries: for not only would such finance facilitate the provision of the infrastructure on which major investment would depend; but it would also permit Governments and transnational enterprices to agree on terms which would not be inconsistent with the kind of demands which all Governments face for greater control over the exploitation of the national partrimony.

As a minimum, the World Bank should be enabled, through an appropriate expansion in its capital, at least to maintain its lending in real terms to the developing countries. But over and above this, the opportunity for reappraising the role and functions of the international institutions should be used to re-examine also the relationship between the IMF and the development finance institutions. In the circumstances of an increasingly interdependent world and of the fact that the balance of payments gap may be a reflection of an inadequate flow of development capital being structural and not cyclical in nature, is there not a case for establishing a functional financing link between the two while maintaining their separate identities and roles.

One further point must be noted. The creation of facilities is one thing; the conditions of their utilization are another. If there is one lesson which experience of the past has taught, it is that rules which may be quite appropriate to developed countries may not be consistent with the development requirements of the developing countries. The world community has long gone beyond the period of political colonialism when prescriptions for behaviour could be laid down by the industrialised countries acting alone. The development requirements in the developing countries, in the context of an increasingly interdependent world, can be effectively served only if the developing countries had a greater say in shaping the rules under which the credit is disbursed, This greater voice will not, as some fear, induce irresponsible behaviour in monetary affiairs; it is more likely to control such behaviour. Certainly the inflation/recession of the past cannot be attributed to the conduct of the developing countries. The developing countries' request for a greater role in the management of the international monetary mechanism should not therefore be disregarded.

While there may be differences of view on the details required for reshaping the international monetary order, there is little disagreement that the call by the developing countries for a more responsive international financial system is timely, consistent with the long term needs of the international community and mutually supportive of an expanding role of the private international credit agencies. In the 1960's eminent American economists signalled the dangers which policies and practices at that time, and more particularly the absence of willingness to introduce satisfactory structural change in the international monetary system , posed for international monetary and world economic stability. The consequences of the inaction then are reflected in the international monetary disorder that now prevails. Positive action in the 1970's to structure the international credit system to meet the circumstances which the world community will almost certainly face in the 1980's is not a subject in which any country can afford to be ambivalent.

The management by the industrialized countries of the changes introduced by the oil price increase and the attendant surpluses of certain OPEC countries may induce an atmosphere of complacency. But responsible opinion, weighing the consequences of the past and the requirements of the future, must question the wisdom of postponing consideration of the kind of structural changes (some of which were outlined above) which experts from both developed or developing countries consider to be the minimum required to meet the circumstances. This call can go unheeded only at the cost of a substantial set back both to the developing and the developed countries.

INDUSTRIAL COOPERATION

No one now questions the need for an acceleration in the rate of industrialisation of the developing countries. The recent study undertaken for the United Nations (Leontief) confirms that, in the absence of a sustained expansion in manufacturing and processing, economic development in the developing countries will not advance at a rate which will enable them, within an acceptable period of time, to satisfy the basic needs of their population and reduce the income disparities in the world. Without such expansion in manufacturing, the developing countries have little chance of providing jobs for their labour force—up to 40% of which is now effectively unemployed—and to which 1000 million more will be added by the end of the century. A commitment to support development of the developing countries is meaningless in the absence of tangible support for their industrialisation.

However, one of the realities of contemporary experience is that the recognition of the need for industrialisation is not matched by a resolve to satisfy its basic preconditions. In addition to other problems mentioned earlier, developing countries face severe restraints in their access to the markets of the industrialised countries for the kinds of goods in which they have an advantage.

Measures to improve the conditions of access have been under consideration for some considerable time; but there is little susbtantial progress to show. The complicated rules of origin and the stringent safeguard and exception clauses that attach to the recently introduced Generalized System of Preferences operate in the same way as effective non-tariff barriers and significantly reduce the benefits which the GSP was expected to confer to the developing countries. Progress in the Multilateral Trade Negotiations (The Tokyo Round) has been minimal.

The developing countries are hurt particularly severely by the restrictions imposed against their exports of light manufactures and processed primary products because—

(i) these goods are the principal items that many of them can produce, given the level of sophistication of their labour force;

(ii) these goods are large employers of semi-skilled or cottage labour;

(iii) they provide necessary introduction for the disciplines upon which entry into more complicated forms of manufacturing, such as process engineering, depends.

There is a body of opinion in some developing countries that the failure by the industrialised countries to relax the conditions of access to their markets for goods coming from the developing countries derives from two considerations. First, an unexpressed view that the developing countries should continue to be suppliers of raw materials for the industrial machines of the developed countries, and that such manufacturing as they should undertake should be restricted either to basic goods for their own needs or as outposts of the transnational enterprises. Second, that the developed countries do not fear retaliation from the developing countries to the same extent as they do from other developed countries.

The more conventional view is the concern that action to ease the entry of manufactures from the developing countries could cause major dislocations and mass unemployment in the developed countries.

Based on the evidence, this latter fear is exaggerated; the consumers in the industrialised countries pay a high price in keeping out goods from the developing countries; and the restrictions which are imposed against manufactures from the developing countries also impede the expansion of exports of manufactured goods by the industrialised countries; consequently, so far from protecting jobs in the industrialised countries, the restrictions destroy jobs in both the developed and developing countries.

The following table gives some data on recent trade in manufactures:

TABLE 4.—SELECTED STATISTICS ON TRADE

		Manufactured goods					Primary products		
	Total	Total	Motor vehicles	Engineering goods	Textiles	Other	Total	Oil	Other
	Billions of dollars								
A. Imports of industrialised countries:									
1969	186.3	115.6	14.2	36.8	11.2	53.4	67.2	18.5	48.7
1975	570.7	314.4	38.5	110.0	29.9	136.0	248.0	131.4	116.6
Increase 1969–75	384.4	198.8	24.3	73.2	18.7	82.6	180.8	112.9	67.9
B. Exports of developing countries:									
1969	49.5	11.7	.1	1.2	2.8	7.7	37.3	16.3	21.0
1975	212.4	37.6	.4	7.3	9.7	20.2	172.4	132.0	40.4
Increase 1969–75	162.9	25.9	.3	6.1	6.9	12.5	135.1	115.7	19.4
	Percentages								
C. Developing countries' shares of imports by industrialised countries:									
1969	26.6	10.1	3.5	3.3	25.0	13.5	55.5	88.1	43.1
1975	37.2	12.0	1.0	6.6	32.4	14.8	69.5	100.00	34.6
Increase	42.4	13.0	1.2	8.3	36.9	15.7	74.7	102.5	28.6
D. Industrialised countries' share of exports of developing countries:									
1969	70.7	69.2	--------	50.0	60.7	76.3	72.7	74.8	71.0
1975	71.8	60.9	50.0	57.5	67.0	59.4	74.4	73.3	78.0
Increase	72.2	57.1	66.7	59.0	70.0	49.2	74.9	73.1	85.6
E. Industrialised countries' share of imports of developing countries:									
1969	70.6	82.1	93.8	85.8	67.6	78.8	37.2	13.6	47.1
1975	66.6	83.6	95.5	90.0	61.3	76.9	32.0	6.2	55.3
Increase	65.2	84.2	96.0	91.5	56.5	76.2	30.4	4.9	59.2

Source: Data derived from GATT reports on international trade; 1975 data are provisional.

Among the features of contemporary reality on which the data throw light are the following:

First, imports of the industrialised countries have grown very sharply in value terms over the 6 yr.; imports of manufactured goods have grown almost as sharply as total imports, in spite of the fact that total import values reflect the increases in the price of oil.

Second, the developing countries are not major suppliers of manufactured goods to the industrialised countries; only in textiles is the share of the developing countries significant. Even in this category, trade among the industrialised countries supplies ⅔ of the imports purchased by the industrialised countries. For other manufacturers, the developing countries share was only 12 cents out of each dollar of imports.

Third, and contrariwise, the markets of the industrialised countries, restricted though they are, are critically important for the manufactures of the developing countries; 61 cents of every dollar of manufactures exported by developing countries in 1975 went to the industrialized countries. The restrictions, and particularly sudden increases in these restrictions, therefore are highly disruptive to production and trade in the developing countries.

Fourth, the industrialised countries supply virtually all the manufactured goods purchased by developing countries; they supplied 96 cents of every dollar imports of motor vehicles, 90 cents of every dollar of engineering goods, 61 cents of every dollar of textiles and 77 cents of every dollar of other manufactured goods imported by developing countries.

In these circumstances, it is possible to assert the following—

First, even if there were a very large expansion in exports of manufactured goods by the developing countries, it would have a negligible dislocation effect on the markets of the industrialised countries; and such an expansion could be readily accommodated by marginal adjustments in intra-developed country import trade which, for reasons given later, would be easily compensated. To be specific, except in the case of textiles, an overnight increase in exports of manufactures of 50% in value, would mean merely 4% of the current level of imports of these goods by the industrialised countries. This could not cause massive unemployment in the industrialised countries.

Second, the developing countries spend their export receipts very largely on the goods produced by the industrialised countries. The principal increases in their imports have been in motor vehicles and engineering goods, which are large employers of labour of the type available in industrialized countries. As pointed out earlier, the developing countries are absorbing an increasing share of exports of these goods from the industrialized countries.

Third, the industrialized countries benefit directly and immediately from an increase in export earnings of the developing countries. But the gains go beyond direct exports. There is a growing, largely one way, trade in consulting, financial and technical services from the industrialized to the developing countries.

In this connection, it is appropriate to comment on one of the arguments used in justification of restrictions against goods from the developing countries; it is that the low wage imports displace domestic production in the industrialized countries, and that to allow such imports would be assisting the exploitation of labour in the developing countries. This argument, in any of its variants, is without merit. While it may be countered by pointing out that the low wage imports could equally displace high wage imports from other industrialized countries, so that consumers benefit all round, the argument as applied to developing countries makes no sense at all. Wages in the developing countries are low because incomes generally are low; indeed wages in the export sector in these countries tend to be higher than the average for the country as a whole. Consequently, the use of restrictions against such imports amounts to a determination to use administrative power in the industrialized countries to impoverish further the countries which are poor. It is not a means of avoiding exploitation; it is in fact one of the most pernicious forms of it.

Intra-developing country trade in manufactures is relatively small; there is however, a great deal that the developing countries can do on their own, and in cooperation with one another, to accelerate their industrialization. These have been mentioned before—the pursuit of appropriate, domestic policies, the transfer of appropriate technology and the enlargement of markets available to the least developed countries.

However, in the foreseeable future, the industrially advanced developed countries have the greatest amount to contribute; their gains from such cooperation will also be significant. The principal means by which they can assist the developing countries in their efforts to industrialize is by providing them with a growing market for the kinds of goods which the developing countries can supply. In such access, the industrialized countries should take a dynamic view of the world economy and of their own rôle in it; more particularly they should examine those industries which, either for reasons of pollution deriving from excessive concentration, or because of social inefficiency, should be phased out.

As a minimum, in order to expand world production and trade and to assist the developing countries to industrialize, the industrial countries should inject a greater sense of urgency and purpose to the Multilateral Trade Negotiations and ensure that by the schedules closing date of December 1977, meaningful concessions are granted to the developing countries. In particular, they should agree, (as the Commonwealth Experts' Group has recommended) first, to "remove speedily and effectively restrictions on imports from the developing countries, whether in the form of tariff or of non-tariff barriers such as quantitative restrictions, 'voluntary' restrictions schemes and fiscal charges"; and second, to "accept and provide for the consequences of the fact that the relocation of some industries, or parts of industries, to developing countries is an essential, inevitable, continuous and desirable element in a new economic order and one which is in the long term interest of developing and developed countries alike". [Experts' Group Further Report, pages 8 and 29]

Naturally, in making these changes in policy, there will be short term problems to be overcome. It is unrealistic for the developing countries to expect the immediate removal of all restraints against their exports, and they do not seek this. However, it would be a realistic expectation that the developed countries should be prepared to agree to a phased removal, over a short period of time, of trade restrictions and to the relocation of certain industries; and to demonstrate their earnest by introducing programmes of adjustment measures, acceptable to the labour unions, to ease any transitional problem that may ensue. But it would be the antithesis of an appropriate policy for adjustment measures to be applied, as they appear to have been applied in certain OECD countries in the 1960's mainly to shore up non viable industries.

If the past is any guide, the industrialized countries will derive enormous direct and indirect benefit, by way of the additional exports, jobs and incomes that expansion of industry in the developing countries will generate. The past evidence of mutuality of benefit is clear. The future is equally promising.

The World Bank has estimated that the developing countries can reasonably expected to earn an additional $30 bn (in 1975 prices) if the restrictions, which the industrialized countries apply against their exports, are lifted. This amount, which is almost as much as the developing countries earned from their exports of manufactured goods in 1975, takes no account of the possibilities inherent in a systematic programme of phased relocation of certain industry. These additional export earnings, deriving from a wide domestic base in the developing countries, could go a long way towards providing new opportunities to the labour force in the countries, reducing the pressure for emigration and generating the kind of momentum which developing countries need to improve their rate of development; for as the Leontief Study points out, "there is no way an economy can develop at any substantial rate without rapid industrialization". But this is not a zero sum game. These earnings, and the multiplier effect they generate within the developing countries, would be spent quickly on goods and services from industrialized countries.

The industrialized countries have reached their current levels of living by continually reaching out for higher levels of sophistication in production. This process must continue; it could assisted by allowing the developing countries a more effective role in world industrialization.

As in other areas, the gains from positive action in assisting the industrialization of the developing countries are there to be reaped; the losses from inaction, though less obvious, will also have to be borne. One of these losses will be an increasingly disturbed world that will follow the widening disparities that an unnecessarily slow rate of industrial change in the developing countries will generate. The question, therefore, is one of an exercise of political will. The resumed negotiations at CIEC and at the Multilateral Trade Negotiations will provide important insights into the calculations which the industrialized countries have made and the consequences for which they are planning.

AID AND DEBT RELIEF

A final word about aid and debt relief. Aid has been one mechanism used for transferring part of the increase in incomes in the industrialized countries to the developing countries; private capital movement has been another. Three comments should be made:

(i) the aid effort of some of the industrialized countries has been declining; the humanitarian concern implied in recent policy statements on an increasing share of aid to the poorest countries and to the poorest in these countries has not, in many cases, been reflected in an overall expansion in aid effort;

(ii) traditional forms of aid need to be adjusted and enlarged to deal with some of the truly monumental problems which some developing countries face, particularly in a regional context;

(iii) aid will not yield its optimal effect unless structural changes are introduced in the international economy and in national and international economic arrangements.

The aid effort of the DAC countries, measured in relation to GNP, declined from an average of 0.42 percent in 1965–67 to 0.36 percent in 1975. Some of the richest countries show the poorest aid performance and the largest declines in such efforts. Whereas, Canada improved its aid effort from 0.28 percent of GNP in 1965–67 to 0.57 percent in 1975, the United States has reduced its aid effort from 0.40 percent of GNP in 1965–67 to 0.27 percent in 1975. Australia's aid effort has been maintained at a level higher than the average for DAC countries, being 0.56 percent of GNP in 1965–67 and 0.61 percent in 1975. Japan's aid effort, on the one hand, has been much lower and declining; it was 0.29 percent of GNP in 1965–67 and 0.24 percent in 1975. The Netherlands and Sweden are the only two DAC countries which reached the UN aid target of 0.7 percent of GNP; the former increased its aid effort from 0.23 percent in 1965–67 to 0.82 percent in 1975, while the latter increased its performance from 0.44 percent to 0.75 percent over the period. Germany, on the other hand, has shown little improvement in its aid performance; its aid effort, which was 0.38 percent of GNP in 1965–67, reached 0.40 percent in 1975 after a significant decline during the early 1970s.

The aid effort of the centrally planned economies (excluding China for which data are not available) has been particularly low; it was $1.2 bn. in 1970 or 0.27 percent of gross product and $0.5 bn. or 0.04 percent of gross product in 1975. The efforts of the DAC countries and centrally planned economies stand in sharp contrast to the performance of the OPEC countries. By 1975, OPEC aid had reached 1.35 percent of GNP, an effort which is expected to increase further as disbursements catch up with commitments.

The decline in aid effort by DAC countries is projected to continue; the World Bank has calculated that, based on current trends, aid performance may fall to 0.33 percent of GNP by 1980 and 0.39 percent by 1985. Yet, if developed countries were to apply barely 2 percent of the increase in incomes which they expect, then the aid performance would exceed 1 percent by 1985. Such an effort which clearly will not impose a severe burden on the industrialized countries will make a major impact on conditions of life in the developing countries. What is more, it could assist the international community in taking action on some of the major physical problems that impede development in the poorest countries.

There are a number of such projects which require urgent global attention. To mention a few: programmes to arrest the southward movement of the Sahara desert in the Sahel area; flood control and typhoon protection in Bangladesh; the control of river-blindness and the eradication of the tsetse fly in parts of Africa; the provision of pure water and rural electrification in many parts of Asia, Africa and Latin America.

A major and sustained attack on these problems will not only bring relief to the countries directly affected; it will improve the whole environment for human enjoyment on the planet. The existing systems of aid are not adequate to deal with these types of problems. The introduction of the necessary programmes requires a cooperative effort by groups of developed and developing countries; it requires the provision of resources on a scale and basis which will permit not only the identification of possible methods of solutions through research, but also the application of these methods over the period of time required for lasting solutions. To continue to ignore these problems in the present can only make it more difficult and costly to deal with them in the future and perpetuate the human suffering they cause.

And this secular decline in ODA is coinciding with a corresponding increase in the rate of resource transfer from the poor to the rich in the form of debt service obligations. There is an urgent need for the developed nations and the international community, to show a more sympathetic understanding of the question of debt relief. In 1974, a group of 84 developing countries (for which data are available), were already applying more than one half of the assistance they received to the service of their debts; a proportion which will increase as moratoria expire on the large private debts accumulated in the past few years. Many of these countries have already had to allow questions of sheer survival to take precedence over the pursuit of development; for them, there is no room for further compression of their rates of development.

It is pointless to argue, in justification of inaction, in that the provision of debt relief on some predictable basis will be tantamount to giving assistance to the improvident. It is not necessarily the case that countries with a serious debt service problems were improvident—many countries had no alternative but to incur debt in order to survive, a situation which is not without precedent for some developed countries for which generalised solutions have been found. But quite apart from this, the fact of the matter is that, improvident or not, these countries face critical problems; the consequences which their continuation could generate may extend far beyond the confines of their own territorial boundaries and could trigger results which cannot easily be calculated. It may well be that some creditor countries encounter legal constraints in providing generalised debt relief; but alternative ways can be explored, including, for example, allowing debt service payments in debtor currencies. The point is that the technical difficulties will be overcome once there is a political will to face this problem—which only grows more larger by ignoring its existence.

But aid and similar forms of relief alone cannot provide all the external preconditions required to enable the developing countries to overcome their problems of development. An increased aid effort is necessary. But the increased flow, even if it is put on a more predictable basis will yield the benefits which its recipients hope for and its donors legitimately expect only when at least two other conditions are met. First, that it should be adequate in size; secondly, that it should form part of international economic arrangements which are supportive of the efforts in the developing countries to develop and grow. To provide aid as a substitute for introducing other changes is to misunderstand both the fundamental role that aid can play in the development process and also the needs of the developing countries to promote development and growth.

It is not unlikely that such misunderstanding exists; it may form the basis of some of the disappointment expressed by observers in the developed countries who contrast the results of aid to the developing countries with those forms of similar aid granted in the post-war period to the developed countries. Any such feeling of disappointment could be dispelled if account is taken both of the relative size and terms of aid provided and of the fact that those essential preconditions for growth which existed in Europe—in particular a highly developed human infrastructure and international marketing and other arrangements supportive of Europe's reconstruction programme—are still to be established in the developing countries and in the relationships between the developed and developing countries.

Whatever view one may take, this much can be asserted. It forms no part of the requests of the developing countries that the poor in the rich countries should subsidise the rich in the poor countries or that aid is a substitute for fundamental internal or external change. The developing countries want to develop; properly structured aid is a means towards such development, not a substitute for it.

A COMMONWEALTH CONTRIBUTION

And at the multilateral level, there is work to be done. The Commonwealth is a representative cross-section of the world community; it perhaps possesses a special capability for promoting conversion. Certainly, it is uniquely equipped to advance consensus through understanding, dialogue and accommodation. In the discussions at the Kingston Heads of Government meeting in 1975 on the international economic situation; in the commitment of Commonwealth leaders, and particularly the leaders of the Commonwealth's developed countries, to the principle of "immediate action towards the creation of a rational and equitable new international economic order"; in the entrustment to the Commonwealth Group of Experts of the task of putting forward "a comprehensive and inter-related programme of practical measures directed at closing the gap between the rich and poor countries"—the Commonwealth was placing its special talents and facilities at the service of the international community in the cause of consensus-building. The Kingston meeting, the work of the Experts' Group, the presentation of its Interim Report to the Seventh Special Session and its Further Report to UNCTAD IV were important contributions to the process of conversion.

The work of the Group represents to date the only package of measures and approaches agreed upon by any group of persons from developed and developing countries designated by their Governments to chart the way towards "a more rational and equitable new International economic order". Their two reports so far published (shortly to be considered as enlarged and consolidated in the Final Report by Commonwealth Heads of Government at their forthcoming meeting in London in June) deal with a wide range of current issues. They cover such questions as: 'commodity arrangements'; 'food production and rural development'; 'industrial cooperation and development'; 'invisibles'; 'international finance;' and 'international institutions'.

The members of the Experts' Group from widely differing national backgrounds of North and South have found it possible to reconcile their view points in the programmes they propose. I incorporate the Reports in this submission as a constructive approach to these issues.

Representative LONG. Mr. Lewis, if you will proceed in your own manner.

STATEMENT OF JOHN P. LEWIS, PROFESSOR OF ECONOMICS AND INTERNATIONAL AFFAIRS, PRINCETON UNIVERSITY

Mr. LEWIS. Congressman Long, I have a rather brief statement that hurriedly touches on several points, some of which may provoke discussion.

I think in the first round I will stick closely to it. I think that would be the best way to meet your time limits.

Representative LONG. That will be satisfactory.

Mr. LEWIS. I start out by saying that in London and henceforward, I hope the United States will bespeak an awareness that the Third World call for a major overhaul of relations between rich and poor countries is very serious, is on balance just, and is fairly potent politically.

That is, I mean the solidarity of the third world, including OPEC, is solidly motivated and is unlikely to dissolve quickly.

The second primary point is that it is essential for the United States to keep the complex problem of North-South relations in a single view; to keep a sense of proportion and priorities, and not to get hung up either positively or negatively on single-track strategy.

The third point may not be an essential one, but I find myself somewhat troubled by the distinctions sometimes made, indeed, Congressman Long, in the letter of invitation to this hearing, between incremental and structural measures, aid transfers and trade concessions, at least sometimes, are characterized as incremental; and in that letter, technological transfers, and something called special differential treatment is structural.

Now that bothers me, because to my ears, structural reform somehow sounds more fundamental and effective, if you could bring it off, and the contrary, those here that are called incremental seem to me more important quantitatively, and to bring them off effectively will require various kinds of political restructuring in the rich countries, and in the world multilateral areas.

I then go on to tick off several points. No. 1, I think the commodity issue has been blown out of all proportion. I do not include food grains and food in this. I refer to the likes of commodity schemes. There is some possibility of achieving gains for both producers and consumers from a buffer stock type commodity price stabilization, but the past track record of such efforts is exceptionally bad.

The distribution of benefits across the array of developing countries would bear little relationship to needs. That is, some of the poorest would benefit very little, some of the largest poor countries. The mixture of stabilization and average price-raising motives—that is, whether you are trying to smooth fluctuations or trying to get a circular increase in prices in such programs—this would be a source of perennial dispute between sellers and buyers. Compensatory financing seems to me to be a better approach.

I think it was error for the developing countries to have let UNCTAD to put the integrated commodities scheme at the top of their negotiating list. Now that it is there, probably it is tactically desirable for the Carter administration to project a more favorable response, and if it does, it would be perfectly appropriate, I think, to experiment with commodity schemes case by case.

If we do that, then there is good reason to let the buffer stock fund be interconnected. But it would be a tragedy if the administration persuaded itself or anyone else that limited acceptance of the commodity scheme could serve as our principal economic response.

Very possibly the United States can do that, it is most important, and persuade its OECD partners to do for the North-South relations will be essentially defensive.

Namely, avoid retrogressive protectionist systems on the trade front. The importance of market access for developing country manufactured products can scarcely be overstated. But neither in a period of slack employment can be the painful problems that uninhibited imports would pose for our more vulnerable industries.

There is no question in my judgment that the side of the angels is that of trade liberalization. But realistically, at least for the time being, the administration and the Congress may do well to hold their own.

There are other, more exotic items on the NIEO agenda, such as "technological transfer," that are fascinating to discuss, but where it is by no means clear exactly what is desired.

For instance, in the matter of multinational corporations.

But the overwhelming implication of the foregoing argument is that the dominant action item—the one that must carry most of the freight in a more forthcoming U.S. response to North-South issues—is that of concessional transfers; that is, aid. The need for such aid, especially in the poorest countries, is massive.

Much could be said about forms, terms, and flexibility. Aid should be as effective as possible. For the poorest countries it should go essentially on grant terms. Much, but not all, of it could be targeted on the low-end poor.

A larger fraction than in the past should be multilateral. But the greatest change should be, plain and simply, quantitative U.S. overseas development assistance, at some 0.25 percent of GNP, is little more than a third of the target the international community has set us and that a number of our OECD partners are approximating. The issue is not one simply of meeting norms. The ability of the poor countries to use such transfers productively is unmistakable. With a strong lead from the administration, my hope is that, on this count, the Congress may be prepared to do substantially better—and in process carry the other two strong-economy aid laggards, Germany and Japan, with us.

One thing that makes a serious recovery of aid more feasible—albeit, of course, not cheap or easy—is that a good part of an augmented U.S. aid contribution could be in the form of food aid—to help close demand-supply food gaps in the poor countries without inhibiting their indigenous agricultural expansion, to reinforce their national food buffer stocks, and, in particular, to fund the highly productive, labor-intensive construction programs that many of them need to pursue, especially in behalf of rural development. The need for a rural infrastructure is very high.

The third world, in some of its demands, is trying to make a monolithic issue out of debt relief. But the latter in fact branches into two quite different matters. The other than poorest countries who have incurred heavy commercial debt explosures since 1974 need to roll over their obligations into more secure, longer term, and perhaps moderately lower rate forms. They need refinancing facilities for this purpose. The poorest countries, on the other hand, need a forgiveness of their official debt servicing obligations as the latter come due—not primarily because their debt burdens are high relative to their exports, but because they need aid, and because debt relief is one very efficient form of aid, and because they never should have been given credits in the first place: They should have been given grants; there never was any reason to believe, and I think many of us knew this, that a country with an income of $100 per capita would prosper at such a compelling rate that, even within the timespan of an IDA loan, it would have so adequately met the needs of its own poor that it would be ready to start making net transfers to the rich countries.

One last point: It is—at least it should be a—a thorough-going canard to argue that relief from official debt service will impair the creditworthiness of poor countries vis-a-vis commercial borrowing. The effect should be exactly the opposite: A reduction in official debt obligations should only increase a country's foreign-exchange capacity to service other debt.

In short, it seems to me that, both in its own right and in terms of the leads it offers to its OECD partners, the U.S. needs, compared with its recent stance, to make a rather thorough-going about-face on the debt issue.

These are among the points that I would like to see in Mr. Carter's brief for London.

[The prepared statement of Mr. Lewis follows:]

PREPARED STATEMENT OF JOHN P. LEWIS

NORTH-SOUTH ISSUES AT THE SUMMIT

I am delighted not only to see the Congress participating in the preparations for the new Administration's first economic summit but to see this focus on North-South issues.

In the first place let me make three background, or framing, points.

The first is, simply that the United States, more than it has done heretofore, needs to bespeak an awareness that the third world's call for a major overhaul of relations between rich and poor countries is very serious, is, on balance, just and is fairly potent politically (i.e., the solidarity of the third world, including OPEC, is strongly motivated and is unlikely to dissolve quickly). Accordingly, our response needs to be serious and forthcoming—as a matter of self-interest, and also for the sake of global welfare, to which all of us, and especially we in the affluent countries, need to pay our dues.

Second, it is essential that the U.S. keep the complex problem of North-South relations in single view—that we see it whole, keep a sense of proportion and priorities, and not get hung up (positively or negatively) on single-track strategies.

Third, I would, with all respect, demur from the distinction made in the letter inviting me to this hearing between "incremental" and "structural" measures. The first are said to include aid transfers and trade concessions, the second, technological transfers, indexation and something called "special and differential treatment." I demur if the distinction, as it does for me, carries the implication that, if we could just bring them off, the "structural" reforms somehow would be more fundamental and effective. On the contrary, those which are called incremental seem to me more important quantitatively, and to bring them off effectively will require various kinds of politically difficult restructuring—in the rich countries, in the poor countries, and in the world's multilateral apparatus.

Against this background let me tick off some impressions about a few items on the North-South agenda.

1. I think the commodity issue has been blown out of all proportion.. I emphatically do not include foodgrains management and food aid in this comment, but I deal with food under concessional transfers below. Here I refer to the likes of UNCTAD's integrated commodity scheme. In theory there is some possibility of achieving gains for both producers and consumers from a buffer-stock type commodity-price stabilization. But the past track record of such efforts is exceptionally bad; the distribution of benefits across the array of developing countries would bear little relationship to needs; the mixture of stabilization and average-price-raising motives in such programs will be a source of perennial dispute between the seller and buyer members of such commodity scheme; and if the

objective is to smooth fluctuations in sellers' incomes, then the compensatory financing approach is simpler, cleaner, and more direct.

The main thing wrong with the commodity item is that it is an inherently lesser item. Tactically, from their point of view, I think it was an error for the developing countries to have let UNCTAD put the integrated commodity scheme at the top of their negotiating list. Now that it is there, probably it is tactically desirable—in terms of "forthcomingness—for the Carter Administration to project a more favorable response (and in particular, if we are willing to experiment with commodity schemes case by case, there is no good reason not to let their buffer stock funding be interconnected). But it would be a tragedy if the Administration persuaded itself or anyone else that limited, experimental acceptance of the commodity scheme could serve as our principal new-international-economic order response.

2. Very possibly the most important thing the United States can itself do and persuade its OECD partners to do for North-South relations will be essentially defensive: namely, as the Administration already has courageously begun to do, avoid retrogressive, protectionist steps on the trade front. The importance of market access for developing-country manufactured products scarcely can be overstated. But neither in a period of slack employment, can be the painful problems that uninhibited imports would pose to our more vulnerable industries. There is no question in my judgment that the side of the angels is that of trade liberalization. But realistically, the least for the time being, the Administration and the Congress may do well to hold their own.

3. There are other, more exotic items on the N.I.E.O. agenda, such as "technological transfer," that are fascinating to discuss but where it is by no means clear exactly what is desired. But the overwhelming implication of the foregoing argument is that the dominant action item—the one that must carry most of the freight in a more forthcoming U.S. response to North-South issues—is that of concessional transfers, i.e., aid. The need for such aid, especially in the poorest countries, is massive. Much could be said about forms, terms, and flexibility. Aid should be as effective as possible. For the poorest countries it should go essentially on grant terms. Much, but not all, of it could be targeted on the low-end poor. A larger fraction than in the past should be multilateral. But the greatest change should be, plain and simply, quantitative U.S. overseas development assistance, at some 0.25 percent of GNP, is little more than a third of the target the international community has set us and that a number of our OECD partners are approximating. The issue is not one simply of meeting norms. The ability of the poor countries to use such transfers productively is unmistakable. With a strong lead from the Administration, my hope is that, on this count, the Congress may be prepared to do substantially better—and in process carry the other two strong-economy aid laggards, Germany and Japan, with us.

4. One thing that makes a serious recovery of aid more feasible (albeit, of course, not cheap or easy) is that a good part of an augmented U.S. aid contribution could be in the form of food aid—to help close demand-supply food gaps in the poor countries without inhibiting ther indigenous agricultural expansion to reinforce their national food buffer-stocks, and (in particular) to "fund" the highly productive, labor-intensive construction programs that many of them need to pursue, especially in behalf of rural development.

5. The third world, in some of its demands, is trying to make a monolithic issue out of debt relief. But the latter in fact branches into two quite different matters. The other than poorest countries who have incurred heavy commercial debt exposures since 1974 need to roll over their obligations into more secure, longer-term; and perhaps moderately lower-rate forms. They need refinancing facilities for this purpose. The poorest countries, on the other hand, need a forgiveness of their official debt servicing obligations as the latter come due—not primarily because their debt burdens are high relative to their exports, but because they need aid, and because debt relief is one very efficient form of aid, and because they never should have been given credits in the first place: they should have been given grants; there never was any reason to believe that a country with an income of $100 per capita would prosper at such a compelling rate that, even within the time span of an IDA loan, it would have so adequately met the needs of its own poor that it would be ready to start making net transfers to the rich countries.

One last point: it is—at least it should be—a thorough-going canard to argue that relief from official debt service will impair the credit worthiness of poor countries vis-a-vis commercial borrowing. The effect should be exactly the opposite: a reduction in official debt obligations should only increase a country's foreign-exchange capacity to service other debt.

In short, it seems to me that, both in its own right and in terms of the leads it offers to its OECD partners, the U.S. needs, compared with its recent stance, to make a rather thorough-going about-face on the debt issue.

These are among the points that I would like to see in Mr. Carter's brief for London.

Representative LONG. Thank you very much, Mr. Lewis. We appreciate your consolidating your statement. I think that you are correct, that it will give us an opportunity to explore your views further, and, perhaps, get the views of some of our other experts with respect to your opinions.

Mr. Krause, we are particularly pleased, again, to have you, and request you to proceed in your own manner.

STATEMENT OF LAWRENCE B. KRAUSE, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. KRAUSE. Thank you, Congressman Long.

More time is likely to be available at the economic summit in May to discuss relations between developed and developing countries now that the United States has endorsed the German position that further macroeconomic stimulus is not needed.

However, the macroeconomic problem has been made more serious by the U.S. action. The administration, in my view, has chosen a strategy that increases the risk of a premature world recession in the next couple of years; a recession that, if it should occur, would have serious consequences for the entire world economy.

Thus, at this summit, it would be wise to consider a contingency plan to salvage the world economy should the economic forecasts turn out to be too optimistic.

The Carter administration has not yet made clear its own position on many of the issues involved in the North-South Dialog so the discussion at the summit might be used for mutual education and coordination of the basic approaches among the seven governments to the demands of the developing countries for a New International Economic Order (NIEO).

It may seem strange at this late date to be talking about basic approaches, nevertheless I do not believe the meaning of the NIEO has been comprehended or the critical choice of a response has been made.

The developing countries have demanded, through a series of specific measures, to be treated preferentially by developed countries; they have also demanded to be treated as equals by the developed world.

There is an obvious contradiction here and developed countries must choose between the two demands.

If we choose the preferential route, then we need only continue the policies of the past, except provide more resources to be transferred, possibly through a new wrinkle or two.

As a result of such an approach, the LDC's will become more dependent on developed countries, their appetites for even greater concessions will be whetted, and the seeds of an eventual larger conflict will be sown because the approach is not sustainable on either side.

Such an approach is at best a zero sum game, that is, the gains for the LDC's will be matched by equal losses for developed countries, but it could be a negative sum game with the losses exceeding gains because the "new wrinkles" might introduce market inefficiencies.

The alternative approach is to treat the developing countries sympathetically, but essentially as equals. Only those policies would be formed and negotiations sought that would promise gains for both the LDC's and developed countries.

Reciprocity in negotiations would always be a part of this approach. Of course, with responsibilities, the LDC's would gain the right to share in the control of the international system through writing rules for international organizations and the like.

Thus the LDC's would be brought into full participation in the international system and their sovereignty properly recognized.

New agreements would be sought that yielded positive sum outcomes.

While some gains must go to both developed and developing countries, they need not be divided equally; indeed, it is a well-established principle in international negotiations to tilt the outcome toward the weaker party.

Nevertheless, the tilt cannot become so extreme as to distort the outcome completely. Such an approach would indeed bring about a new international economic order and is the one I endorse.

For each functional topic being discussed under the new order, there is a possible initiative that reflects the mutual benefits approach. I will concentrate my remarks, however, on commodity and trade matters.

Mutual benefits could be obtained from a series of well-designed commodity agreements which have as their purpose price stabilization.

I stress the goal of price stabilization because it is incompatible with attempts to raise commodity prices above long-run equilibrium levels as some have suggested in order to transfer resources from consumers to producers.

Such an attempted resource transfer is wholly inefficient and bound to fail.

To stabilize prices would require the setting up of buffer stocks with sufficient financial resources to be able to buy substantial quantities of commodities when prices are depressed.

If several commodity buffer stocks were in operation, then it would make sense to finance them from a common fund. If international buffer stocks existed today, they would probably be buying sugar, wheat, and rice, and selling coffee, cocoa, tin, and soybeans.

Both producers and consumers would gain from the anti-inflationary consequences of price stabilization.

Furthermore, producers would gain from fuller use and better allocation of labor and capital in production and consumers would gain through greater certainty of supplies under international control.

Since the buffer stocks will be buying cheaper and selling dear, they should make financial returns on invested capital which could be distributed disproportionally to developing countries, regardless whether they were buyers from or sellers to the buffer stocks.

Without going into greater detail, it is clear that such agreements would fall within the mutual benefits approach.

Trade is another area where mutually beneficial agreements are possible. Recent economic research has indicated that rapidly growing exports, particularly of manufactured products, are a major stimulus to economic growth of developing countries.

Thus secure market access is of great interest to LDC's. Developed countries have given preferential access to manufactured goods of LDC's under the general system of preference—GSP.

With hindsight, I judge this to have been a mistake. Unilateral programs of this type never really provide the certainty of markets required to make rational investment decisions.

What is unilaterally granted can be unilaterally withdrawn and even the granting is limited and circumscribed in various ways.

Furthermore, the failure of developed countries to demand reciprocity has encouraged inefficient import replacement strategies in many LDC's.

I would suggest that we shift our energies to promote a real trade negotiation between developed and developing countries.

Attention could then be given to solving some serious matters such as tariff escalation in developed countries and stimulation of inefficient industries in certain LDC's.

Furthermore, obligations could be established within the GATT framework and, if withdrawals were necessary, an established and recognized procedure would exist to control the situation.

Negotiations between developed and developing countries need not call for balanced reciprocity in some strict sense as long as the principle of reciprocity is established.

Due consideration can be given to degrees of development of LDC's and special forms of reciprocity are conceivable.

Nevertheless, all participating countries should accept obligations growing out of the negotiations.

Let me add that resource transfers from developed to developing countries are consistent with the mutual benefit approach to the NIEO. Social rates of return are higher in LDC's where capital is scarce relative to developed countries.

Thus, on efficiency grounds, developed countries should invest to promote development of LDC's. This investment can be carried out in part by private enterprises and in part by governments.

That part which is to be provided by governments is best arranged with international financial institutions as intermediaries. Some time at the summit might usefully be spent discussing how to increase the resources and the management capabilities of international institutions such as the World Bank—IBRD.

In conclusion, I believe that the issues involved in the North-South Dialog are likely to dominate the economic horizon for many years to come. They will not fade away. It is time for us to begin searching for mutually beneficial solutions to the issues and a useful step can be taken at this economic summit.

Thank you.

Representative LONG. Thank you very much, Mr. Krause.

Ms. Krueger, as I have mentioned earlier, we are pleased to have you here, and if you will, proceed in your own manner.

STATEMENT OF ANNE O. KRUEGER, PROFESSOR OF ECONOMICS, UNIVERSITY OF MINNESOTA

Ms. KRUEGER. Thank you.

I thought I would proceed by trying to give my overall assessment of the NIEO Dialog and then focus, first, on commodity agreements, and second, on the need for domestic policy changes within the developing countries themselves.

When the first discussion of the new international economic order were first voiced, it seemed easy to reject the rhetoric and conclude that there was no way which the things that were being said made sense.

There had been tremendous growth of international trade over the two preceding decades with liberalization of trade and payments in developed countries, and I still think that if one accepts the NIEO discussions at face value, there is a great deal of room for skepticism.

On the other hand, the developing countries face a number of extremely difficult problems, and I now interpret the NIEO discussions not as a condemnation of what happened in the past, but a realistic, if somewhat pessimistic, view of future prospects.

To start at the beginning, it seems to me that the best prospects for growth of the developing countries as a group entail two sets of preconditions in the international economy.

First, there has to be some kind of increased resource transfer, probably in the form of official development assistance; and second, there has to be a sure access for the goods and services produced by the developing countries in the developed countries' markets.

I take the NIEO discussion as resulting from pessimism about the likelihood of those conditions being met.

At one time we had targets for ODA, and in recent years the ODA has fallen far below that. In fact in real terms ODA was $11 billion in 1960, and only up to $16 billion in 1975, so that on a per capita basis, either for donors or recipients, it fell in real terms over that period.

The second precondition, the rapid expansion of world trade, also seems threatened at this time. There are mounting signs of protectionist moves in many developed countries.

However, in terms of self-interest of developed and developing countries, resistance of those tendencies seems to me to be the top item on the agenda, and one where mutual benefit can be realized. There are obviously consumer interests in the developed countries, as well as export interests, present and future, which will benefit by continued trade liberalization.

If the developing countries export more, it has been amply demonstrated that they will spend their foreign exchange earnings in the long run, and the year-to-year changes in foreign reserves are a very minor item over a period of time. Our markets in those countries will grow at the rate their export earnings do.

Therefore, we have to concentrate on very difficult issues, including ODA and access to developing countries' markets.

This, I think, requires that several things be done.

First, there have to be negotiations among the industrialized countries themselves to insure access to all their markets on a coordinated basis.

There is evidence to suggest that some of the pressures experienced by some of the developed countries have come about because their markets have been differentially opened. One remedy might be multilateral action.

Second, it obviously requires attention to strengthening adjustment assistance and otherwise buffering the impact of increased imports on selected industries within the developed countries, and finally, I think it also requires negotiation as to increased level of ODA.

With all that said, I now turn to commodities agreements and discuss the alternatives to ODA and continued liberalization.

Although there are difficulties in the path I just outlined, any consideration of commodity agreements indicates that the difficulties with that sort of a scheme are at least as great, if not greater.

Now, there are gains that could be had by an appropriately functioning commodity buffer scheme. Smoothing out fluctuations in prices could potentially lead to some realized gains for individual producers and individual consumers, under some circumstances. That is so.

It is also true that while such gains could accrue, it is extremely unlikely.

I can't go into a full discussion of why I am skeptical about the actual prospects for commodity stabilization here, but let me point out some of the key problems.

The first, and probably the most important, is that the only way such an agreement could be reached would be with a very realistic discussion of some hard, technical issues.

Unfortunately, the discussions sometimes sound as if the purposes is commodity price stabilization, and sometimes it sounds as if it is to increase commodity prices.

Now, it is one thing to try to stabilize prices around whatever the trend of the commodity prices is; for example, falling 1 percent per year.

It is another thing to try to offset declines in prices that would otherwise occur.

The latter path, even without raising prices, would lead to increased stockpiles, increased costs of the operation, and so forth.

If, then, stabilization is all that is intended, the gains cannot be very great, and price stabilization does not necessarily mean earnings stabilization.

For example, when price fluctuations come about because of weather or other supply conditions, then stabilizing prices destabilizes incomes, because when farmers produce less, they have the same price, whereas without price stabilization, some of the effect of reduced volume is offset by increased prices.

There is a whole range of technical issues that must be resolved for a workable commodity scheme. The first pertains to trend. If you try to stabilize prices, how do you determine what the trend is?

Obviously that discussion itself would be quite political, with producers arguing for a higher trend. I have no doubt that in case a lower trend were decided on and were wrong, it would quickly be raised upward. If the opposite did not also happen, costs would mount over time and commodities whose prices had been incorrectly estimated would accumulate.

A second issue concerns the band. You cannot perfectly stabilize commodity prices. There has to be a range between buying and selling. The best evidence I have seen is that probably a plan of plus or minus 15 percent is the best you could hope to do.

Plus and minus 15 percent is 30 percent. On that criterion, if you go back over the data of the past 20 years, you would, on average, have intervened in one commodity market every third or fourth year, and there would have been long periods of time without intervention in many of them.

The band, in order to make the scheme profitable, would have to be fairly large.

It should be clear, too, that if one entered into buffer stock arrangements, private investors have in the past borne some of the costs. If they disappeared, costs would increase more than present estimates indicate.

I should, however, point out that, despite these difficulties, there are commodities which could have benefited from some stabilization scheme. Sugar, cocoa, and copper have bad track records with respect to price fluctuations, and had the trend been correctly forecast, and that is a big "if," then stabilizing around those trends might have made some sense.

This leads finally to the question of financing. You can't really talk about a price increasing scheme over time, I think, and even a price stabilizing scheme operated on the commodities listed by UNCTAD would require significantly larger financing than is suggested.

The initial financing is required to guarantee that you can buy up the shortfall and not face speculative pressures that way, and, of course, there have to be sufficient initial stocks to keep commodities prices within the band.

On that, then, I am very skeptical about the benefit to the LDC's from commodity stabilization and concur with the others who expressed surprise that this should be in their interest as a negotiating point.

On the other hand, as problems are realistically dealt with, there is benefit. I do not disagree with the commodity-by-commodity consideration as now suggested by the United States. I might even venture to suggest that some sort of position paper spelling out some of the issues and illustrating what some of the difficulties are might entail smoother negotiations for all parties.

Even if you did get such agreements, there will be very great differences in benefits among countries. Some of the poorest would have very little to gain even if there were commodity price increases, unless they happened to center upon their commodity.

This brings me the final question on which I was asked to comment specifically: namely, the relationship of the NIEO proposals and the policies developing countries themselves can undertake to improve their development prospect.

That issue is as complex, if not more so, than the commodity agreement problem. Different countries have different economic policies and problems, so that there is no uniform answer. There is no country in the world whose economic policies could not be improved upon. There are political pressures impinging on economic policy in all countries, developed as well as developing. There are some developing countries for whom domestic policy will have to alter before any prospects of greater growth of income can be realized, and under all circumstances 90 percent of the policies that contribute to development are internal.

Even with all those considerations, though, it seems to me that one can turn the question around and say, "Suppose the developing countries all adopt the best of all possible policies—if we knew what they were—what, then, would be growth prospects?"

The answer is that, in what is called the fourth world countries, without some transfer of resources, the best that could be done over the near-term period, which might be 10 or 15 years, is not satisfactory in any sense, ours or theirs, and some transfer of resources for those countries is desirable, and probably essential if even with optimal policies their development aspirations will be minimally met.

The second comment is that if I tried to perform the mental experiment of ideal economic policies in the third world developing countries without growing markets for their commodities in the developed countries, those prospects, I think, are pretty pessimistic.

We have the evidence of the 1950's and 1960's when many developing countries did try to go through inward looking policies, and it was only as they abandoned those in the 1960's that the growth rate significantly improved. Prospects for economic growth in the developing countries were never better than they were in 1972 and 1973, as the past inward-looking development strategies were indeed being abandoned in one country after another.

Since that time, there has been increased skepticism as to the likelihood that access to markets will continue, and some evidence that trade restrictions may be placed upon the successful exporters to the developed countries. These conclusions, if correct, do not argue well for the development of the international economy for the developing countries.

But, even though 90 percent of development comes from domestic efforts, the difficulty of intervening in someone else's internal political affairs is great, and it seems to me that the issues for international discussion are what impinges upon both developed and developing countries. That is the international trade network and the degree to which it is liberalized.

I therefore would urge discussion of constructive measures whereby assured access to markets could be achieved, and would try to focus more on those issues than on some of the things that are much harder to define.

Thank you very much.

[The prepared statement of Ms. Krueger follows:]

Prepared Statement of Anne O. Krueger

I appreciate this opportunity to discuss some of the problems in the north-south dialogue before the committee. I have been asked to give my overall assessment of the issues, and also to examine the commodity agreements proposals and the need for internal adjustments within the developing countries.

When the first calls for a "New International Economic Order" (NIEO) were voiced, they were cast in a light which suggested that the international economy was in some way responsible for the economic problems of the developing countries. It was all too easy to dismiss the rhetoric, couched as it was in assertions that were manifestly dubious, if not false. In light of the tremendous growth of international trade over the preceding two decades with the accompanying liberalization of trade and payments regimes in the developed countries, it was difficult to place credence in the assertions that something in the system was frustrating development efforts, especially when growth rates, while far from desirable levels, had been satisfactory and generally accelerating.

If one takes the NIEO rhetoric at face value, there is still a great deal of room for skepticism. The developing countries do, however, face a number of extremely difficult problems, and I think one can interpret the NIEO discussion, not as a condemnation of what happened in the past, but as a fairly realistic, if pessimistic (I hope), assessment of present prospects. Viewed in light of development objectives the NIEO proposals make sense if prospects are dim for increased ODA and for continued liberalized trade regimes in the developed countries.

The problems of the third and fourth world non-oil exporters are many and varied, and their particular economic interests do not always coincide. But, if one views the prospects of the developing countries as a group, the weight of the evidence is overwhelming that the policies of the developed countries most conductive to their growth would be: 1) an increased flow of official development asistance (in addition to whatever access to private capital markets is available on commercial terms); and 2) assured entry for the goods and services produced in the third world countries to the markets of the developed countries.

I interpret the NIEO discussion as a response borne out of pessimism about the prospects for increased ODA and relatively unhampered entry for their exports to developed country markets. In the 1950's and 1960's, there was a great deal of discussion throughout the world as to appropriate levels of resource transfer: at one time, 1 percent of GNP was thought to be a reasonble target. Since the late 1960's, however, that talk has vanished, and ODA has become an increasingly smaller fraction of DAC countries' GNPs—falling from 52 hundredths of 1 percent in 1960 to about 33 hundredths of 1 percent in the 1970's. [1]

In 1975 prices, ODA was $11 billion in 1960, $11.5 billion in 1970, and $15.9 billion in 1975. The United States, which was a leader in providing assistance in the late 1950's, has fallen far behind, with its 1976 expenditures estimated at 26 hundredths of 1 percent of GNP, less than half the proportion of 16 years earlier.

Contrasted with rising per capita income (and populations) in the developing countries, the stagnant levels of ODA, combined with the poor prospects for future increases, are surely cause for alarm on the part of responsible leaders seeking to increase per capita incomes at rates exceeding those of the 1950's and 1960's.

But that phenomenon is only half the story. The 1960's and early 1970's were a period of rapid growth for a large number of developing countries. During that period, world trade was expanding rapidly. The rapidly growing developing countries sharply increased their exports, especially to the developed countries. There is a great deal of evidence supporting the proposition that a large part of the explanation for more satisfactory rates of growth of real output of the developing countries in the 1960's than in the 1950's lies in the rapid expansion of world trade and the opportunity it provided for export expansion. Increased foreign exchange earnings on the part of developing countries permitted expansion in imports of goods, and broke the "foreign exchange constraint" which had hampered economic growth in many countries during the 1950's.

Since the early 1970's, however, there have been alarming signs of mounting protectionist sentiments in the developed countries. In some cases, such as textiles, those protectionist tendencies have resulted in agreements to restrict exports on the part of those successfully penetrating developed country markets. In other cases, restrictions have not been imposed, but political pressures have mounted for them.

There are alarming portents of an increasingly restrictionist atmosphere in many of the rich countries. Realization of increased restrictions will be detrimental to consumers in the restrictionist countries, and also to the export interests, as the developing countries' imports are truly constrained by foreign exchange availability: except in the very short run, more export earnings are rapidly translated into increased imports.

[1] Overseas Development Council, *The United States and World Development Agenda 1977*. Table E 9. P. 231.

In light of these portents, it is small wonder that leaders of third world countries are seeking alternatives that will enable them to sustain their countries' development efforts. The NIEO discussion, I fear, is not a discussion aimed at achieving the "best of all possible worlds." Rather, it is a response to the flagging of ODA and the increasingly restrictionist tendencies manifested in the developed countries.

It therefore seems to me that constructive response to NIEO concerns should properly focus upon increasing ODA, and asuring access to markets in the developed countries. This would entail several things: 1) it would involve negotiations among the industrialized countries to insure access to all their markets—there is some evidence that suggests that pressures have been particularly severe in some countries precisely because other developed countries have sustained high trade barriers;[2] 2) it would require measures to strengthen adjustment assistance and otherwise to buffer the impact of increased imports on selected industries; and 3) it would require negotiation as to appropriate levels of ODA on the part of the developed countries. None of these is easy, but the alternative to this sort of response is to attempt to deal with a range of issues, some of which I shall discuss shortly, which will offer inferior prospects for satisfactory rates of increase in living standards in the developing countries and simultaneously will impose larger costs, in the long run, to the developed countries. I would therefore plead for biting the bullet, and negotiating with the developed and developing countries, for a package which assures access to markets of the developed countries and simultaneously increases ODA, and taking appropriate measures to enhance adjustment assistance domestically.

In this regard, I should mention that all available evidence I have seen suggests that a generalized reduction in trade barriers is probably more to the interests of the developing countries than is any extension of a GSP system. Recent studies by Baldwin[3] and Cline[4] both indicate that the potential gains for the developing countries through multilateral elimination of trade barriers far exceed the likely expansion of export earnings resulting from GSP.

The alternative to increasing ODA and guaranteeing market access is probably item-by-item negotiation with respect to the proposals raised by UNCTAD and other representatives of the third and fourth world countries. Consideration of the commodity agreement proposals gives an idea of some of the difficulties, and the basis for preferring ODA and market access.

A technically-correct response to any question about commodity agreements is that there are ways in which agreements could be worked out whereby both producers and consumers could gain. Honesty, however, would compel a second statement, namely, that while such an outcome is possible, it is highly unlikely.

The issues involved in the commodity agreement discussion are many and varied, and a great deal of confusion surrounds them. First and foremost, there is the question as to whether commodity agreements would reduce fluctuations around whatever long-term trends there happen to be, or whether they would attempt to alter those trends themselves, raising prices above the levels which would otherwise occur. Second, there is a question as to what should be stabilized. Third, there are technical problems regarding the operation of the scheme. Fourth, there is a question of financing. Fifth, there are questions about the distribution of benefits among LDC's. Finally, there is a very real question as to whether, once a scheme were in operation, there would not be pressures for changes in the rules.

Detailed discussion of each of these aspects would require a treatise, so let me try to spell out the main considerations briefly. The first issue—whether fluctuations around trend are to be stabilized or whether trends are to be altered—is perhaps the critical one. If the objective of commodity agreements were truly only to stabilize around long-term trends, this would imply declining trends for some commodities, and rising trends for others. Unless stabilization is around those trends, the costs of the operation will mount enormously over time. In one study, wherein stabilization costs were simulated over the actual path of price behavior over the twenty-year period from 1953 to 1972, the twenty-year accumulation of thirteen commodities necessary to achieve a two-percent upward shift in trends (some of which would nonetheless have remained nega-

[2] See Robert Baldwin, *Nontariff Distortions of International Trade*, Chapter 2. Brookings Institution, 1970.

[3] Robert E. Baldwin and T. Murray, "MIN Tariff Reductions and LDC Benefits Under the GSP," *The Economic Journal*, March 1977.

[4] William R. Cline, et al., "Trade, Welfare, and Employment Effects of Multilateral Trade Negotiations in the Tokyo Round," mimeo, Chapter 7.

tive) would have been on the order of $270 billion 1975 prices. This compares with about $15 billion for a "pure" stabilization scheme.[5] Such an estimate cannot accurately take into account the probable emergence of new suppliers and other phenomena that would arise if price trends were significantly altered. It also does not take into account the various forces that would work over time to erode such an operation, with a very possible increase in fluctuations that could arise if the agreement broke down. Nonetheless, it is suggestive of the very great cost of attempting to alter long-term market trends. To do so would also adversely affect the interests of consuming nations. Whatever the value of resources transferred, there is little question but that it would be a small fraction of the economic losses that would be sustained as commodity stockpiles mounted and input prices increased over time.

If, then, one accepts the proposotion that the proposals are purely for purposes of stabilization, the question is: stabilization of what? Stabilization of prices does not necessarily result in stabilization of earnings: when price fluctuations are the result of supply-induced disturbances (such as weather), stabilizing prices destabilizes earnings. Yet all the commodity proposals so far made have centered upon price stabilization, and I shall talk in those terms here. Aside from anything else, earnings stabilization is probably administratively infeasible, involving as it would the interests of numerous producer countries.

If an agreement is set forth to stabilize prices, a number of questions would have to be answered: how would the trend, around which stabilization occurred, be determined? Once that trend was determined, what would be the intervention points relative to trend? If the trend were fundamentally misjudged, all the concerns pertaining to price-increasing schemes that I discussed above would arise. Yet the problem is a real one, since future price trends are not known with certainty. If, on any grounds, there were basis to believe that the underlying price trend were too unfavorable, political pressures to increase it would surely arise (and, if allowed to persist, the buffer stock would run out of supplies). On the other hand, if for a particular commodity, the underlying trend had been overestimated, it would be difficult to alter it downward. Pressures to convert a price-stabilization agreement into a price-raising scheme would be inevitable.

Considerations concerning the band are also important. The narrower the band, the higher would be the costs of operating the scheme: annual storage and interest costs on commodities held are probably at least ten percent of price and there would often be long periods of acquisition. A band so narrow that selling price did not exceed buying price by more than that amount would entail very large losses to the operation. Indeed, it is estimated that a 15 percent band—permitting a 30 percent fluctuation around trend—is probably the best that could be achieved. On that criticism, there have not been very many commodities, or very many years, in which prices were not "stabilized."

To be sure, there are exceptions. Sugar, cocoa, and copper have experienced relatively large price fluctuations around their trends.[6] For the 1953–72 period, therefore, a commodity agreement based upon correct perception of underlying price trends could indeed have stabilized prices for the first group of commodities. It is important to note that some of the commodities subject to large price fluctuations, such as sugar, have been precisely the commodities with which governments have intervened most. and it is not evident what the cause of fluctuation was. In that regard, it should be remembered that private speculators do indeed intervene in commodity markets, and their activity increased in the 1960's as U.S. government stockpiles (and agricultural holdings) diminished.

Technical problems surrounding any commodity agreement are numerous. They include the setting of intervention prices, as already mentioned, the physical location of storage, and related matters. They also involve the very fundamental consideration that the agreement must make provision for adequate initial stocks and financing so that in early years the price limits can be enforced. Acquisition of initial stocks is itself a problem. If stocks are inadequate, prices may rise above the ceiling, and if financing is inadequate, prices may fall as private speculators test the agreement.

This leads directly to the question of financing. I already stated that a price-raising scheme would entail a very significant increase in financing requirements. Even a price stabilizing scheme, operated over the ten "core" commodities listed

[5] Jere R. Behrman, "International Commodity Agreements," paper prepared for Overseas Development Council, October 1976. Estimates were derived from data in Tables 5 and 12.

[6] Behrman, *op. cit.*, p. 34.

by UNCTAD, would undoubtedly require a significantly larger initial fund than has been suggested.[7] The exact amount would depend upon the provisions of the agreement, the size of the band within which prices were allowed to fluctuate, and the number of commodities covered. While it is true that the required financing would be somewhat smaller if there were a common fund than if each agreement operated separately, the savings are probably not anywhere nearly as large as has been suggested.

On net, then, I conclude that, for some commodities, it is possible that some gains could result both to producers and consumers from stabilization schemes, especially if the expectations of what such schemes can accomplish are realistic. If the problems are recognized and realistically dealt with, there is scope for mutual benefits, and commodity-by-commodity consideration, as suggested by the United States, does not seem to me to be an unreasonable approach. It might well be furthered by the issuance of a position paper spelling out the various considerations—price stabilizing and not price-increasing, determination of the band, and so on—that would be taken into account in reaching a decision.

Even when agreements can be reached, however, there is the important consideration that the gains will be unequally distributed among the countries of the world. Just as the OPEC price increases had very differential effects on developed and developing countries alike, whatever benefits may accrue from price stabilizing schemes will not necessarily go to those developing countries most afflicted by export instability or poor export prospects. Aside from tropical products, most of the commodities under consideration are produced by developed and developing countries. Some of the poorest developing countries—in South Asia and in Subsahelian Africa—would stand to gain relatively little from price stabilization schemes.

I would, therefore, urge continued examination of commodity agreement proposals, but I do not regard the issue as one vital to the development prospects of the developing countries. To reiterate what I said at the outset, ODA and market access are the crucial issues. In comparison, whatever benefits can arise from commodity agreements are small and, to the extent that they might entail a resource transfer, they would do so at a relatively high cost, and provide very uneven benefits among the developing countries.

This brings me to the final question on which I was asked to comment: the policies developing countries can themselves undertake to improve their development prospects. That issue is as complex as the commodity agreement one: different countries have very different sets of economic policies so that there is no single answer appropriate to them all; there is no country in the world with economic policies that could not be improved upon; there are political pressures impinging upon economic policy in the developing, as well as the developed, countries; there are some developing countries whose domestic policies will have to alter before any significant prospects for increased rates of growth of per capita income can be realized; and 90 percent of the efforts and policies that contribute to development are internal.

Of these, the last point is the most fundamental. No matter what the external environment, or the level of resource transfer, anything that represents a genuine step forward in raising productivity and living standards of the people is going to require at least 90 percent of the inputs from domestic efforts. If this was not already known before the oil price increases, the problems that some of the oil-rich countries are having in translating their oil revenues into resources that can raise the productivity and living standards of their own people is proof enough.

There are, however, two important corollaries to that basic proposition: (1) some of the developing countries' basic economic plights are so desperate that ideal economic policies would nonetheless result in unacceptably low rates of growth of per capita income in the absence of resource transfers; and (2) the state of the world economy, and particularly the degree to which developing countries have free access to its markets, is of vital importance in determining the growth of potential of the developing countries under appropriate policies.

With regard to the first of these, very low per capita incomes and poor initial endowments of skills and capital can mean that even very great efforts yield only moderate increases in income levels. That group of countries, often identified as the fourth world, probably has very poor growth prospects even under appropriate domestic policy in the absence of resource transfers from the

[7] Behrman, *op. cit.*, p. 10.

developed countries. And those countries are precisely the ones which are not eligible for large amounts of private commercial lending, and probably will not be until they have achieved significant domestic growth.

The second corollary, the importance of access to international markets, is perhaps of greater concern to so-called third world countries. In the absence of growing foreign exchange earnings, countries would be forced to rely on domestic production to satisfy increases in demand for all commodities. In light of the small size of domestic markets, the impact of this on costs, and on the extent to which domestic resources can generate growth, is enormous.

There is no better proof of this proposition than the fate of those countries which adopted inward-looking policies in the 1950's and 1960's because they were pessimistic about their prospects in world markets: they all experienced very significant limits to the extent to which they could grow through inward-looking policies. Even the strongest proponents of those policies have now recognized the importance of the international economy, and have backed off their advocacy of "self-sufficient" growth.

The common area of concern for the developed and developing countries is therefore the international economy. A liberalized network of international trading relations, combined with assistance of fourth world countries, will provide conditions under which developing countries pursuing sensible domestic policies can achieve satisfactory rates of growth and begin to lower the gap in standards of living. Such a network is of interest to the developed countries for its own sake. In my judgment, it is over these issues that the North-South dialogue should center.

Senator HATCH [presiding]. Thank you. We have appreciated your statement.

I do have questions.

The other two members had to go and vote, but they will be back, but they have questions, also.

Let's start with you, Mr. Ramphal. In your prepared statement, you have a long list of charges against the developed world, and a longer list of what the developed world ought to do to help the less-developed world.

You have devoted only three paragraphs, as I see it, to what the lesser developed world ought to do, and that struck me as sociology and not economics.

I think for the record, it might assist you and certainly assist us, also, if we asked this question: What has the Third World done to help itself? As you know, some of the countries have welcomed foreign investment, but not all. Can you give us some input on that so we can have it in the record?

Mr. RAMPHAL. First of all, may I say in response that I thought I was coming to talk with the committee about what the North needed to do. If you had invited me to come and talk about what the South needed to do, I would have devoted at least as much length to that.

Senator HATCH. Please do not be offended by my question.

Mr. RAMPHAL. No, no, but I must respond to your suggestion that there has been a lack of equity in the treatment of the two. The fact that I alluded at all to what the South needs to do is to make it quite clear that I believe there are a great many things that the developing countries need to do to help themselves.

Senator HATCH. Could I interrupt you a second on that? It might be helpful for your case to show what they need to do, and what they are doing, and the efforts that are being put forth.

Mr. RAMPHAL. First of all, of course, the Third World, no more than the first, is not monolithic. There is no single record that applies to all developing countries.

Senator HATCH. The fact is that it would be very difficult to come out with any simplistic approach to this, that is true.

Mr. RAMPHAL. There are developing countries that have done rather better in terms of their own national restructuring than others. A country like Tanzania, in my estimation, is a country that has moved its internal economic policies in a direction which has created an egalitarian society. It has dismantled elitism, and dismantled privilege. By my lights, that has been a progressive record. There may be others who take issue with it. There may be others who feel that there is nothing wrong with a system which allows an elite class to emerge by one means or another.

Indeed, one of the problems, when we get into this area of value judgments about domestic policies, is that sometimes relations between developed countries and the elites of developing countries tend to throw the mantle of approbation on systems that, to me, would seem to be undesirable. That is a problem that has faced the United States, not only with respect to is relations with the Third World, but more acutely over the past 50 years in its relations with Latin America with which I was more intimately connected in another capacity.

But there is always a danger that you are attempting to introduce reform from a base that is almost nothingness—it is argued that in Tanzania what President Nyerere has managed to do is establish an egalitarian society where there are equal shares of poverty. It is not a very sustaining system when all you can achieve is that. But, when the essential constraints of growth are external ones, what more is he to do?

If the prices of his commodities are not stable and are not reasonable, if the prospects for industrializing are not good, Tanzania, for example, produces sisal, it is a material out of which rope and twine are manufactured; but it is manufactured in Europe; the shipping costs for sending raw material sisal to Europe is very much lower than shipping twine.

Senator HATCH. Could I interrupt you a second? It seems to me that it might be well to manufacture sisal there—or, rather, the rope and twine there.

I think what I am really asking you is what has been done to get foreign and private investment? It seems to me that good economic growth of these countries, at least the 36 that you represent, is preferable to asking the taxpayers of the North to do the job. I think many developed countries are willing to invest in other countries if there is stability, and there are many other factors, as you know.

Now, could you answer that question? Maybe it would be easier for the answer if you take your 36 countries and tell us what percentage you think are making a real effort to obtain foreign investment, and develop an investment climate that works, and how many are not. Maybe that will assist us.

Mr. RAMPHAL. The question makes an assumption which makes it difficult for me to answer it in direct terms without questioning the assumption.

The assumption is that the route to development lies through private foreign investment.

Senator HATCH. That is an assumption I made, because I do not believe that the path to development is in controls on commodities. I personally believe that it has to be through investment and through creativity in the countries themselves.

My question is, are there any countries among your 36 members that are doing anything to increase the possibility of investment in their countries so that they can achieve some stability, and develop industry, and have the financial strength that comes from that so that they do not have to ask for a controlled worldwide economy with all of the economic consequences that would bring?

Mr. RAMPHAL. You mean investment from within?

Senator HATCH. From without and within.

Mr. RAMPHAL. Then we get back to the question. Is this a desirable path?

Senator HATCH. I want to know how many of them desire that, and how many do not, and therefore, make the economic climate not fruitful from that standpoint, and how many of them need to——

Mr. RAMPHAL. I think there are very few who say they do not want foreign investment in any form. What most will say, if you will permit me, is that they want investment, they will have investment, on new and what they regard as more reasonable and more propitious terms.

The experience of developing countries has been very uneven with private foreign investors.

Senator HATCH. They are worried that the foreign countries will come in and control their countries with investment.

Mr. RAMPHAL. I am not sure one has to put the anxiety as high as "foreign countries." I think when you are dealing with large international companies, there is as much anxiety as over "foreign country" control.

Senator HATCH. So this is a very real fear on the part of the developing countries?

Mr. RAMPHAL. It is, and it is one that has lead to discussion about a code of conduct to see if one can maximize the gains of foreign investment and the immense amount that multinational corporations in particular can contribute to the development process, while safe guarding the developing countries against these anxieties, to somehow establish ground rules for investment.

Now, if progress can be made in the direction of a code of conduct, and there was some reason to believe a few years ago that there might have been progress, then I think the climate for investment as part of the development process will be altogether more propitious.

Senator HATCH. I remind you that Taiwan, Nigeria, Venezuela, and Gabon, they all seem to do well with industrial development with very little aid. It just seems that they have been able to adapt to a good investment policy, and that multinational corporations have not always created instability.

Let me throw another thing at you.

Some of the countries as I see it, have ridiculous exchange rates, and various forms of redtape.

Let's limit this to your countries. How many still stifle their own financial markets—in other words—by having ridiculous exchange restrictions, foreign exchange rates and controls?

Mr. RAMPHAL. I cannot accept the premises on which your question is based. It is ridiculous. These are countries fighting for survival. I invite you to go to some of them and see what lies behind these controls. There are very few countries that "enjoy" redtape and strangulation.

Senator HATCH. There are those who stifle the development of their own country——

Mr. RAMPHAL. There are many developed countries whose economic systems have to be ringed with regulatory arrangements.

Senator HATCH. I have to admit that I am assuming the answer, but it is something that I consider to be very important. If countries want to develop, they ought to encourage investment within those countries. And to encourage help from the outside, it means they will have to have internal stability rather than external stability. You seem to be saying that you want external stability which would automatically bring internal stability, because of the management of commodities and other effects.

Mr. RAMPHAL. No. What I am suggesting is an international system, an international climate, which will assist the developing countries in the kind of efforts they have to make to put themselves on their feet, and not an international climate that is hostile to it, and that tends to frustrate it.

Senator HATCH. My point is that the international climate might be a lot better if we had reasonable conditions under which foreign investment could assist these countries to help themselves rather than a strange management of the world economic system that is a detriment to the developed countries, especially the United States, Germany, and Japan, and may not really involve or result in benefits to the Third World countries, or the lesser developed countries. That is what I am concerned about.

Mr. RAMPHAL. I think our basic disagreement is on the basic assumption.

Senator HATCH. This is what bothers most Americans. Before you can call on the United States of America to come in and participate in a world economic order, we have to show that every effort is made to comply with, or at least to reach certain aspects of stability within the countries themselves, and the desire to develop the countries through investment rather than just aid.

Mr. RAMPHAL. But many developing countries have found foreign investment a source of instability.

Senator HATCH. A source of what?

Mr. RAMPHAL. A source of instability.

Senator HATCH. Well, many of them have had a different experience. I have listed a number of countries that have gotten along well——

Mr. RAMPHAL. In that list, too, I would suggest there are some who have suffered.

Senator HATCH. I have 30 or 40 seconds more.

Some of these countries have high tax rates, and even threaten to nationalize industries. How many of these countries, if you can give us a percentage, actually in a sense scare private help away because of the threat of political instability? Aren't there countries that do this that are now asking us to manage the world commodity markets?

Mr. RAMPHAL. I think there are countries in the developing world that clearly and obviously have adopted policies to private foreign investment, and I emphasize private foreign investment, in large measure deriving from their experience, which create a climate in which private investment is not going.

Now, many of these countries are prominent among those who say, "We do not object to foreign investment in principle, but we want to discuss new and better rules under which it can operate."

Now, if there is a role, as I think there is a role for foreign investment, and if the developed world wants to promote it, I would have thought that one form of policy, one kind of decision the developed world might advance is for a more sensible and meaningful dialog on, for example, a code of conduct under which foreign investment will operate. That should not be too difficult a decision for the developed world to take.

Senator HATCH. My time is up for this round, but I would like to say this, that what concerns me, and I think this record should show it, for the benefit of those who are going to go to these summit conferences. We will come back to this so that you can think about this during the interim. Have the third world nations done enough to help themselves, and can our assistance do any real good, really, excepting for those countries that have taken self-help measures? These are the things that bother me.

Or are we just, to the detriment of stability in the world, imposing what you call a better economic system to the detriment of everybody? This is really a large concern, and I think a great concern for the people in this country in particular. I know it is a great concern for the people in Germany and Japan.

So you might give some thought to that. I would like to hear some analysis, because you are very well educated, and extremely interesting, from what I have seen here today. But I think some of those questions have to be answered. Of course, time constraints will hurt both of us.

So I would like to get some consideration for those points.

Mr. RAMPHAL. I hope time doesn't prevent my responding for the record, too, that I believe the developing countries have done an immense amount to help themselves, that a good deal of this has been frustrated by an international system that is unpropitious and in some instances downright hostile to those efforts; and unless we get into a sensible dialog, which doesn't have as a starting point "private foreign investment as the only route to development," then we can work it out.

Senator HATCH. You may have a point there, but we have a pretty persuasive argument that it is not a very good point; and you feel mine is not a very good point; but I think that is the way nations do develop.

Thank you.

Representative LONG [presiding]. Thank you, Senator.

Let me apologize to our panel for having to run off a few minutes to vote.

Mr. Lewis, the whole problem of comodities and commodity agreements is of great interest to me. In your prepared statement, you seem to indicate that in your opinion it has been blown out of proportion. I have always believed that this is one area where there is a mutuality of interest sufficient to enable us, perhaps, to make progress right at the begining. And, as I said in my opening statement, I believe that mutuality of economic interests, leaving aside all of the good intentions and the other things that might motivate us to take particular steps, is the key to negotiations. If common interests are involved. these can be a basis for discussion.

Mr. Ramphal spent a great deal of his time on this subject, and he said that, in his opinion, this is a major subject. Ms. Krueger spent a good bit of her time on the commodity agreements, also, as did Mr. Krause.

I wonder if you have any further comments on that?

Mr. LEWIS. Congressman Long, I think the fact that we all, one way or the other, spent a lot of time on this issue suggests that UNCTAD has really been very successful in getting it up to the No. 1 point on the agenda.

I must think that there are some historical accidents that explain that more than the inherent priority of this issue, or the feasibility of resolving it.

UNCTAD, and I have a very great respect for UNCTAD and its staff, but of the U.N. specialized agencies, this is the one that is most clearly responsive to the interests of the Third World, and ever since its beginning in 1964, it has a history of concern, almost of specialization, on the commodity issue.

Then along comes OPEC, with a tremendous bang, and I think the group of economists here have not reflected sufficiently this morning that this question is fundamentally political. It isn't that they suddenly had a new set of ideas. These have been kicking around a long time. It was when the oil price explosion occurred, and it turned out that cartelization had some real power to it from the Third World side, and further, there was a decision within the Third World to deliberately sort of renew solidarity between the oil exporters and the non-oil-exporting countries. Only then, really, did the new economic order get our attention, and they have had it ever since.

So this model of using market power to move resources has certainly impressed itself on a lot of third world minds.

If I may say so, I have the greatest respect for many, but I think the present head of UNCTAD has had a preoccupation, as wise as he is, has had a preoccupation with commodity issues, which is perhaps out of proportion, for a number of years. We all react to it in different ways.

I think Ms. Krueger, more than I did, spelled out difficulties with this approach. If it were possible to set up, instead of having just a power movement, a cartelization move from the other side of the market, they have a foot, a civilized coming together of buyers and sellers to mutually agree, I think. The only thing there is a chance of getting them to agree on is the smoothing out of the instability in prices, and perhaps devices for doing that. It is difficult to believe that the buyers-members of that club are ever going to cheerfully agree to have the prices pushed up in a monopoly like that, and that is really what the Third World wants.

Representative LONG. But does that necessarily follow?

Mr. LEWIS. No. But I think then there are problems, as Ms. Krueger points out, to get an honest stabilizing action, suppose everybody plays it straight and fair. But where is the trend. There are tremendous differences about identifying the trend around which you stabilize.

I don't mean to knock commodities too much. I think that it is too much. I think that it is at the top of the agenda, because I think the Third World new international economic order demands are enormously important; but I think it is important to the United States to be as forthcoming that it feels that it honestly and rationally can be, and to do some experimentation.

My main plea would be "don't think this is the big issue." It is not center of the range. It is a relatively trivial issue compared with trade liberalization issues, and trade development assistance.

Representative LONG. Ms. Krueger, do have a comment? If you do not—may I ask you a related question? Then maybe you can add any additional comment you would like to make.

Let's take sugar, which is one of the commodities you mentioned in your prepared statement. You indicate that a commodities agreement might very well have reduced the fluctuations that have occurred in the sugar market. Sugar is a commodity that is of particular interest to me, since we have a great deal of sugar production in the State of Louisiana, the area that I represent. We also happen to be the highest priced producers of sugar in the continental United States, by nearly everyone's admission.

So it becomes not only a question of overall impact to us, but one of degree because of the cost differential we have in Louisiana compared to other parts of the Nation, and certainly compared to countries like the Philippines.

Do you think it would be possible to set up a commodity agreement—I know this has been proposed—that would meet the objectives of developing countries, that would meet our income objectives for domestic producers, and that would preserve production of some sugar in this country for the benefit of our consumers, taking into consideration concern over the price factors involved?

Let me add one other thing. If that question is not complicated enough, let me throw one other fraction into this equation: Add to the problem the fact high fructose corn sweeteners are coming on the market, at a price, I understand, of no higher than 13 or 14 cents, or maybe less. I think they are willing to admit that at that price it can be economical for them, which to me suggests that it can probably be economical to them at a lesser price.

Do you think that sugar is a manageable commodity within the context of an international agreement?

Ms. KRUEGER. What I tried to say is, if I went back and looked at what happened to commodity prices over the last 20 years, and if you took what was a reasonable range of fluctuation so that you would be running your commodity stocks without too great a loss, sugar was one of the commodities where you could have indeed reduced fluctuations.

In order to do so, it would not have been enough, in the period of 1953 to 1972, it would not have been enough in 1972 to go back and say, aha, here is where we should have stepped in to stabilize the price.

You have to estimate what the long-term price is, and try to stabilize it on that.

Everything you said after that illustrates the great difficulty of trying to forecast what the trend in sugar prices will be. We don't know what sugar substitutes are coming on the market. We have the corn sugars and the saccharine and all the other things impinging on that market. That indicates the difficulty of trying to set something like this up.

The other thing, as you pointed out, is that we have economic interests domestically in certain kinds of sugar prices. Other countries do, too. This is precisely the difficulty that I see in trying to get a commodity agreement. Whenever we negotiate, we are going to be getting something and giving something. I guess if we negotiated a sugar agreement at a realistic price, we might be giving something on the domestic production front, but how much would depend on the nature of the agreement.

Now, if Louisiana sugar producers would have been better off with a price that fluctuated less, then in principle by allowing an agreement to come into effect, where the prices would change, plus or minus 15 percent, it is possible to get a mutually satisfactory commodity agreement.

If, however, it is in the interest of domestic sugar producers to have a higher price for sugar, then it becomes difficult to arrange a satisfactory agreement and it puts you right into the issue of price supports in the domestic economy.

Representative LONG. Of course, there are so many variables and so many things that you are unable to predict. For example, if sugar had gone to $60, and I think it went nearly that high, then the corn fructose people might not have made the major effort they made to move into the market rapidly. That might have led to a more gradual integration of the sweetner market.

Ms. KRUEGER. May I comment on what Professor Lewis said earlier with regard to why commodity agreements are at the top of the NIED list. Some of us have had to reach the conclusion that some of the political pressures on leaders of the developing countries are so great that they haven't in some instances, had time to take a look at hard economic realities.

I think the commodities agreement is one such instance in the face of a tough set of economic problems. They look to the outside world and "where can we get some help?" This is identifiable and is easy. The fact that world trade grew at an annual rate of 8 percent since 1960 wasn't looked at and recognized.

The same thing holds for the pressure for GSP. Every piece of evidence that I have seen says they would have been smarter to use whatever pressure they had to push for more liberlized trade in the Kennedy round than to go for GSP.

Yet we have this irrationality in the economic sense because of the political pressures, and the responses, I think, have to recognize those pressures, as well as the fact that the economic realities may enable a different response than the precise solution proposed.

Representative LONG. Well, the commodity issue is, of course, an important one, but I think most of you agree—I think you and Mr. Krause both agreed with Mr. Lewis—that while it has pushed itself to the forefront, it is not, relatively speaking, the most important issue under consideration in the relations between the developed countries and the developing countries.

So, may I address another issue?

I would like to ask this of Mr. Ramphal, if I may, and then perhaps the three of you might like to comment further.

I will make, first, a short statement, which is a predicate toward the question itself, and then the question itself is divided into two parts.

In your prepared statement, Mr. Ramphal, you said that "it forms no part of the requests of the developing countries that the poor in the rich countries should subsidize the rich in the poor countries."

It seems to me that the demand for better access to the developed countries' markets for light manufactured products might come to exactly that result.

The products in which the developing countries are most competitive are precisely those which provide jobs to the poorest groups within our own society. I use the United States as an example.

This is striking the case within an industry such as shoe manufacture. It is the case for textiles, where the workers are among our lowest waged industrial workers. These people have very few alternatives for employment if they lose their jobs in these particular areas, because of everything from education to geography. They really don't have many other chances for a job.

So if you open up these industries to more import competition, as we have been doing in this country, it might very well mean, precisely, that the poor of our country are subsidizing some of the rich in lesser developed countries.

Moreover, the LDC's often lack an effective income tax, or other welfare measures that would insure a fair distribution of the income, and their export manufacturing industries frequently have to rely on sweatshop types of conditions—and we both know that they often do. The exportation of labor, I guess, is really, in many instances, what they have to rely upon in order to be able to sell at low prices.

Isn't there every reason to believe that the beenefits of more market access, which all of the LDC's asking for, would only go to the handful of rich entrepreneurs in the poor countries?

That is my first question, and directly and specifically related to that is the following: As a minimum, shouldn't we demand that poor countries adopt measures aimed at economic and social justice within their own societies before we provide them with privileged access to the markets in our country?

Mr. RAMPHAL. Congressman Long, I hope that the developed world will do everything it can. I am not sure that demand is the right form, but everything it can to help social and economic justice within the developing countries.

I believe that some developing countries in some instances, those that have copied the styles of the West, do have elites, and some are in the entrepreneural exporting areas, and there is a need to dismantle structures of that type.

But the way, really, in the developing country, that there is a best chance of creating social and economic justice with the returns from national productivity, filtering down to everyone within the society, is for them to earn income, and really the proposition that access to markets for cheap goods is really perpetuating a system of sweated labor is, I really think, turning reality on its head.

It is low-income labor, because national wages are low. If there is access to market, then all the trends demonstrate that the exporting sectors of the economy in the developing world tend to be the higher paying jobs.

Now, if we can get into a situation where markets are opened in the developed world and the small secondary industry can begin to export their products, wages, I am certain, in those sectors will go up, and you will have a general rise and uplifting of the standard of living.

The problem of what this means for the sectors of employment in the developed world, which would be among the poorer sectors, would be a very difficult one, and I am not in any sense unmindful of it.

It was one that I have to address myself to in talking with American labor leaders when I have the opportunity to do that.

I think the answer really must lie in the fact that when we talk about the poor in the rich countries, we really are talking about poverty in relative terms, and we are talking also about the situation in which the capacity to upgrade technology, to upgrade training, and upgrade the level of employment is so vastly greater in the developed world that we should be moving, and nobody, I think, expects in the developing countries that access to markets would come overnight, that the process of adjustment will be coordinated so that as technology is upgraded in the developed world, and the developed countries come out of those industries in which the developing countries have a chance, far from unemployment resulting, greater purchasing power will devolve on the poorer countries to support the new industries that will be emerging in the North.

Representative LONG. Mr. Krause, you haven't had a good say here in a while.

Mr. KRAUSE. Let me just make a brief remark about the commodity issue, because I seem to be the greatest proponent of it at this table.

I think that commodity problems should not be so high on the list of concerns of developing countries, but it should be high on the list for developed countries.

The period 1953 to 1972 was a unique period of price stability of commodities. If we look to the statistics that we have going back into the 19th century, commodity prices have been more unstable over this whole period than they were during 1953–72, and I think the explanation for this unique period revolves around multinational firms.

But as we look forward, I think industrial countries have a strong interest in trying to stabilize commodity prices for anti-inflationary reasons. It is very worth while from our point of view. Since they have made that the top priority issue, we ought to take advantage of it. For instance, I think a sugar agreement is possible.

The problems are difficult. I don't think they are as difficult as they may have been made out to be this morning. You don't have to predict forever. You make sequential decisions.

Furthermore, you have information about costs—possible production outcomes.

There are ways to come to grips over time with the pricing question. What you cannot do is fix prices politically and freeze them. That is a formula for disaster.

Representative LONG. Let me say that I agree with you, Mr. Krause, for a number of reasons. The principal reason I agree with you is that it is one of the areas in which the developed countries have a real interest in getting something done.

I think if we can accomplish something in this area, it will open up avenues for agreement in other areas.

Mr. KRAUSE. In the trade area, it is true that export industries have higher wages in every country in the world, almost without exception. Theory says that is what we should expect, and our empirical analysis shows that to be the case. So when you expand trade, and you view it as the importer's loss and the exporter's gain, it is going to look like the poor lose and the rich gain. However, the way to look at that tradeoff is to try to get more jobs in the high-wage sectors of each country, and fewer jobs in the low-wage sectors of each country.

Now, one has to be mindful of when jobs can be created. If you have high unemployment, it is obviously the worst time to make adjustments in the economy. Economists claim that that is a political issue. It is not a political issue. It is an economic welfare issue.

We must be aware that it is a dynamic process: That import penetration has to slow down at certain times and then speed up. It speeds up at the time when adjustments can be made.

We must also remember that the poor in the country are also consumers. This very painful issue of imports of shoes poses the issue squarely. It is the poor people making those shoes, and the poor people who are buying the imported shoes. So you have to be very careful about the welfare judgment, who you are going to help and who you are going to hurt.

Representative LONG. Thank you, Mr. Krause.

Senator Hatch had a question.

Senator HATCH. I have to leave, so I do want to make a couple of points before I am through.

With all due respect to Mr. Ramphal, his suggestion that the developed world has exploited the third world has to be shelved.

The United States is 90 percent self-sufficient. We import only 10 percent of GNP, and pay for it with exports. We do not conduct trade at gunpoint the way the Russians do.

Now, our biggest exports, it seems to me, are commodities, too. We are the world's biggest exporter of wheat, corn, and soybeans. We ship coal halfway around the world. If commodity price supports are such a good idea, why cannot the United States participate, too, and why cannot we get into this program?

I think I can tell you why. Because it is not a commodity stabilization program at all. It is a program to raise prices. It is a foreign aid program from the North to the South.

Ms. Krueger, I notice in your prepared statement that you state that:

> No matter what the external environment, or the level of resource transference, anything that represents a genuine step forward of raising productivity and living standards of the people is going to require at least 90 percent of the input from domestic efforts.

I find that to be extremely interesting. Instead of this aid, which will be wasted on commodities to be placed in storage, why cannot the North give loans to help countries that are willing to help themselves?

I have to leave, but let me ask this, and then I would like to have your answer for the record even if I have to leave a little before. Please do not consider it rudeness.

Suppose we do increase loans. What steps, in turn, should the LDC's take to encourage foreign investment?

Let's start with you, Ms. Krueger.

Ms. KRUEGER. Those are tough questions to which a lot of people give a lot of time, and I do not think there is any one magic formula which is known and bottled and ready to sell. There are a lot of considerations involved.

I want to start by saying there is disagreement about this. In the poor countries, I am convinced there is a bigger role for government in promoting economic growth than there was historically in the new developed countries, for a variety of reasons. You already pointed to education, which is very important.

It is very, very difficult with new governments, inexperienced bureaucracies and so forth, to handle all of those economic interests in any sort of rational fashion, and this really is shortage of skilled manpower. Economic policymaking now in many of the developing countries is a lot more sophisticated than it was 10 years ago, and 10 years ago it was more sophisticated than before that.

Having said that, there have been a number of countries in the process of trying to get handles on the things they do, and they have intervened in markets and have experienced failures of policy, meaning another intervention, and somehow in that process, they have strangled economic performance. That does account in some cases for the failure of adequate growth performance.

As I said, this is a little controversial, and no one can quantify that "88 percent of the failure to achieve 10 percent growth in GNP is due to this," but it is part of the problem.

That sort of intervention is so much in the domain of domestic political concerns, and it is related to ideological issues.

The countries that have accepted foreign investment by and large have had better growth than those that have not. But there are exceptions. Egypt at the moment is illustrative of a government that, as far as I know, and I am no expert in Egypt, has listened to the international community and they have had to attract foreign investment but have not been successful. I understand the lesson there, it is that there are internal policies that must be altered. If they are difficult to undertake, and involve opening up the functioning of the entire domestic economy, which is a function of domestic policy. It is not separate from that process.

To take it the last step, for the truly poor countries now, you could, of course, have loans instead of grants. If you did, we are going to have the problem that Mr. Lewis referred to 20 years down the road. No optimistic assessment of the best that can be done can tell me that 20 years from now we can say, "Their income is all right now, so they can transfer that back to us."

The gap is too large.

That is why I tried to come out for help for the very poor, and access to the markets for those who are further along.

May I say something about the rich entrepreneurs getting all the profits? That, I think, is a misunderstanding. You have to provide incentives, and some of those have to be in the form of profits and so on.

But having said that, the evidence is by and large that once exports start growing rapidly, the real standards of living of the poorest cut of the community rise faster than they otherwise would. It may not be trickling down, it may not be a more even income distribution, but if you compare the real rate of growth in income of the South Korean population, it is much faster than the real rate of growth of the bottom 40 percent of the Tanzanian population.

There are problems here, and I think it is tought to ignore them, but if you do not allow productive jobs to become profitable in labor-intensive industries in developing countries, the alternative is to try to grow through their own domestic markets, and that means very slow growth.

Senator HATCH. I would like to hear responses from the others.

Mr. LEWIS. Senator, let me say——

Senator HATCH. I have to leave, but your response is in the record. If you will excuse me, and if you would put that in the record, I would appreciate it.

Representative LONG. Go ahead, Mr. Lewis.

Mr. LEWIS. I will be fairly brief. I think that the export-lead cases where there have been heavy rolls in investment that the Senator is talking about, in some of the Asian cases, Korea and Taiwan, and Hong Kong and Singapore—it is not limited to those, but those are the important ones.

Malaysia would be another one.

I think there are a few things worth pointing out. The Senator seems to sense a dichotomy between private investment and foreign aid. The fact is that both in the Korean case and the Taiwan case, there were very, very heavy sustained periods of heavy foreign aid.

Also, I think that it is probably fair to say that the proximity to Japan and the special kind of subdivision of labor that was possible as a byproduct of the extraordinary Japanese growth have been important in these cases, and you might argue that if you tried to generalize that model worldwide, particularly the big countries, and they really were anything like as successful in an export-lead foreign private investment centered growth, and the volume of exports, labor-intensive exports, that would be coming to the OECD countries might make us boggle somewhat. I am for trade liberalization, but I think it has to be somewhat modulated. At least, it appears that that is the case. I think the idea that India, for instance, should become a Taiwan is, you know, in some sense that does not make very good sense.

I thought I might just say, Congressman Long, that since the Senator—I suspect among the countries that he was thinking of as not helping it or adopting the kind of policies that he thinks should qualify for the special American attention, one of those countries, I suspect, might be India, and since it is one I know a little bit about, perhaps it is worth saying a few words about self-help.

It is very easy to underestimate what these countries have done. They have gotten up to quite high rates. They tax themselves quite stringently, particularly——

Representative LONG. What did you say they have gotten themselves up to?

Mr. LEWIS. Fairly significant rates of savings and of taxation. They have also made really remarkable progress in agriculture, which is masked by what is going on in the population front. But, the fact is that in a country like India, at the worst estimate, 2.5 percent a year since 1950.

That, historically, would have been a blue ribbon record worldwide. The United States never did better than that until 1940. The fact is that it is not very good relative to need, because population has been growing at nearly the same rate.

But the two things are quite separate in terms of achievement, and so the record on agricultural expansion is really quite good, only not quite good enough. That is the point.

The charges of misdesigning their industrial strategy and so on, while having a good deal to it, could easily be exaggerated. In India in the last 10 years, I think there is a clear pattern in moving toward liberalized policies, and pushing exports more vigorously than they have done before, and they have been doing quite well.

On the matter of foreign investment, I think it must be said to the Senator that governments feel that it is their business in some measure to choose the pattern of political-economic organization, for their publics to choose them.

A country like India shows that they are not hostile a priori, to foreign investment at all. But they are selective. They want to take it in where they think it fits into their design. They put up a thicket of clearances and so on. But if one has the stamina to get through the thicket, it is profitable, and the Government is very straight in terms of keeping its commitment. It is a rather good place for investment to work, but it is not one that the multinationals have really found enormously attractive.

It is very hard to imagine, if you look at the Indian economy, and the quantities involved, it is just inconceivable that the really big resources are going to be brought in by foreign corporations. There is no chance.

In some of the smaller countries, it may be a more viable strategy. But it is a misconception to say that this is a precondition for everything else.

Thank you.

Representative LONG. Mr. Ramphal.

Mr. RAMPHAL. I do not want to add very much to what I have already said to the Senator, but I think one of the realities to the benefits, one of the arguments against the notion of self-sufficiency even in as large and as powerful an economy as the United States, is the statistical evidence that we have of the trend of the U.S. exports over recent years. I have tried to draw attention to some of that in my prepared statement, and they really are quite remarkable.

For example, in the period 1969 to 1975, 43 percent of the growth in exports was attributable, in the engineering sector, to growth in exports to the developing countries.

Now, it is true that that represents a small part of U.S. engineering production, but it is important. I am informed by all the U.S. authorities, that an enlargement of the export base in the engineering sector would be an important element of growth in the economy; and when as large an amount as 43 percent is going to the developing countries, that must mean that these markets, as depressed as they are at the moment, must have enormous capacity to contribute to growth in the United States itself.

This is a very good example of the kind of interdependence that ought to condition relations in the future.

I would like to say, Congressman Long, in answer to your question about commodities, that one reason I feel commodities will remain high on the international agenda today is that it is a reality that, for 73 out of 94 developing countries, there is a 50 percent or more reliance on commodities for export earnings; given that reality, commodities are just bound to remain very high on the list.

Representative LONG. Conversely, most of the developed nations now rely upon imports for a very substantial percentage of their essential products—commodities and other types of products.

This is the reason that I feel, from this side, that it will attract their attention; certainly, from the point from which you are speaking, it should attract attention.

It seems to me that it is necessarily coming to the forefront.

Mr. RAMPHAL. Because of the mutuality of interest that lies in doing something about it.

I am greatly encouraged by my own experience, the experience of the Commonwealth, in relation to commodity agreements, particularly in the field of sugar. We had, for example, for a period of about 20 years before Britain went into the EEC, a Commonwealth Sugar Agreement that did fix prices, and a mechanism that did not allow prices to be fixed so that they could not be changed in response to substantial movement, and which worked relatively well. An attempt is being made to globalize that, and I would hope that that kind of thing can in fact be multiplied over a much larger range of commodities.

Representative LONG. Mr. Krause, do you have any comment to make with respect to Senator Hatch's statement?

Mr. KRAUSE. I think he has received quite a bit of answers. No, I do not have any more.

Representative LONG. Thank you.

This question relates, to some extent, to what Mr. Lewis was speaking of, as I understood it.

Ms. Krueger, in your prepared statement, you have projected one thought I am not sure I understand. You said that regardless of the external environment, or the level of resource transfer, anything that represents a genuine step forward in raising productivity and living standards of the people is going to require at least 90 percent of the inputs from domestic efforts.

Expand upon that a bit. I don't understand what you mean by "the inputs from domestic efforts."

Do you mean that no matter what happens from an outside source, that 90 percent of the effort must come from an inside source?

Ms. KRUEGER. Yes. In fact, this is much the same that I understood Professor Lewis to be saying.

Representative LONG. Yes, I think it relates to what he was speaking of.

Ms. KRUEGER. The direct example is that even if there is access to Western markets, unless there are developments domestically, little use can be made of it. Unless firms have expanded, unless there is economic organization which enables these opportunities to be taken advantage of, nothing very much happens.

We do have historical examples of countries that experienced favorable changes in their trade in 5 or 6 years, and they get no economic growth. This seems to be because of domestic difficulties. Foreign exchange earnings by themselves do not do it.

Representative LONG. If that is true, and maybe Mr. Lewis will want to comment on this, and maybe I do not understand it correctly, but if this is true, why is foreign assistance very significant, in the first place? And, in the second place, if it requires 90 percent domestic effort, should we not tie whatever foreign assistance we put in to the adoption of an appropriate set of domestic policies and, to use your word, "input"?

Ms. KRUEGER. What I was trying to say was, if you had perfect policies everywhere and all the right domestic inputs, there would still be relatively low rates of economic growth in many of the developing countries, without aid and access to markets. This is true for the so-called Fourth World, because it simply cannot generate enough resources, even at best, to grow at what we would regard as a satisfactory rate to begin closing the gap. It is true for the Third World, because if it has to develop by its own markets only, development would be a lot slower. We know poor countries are labor-abundant, their capital and skill are poor. We should specialize in capital and skill and their shortages of those factors could be met in part through trade.

The second part of your question is a tough one. There have been a number of efforts made on the part of a lot of people, including myself, to try to figure out some kind of way you might get some meaningful "objective" standard of performance against which some sort of monitoring could be undertaken.

So far at least, the real problem is that nobody has even begun to have a hint of a good idea as to how to do it. You cannot say, "We will give it to the countries that are growing most rapidly." That would be self-defeating. You cannot give it to the countries growing least, because that is not a good performance.

I think the best argument for not trying to find a performance criterion per se, is simply—well, go ahead and try it, but anything that has been thought of so far does seem to be unsatisfactory.

Representative LONG. Mr. Lewis, you had commented on this.

Mr. LEWIS. Congressman Long, I would add a few points. I agree with what Ms. Krueger said. I think she might be right about the 90 percent. I am emphasizing also, however, that the percentage of domestic resources is much, much bigger than any importation of resources, but that last 10 percent at the margin may be absolutely critical, and if you do not have it, it can abort what you are trying to do internally.

One can spell this out. These resource bottlenecks are very, very real, and I could give you a long recital of the present situation in India, but I do not want to take up the time. I just think that there is no question that the uses of import resources can be of very good service, No. 1, and No. 2, they do put a government, if they do get into a difficult sort of situation in this regard, they may allow it to make a general shift of strategy to a substantially higher rate of growth, and I will mention one thing about the present Indian case.

It would be possible to go for a much more aggressive egalitarian strategy to look after labor-intensive employment, and the conditions of the poor, with some increment resources.

Let me come to the second part of the question about performance conditioning. I was a little startled at first when I thought Ms. Krueger was saying that we did not know how to do that, because I spent one of the most traumatic parts of my life in India in the 1960's in that regard.

It depends what constitutes good performance. We did not have doubt in those days that we knew generally what kind of policies were in a better direction as against a worst direction. We felt there was no question that an increased priority for agriculture was needed, and one could see certain kinds of moves that made sense, we thought, and likewise, in liberalization of controls.

I am unreconstructed. I think 10 years later, we were pushing about in the right directions in those days. I might argue, too, that we made quite a lot of impact, and some changes in policy occurred and as a matter of fact, survived quite a bit.

It is, Congressman Long, a rather unnatural business, because you have one sovereign state dealing with another, and arguing in terms of what is in the recipient's best interests. It is hard to sustain that argument without saying you are smarter than they are, or that you know what their best interests are. That leads to poor relations, even among friends.

So, I would argue that India is a good case why freewheeling performance conditioning is not a very easy thing, or a very wise thing to undertake. It has to be done selectively, at the right time, and with great sensitivity.

Representative LONG. That, becomes extremely difficult, even in a developed economic system. And, certainly, it becomes most, most difficult when an economy is not developed.

Ms. Krueger, you spoke a while ago of inexperienced bureaucracies. Sometimes I wonder which is best, or which is worse, an inexperienced one, or an overexperienced one. We are going through a little of that in this country today.

One other question, if I may have your comments; I guess this might be called in the United States "energy week."

Assume that the people of the United States really become involved in conservation, not only of oil and fuel, but of other things as well. And they might very well, because if they become involved in conserving one product, this involvement might well result in the conservation of others.

Suppose we cut, say, 10 or 12 percent off of our need for, let's take bauxite, by the recycling of aluminum: What would be the effect on the LDC's in the event that happened? Would any of you venture a wild guess.

Ms. Krueger.

Ms. KRUEGER. Yes. The first statement is that we have gone through swings over almost that magnitude from year to year anyway with recession.

With some commodities, of course, we already have moved in that direction. I am out of date, but the last figure I saw was that 40 percent of our copper needs are met by recycling.

The second part of the answer is that we are, at the moment, not contemplating zero growth in GNP. As long as we just cut the percentage down, and you are talking about a sustained rate of growth—if that cutback is gradual, as it surely would be—then it is not very likely by itself to have a major impact in that regard.

Of course, and in fact this is a funny thing about commodity agreements, the reason for conservation anyway is concern about resource depletion. So, the argument for conservation is, "We are going to put pressure on this commodity, and the price will rise, unless we conserve, and 10 or 12 percent conservation will reduce price increases."

It is also true that economic development is going to entail reduced emphasis or reduced share of primary commodities in total exports for the LDC's, in any event. That is a worldwide trend.

Representative LONG. Mr. Krause.

Mr. KRAUSE. Congressman Long, in my judgment energy is a difficult issue. Energy is difficult because the day-to-day market price signals that are not good forecasters of the long run resource costs to the country. We know also that energy can have a political cost, a military cost, when you are import-dependent. We have had one price jump in the past, and no market analysis can tell you what is going to happen in the future.

I would hope that this will be a very successful energy policy. I would also hope that we will not learn from that experience to do it for other commodities where the market mechanism works well. Why should we want to conserve on aluminum if the market price is giving us the proper signals of what its costs are to the country?

So, we have to be very careful about getting caught up in social causes in the form of economic output questions.

Representative LONG. Well, Ms. Krueger and gentlemen, we are most appreciative of your coming. As I said in my opening statement, we appreciate the work that went into the prepared statements that you submitted, which have been made part of the record. I know many of you came long distances, and took off from important things you were doing. On behalf of the committee, I want to thank you, and the committee stands adjourned.

[Whereupon, at 12:30 p.m., the committee adjourned, subject to the call of the Chair.]

97-637—78——15

APPENDIX

[News from the office of Representative Henry S. Reuss, Wisconsin—5th District, Friday, March 18, 1977]

INVITE OIL SURPLUS COUNTRIES TO JOIN WORLD COMMUNITY

NEW YORK—"The OPEC countries, particularly Saudi Arabia, Kuwait, and the United Arab Emirates, which will be running a current account surplus this year of around $45 billion, should be welcomed into the world economic community," Rep. Henry S. Reuss (D-Wis.), Chairman, House Committee on Banking, Finance and Urban Affairs, told the Tsai Forum in a speech at the Regency Hotel today. "The industrialized countries should climb down from their high horse and recognize that it's in everybody's interest for the oil producers to participate fully in the economic fate of the world."

"Since the quadrupling of oil prices in 1973, commercial banks in the United States and Europe have been able to recycle most of the OPEC surplus into balance of payments loans to the weaker industrialized and to the less developed countries," Reuss continued. "But now the honeymoon is over, and these huge increases in bank loans are over."

None of the three "easy courses of action" is realy acceptable, Reuss said:

"First, one could leave the debtor countries to their own devices, unable to buy the minimum needed to get their economies moving—a solution capable of tearing the world apart. Second, one could ask the taxpayers of the United States and of the other industrialized countries to do the 'recycling' themselves by vastly expanded contributions in foreign aid—a solution that is neither just, since it puts on us all the risks of the shaky loans, nor politically feasible. Third, one could remind Saudi Arabia and the others that, since they own the wealth and the reserves, they inherit also the obligation to channel their surpluses to the needy, much as the United States did in Marshall Plan days. To this suggestion, the oil rich would undoubtedly reply that they are just now becoming wealthy, and that they will need to save their reserves for years hence when their development requires more imports."

"A better solution would be to offer to integrate Saudi Arabia and the others into the world economic community," Reuss continued. "It is to their advantage, for if nothing is done, international crises will almost surely arise; the oil rich would then see their markets for oil dry up, and their existing investments and reserves imperiled."

Reuss listed several ways in which Saudi Arabia, Kuwait, and the United Arab Emirates could be welcomed into the world economic community:

"1. *We should encourage the Arab surplus countries to establish their own commercial banks to lend to the oil-consuming countries.* This would generate a vital interest on the part of the wealthy Arab countries in the global financial community. It would increase competition among world financial institutions, always desirable. The West could help by training and recruiting bank personnel, perhaps through existing organizations like the Joint U.S.-Saudi Commission.

"2. We should favor increased involvement of the Saudis and the others in the International Monetary Fund. The IMF is likely to run short of lendable assets in the next year or two. The Group of Ten, all old established members of the club, presently assist the IMF under the General Agreements to Borrow. Why not change the G–10 to G–13, and make a place at the table for Saudi Arabia, Kuwait, and the Emirates?

"3. We should work for increased concessional lending by greater participation of the Saudis and the rest in the World Bank, IDA, and the regional banks. Many non-regional members, for example, belong to the Asian and Inter-American Development Banks; why not invite the Arabs? Earlier this week, the

Emirates and the Saudis joined for the first time in IDA, a healthy sign. To the extent that the oil-rich Arab countries want to make something of their own international development institutions, the multilateral development banks ought to work closely and harmoniously with them. This is being done right now in the excellent Gezira agricultural project in the Sudan.

"4. We should encourage the oil-rich Arabs to develop their own economies and societies as rapidly as possible. The main reason why the three surplus-heavy countries have that heavy surplus is because their small populations cannot absorb super-rapid increases in imports. As it is, imports have risen by over 50 percent annually. Tremendous capital projects, such as ports, roads and universities, are being constructed. But there is still a great need for housing, schools, and hospitals. The industrialized world should be fully cooperative to see that every assistance is given so that economic progress in the Middle East is as rapid as its people want.

"5. We should welcome further Arab investment in the industrialized countries. Fortunately, the inhospitable grumbling which greeted early Arab investment overtures in this country has now subsided. The United States, West Germany, and Japan, among others, ought affirmatively to welcome Arab investment. From our standpoint, it helps to increase our economic growth rate, and at one stroke solve our domestic problems and also give us the wherewithal to buy more from the poorer non-OPEC countries and thereby take some of the sting out of the oil price increases. From the standpoint of the Saudis, long-term direct or portfolio investment is a most sensible way in which to save their reserves for the rainy day years hence when they will be needed. And, as with all these proposals, the greater the integration, the more responsibly these countries are likely to view the oil price increase question."

"The process of integration could certainly be furthered by a series of small actions, rather than by one vast summit," Reuss said. "Nonetheless, following the summit meeting of the industrialized nations scheduled for London in early May, the Midle Eastern three could well be invited to attend Act II of this summit, to discuss cooperation.

Statement on "International Economic Conditions and Issues," for Submission to the Joint Economic Committee of the U.S. Congress, on Behalf of the Chamber of Commerce of the United States

(By Jack Carlson,[1] Apr. 29, 1977)

I welcome this opportunity on behalf of the Chamber of Commerce of the United States to comment on international economic conditions and policies. This topic is particularly timely as President Carter prepares to participate in the London International Economic Policy Conference. Having chaired U.N. organizations concerned with international economic problems. I appreciate the importance of international economic policy to both our domestic economy and the economies of other nations.

International Economic Outlook

I foresee prosperity for the world economy in the next two years, following the particularly severe economic recession triggered by the OPEC oil embargo of 1973 and the price increases of 1974–75. World GNP declined by about 4 percent, with Japan suffering somewhat less than West Germany or the United States. The bottom of the recession was experienced first by Japan, then one year later by the United States and six months after that by West Germany.

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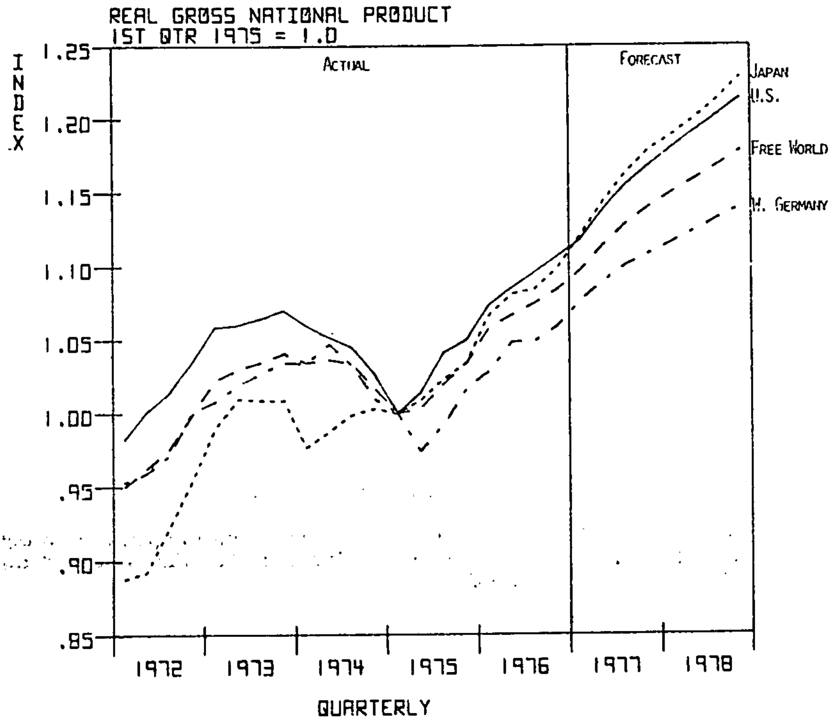
[1] Vice President and Chief Economist, Chamber of Commerce of the United States

However, almost all industrialized countries peaked about the same time, giving rise to a worldwide shortage of capacity. The same development appears likely in 1978 in the Chamber forecast, foreclosing the possibility of capacity—short countries "borrowing" other countries' under-utilized capacity by increasing imports from the latter. Prior to the boom of 1972–73, such "borrowing" of productive capacity was possible, because some countries grew rapidly to full employment long before other countries. Then these faster-growing countries peaked and generated unutilized capacity for the slower growing countries as the latter approached full utilization of physical and human resources. Now all industrialized countries appear to be synchronized and may peak together creating greater shortages of plant capacity and skilled labor than was experienced prior to the 1970's. Figure 1 shows this effect as measured by real GNP.

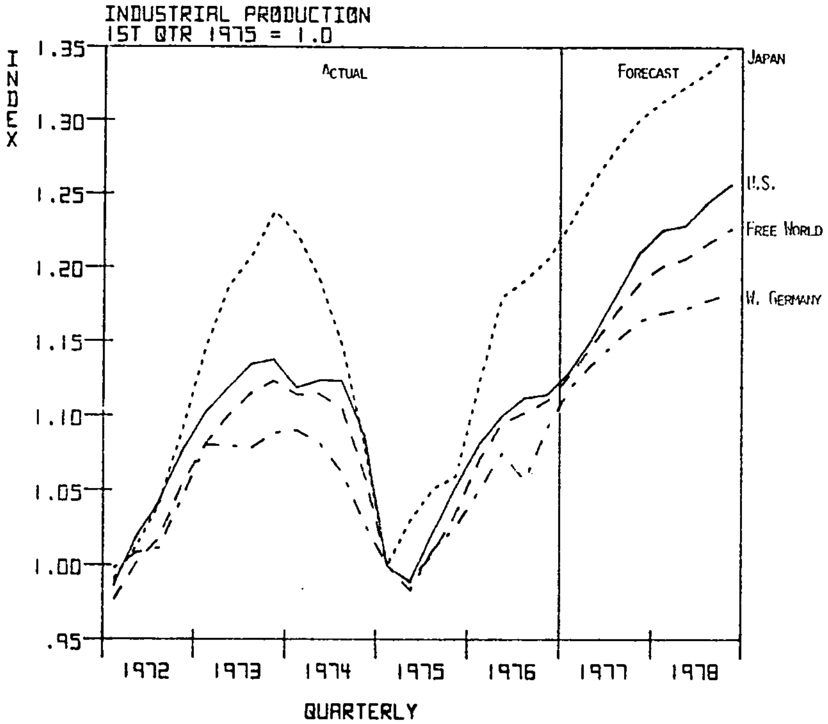
FIGURE 1



Source: The Forecasting Center, Chamber of Commerce of the United States.

The same pattern is visible in the movement of industrial production although it is subject to wider swings than GNP and the timing is somewhat different. Nonetheless the pattern is similar. Japan is forecast to grow most rapidly in the next two years followed by the United States and then West Germany. (See Figure 2.)

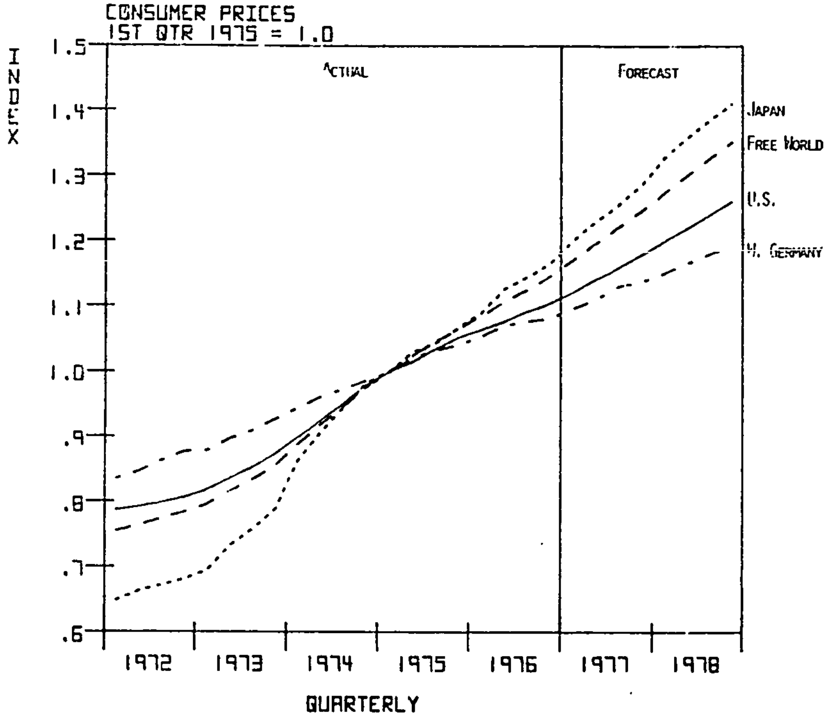
FIGURE 2



Source: The Forecasting Center, Chamber of Commerce of the United States.

With regard to inflationary developments, partly because Japan is growing most rapidly, it has and will experience more inflation than the average of all Free World countries. (See Figure 3.)

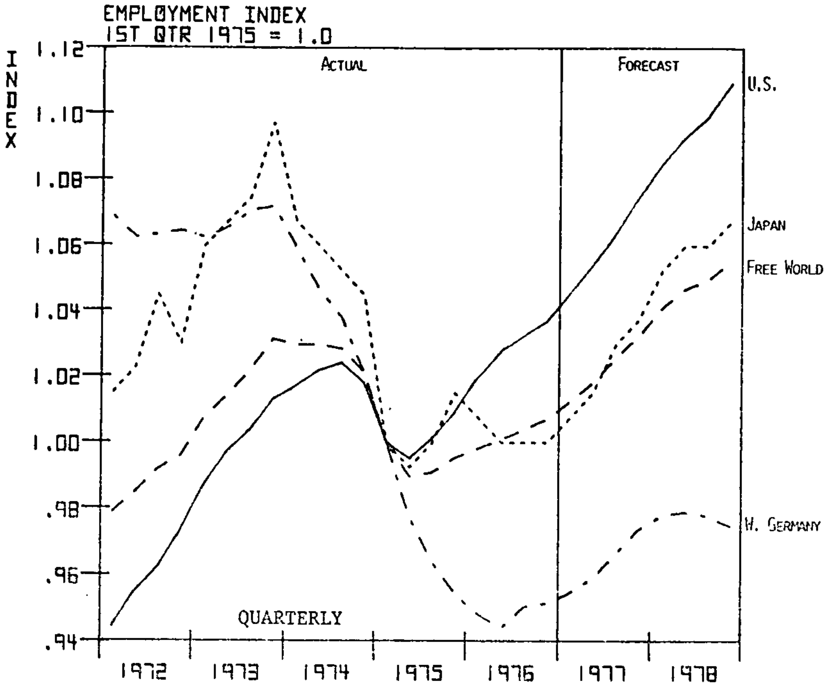
FIGURE 3



Source: The Forecasting Center, Chamber of Commerce of the United States.

Employment growth in the United States is the marvel of the Free World. Growth in employment is and will likely remain higher here than in other countries. Moreover, less growth is lost during recessions. (See Figure 4.) Unfortunately, popular discussion within the United States focuses on unemployment statistics instead of the job-creating capability of the U.S. economy. A growing body of economic literature on the subject suggests that the U.S. is creating unemployable people through governmental incentives not to work such as higher and extended unemployment compensation, welfare, rent subsidies, Medicare, Medicaid, food stamps and social security income limitations. Government action to raise wages, such as higher minimum wages, and the Walsh-Healy and Davis-Bacon Acts have the same effect. Also having the same cost-increasing effect are rising payroll taxes and a growing volume of regulatory activities of various kinds.

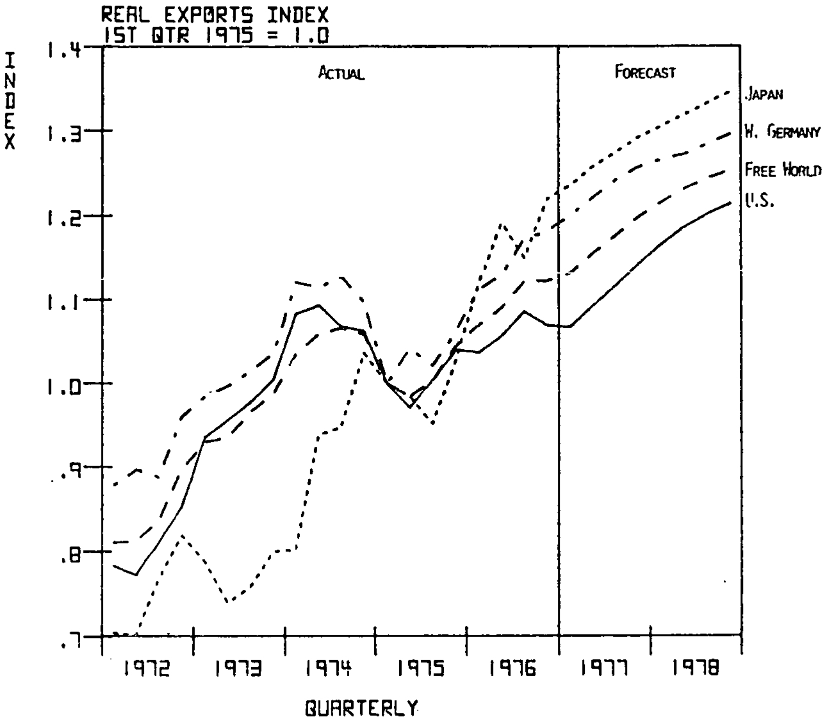
FIGURE 4



Source: The Forecasting Center, Chamber of Commerce of the United States.

The greater interdependence of the world economy is obvious from the rapid growth in exports and imports, much faster than growth of GNP for many countries, including the United States. Growth of U.S. exports is forecast to be slower than other countries. (See Figure 5.)

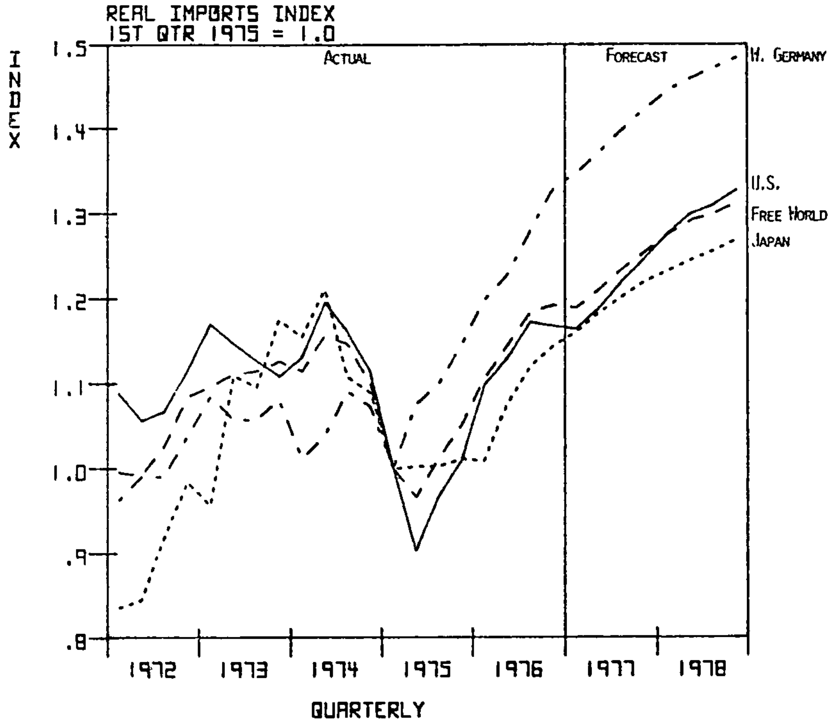
FIGURE 5



Source: The Forecasting Center, Chamber of Commerce of the United States.

However, in contrast, U.S. imports are forecast to grow faster than imports of most other major countries excluding West Germany. Both the U.S. and West German appetite for imports should boost the exports of other countries, including Japan, and improve their GNP growth. (See Figure 6.)

FIGURE 6



Source: The Forecasting Center, Chamber of Commerce of the United States.

REFLATING OTHER ECONOMIES

It was widely proposed earlier this year that the U.S. should stimulate its economy to help the European and Japanese economies. Less is heard of this argument currently. There are several reasons for this.

First, it is increasingly realized that each country should be responsible for its own basic economic stimulus policies. If its recovery policies are such as to encourage an orderly increase in income and job-creating investment, the country's imports (and exports) will rise in consequence. Ill-advised over-stimulation of the economy will be self-defeating by leading to a boom-bust sequence.

Second, International Monetary Fund Managing Director Johannes Witteveen cautioned against reflating economies in an inflation-sensitive world in a late 1976 address to the directors of the fund:

Recent experience clearly indicates that the effects of policies aimed at stimulating growth and employment are likely to be short lived unless the currently high rate of price inflation is brought down and inflationary expectations are greatly reduced. Abatement of inflation will not come about unless fiscal and monetary policies are able to achieve and maintain restraint over the rate of growth in aggregate demand. These policies must be adhered to fully, and policy risks must not be shaded—as they often were in the later 1960's and early 1970's—so as to extract additional output in the short term.

Third, British Prime Minister James Callaghan has verified Witteveen's concern. Prime Minister Callaghan stated in a speech to the British Labour Party in 1976:

We used to think that you could just spend your way out of a recession and increase employment by cutting taxes and boosting government spending. I tell you, in all candor, that that option no longer exists, and that insofar as it ever did exist, it only worked by injecting bigger doses of inflation into the economy followed by higher levels of unemployment as the next step. That is the history of the past 20 years.

Fourth, the U.S. economy is growing rapidly without heavy governmental stimulus. As a result, President Carter has withdrawn his proposal for a one-time tax rebate. By the same token U.S. representations to West Germany and Japan to reflate in order to increase their imports would be inconsistent with the President's action.

TRADE DEFICITS

Although domestic U.S. employment in certain industries is adversely affected, other countries should applaud the U.S. trade deficit. U.S. trade figures continue to be negative this year, after a record $9.2 billion deficit in 1976. But Japan's foreign trade is $10 billion in surplus and this great surplus may be a major reason for other countries' flirtation with more protectionism. Obviously, something must be done to head off demands for unilateral limitations by other nations on imports from Japan while multilateral methods are sought to reduce her surplus.

President Carter has appropriately resisted domestic demands for higher tariffs and quotas on imports from Japan which would not only damage consumers in all countries but would also shrink the volume of world trade and impede worldwide recovery. Other industrialized countries should also resist demands for more protection.

THE EMERGING NEW INTERNATIONAL ORDER

The larger issue involved in the current debate about outsized trade surpluses in some countries and outsized trade deficits in others is the changing structure of the world economy, including monetary and financial arrangements. Impatience with the restrictions on expansive domestic economic policies imposed by the gold standard has led to its abandonment; and its system of fixed exchange rates has been replaced by a system of semi-flexible rates. With the disappearance of the international discipline of the gold standard (which led to growth retarding capital outflows from rapidly expanding economies), the industrialized nations have been able to pursue highly expansive policies. The great growth of international trade over the past two decades and the accompanying liberalization of trade and payment systems has benefited not only the developed but the developing countries as well.

But now the less developed countries (LDC's) are demanding more aid—they have already had more trade—from the developed nations. The problems associated with international trade in basic commodities and the related problems of developing the LDC's can best be solved by five specific programs:

(1) *Improving the International Monetary Funds' Compensatory Financing Facility* established in 1963 to ease the payments problems of primary producing countries that experience large swings in their export earnings.

(2) *Negotiation of Long-Term Consumer Producer Agreements* between private parties—not governments—in the countries concerned. While U.S. action in June 1973 embargoing soybean exports was unfortunate in this regard, the multilateral GATT trade negotiations should arrive at a general principle binding member nations to long-term price and supply agreements.

(3) *Greater International Exchange of Information* to provide more reliable projections of supply and demand for internationally traded basic commodities. This U.S. is the most open country in publishing statistical information regarding commodities in which we trade. We should encourage other countries to follow our example.

(4) *Improving World Bank Loan Facilities to Diversify LDC's Production.* Such efforts should be aimed at three objectives: (a) projects producing primary products likely to be in demand; (b) projects that process locally-produced primary products; and (c) research aimed at reducing costs and developing new uses for such primary products.

In this commitment more emphasis should be placed on the approach of the International Finance Corporation (IFC), a Bank affiliate, which participate only in projects organized on a profit and loss basis. This assures that assistance is directed to the most productive purposes with visible result in terms of jobs, production, and earnings. Productive investment is the key to economic growth, and the roles of international financial institutions and commodity stabilization systems are secondary to this factor.

(5) *Encouraging Parallel Private Investment to Support Diversification of Production.* Multinational corporations can contribute greatly to the foregoing investment objectives in LDC's. But to do so, they need reasonable assurance that

their investments will be protected, including the use of their patents, trademarks and other forms of know-how, in joint ventures with local partners.

We appreciate the opportunity to present our assessment of international economic conditions and policies to improve these conditions.

[From the U.S. Council for an Open World Economy, Inc., Washington, D.C.]

Statement on Foreign Economic Policy Released by the Board of Trustees on March 3, 1977

Introduction

Although the new Administration has not had time to announce definitive plans for substantial new progress toward a more open world economy, it seems that this objective is high on its agenda; that it regards closer economc cooperation among the leading industrial countries of the Free World, including the reduction of trade barriers, to be a vital step toward world economic recovery, sustained economic growth and overall world peace; and that progress in this area requires close interrelation and interdependence between the nation's domestic and foreign economic policies.

This Council fully supports this apparent policy intent, as well as the contemplated convening of a summit conference to build a healthier, more secure world community. We urge the Administration to give achievement of an open world economy a high priority in its own policy planning and in its proposals for the international conference agenda. We are deeply concerned over the shortcomings of current national policy and preparedness in this field. The following views outline our overall position on these issues.

Policy Shortcomings

The United States and the other economically advanced counties are not adequately addressing the need for deliberate, dependable progress toward an open international economic system, and for the domestic economic policies required to secure and sustain such a foreign economic strategy.

Although the world in the last four decades has made impressive progress toward removing tariffs and other trade distortions, hundreds of old barriers continue to impede legitimate world trade, while scores of new obstructions have been added. Current authority for negotiating removal or relaxation of these restrictions, and for developing an up-to-date, binding code dealing with unfair competition in international commerce, falls far short of what is needed. Recourse to additional trade restriction remains far easier than national policy and international law should permit.

A great deal of uncertainty surrounds the resolve of the United States and the other industrialized countries to develop a genuinely open international economic system. This uncertainty breeds suspicions and nationalistic tendencies among the advanced countries, deepens antagonisms toward the "rich" countries on the part of the "poor" countries, and is a principal reason our private enterprise system is not performing as well as it should. Uncertainty in this vital policy area sounds no call for excellence in the decision making of business and government.

Negotiated controls on world trade in a number of products (for example, textiles, steel and meat) appear to have given this form of protectionism undeserved respectability, even among most opponents of protectionism, solely by reason of its having been negotiated. Liberal-trade advocates, with few exceptions, stand surpirsingly silent in the fact of this new fashion in an old, discredited response to the problems of foreign competition.

Although the greatly confining, grossly unrealistic and inherently protectionist "peril point" device for disqualifying products from tariff cutting was excised from trade legislation by the Trade Expansion Act of 1962, there remains a significant residue of "peril point" mentality in decisions on the U.S. negotiating position and on the products selected for tariff-free treatment under the policy of tariff-preference aid to developing countries.

Although improvements have been made in the adjustment assistance provisions of the trade legislation (authorizing adjustment aid to qualifying firms and workers), the "import relief" ("escape clause") provisions—relating to overall aid to a whole industry—remain protectionist in standards and concept. Trade restriction, if justifiable at all to help a severely impacted industry which has done as much as possible on its own to cope with foreign competition, should be only a marginal part of a coherent policy of constructive aid, reflecting careful assessment of the industry's real problems and needs. Thus, there should be no trade-restriction policy for a particular industry without a comprehensive adjustment policy addressing the real problems and needs of that industry. This approach to trade restriction should be on the agenda for early reform of U.S. trade legislation and of the General Agreement on Tariffs and Trade. The essentials of this approach can be put into effect by Presidential initiative without new legislation and without violating existing law.

POLICY REFORMS

We urge President Carter to initiate this reform in "import relief" policy, setting a standard for subsequent legislative action and international agreement along these lines.

We urge the new Administration to assess, and announce to the American people, the consumer cost and overall national cost of every additional measure of import control that may be found necessary. This should also apply to the cost of export-control arrangements with supplying countries, and of product exemptions from trade negotiations or from tariff-preference aid to developing countries. Whatever government help is given to import-impacted industries should be subjected to periodic, public review by appropriate government agencies to ensure that the public interest is fully served by such measures and that such aid is terminated as quickly as the public interest dictates.

We urge earliest U.S. enunciation of a "free trade" commitment, and a U.S. invitation to the other industrialized countries to join in such an objective following conclusion of the current round of trade negotiations. What this envisages, in addition to an updated code of fair international competition, is the programmed removal, in accordance with a realistic timetable, of all artificial barriers of the industrialized countries against legitimate trade and investment. A 10-year timetable for achieving at least most of this objective is within the capacity of the United States and most or all of the other advanced countries. A fully open world economy by the year 2000, insofar as the industrialized countries are concerned, is a reasonable goal toward which our trade policy should be directed. A determined effort to achieve this goal may well accelerate its realization. Exceptions may at times be necessary, but firm commitment to an open world economy will keep these to a minimum.

A dependable "free trade" commitment is the trade policy best calculated to combat inflation, and overall to stimulate the best performance from our economic system, including sound solutions to the nation's adjustment problems in a rapidly changing world. Abroad, such an initiative would stimulate urgent, far-reaching efforts to develop a strong, stable international monetary system, and would in every way help build the kind of world economy essential to the security and prosperity of the United States. Acceleration of the free-trade timetable to provide quicker freedom of access for imports from the developing countries would contribute substantially to a greatly needed effort to bring the world's "North" and "South" together in a new partnership—a "new international economic order"—beneficial to peoples everywhere. Serious search for such a partnership, incorporating such a trade policy, would help secure a greatly improved climate of world cooperation for achieving needed access to critical materials at fair prices, for expanding world markets for the widest range of goods from the widest range of countries, and for raising the labor standards and overall living standards of all countries participating in such a venture. All this has been too long retarded by the nations whose skills and resources should have made them far more resourceful proponents of such a goal than they have proved to be.

Gearing the American economy for this kind of world economy would contribute greatly to the "full employment" policy that is an essential backstop for securing and sustaining such an international policy commitment. Such preparedness in this and other industrialized countries would also contribute materially to the economic revival which all these countries must stimulate as quickly as possible to help rescue a depressed world economy and make the recovery durable. A "full employment" policy, basic to an effective adjustment program, is also essential to the effort that must be made to bring organized labor back to the campaign for a freerer world economy—back to the role which labor once played with great distinction. This Council laments the failure of most advocates of freer world trade, including multinational corporations, to strive for a domestic economic policy capable of uniting the nation behind the foreign economic policy essential to our enlightened national interest.

The current state of national unpreparedness for the foreign-and-domestic policy imperatives of a healthy American economy in a healthy world economy must be remedied as quickly as possible. We urge the new Administration to make an open world economy a priority American goal which the American people can support, and on whose reliability the world can depend.

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