1271

PROSPECTS FOR THE LONDON ECONOMIC SUMMIT

JOINT HEARINGS

BEFORE THE

SUBCOMMITTEES ON

EUROPE AND THE MIDDLE EAST

AND ON

INTERNATIONAL ECONOMIC POLICY AND TRADE

OF THE

COMMITTEE ON FOREIGN AFFAIRS

HOUSE OF REPRESENTATIVES

AND THE

SUBCOMMITTEE ON ECONOMIC GOALS AND INTERGOVERNMENTAL POLICY

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-EIGHTH CONGRESS

SECOND SESSION

MAY 14 AND 30, 1984

Printed for the use of the Committee on Foreign Affairs

U.S. GOVERNMENT PRINTING OFFICE

36-484 WASHINGTON : 1984

COMMITTEE ON FOREIGN AFFAIRS

DANTE B. FASCELL, Florida, *Chairman*

LEE H. HAMILTON, Indiana
GUS YATRON, Pennsylvania
STEPHEN J. SOLARZ, New York
DON BONKER, Washington
GERRY E. STUDDS, Massachusetts
ANDY IRELAND, Florida
DAN MICA, Florida
MICHAEL D. BARNES, Maryland
HOWARD WOLPE, Michigan
GEO. W. CROCKETT, Jr., Michigan
SAM GEJDENSON, Connecticut
MERVYN M. DYMALLY, California
TOM LANTOS, California
PETER H. KOSTMAYER, Pennsylvania
ROBERT G. TORRICELLI, New Jersey
LAWRENCE J. SMITH, Florida
HOWARD L. BERMAN, California
HARRY M. REID, Nevada
MEL LEVINE, California
EDWARD F. FEIGHAN, Ohio
TED WEISS, New York
GARY L. ACKERMAN, New York
ROBERT GARCIA, New York

WILLIAM S. BROOMFIELD, Michigan
LARRY WINN, Jr., Kansas
BENJAMIN A. GILMAN, New York
ROBERT J. LAGOMARSINO, California
JOEL PRITCHARD, Washington
JIM LEACH, Iowa
TOBY ROTH, Wisconsin
OLYMPIA J. SNOWE, Maine
HENRY J. HYDE, Illinois
GERALD B. H. SOLOMON, New York
DOUGLAS K. BEREUTER, Nebraska
MARK D. SILJANDER, Michigan
ED ZSCHAU, California

John J. Brady, Jr., *Chief of Staff*
Roxanne Perugino, *Staff Assistant*
Sue E. Eckert, *Staff Assistant*

Subcommittee on Europe and the Middle East

LEE H. HAMILTON, Indiana, *Chairman*

TOM LANTOS, California
ANDY IRELAND, Florida
MERVYN M. DYMALLY, California
ROBERT G. TORRICELLI, New Jersey
LAWRENCE J. SMITH, Florida
MEL LEVINE, California

LARRY WINN, Jr., Kansas
MARK D. SILJANDER, Michigan
ED ZSCHAU, California

Michael H. Van Dusen, *Subcommittee Staff Director*
Alison Brenner Fortier, *Minority Staff Consultant*
Kenneth B. Moss, *Subcommittee Staff Consultant*
Christopher A. Kojm, *Subcommittee Staff Consultant*

Subcommittee on International Economic Policy and Trade

DON BONKER, Washington, *Chairman*

DAN MICA, Florida
HOWARD L. BERMAN, California
EDWARD F. FEIGHAN, Ohio
MICHAEL D. BARNES, Maryland
HOWARD WOLPE, Michigan
SAM GEJDENSON, Connecticut

TOBY ROTH, Wisconsin
OLYMPIA J. SNOWE, Maine
DOUGLAS K. BEREUTER, Nebraska

R. Roger Majak, *Subcommittee Staff Director*
Harold P. Luks, *Minority Staff Consultant*
Carol Page Rovner, *Subcommittee Staff Consultant*
Carole A. Grunberg, *Subcommittee Staff Consultant*

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Congress)

SENATE	HOUSE OF REPRESENTATIVES
ROGER W. JEPSEN, Iowa, *Chairman*	LEE H. HAMILTON, Indiana, *Vice Chairman*
WILLIAM V. ROTH, JR., Delaware	GILLIS W. LONG, Louisiana
JAMES ABDNOR, South Dakota	PARREN J. MITCHELL, Maryland
STEVEN D. SYMMS, Idaho	AUGUSTUS F. HAWKINS, California
MACK MATTINGLY, Georgia	DAVID R. OBEY, Wisconsin
ALFONSE M. D'AMATO, New York	JAMES H. SCHEUER, New York
LLOYD BENTSEN, Texas	CHALMERS P. WYLIE, Ohio
WILLIAM PROXMIRE, Wisconsin	MARJORIE S. HOLT, Maryland
EDWARD M. KENNEDY, Massachusetts	DANIEL E. LUNGREN, California
PAUL S. SARBANES, Maryland	OLYMPIA J. SNOWE, Maine

DAN C. ROBERTS, *Executive Director*
JAMES K. GALBRAITH, *Deputy Director*

SUBCOMMITTEE ON ECONOMIC GOALS AND INTERGOVERNMENTAL POLICY

HOUSE OF REPRESENTATIVES	SENATE
LEE H. HAMILTON, Indiana, *Chairman*	LLOYD BENTSEN, Texas, *Vice Chairman*
AUGUSTUS F. HAWKINS, California	ROGER W. JEPSEN, Iowa
OLYMPIA J. SNOWE, Maine	ALFONSE M. D'AMATO, New York

CONTENTS

WITNESSES

MATERIAL SUBMITTED FOR THE RECORD

APPENDIXES

PROSPECTS FOR THE LONDON ECONOMIC SUMMIT

MONDAY, MAY 14, 1984

HOUSE OF REPRESENTATIVES, COMMITTEE ON FOREIGN AFFAIRS, SUBCOMMITTEES ON EUROPE AND THE MIDDLE EAST AND ON INTERNATIONAL ECONOMIC POLICY AND TRADE, JOINT ECONOMIC COMMITTEE, SUBCOMMITTEE ON ECONOMIC GOALS AND INTERGOVERNMENTAL POLICY,

Washington, DC.

The subcommittees met at 2:05 p.m., in room 2172, Rayburn House Office Building, Hon. Lee H. Hamilton (chairman of the Subcommittee on Europe and the Middle East and the Subcommittee on Economic Goals and Intergovernmental Policy) presiding.

Mr. HAMILTON. The meeting of the subcommittees will come to order.

The Subcommittees on Europe and the Middle East and on International Economic Policy and Trade of the Committee on Foreign Affairs and the Joint Economic Committee's Subcommittee on Economic Goals and Intergovernmental Policy meet today to examine the prospects for the upcoming London Economic Summit.

The London summit, which is the 10th in a series of annual economic meetings of the leaders of the seven major industrial countries, will take place June 7-9.

The summit takes place against a global economic backdrop which is both favorable and ominous. U.S. economic recovery certainly has been stronger than anticipated a year ago at the Williamsburg summit. Japan and the European countries also are beginning to show signs of economic strength.

However, huge U.S. deficits, coupled with high and rising U.S. interest rates, threaten the favorable economic progress made to date. Furthermore, the international debt problem is far from resolved, and, in fact, is made more precarious with each percentage point rise in the U.S. prime rate. Equally disturbing, protectionism, despite pledges to the contrary at last year's summit, has been growing, not waning.

I would like at this point to ask unanimous consent to include in the record of the hearing a letter from Lee L. Morgan, Chairman of the International Trade and Investment Task Force, the Business Roundtable, to the Hon. Malcolm Baldrige regarding the London Economic Summit.

[The letter referred to above follows:]

CATERPILLAR TRACTOR CO.

Chairman and Chief Executive Officer

Peoria, Illinois 61629

May 3, 1984

The Honorable Malcolm Baldrige
Secretary of Commerce
Washington, D.C. 20230

Dear Mac:

I promised to get back to you with the Business Roundtable's thoughts concerning the upcoming London Economic Summit. Since we last spoke on this subject at the Trade and Investment Task Force meeting in Washington, my staff has been briefed by Alan Wallis on the outlook for the Summit. The comments that follow are intended to reflect what we understand will be on the agenda in London.

Our perception is that the meetings will not be highly achievement oriented. The "conventional wisdom" is that some of the tough issues which have been the focus of previous meetings may be avoided. For example, we're not aware of plans to follow up on last year's discussions on the critical issue of exchange rates and their effect on trade flows. We believe that's a mistake. We recognize that some steps are being undertaken -- particularly with the Japanese -- to address this problem. However, we continue to believe that the heads of state must focus on the critical multilateral implications of exchange rate relationships on trade balances.

Looking at trade more broadly, we understand that there will be discussion about the need for a new round of trade negotiations. This initiative is timely and we commend the United States for undertaking it. We only urge that before taking a major substantive step forward on the content of such negotiations, the U.S. government consult closely with businessmen and other interested parties to carefully develop objectives and strategy. You know better than I that there is some "unfinished business" from the last round of negotiations. In addition, I would reiterate our view that the trade distorting effects of national investment policies and the increasingly important issues surrounding trade in services both deserve priority attention in international discussions. As momentum builds toward further international discussions, the Business Roundtable would be pleased to offer more specific recommendations for the U.S. agenda.

We are encouraged that the issue of "protectionism" and the havoc it plays with Western economies will be discussed at the Summit. Increasing pressures in the United States for "protectionism" cause us great concern. Defeat of proposals like domestic content legislation continue to be a priority item on our legislative agenda. We urge the Summit countries to reaffirm their commitment to free and open trade policies.

The question of lesser developed countries' debt problems is of similar concern to the Business Roundtable. You recognize the impact the situation is having on the ability of U.S. exporters to help extricate the United States from its present trade deficit situation. We are encouraged that this continuing problem is likely to be a subject of discussion in London. A strong commitment by Summit countries to coordinate efforts to assist the countries seeking positive solutions to their debt problems is necessary. Such an approach will serve us well as we seek to set the stage for equally important discussions with these same countries regarding removal of existing trade and investment barriers.

Much of the foregoing relates to the broad objective of achieving better overall economic policy coordination among the OECD countries as a means of assuring maximum economic growth. That's a topic of past Summit meetings, and it should remain a priority. We believe a strong, continuing endorsement from the heads of state will help ensure that the national bureaucracies will sustain the policy coordination effort.

Finally, the Business Roundtable encourages the Administration to heed the concerns of many Summit participants regarding the present U.S. budget deficit and its impact on the world economy. The effects of the deficit are already being felt -- particularly by exporters -- in terms of higher U.S. interest rates and the disasterously high dollar value. We hope the President will return from the Summit with a renewed commitment to take the necessary steps to bring the deficit problem under control.

I hope my comments are of help as you prepare for the upcoming meetings. As always, the Business Roundtable is ready to provide whatever assistance is necessary to assist your efforts.

Sincerely,

Lee L. Morgan
sm

cc: William E. Brock
Robert C. McFarlane
Edwin Meese
Donald T. Regan
George P. Shultz

bcc: BRT Task Force
BRT Coord. Comm.
Sen. Dole
Larry Fox
Repr. Gibbons
Robert McNeill
Ruben Mettler
Paul Murphy
Mike Samuels

Mr. HAMILTON. Our panel of witnesses today have been asked to discuss prospects for the London summit against this economic backdrop and to indicate what they feel should be our priorities for the summit. They have been asked to provide us with a gauge by which to judge the results of this meeting.

We are fortunate to have with us today Mr. Edmond T. Pratt, Jr., chairman and chief executive officer of Pfizer, Inc.; Mr. C. Fred Bergsten, director of the Institute for International Economics; and Mr. Alan Greenspan, president, Townsend and Greenspan.

Gentlemen, we look forward to your testimony and discussing this important meeting with you. Your statements will be included in the record in full. You may proceed to summarize your statements, if you will.

Mr. HAMILTON. Mr. Pratt, if you would, you may begin.

STATEMENT OF EDMUND T. PRATT, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PFIZER INC.

Mr. PRATT. Good afternoon, Mr. Chairman. Thank you for inviting me today to express my thoughts about both domestic and international economic issues that might be discussed at the upcoming economic summit meeting to be attended by President Reagan and other leaders of the industrial world.

I am Edmund Pratt, chairman of Pfizer and of the Emergency Committee for American Trade [ECAT]. Pfizer is a leading world manufacturer of pharmaceutical and other health care products, and ECAT is an organization of the leaders of 63 major U.S. firms with extensive overseas business operations. We thus have a lot at stake in the discussions that will take place at the June 1984 summit meeting.

Undoubtedly President Reagan's colleagues will want to discuss the management of the U.S. economy and particularly the necessity of controlling current and future U.S. budget deficits. I have no unique insights into possible solutions to the deficit problem. I share with my business colleagues the recognition that Federal spending as a percentage of gross national product must be reduced and that Federal revenues must be enhanced.

Without appropriate solutions, continuing huge U.S. budget deficits will continue to attract foreign funds to U.S. shores with attendant disadvantages to U.S. producers who will continue to find the consequent strong U.S. dollar pricing them out of both domestic and foreign markets. This forebodes nothing but the prospect of economic disaster.

I would hope that the summit leaders will devote time to the discussion of the rise of protectionism in each of their respective countries.

One result of the restructuring of the world economy—together with severe economic competition among the summit nations themselves—is the rise of demands for governmental measures that will help insulate domestic producers from foreign competition. Perhaps at no time in our history has the demand for protection from foreign competition been as virulent or as well organized or as sophisticated. However, the basic premises of economics have not ceased to operate. Inefficiencies are still more costly than efficiencies and the general welfare continues to be better served by competitive producers than by noncompetitive ones.

While the United States and its trading partners should implement their domestic statutes guarding against internationally agreed unfair trade practices, we should all guard against the seductiveness of adding to the arsenal of domestic unfair trade statutes a variety of domestic legalisms that pioneer new protective measures that could be emulated by all and in the process throttle a downward spiral in world trade.

We should also very carefully consider the domestic and international consequences of legislative measures that would protect domestic industries from foreign competition in ways that would be violative of our international legal and other obligations.

I would hope that the summit leaders would agree to the continuation of the freeze against protectionist measures currently in effect among them.

I would also recommend that the summit participants carefully consider the economic development and the international debt problems of the countries of the Southern Hemisphere.

Their ability to continue to advance their economies in most instances vitally depends on their access to foreign capital and to their ability to export to foreign markets.

From a narrow national economic interest, the developing countries are in fact the fastest growing markets for U.S. exports and investments. About 40 percent of U.S. exports go to these countries. As their economies grow, so does our business with them and as their economies stagnate or recede, so does our business with them.

While recognizing this, it nevertheless behooves the United States and others to insist on the developing nations adhering to international norms affecting the conduct of business. If they do, they will help themselves and others. If they do not, their economic and social development will be retarded.

I particularly have in mind the treatment by the developing nations, as well as by some economically advanced nations, of foreign investment and of intellectual property rights.

Foreign direct investment can contribute to the long-term solution of the LDC debt problem because it is an important source of foreign capital and technology. Unfortunately for both the developing countries and prospective investors in them, many of the developing countries pursue investment policies—as well as trade policies—that create disincentives for new investments.

Hopefully, President Reagan and the other participants at the London Economic Summit could discuss this issue with a view to developing a collaborative dialog with interested developing nations on steps that could be taken by both investing and borrowing nations to stimulate the flow of foreign direct investment. Consideration might be given to establishing a center to this effect under the auspices of the GATT.

In international discussions on foreign investment, the U.S. objective should be to encourage in both developing and developed countries openness in the area of investment to the same degree that exists in the United States. It is particularly significant that this past year U.S. Government policy on direct international investment was changed from one of neutrality to one of forceful opposition to foreign investment distorting practices.

The protection of intellectual property rights is also a significant issue affecting the conduct of business in many countries of the world, including the developing countries

We would hope that the London Summit participants in their final declaration will recognize the necessity for seeking measures to improve the protection of intellectual property rights.

Another vital issue that undoubtedly will be discussed at the economic summit is East-West trade. We in the business community recognize the need for and strongly support an export control program to serve, among other things, U.S. foreign policy and national security interests.

There is a tendency, however, to place unilateral controls—for reasons of either foreign policy or national security—on the export of goods and technology when the functional equivalent of those goods and technology is available from foreign sources, including our allies.

I am troubled by a recent newspaper report commenting on a cable from the U.S. consulate in Hong Kong reporting that a significant foreign customer was switching his purchases to non-U.S. firms because U.S. licensing delays have become progressively worse over the last year or two. The same customer stated that U.S. export controls are reducing U.S. firms to "unreliable, last-resort suppliers."

We must work collaboratively with our allies in the devising of multilateral controls that reflect the realities of foreign availability.

To conclude my remarks, Mr. Chairman, I would urge the summit leaders to call for a new and major round of international economic negotiations to take place under the GATT. I think the negotiations should be broad in scope and should include all GATT members. It certainly should address the development of new rules governing foreign investment.

According to the Department of Commerce, 40 percent of U.S. exports, manufactured exports, go to the foreign affiliates of U.S. companies. Over 80 percent of U.S. exports, directly or indirectly, are generated by U.S. direct investments abroad. To put it simply, where American companies go, American-made products follow.

Thank you.

Mr. HAMILTON. Thank you very much, Mr. Pratt. That gets us off to a good start.

[Mr. Pratt's prepared statement follows:]

PREPARED STATEMENT OF EDMUND T. PRATT, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PFIZER, INC., ON BEHALF OF THE EMERGENCY COMMITTEE FOR AMERICAN TRADE

MONDAY, MAY 14, 1984

Mr. Chairman, thank you for inviting me here today to express my thoughts about both domestic and international economic issues that might be discussed at the upcoming economic summit meeting to be attended by President Reagan and other leaders of the industrial world.

I am Edmund T. Pratt, Jr., and am Chairman of Pfizer Inc. and of the Emergency Committee for American Trade (ECAT). Pfizer is a leading world manufacturer of pharmaceutical and other health care products. ECAT is an organization of the leaders of 63 large U.S. firms with extensive overseas business operations. Member firms of ECAT had nearly $700 billion in worldwide sales last year and they employeed over five million workers. Pfizer had total 1983 sales of nearly $4 billion and we employed 41,000 workers. The economic well being of our firms and our employees are vitally affected by the actions and policies of the United States and of all the other countries where we conduct business. We thus have a lot at stake in the discussions that will take place at the June, 1984, economic summit.

Undoubtedly President Reagan's colleagues will want to discuss the management of the U.S. economy and particularly the necessity of controlling current and future U.S. budget deficits. I have no unique insights into possible solutions to the deficit problem. I share with my business colleagues the recognition that federal spending as a percentage of gross national product must be reduced and that federal revenues must be enhanced. There is no business consensus as to how this might be accomplished. I believe, however, that there is general agreement that government tax policies should encourage savings and investment and that antitrust and other related policies should be interpreted and administered in a way that will encourage joint business ventures that will spur the discovery of new products as well as lead to improvements and efficiencies in producing current ones.

Innovative thinking about solutions to the deficit problem on the part of all of us is needed. Without appropriate solutions, continuing huge U.S. budget deficits will continue to attract foreign funds to U.S. shores with attendant disadvantages to U.S. producers who will continue to find the consequent strong U.S. dollar pricing them out of both the domestic and foreign markets. This forebodes nothing but the prospect of economic disaster.

I would hope that the summit leaders will devote time to the discussion of the rise of "protectionism" in each of their respective countries. This is an unsettling time for the industrial democracies. No longer do they hold amongst themselves the basic core of world industrial production. A number of Asian countries have come to the fore of industrial production and economic power, and a number of developing countries are close behind. These developments are causing very basic changes in international economic and political relations.

One result of the restructuring of the world economy -- together with severe economic competition among the summit nations themselves -- is the rise of demands for governmental measures that will help insulate domestic producers from foreign competition. Perhaps at no time in our history has the demand for protection from foreign competition been as virulent or as well organized or as sophisticated. However, the basic premises of economics have not ceased to operate. Inefficiencies are still more costly than efficiencies and the general welfare continues to be better served by competitive producers than by non-competitive ones.

While the United States and its trading partners should implement their domestic statutes guarding against internationally agreed unfair trade practices, we should all guard against the seductiveness of adding to the arsenal of domestic unfair trade statutes a variety of domestic legalisms that pioneer new protective measures that could be emulated by all and in the process throttle a downward spiral in world trade. While I am not familiar with all of them, I understand that there are a variety of such proposals before the U.S. Congress as well as under consideration by other countries.

We should also very carefully consider the domestic and international consequences of legislative measures that would protect domestic industries from foreign competition in ways that would be violative of our international legal and other obligations. Such things as auto domestic content legislation recently passed by the House and currently before the U.S. Senate, for example, could lead to like foreign measures that would impede U.S. exports. Similarly, there are a variety of "protectionist" measures under consideration abroad that would unjustifiably curtail U.S. exports.

Such measures both at home and abroad should be resisted in the interests of the economic well being of all. I would hope that the summit leaders would agree to the continuation of the freeze against "protectionist" measures currently in effect among them.

I would also recommend that the summit participants carefully consider the economic development and the international debt problems of the countries of the southern hemisphere. Together with the Pacific rim countries, the developing countries are becoming major economic producers. Their ability to continue to advance their economies in most instances vitally depends on their access to foreign capital and their ability to export to foreign markets. As in the case of the U.S. budget deficit, innovative thinking and measures are necessary to prevent a halt in the economic advancement of the poorer countries of the world.

From a narrow national economic interest, the developing countries are in fact the fastest growing markets for U.S. exports and investments. About 40 percent of U.S. exports go to these countries. As their economies grow, so does our business with them and as their economies stagnate or recede, so does our business with them.

While recognizing this, it nevertheless behooves the United States and others to insist on the developing nations adhering to international norms affecting the conduct of business. If they do, they will help themselves and others. If they do not, their economic and social development will be retarded.

I particularly have in mind the treatment by the developing nations, as well as by some economically advanced nations, of foreign investment and of intellectual property rights.

Foreign direct investment can contribute to the long-term solution of the LDC debt problem because it is an important source of foreign capital and technology. Unfortunately for both the developing countries and prospective investors in them, many of the developing countries pursue investment policies -- as well as trade policies -- that create disincentives for new investments. Restrictions on equity, local content, export requirements, and discriminatory technology and labor laws are but a few of the disincentives increasingly being utilized by a number of countries.

Hopefully, President Reagan and the other participants at the London Economic Summit could discuss this issue with a view to developing a collaborative dialogue with interested developing nations on steps that could be taken by both investing and borrowing nations to stimulate the flow of foreign direct investment. Consideration might be given to establishing a center to this effect under the auspices of the GATT.

In international discussions on foreign investment, the U.S. objective should be to encourage in both developing and developed countries openness in the area of investment to the same degree that exists in the United States. It is particularly significant that this past year U.S. government policy on direct international investment was changed from one of neutrality to one of forceful opposition to foreign investment distorting practices.

The protection of intellectual property rights is also a significant issue in conducting business in many countries of the world, including the developing countries. Strong and internationally recognized and enforced protection for patents, copyrights, trade-marks, and trade secrets is essential to foreign investment and particularly to investment in the less-developed-countries where the investment risks tend to be greater than they are in the industrialized countries.

We would hope that the London Summit participants in their final declaration will recognize the necessity for seeking measures to improve the protection of intellectual property rights. As in the case of direct foreign investment above, the summit leaders might consider establishing a working group to explore ways to increase the protection of intellectual property rights under existing multilateral agreements.

Another vital issue that undoubtedly will be discussed at the economic summit is East-West trade. We in the business community recognize the need for and strongly support an export control program to serve, among other things, U.S. foreign policy and national security interests.

There is a tendency, however, to place unilateral controls -- for reasons of either foreign policy or national security -- on the export of goods and technology when the functional equivalent of those goods and technology is available from foreign sources, including our allies. Such controls mean lost markets for U.S. firms and do not necessarily deny goods or technology to adversary nations who are frequently able to obtain them from alternative sources.

The complex and cumbersome licensing system in place under the control program works against increases in U.S. exports. Indeed, changes in the licensing system under consideration in the Administration will, if implemented, lead to further licensing delays and lost business. Their extraterritorial reach could further exacerbate relations with our closest allies.

I am troubled by a recent newspaper report commenting on a cable from the U.S. consulate in Hong Kong reporting that a significant foreign customer was switching his purchases to non-U.S. firms because U.S. licensing delays have become progressively worse over the last year or two. The same customer stated that U.S. export controls are reducing U.S. firms to "unreliable, last-resort suppliers."

We are hearing this type of comment regarding U.S. exports. If the situation which leads to it is not corrected, significant adverse consequences for the U.S. economy and the

U.S. defense effort, which depends on a strong American economy, are in order.

We must work collaboratively with our allies in the devising of multilateral controls that reflect the realities of foreign availability. We must respect their sovereign rights to control trade within their own borders. Most importantly, the Congress needs to get on with the extension and reform of the Export Administration Act. A number of the pending changes address the problems which have arisen with our allies.

To conclude my remarks, Mr. Chairman, I would urge the summit leaders to call for a new and major round of international economic negotiations to take place under the GATT. I think the negotiations should be broad in scope and should include all GATT members. It certainly should address further measures of both tariff and non-tariff trade liberalization. But significantly, it should also address the development of new rules governing foreign investment. According to the Department of Commerce, 40 percent of U.S. exports go to the foreign affiliates of U.S. companies. Over 80 percent of U.S. exports directly or indirectly are generated by U.S. direct investments abroad. To put it simply, where American companies go, American-made products follow.

Thank you.

Mr. HAMILTON. Mr. Greenspan, would you continue, please.

STATEMENT OF ALAN GREENSPAN, PRESIDENT, TOWNSEND & GREENSPAN

Mr. GREENSPAN. Thank you, Mr. Chairman.

I presume my colleague Fred Bergsten will discuss more of the economic issues involved in the summit. I would like to restrict myself basically to two special points which I believe will have an important effect on world economic events over the next year or so, and to which the heads of government I believe are going to have to direct a great deal of attention.

The first is the issue of the dollar, not in the sense that the dollar is becoming much too strong relative to other currencies, but that its probably on the edge, at the moment, of beginning to tilt over. The problems which are likely to confront us in the context of a weakened dollar may in fact turn out to be as difficult as our problems of a strong dollar.

The reason we are probably tilting over is a theoretical one. Having examined the international portfolios of dollar and other currency holdings, it is fairly apparent that there has been a fairly significant amount of accumulation of dollars vis-a-vis other currencies in the Eurocurrency market, in the international bond market, and in other areas of international exchange.

As a consequence it is becoming fairly obvious that the extraordinarily strong dollar, which is clearly significantly above its purchasing power parities by any measure of which we can conceive, is being created by a massive portfolio shift from non-U.S. dollar currencies into dollar currencies.

The high real rates of short-term dollar-denominated interest is a factor pulling funds, as indeed the concept of the United States and the dollar generally as being a safe haven.

The problem, however, is that as the portfolio shift increasingly toward dollars, they must inevitably at some point come to saturation, a point at which no further adjustments seem desirable. We will arrive at a point, if indeed we are not already there, in which (1) the view of investment in U.S. dollar-denominated instruments, because of their real rates of return, remains undiminished and (2) the concept of the United States as a safe haven remains as strong as ever, and yet there is no one left to continuously accumulate dollars at the old rate since saturation has arisen. As a consequence, we would expect, and indeed in fact we may already be seeing, a decline in the dollar. A tilting downward of the trend, would probably be helpful to world international trade and stability, if it were limited to a drift down at a rate of say 10 to 15 percent a year. But there is always the possibility, if not a probability, that when it turns, the dollar could come down rather rapidly.

I am fearful that should the decline be precipitated the normal response will be to intervene into the exchange markets, endeavoring to support the dollar. This I believe is likely to fail largely because it is very difficult to, granted the size of the Eurocurrency markets, have adequate resources amongst central banks, to support currencies. This is especially the case with the dollar, without creating potentially major problems for domestic monetary policies, as the Federal Republic, you may recall, experienced several years ago.

We clearly have to get the solution coming from a reduction in net requirements of external funds to finance U.S. credit, and that is one of the major reasons why the U.S. budget deficit, must be addressed fairly quickly. It is probably the major force which we can bring to bear which would create some semblance of probability that when the dollar turns, its downward decline is likely to be modest.

Point number one is I think to look into the future, recognize the dollar as a problem, and I would suspect that instead of looking at what the past and our struggle with an extraordinarily strong dollar and its consequences, we begin to focus on what might happen, and that is a different issue altogether.

Mr. Chairman, rather than go on with a few other issues, I would like to terminate my opening remarks, and address a number of other questions, specifically the international debt one, during the question period.

Thank you.

Mr. HAMILTON. Thank you very much, Mr. Greenspan.

[Mr. Greenspan's prepared statement follows:]

PREPARED STATEMENT OF ALAN GREENSPAN, PRESIDENT, TOWNSEND & GREENSPAN

I appreciate the opportunity to appear before this committee to present my views on the issues likely to emerge during the forthcoming economic summit in London. Rather than commenting on the relatively large agenda of that meeting, I should like to restrict myself in my opening remarks to two major issues that are likely to require concerted action at the highest level over the next year. The first is the possibility of a significant weakening in the value of the United States dollar relative to other currencies in foreign exchange markets; the second the marginally related issue of the disturbing debt problems of some Latin American countries.

Despite the huge and growing American current account deficit and increasing unanimity that the U.S. currency is overvalued for the long pull, the dollar exchange rate with the yen and the European currencies continues to hold up remarkably well. After slipping earlier this year the dollar has since recovered most of its losses.

Significant retrenchment in the exchange rate is probable eventually, however. What remains uncertain is when. The uncertainty revolves around a number of theoretical considerations about the nature of exchange rates. Standard econometric techniques which relate the exchange rate to differential country price movements, relative money growth, current account balances, and other subsidiary elements have been remarkably unsuccessful in capturing the major exchange rate movement of recent years.

Although we have no conclusive means of determination the dollar currently is almost surely significantly above its average purchasing power parity relative to all other major currencies.

Since exchange rates clear the market in the short run, the elevated dollar exchange rate must result from demand for dollars to purchase items other than goods and services, mainly financial securities. The flow of foreign capital into the United States to purchase dollar-denominated investments has been large and is, in fact, the mirror image of the current account deficit. Movements into the dollar have also been substantial in the Eurocurrency market, and central banks have also tilted their reserves more toward dollars. Clearly, the continuation of high real dollar-denominated rates of interest relative to those of other currencies has been a major factor in drawing funds into the dollar. The dollar also has been a major attractor of funds seeking a "safe haven".

There is one compelling theoretical argument for a lower dollar. Clearly, the net demand for dollars results mainly from a shift in portfolios of dollar and other currency holdings of multinational corporations, governments, individuals, banks, and other institutions. In order to maintain a specific premium of the dollar exchange rate over its purchasing power parity, however, the net flow of funds into the dollar requires a continuing shift from other currencies. As soon as the demand for dollars fall that net portfolio shift evaporates, one must presume that the exchange rate of the dollar would fall back toward its purchasing power parity value. Consider the case of a desired increase in dollar holding at the expense of Deutsche marks. As the dollar share of the sum of dollars and marks in the portfolio rises, for example, from 70% to 75% to 80%, one can presume that the exchange rate premium over the purchasing power parity remains relatively stable. What happens when the shares reach 100% dollars and 0% marks? Barring short selling of marks, no further purchase of dollars will come from this source, even though the portfolio manager believes incremental dollar investments are superior to mark investments. If we generalize this proposition, a situation is quite conceivable in which the inflation adjusted rate of interest in dollars is still higher than any other currency, "safe haven" is still a persistent desire, but opportunities for portfolio rebalancing have been exhausted. Consequently, the net demand shift into dollars ceases and the exchange rate falls back toward purchasing power parity.

This example is oversimplified but nevertheless bears considerable relevance. At some point, portfolio adjustments on a world-wide basis will slacken as all natural limits are achieved. Then potential dollar purchasers disappear even though the incentives to hold dollars owing to high real interest rates and "safe haven" propensities remain.

A modest easing in the dollar relative to other currencies of the order of magnitude of ten to fifteen percent over the next year is on balance favorable to world trade and monetary stability. The danger, however, is that the reversal of a dollar could be far more abrupt than that, creating upward pressure on interest rates, destabilizing world economic activity and trade in the process.

I am aware that there is a significant school of thought which suggests that central bank intervention could be successful in intervening to slow the extent of dollar decline should it be too abrupt. I doubt, however, that central bank resources would be adequate to stem speculative forces once they began and I especially doubt that central banks would be easily capable of sterilizing the large accumulations of dollars that would otherwise create inflationary expansions of domestic monetary bases.

The policy issue is here more readily addressed through a significant reduction in the net demand for external funds to finance U.S. credit requirements. Obviously, a marked lowering of U.S. Treasury credit requirements which are by their nature highly interest rate inelastic, and therefore potentially destabilizing, would be of far greater help than any conceivable central bank intervention. It would surely be a more lasting solution to a structural weakening of the dollar in foreign exchange markets. Even if the budget deficit reduction is backloaded in the latter part of the 1980s and beyond, if it is sufficiently credible to alter long-term inflation expectations, it will induce a decline in long-term interest rates. That would have a far more beneficent effect on world economic activity stability and trade, than even large continuing external requirements of the United States would impose on the other side of the ledger.

Lower interest rates would obviously also be of assistance to the debt problem of our Latin American neighbors. As we move from one rescheduling of developing country debt to another, the immediate "crises" are being resolved. It is becoming increasingly clear, however, that we face a far too deep-seated problem for even the most adroit of finance ministers and bankers to easily overcome. As long as the debt problem is perceived as solely one of illiquidity, i.e., a mismatching of assets and liabilities, rather than possible insolvency, i.e., liabilities in excess of assets, no solution is possible. No reshuffling of debt can restore a positive net worth when the basic problem is one of insolvency.

Obviously, the analogy is not exact, but it is often illuminating to describe developing countries' financial difficulties in terms of business financial statements. For example, if a business borrows to invest in equipment and the productive asset yields gross profit in excess of interest and amortization payments, those payments can be met easily. If, however, the investment is unproductive and thus fails to meet debt payments, a debt crisis arises. Further, if that asset, assuming it is the only asset available to pay off the debt, continues to be unproductive, no rescheduling of the business debt will resolve the problem.

Under such circumstances, we are looking at a gap in the balance sheet. Part of the gap may have arisen because some of the external borrowing financed current consumption which obviously produced no future income to service the debt. Another part may have reflected capital investments which were either unproductive or insufficiently unproductive to meet interest and debt amortization costs even in the best of circumstances. Finally, even though a significant amount of the capital

36-484 O - 84 - 4

investment was potentially productive, the extent of the world-wide recession in recent years has idled many such facilities, thereby producing little in the way of income.

On top of all of this, a general loss of confidence in the economies and political systems of some developing nations led to a significant acceleration in the flight of capital. The errors and omissions component of the balance of payments, generally assumed to reflect unrecorded capital outflows, totaled approximately $45 billion for nonoil developing nations during the past three years, 35% of their net external borrowings from private sources.

It is clear that, if the developing nations can stabilize their financial systems and create an adequate internally generated rate of saving and investment, the economies can grow, making more resources available to service these huge external borrowings. With the flow of voluntary private lendings being virtually nil, however, the repayment burden will fall mainly on the internal consumption and investment of the individual LDCs. Only in this manner would they be able to export goods and services and earn the foreign exchange required to service hard currency debt. What is economically possible is a far cry from what is politically feasible. Internal political difficulties could readily bar LDC governments from applying scarce domestic resources to pay off foreign banks.

There certainly cannot be a realistic solution stemming solely from increased financial resources from the IMF or the World Bank. That approach clearly does not come to grips with the problem of a shortage of real resources. Shuffling paper claims only will produce a larger money supply without corresponding increases in goods. Should that occur on a large enough scale, it would only add to world inflation.

The future restructuring of developing country debt must recognize that the problem may not simply be the debt but rather the lack of assets to fully support the debt. In the case of private debts to foreign banks, some form of debt-equity conversion is theoretically possible. This, after all, is a major aspect of any domestic corporate bankruptcy reorganization. Such debt-equity conversions, however, immediately raise fears of foreign control and emotional charges of economic imperialism. Again, therefore, what is theoretically possible and even economically desirable for the LDCs is often politically difficult. In the case of official government debts, they either must be written down, or some program must be instituted to raise capital assets and strengthen the balance sheet. Only from these choices can a genuine solution be realized.

Obviously, a long term and satisfactory solution to the debt problem is of a larger order of magnitude than problems confronting potential weaknesses in the U.S. dollar. The money center banks in the United States have been exceptionally skillful in rescheduling debt and interest. The same skills are going to have to be marshalled and augmented with U.S. government assistance to restore long term stability to international debt markets. It is regrettable that this cannot be handled in a wholely private manner. However, the federal government through the Federal Deposit Insurance Corporation has chosen, unwisely in my judgment, to guarantee too large a block of liabilities of banks with heavy commitments to stricken debtor countries. As a consequence, write-offs which would impare the capital of a number of our banking institutions would in some cases require FDIC funds. In that sense it would not be new U.S. Treasury monies involved but rather monies which would have been required in any case to make depositors whole.

There are a number of other issues which will confront the seven heads of government when they meet in London next month: protectionism, European structural problems, the large Japanese trading surplus, etc. However, none loom as important as an appropriate solution to the potential rapid dollar weakness and the large continuing international debt problem. An appropriate handling of both would make dealing with the other issues far more tractable.

Mr. HAMILTON. Mr. Bergsten.

STATEMENT OF C. FRED BERGSTEN, DIRECTOR, INSTITUTE FOR INTERNATIONAL ECONOMICS

Mr. BERGSTEN. Thank you, Mr. Chairman.

In response to your questions as to what issues should be the priorities for London, and what standards should we think of in terms of gauging the results, let me specify four issues, and suggest what might be done about them as standards against which one can compare actual results. The four issues are interrelated, in my view. They should dominate the agenda at London.

First, the continued erosion of the international trading system due to growing protectionism, as Mr. Pratt noted. That is occurring despite global economic recovery, despite the pledges taken at the Williamsburg summit 1 year ago to avoid new restrictions and roll back old ones as recovery proceeds. It seems to me we face a risk of major disruption in the entire trading system, and if that were to occur the "debt bomb" literally could explode because only with growing opportunities for export earnings can the developing countries have any hope of again servicing their debt on a stable basis.

Second, the issue to which Alan Greenspan devoted his comments, the massive misalignment of exchange rates. As he mentioned briefly, at the moment we of course have enormously adverse manifestations from the overvalued dollar. The U.S. trade deficit this year will probably hit about $120 billion and on my estimates, next year about $150 billion. In 3 years the United States will have squandered its buildup of international assets of the last seven decades and turned into the world's largest debtor country. That is extremely serious. It intensifies protectionist trade problems. It intensifies the debt problem.

I would agree with Dr. Greenspan that at some point the dollar is going to come off, and unfortunately history suggests that it may come up very precipitately when it does. I am not sure how soon that is going to occur, however, and in the meanwhile we still have the problems of dollar overevaluation.

Nevertheless, both the current problem and the incipient problem to which Dr. Greenspan refers clearly suggest very severe shortcomings in the structure of the international monetary system, which permits these huge misalignments to occur and persist, and disrupt the world. So, in addition to an excessively strong dollar or plummeting dollar we have to worry about the monetary system, and that too should be a priority for the London summit.

Third, the debt bomb. It continues, of course, to be a significant difficulty, especially in Argentina and Brazil, despite some good adjustment in some countries, and some pickup in world economic growth.

It is, of course, now particularly jeopardized by the renewed rise in interest rates, as you mentioned, and by the continuing onset of trade restrictions.

Fourth, underlying all this are very severe imbalances in world economic recovery.

Growth is proceeding apace and indeed quite rapidly here in North America, so rapidly that some fear overheating and therefore want to take some preemptive action to avoid it.

At the same time, we have extremely modest performance throughout the rest of the industrial world, due partly to high interest rates here in the U.S. emanating out through the rest of the world, partly due to deep-seated structural problems in some of those countries themselves, particularly in Europe, and also due to a reluctance on the part of some of those other industrial countries to take even modestly expansionary fiscal policy steps to try to encourage their own recoveries to proceed affirmatively.

So there are a number of problems on the agenda that I would rate as priorities for the London summit.

Now, obviously there are interrelationships among those four issues, and here I would agree wholeheartedly with Dr. Greenspan and Mr. Pratt.

At the root of all this lies the huge and continuing U.S. budget deficit. The high and rising interest rates which it spawns raise doubts about the duration of the U.S. recovery itself, and because high U.S. interest rates force high interest rates abroad, there remains doubt over the degree to which North American recovery will spread.

As I have mentioned, and as the other panelists both mentioned as well, those high U.S. interest rates are, at least at the moment, not only keeping the dollar exchange rate high, but actually moving it higher.

In the last several weeks the dollar has again been moving up. It is almost back to its trade weighted high of early January and, as I said, I agree with Dr. Greenspan, that at some point it is going to turn with a vengeance. But at the moment it is still going up, and if interest rates continue to rise, as I believe they will here until there is action on the budget deficit, the dollar may continue to rise and cause more of the current problems than we have got.

Now, the critical question, of course, can the summit do anything about this nexus of problems?

The record of the past summits is extremely uneven, to put it gently.

In 1978 in Bonn, however, a comprehensive package was agreed under which each of the major countries committed itself to make a substantial contribution to help resolve a set of problems somewhat like those of today.

In fact, if you look at today's problems, there are some similarities with what we had then, with the exception at that time of no big debt crisis.

On the other hand, the last three or four summits have become so soporific that success in such endeavors has come to be defined as the absence of an overt blowup, as occurred after the Versailles summit a couple of years ago. So sights have been lowered, to put it mildly.

The critical issue for a summit is whether each, or at least most of the key countries can more likely achieve the needed policy changes at home through presenting those changes as part of an international package in which so-called concessions by others produce net benefits for its own national interests.

In principle, of course, that is quite possible because cooperative responses to a set of problems such as exists today can well produce a positive summit outcome in which each country does gain.

Each then can credibly present the outcome as a victory to domestic audiences if it proves useful to do so.

It seems to me at the moment there are the ingredients for a fairly extensive package.

Indeed, perhaps surprisingly, a fair amount of groundwork has been laid as a result of study groups working in the normal international organizations and also commissioned by the last couple of summits, so it seems to me there is a package.

Mr. Chairman, I don't have any illusions that this package is going to be adopted, but I have in my statement outlined a seven-point program which I think would make eminent sense and should in fact be put together.

I won't take time to elaborate it, but just tick off the points.

First, the U.S. would agree to make major cuts on the order of $100 billion or so annually in its budget deficits beginning immediately after the election, to follow up this year's down payment, and initiate a trend that would eliminate the structural deficit within a reasonable period of time, thereby achieving Alan Greenspan's objective of providing the best possible framework for a moderate and constructive correction of the dollar.

The Europeans would agree to take equally significant steps to tackle some of the structural imbalances in their economies: excessive real wages, wage rigidity, excessive intrusion of their public sectors, inadequate returns to capital.

There are lots of proposals for how to do that. The European Commission in Brussels has made some. The German Council of Economic Experts have, and there are many private proposals. That is needed for the European side of the package.

Third, the Japanese would have to move decisively to deal with the trade problem, primarily by taking steps to correct the continuing yen/dollar exchange rate imbalance.

For example, they could agree to implement a commitment that was undertaken at the Reagan/Nakasone summit last November, by floating a very substantial amount, I would say, $10 billion of so-called Nakasone bonds.

They would borrow abroad, and convert the proceeds to yen to strengthen the exchange markets. If that were not enough, they could sharply limit the outflow of capital from Japan by using their famous—or infamous—administrative guidance system by calling up the leading Japanese insurance companies, pension funds, banks, and simply telling them to limit the capital outflow for a few quarters as in fact they did successfully after the second oil shock a few years ago.

The Japan trade problem is obviously crucial. Their surplus this year is headed toward somewhere between $40 and $50 billion. Only if the yen exchange rate can be corrected can that be corrected.

I would suggest two concrete steps to help deal with the debt problem, to deal with the ongoing financial needs of the debtor countries, even under their adjustment programs, without continuing to tap the private banks in an involuntary way.

I think there should be a decision to agree on a new creation of Special Drawing Rights at the International Monetary Fund. I would suggest about $30 to $35 billion this year and $9 or $10 billion annually in subsequent years. That would rebuild the reserves of the developing countries, help their return to creditworthiness, reduce the amount they had to draw from the private banks and other sources now difficult to get.

In addition, I think there needs to be agreement to sharply increase the lending capability of the World Bank, which is now making almost no net contribution to resolving the debt problem and could do much more in both quantitative and qualitative terms.

My sixth point is to move on the international monetary system, the point that in different ways Dr. Greenspan and I have both referred to. I think the goal there should be to start seriously looking for a synthesis between the excessive rigidity of exchange rates that came to dominate the fixed rate system of Bretton Woods and the overshooting and excessive volatility that has come to characterize the current regime of floating rates.

I would be the last to say, Mr. Chairman, that any monetary system could cope with enormous policy errors like the massive U.S. budget deficit or the huge policy inconsistencies as now exist between a growing U.S. deficit and tightening fiscal positions in Europe and Japan.

Nevertheless, if we could move to something like a target zone exchange rate system, where countries committed themselves to limit rates from getting way out of line, that would certainly help.

Finally, I would suggest, and here I think there may be at least a ray of hope, that the summiteers agree to move as quickly as possible to launch a major new international trade negotiation. There would be two purposes.

One would be to help fight protectionist tendencies by regaining the momentum toward liberalization, rulemaking and constructive reform of the GATT system.

History clearly shows that trade policy is very much like a bicycle, toppling on its side in the wake of particularistic pressures to restrict unless it is moving ahead toward greater openness in the aggregate interest.

The other purpose is, of course, to try to deal cooperatively with areas of trade conflict that are both new like trade in services, and the investment-related trade issues that Mr. Pratt mentioned, and to deal with old festering problems, like steel and textiles before they again erupt into conflict.

Mr. Chairman, I think a seven point program like that could go a long way toward remedying the world's ills. I think it would help each country, even the United States in doing what it should do at home.

At the same time, I have no illusion it is going to happen, and I think if this committee could give a push in that direction, you would provide an enormous service for all of us.

Thank you.

[Mr. Bergsten's prepared statement follows:]

Prepared Statement of C. Fred Bergsten, Director, Institute for International Economics

AN AGENDA FOR THE LONDON SUMMIT

The Issues

Four interrelated issues should dominate the agenda for the summitteers in London in early June:

-- the continuing erosion of the international trading system due to growing protectionism, despite global economic recovery and the pledges at Williamsburg a year ago to avoid new restrictions and roll back old ones as recovery proceeds, with some risk of major disruption of the entire GATT regime and consequent explosion of the "debt bomb"

-- the continuing massive misalignment of exchange rates, whose most overt manifestations are a US trade deficit already in excess of $100 billion and a Japanese surplus soaring toward $50 billion, which both intensifies protectionism and debt problems in the short run and reveals structural shortcomings in the international monetary system itself

-- the "debt bomb," which continues to tick loudly (especially in Argentina and Brazil) despite good adjustment in some countries (notably Mexico) and the pickup in world economic growth, and is jeopardized particularly by the renewed rise in US interest rates and continuing onset of new trade restrictions

-- the severe imbalances in world economic recovery, which combine potential overheating in North America with extremely modest performance throughout the rest of the industrial world, due largely to (a) continuing massive budget deficits and sky-high interest rates in the United States and (b) deep-seated structural problems plus reluctance to adopt even temporarily expansionary macroeconomic policies in Europe and Japan.

There are intimate interrelationships among the four issues. At the root of all lies the huge and continuing US budget deficit. The high and rising interest rates which it spawns raise doubts about the duration of the US recovery itself. Because high US interest rates force high interest rates abroad, there remains doubt as well over the degree to which North American recovery will spread.

Moreover, US rates are again propelling the dollar upward in the exchange markets, worsening still further the US trade deficit--which seems likely to hit $120 billion in 1984 and $150 billion in 1985.[1] In turn, dollar overvaluation and the trade deficits create growing protectionist pressures in the United States despite the sharp fall in unemployment. The high interest rates themselves, the resulting dollar overvaluation and the induced protectionism severely deepen the debt crisis.

1. C. Fred Bergsten, "The United States Trade Deficit: Causes, Consequences and Policy Responses," testimony before the Subcommittee on Trade, Committee on Ways and Means, 98 Cong. 2 sess., Washington, April 5, 1984.

There are major policy problems in the other industrial countries as well. Despite sluggish recovery, Japan and the major European countries (notably Germany and Britain) continue to pursue extremely restrictive fiscal policies.[2] Their reasons for doing so are fully understandable, in long-run terms, but need not preclude temporary tax cuts to achieve more satisfactory growth.

Perhaps even more importantly, Europe in particular needs to attack much more forcefully its structural problems of high real wages and industrial obsolescence. Only by doing so can Europe halt its side of the drift toward increasing trade restrictions (which in turn links back to resolving the debt problem and restoring some modicum of international payments equilibrium).

Japan, of course, continues to be perceived as the major trade problem for everybody else--via both its renewed export surge and lagging expansion of manufactured imports. With the yen still substantially undervalued against the dollar, the Japanese merchandise surplus will probably hit $50 billion in 1984 and continue to rise--placing enormous pressure on both the world trading system and some of the key debtor countries.

Can the Summit Help?

The record of past summits is extremely uneven in responding to a complex of policy problems such as those which exist today. In 1978 in Bonn, a comprehensive package was agreed under which each of the major countries committed itself to make a

2. Stephen Marris, "Why Europe's Recovery is Lagging Behind," Europe (March/April 1984).

substantial contribution to help resolve a set of problems somewhat (except for the debt crisis) like those of today.[3] On the other hand, the last three or four summits have been so soporific that "success" in such endeavors has come to be defined as the absence of overt blowup (as at Versailles in 1982).

The critical issue is whether each key country can more likely achieve the needed policy changes at home through presenting those changes as part of an international package in which "concessions" by the others produce net benefits for its own national interests. In principle, this is quite possible because cooperative responses to a set of problems such as exists today can well produce a positive-sum outcome under which each country does gain. Each can then credibly present the outcome as "a victory" to domestic audiences, if it proves useful to do so to achieve ratification of the deal.

At the present time, there would seem to be the ingredients for a fairly extensive package. The Administration and Congress here both assert that they would like to achieve a major reduction in present and prospective budget deficits. Most of the European governments, including France, seem to recognize the need for structural change and industrial reform. The Japanese leadership seems genuinely to realize the imperative of opening the Japanese market. All of these countries are, in fact, taking at least modest steps in the direction of achieving such goals.

3. George de Menil and Anthony M. Solomon, Economic Summitry (New York: Council on Foreign Relations, 1983).

Beyond these immediate needs, there seems also to be a growing awareness of the risks to the global economic system of continued protectionist drift, possible renewed deterioration of the debt crisis and currency misalignments. Hence there has been much discussion, if little action, on the need for a major new multilateral trade negotiation, new steps to protect against debt disruption and--based in part on discussion at the last two summits and by working groups created by them--of improving the international monetary system.

Perhaps surprisingly, much groundwork therefore seems to have been laid for constructing and agreeing on a rather major package at London. There is virtually no evidence that any such package is being prepared, however, or even seriously contemplated--a problem of vision and leadership to which I shall return briefly at the end of these remarks. Nevertheless, it is worth outlining what such a package could contain and how it could help, perhaps decisively, to deal with the continuing perils afflicting the international economic outlook in both the short and longer runs.

A Package for London

First, the United States would agree to make major cuts--on the order of $100 billion or more per year--in its budget deficits beginning immediately after the election to follow up this year's "down payment" and initiate a trend that would eliminate the structural deficit within a reasonable period of time. Eminently reasonable proposals for doing so have again been spelled out by the Bipartisan Budget Appeal--organized by former Secretary of Commerce Peter G. Peterson and five former Secretaries of the Treasury, and including over 600 American leaders from various walks of life--in its full-page presentations in the New York Times and Wall Street Journal on May 4.

Second, the Europeans would agree to take equally decisive steps to tackle the structural imbalances (such as excessive real wages, wage rigidity, excessive intrusion of public sectors and inadequate returns to capital) which plague both their overall economies and key individual industries (such as steel). There are numerous proposals for how to do so, offered by groups ranging from the Commission of the European Communities in Brussels to the German Council of Economic Experts.

To complement these major initiatives by the United States on macroeconomic policy and Europe on microeconomic policy, there would also need to be European macro and American micro actions. The Europeans who are recovering at least modestly, notably Germany and Britain, should enact temporary tax cuts to assure more satisfactory growth--and to provide at least a partial offset to the restrictive global impact of the large American budget cuts (which, however, would already be somewhat offset both in America and worldwide by the induced decline in interest rates). On the structural front, the United States should also pledge to adopt domestic adjustment programs for major sectoral problems as an alternative to trade restrictions, though these would not need to be as extensive as the like programs in Europe given the deeper degree of structural difficulty there.

Third, Japan would move decisively to deal with the trade problem by taking steps to correct the continuing yen-dollar imbalance promptly and completely. It would agree to implement a commitment initially undertaken at the Reagan-Nakasone summit in November 1983 by announcing its intention to float $10 billion of "Nakasone bonds" in order to promote massive capital inflow to Japan and push the yen toward its underlying equilibrium level of at least 200:1 (as well as finance part of its budget deficit). If necessary, Japan could also sharply limit capital outflows temporarily by using its famous "administrative guidance" to check the foreign investments of major Japanese insurance companies, pension funds and other institutional investors.

Beyond these national steps, all summit participants would agree to move as quickly as possible to take several important multilateral actions.

Fourth and fifth, to help deal with the debt problem, they would work for decisions at the IMF-IBRD Annual Meeting in September to (a) allocate $35 billion of Special Drawing Rights in 1985 and another $10 billion in 1986, primarily to help rebuild the reserves of the major debtor countries,[4] and (b) raise by 50-100% the annual lending ceiling of the World Bank, to provide a partial replacement for the severe cutback in new lending by commercial banks to the major debtor countries which is almost certain to continue for some years to come.

4. As analyzed and proposed in John Williamson, A New SDR Allocation?, POLICY ANALYSES IN INTERNATIONAL ECONOMICS 7 (Washington: Institute for International Economics, March 1984).

Sixth, to help limit the prospect that major currency misalignments will continue to occur with distressing frequency, they would agree to launch a serious effort to construct and implement a more stable, yet still flexible, international monetary regime. The goal would be to find a synthesis between the excessive rigidity of exchange rates which came to dominate the fixed-rate system created at Bretton Woods and the overshooting and excessive volatility which has come to characterize the current regime of floating rates, perhaps along the lines of the "target zone" approach which has now been extensively analyzed and developed.[5]

More immediately, the major countries could adopt a more modest, but quite important, change in their basic policy toward intervention in the exchange markets. All such intervention is now aimed at "leaning against the wind" of market trends, to limit short-run volatility. The problem is that this may deter, and even reverse, desirable corrective trends in the level of currency relationships. Hence policy should be altered to encompass "leaning _with_ the wind" when the wind is blowing in the direction of underlying equilibrium. Coordinated intervention of this type could have moved the dollar misalignment substantially toward correction on several occasions during the last three years, most recently in February 1984 when the DM and, for a short time, the yen began to move sharply in the right direction.

5. Particularly in John Williamson, _The Exchange Rate System_ POLICY ANALYSES IN INTERNATIONAL ECONOMICS 5 (Washington: Institute for International Economics, September 1983).

Seventh, the summitteers would agree to move as quickly as possible to launch a major new international trade negotiation. There would be two purposes in doing so. One is to help fight protectionist tendencies by regaining the momentum toward liberalization, rule-making and constructive reform of the GATT system; history clearly shows that trade policy is much like a bicycle, toppling on its side in the wake of particularistic pressures to restrict unless it is moving ahead toward greater openness in the aggregate interest. The other is to try to deal cooperatively with areas of trade conflict both new (e.g., services and high technology) and old (e.g., steel and textiles) before they erupt into conflict and further weaken an already stretched international regime.

Adoption of this seven-point program would go far to assure, extend and spread the currently tenuous and unbalanced recovery of the world economy. It would lower interest rates everywhere. It would promote the needed realignment of currencies, shrinking inter alia the huge American trade deficit and Japanese surplus--and reduce the risk of a precipitate dollar collapse, with hugely adverse consequences for the other industrial countries and for the United States, which is inevitable in the absence of constructive action to preempt it.[6]

Moreover, the package would reverse the trade policy tide in several ways--by strengthening recovery in Europe and Latin America, cutting the American trade and currency imbalances,

6. Stephen Marris, "Crisis Ahead for the Dollar", Fortune, (December 26, 1983).

erecting new domestic adjustment alternatives to import relief and seizing the international initiative for renewed trade liberalization. And, by doing all these things plus moving on the problem directly, it would significantly reduce the risk of an explosion of the "debt bomb."

Needless to say, the "summit seven" cannot do all of these things by themselves. They would need to consult extensively with other countries, in particular a number of developing countries, in planning the next trade negotiation and the proposed monetary reforms. But the package seems eminently desirable. Is there any chance it will happen?

Cooperation and Leadership: The Missing Links

It would seem that each country could be better positioned to take the needed internal measures if its partners could be counted on to come through with their part of the deal. Admittedly, this is probably more the case for the Europeans and Japanese--for whom serious US action on its budget deficit would make all other adjustment steps easier. By definition, the multilateral steps--starting trade negotiations, pursuing serious monetary reform, using the IMF and World Bank more effectively--can only be done together. But even US budget action, which will still derive primarily from domestic considerations, should be promoted by such an international package because of the offsetting benefits for US growth and trade from fiscal stimulus and trade liberalization abroad.

As noted above, the likelihood that any such package will be adopted at London is virtually nil. Why not?

In some quarters, there is genuine belief that all is well. The United States is growing rapidly. There are signs of pickup abroad. The trade and debt pictures, though worrisome, could have been much worse. Maybe the markets know best about exchange rates.

Even granting some validity to each of these views, and even granting that summits need not be the prime locales for constructive international economic negotiations, one must still be dismayed by the nearly total demise of these annual events in terms of substantive effort and outcome. Over the past decade, the major countries have preserved the dexterity acquired during the 1960s to react effectively to international economic crises in order to avoid major damage and systemic disruption. Increasingly, however, they have become unable to deal effectively with major problems ex ante--and to deal with systemic problems, such as endemic currency misalignments or creeping protectionism, at all.

The London summit, like its predecessors and presumably successors, offers an opportunity to do so once again. In practice, US leadership--and full European and Japanese cooperation--would be required to do so. Neither seems in much evidence at the moment, despite the enormity of the stakes involved in both dealing with the immediate problems facing the world economy and in restoring public confidence that the world is in capable hands.

Mr. HAMILTON. Thank you very much, gentlemen.

U.S. OBJECTIVES AT LONDON SUMMIT

As you know, these summits last a very short period of time and quite a bit of attention is directed to them. I would like to get your judgment as to what the major objectives of the U.S. Government ought to be in these summits.

Mr. Bergsten, you present a package idea, in which each of the points I think are very good.

I wonder if you were advising the President on these matters what you would suggest that the United States really try to achieve in the summit?

What is the absolute priority? What should we walk away from that conference having achieved?

Mr. BERGSTEN. I would follow up what I said with two priorities.

One would be to start a new trade negotiation as soon as possible to help reverse the tendency toward protection. Secondly, since the monetary problems underlie all the others, I would try to begin serious movement to correct the current misalignments, and try to improve the functioning of the monetary system.

I think those ought to be the two priorities for the United States at this summit.

Mr. HAMILTON. Dr. Greenspan, how do those priorities sound to you?

Mr. GREENSPAN. Mr. Chairman, one of our problems is that summit meets once a year usually, at approximately the same time, and economic problems don't usually coincide necessarily.

Dr. Bergsten has suggested that we are all to one greater or lesser extent concerned that unless the United States unilaterally brings the very substantial Federal budget deficit down, it affects Eurodollar rates and other interest rates around the world, and hence many problems will continue to persist.

IMPORTANCE OF U.S. ACTIONS TO INTERNATIONAL ECONOMY

Aside from a general concern that I would have that protectionism is growing and threatening the structure of our system, most of the actions which will affect the international community probably are ours, not the Japanese, not the Europeans particularly. Were we able to assist in the resolution of the question of Latin American debt, which is to a very substantial extent the province and problem of the American banking system, and if we could resolve concurrently the extraordinary pressures we are putting on the rest of the world as a consequence of our very heavy Treasury borrowing, I suspect that the international economic structure will improve immensely. So that I must say, unlike previous summits, especially in the early years of summitry, most of the problems, as I see them, are ours, not theirs.

That is not to say we should not endeavor to do something about the yen misalignment which is creating major problems. This is not to say we should not endeavor to address a number of other of the trade problems which both Mr. Pratt and Dr. Bergsten raised but I think listing priorities leads me to conclude that there is less to this summit in that respect than is usually the case, or has been in the past.

IMPORTANCE OF PROTECTIONISM

Mr. HAMILTON. Mr. Pratt, do you have any observation on the question of priorities?

Your statement began, of course, with a discussion of the rise of protectionism. Is that the issue that would concern you the most?

Mr. PRATT. Yes, I believe so.

If it is possible to do so, I guess I would be in general agreement, I think, with some of the things that both of my colleagues have said in answer to your question.

I guess one thing we need to keep in mind is that summit meetings don't historically bring about cataclysmic changes, and perhaps we should not expect them to. That doesn't mean they aren't valuable. I believe they are valuable, even if they don't achieve that kind of result.

But, within the framework of that limitation, yes. Certainly we in the business world believe that attacking the problem of protectionism in the world is perhaps the highest priority. In the 30 years that I have been involved in international business, I have never seen circumstances as difficult as they are right now, so I think the threat that this has for the future economic strength of the world is very, very serious, and therefore I think that that is the critical thing we should try to do.

I would think that it may well be that the most important things that have to be done to help settle the international economy have to come from here, but there are others, other issues that are involved with our partners, and I think it is important that this interchange makes those clear as well.

I suspect one of the benefits of an interchange like this is it tends to make it clear to our leaders how significant are the things that we have to do here in the United States as well, as Mr. Greenspan mentioned.

INCREASE IN PROTECTIONISM

Mr. HAMILTON. One of the things that strikes you about the Williamsburg summit is that some of its strongest statements were directed towards halting protectionism.

Mr. PRATT. Yes.

Mr. HAMILTON. And dismantling trade barriers. Yet I think it is fair to say that since that summit, we have really had an increase in protectionism. That raises questions as to how valid or effective some of these statements are that come out of the summit meetings.

Would you, first of all, agree that protectionism has in fact worsened since June 1983? I think the panel would agree to that, would they not?

Why have protectionist forces worsened in a period of economic recovery? We ordinarily think that they ought to lessen, but they seem to be increasing.

Mr. BERGSTEN. Here I would to some extent echo what Dr. Greenspan said in responding to the last question.

Despite the fact that there is growing protectionism in Europe, certainly as well as here, the United States really has the pivotal role in trade as well.

As we have all said, the United States is the only country that has been experiencing very rapid economic recovery and a substantial decline in unemployment.

In that kind of environment, one would have thought the United States would at least have been in the position to implement the Williamsburg agreement. You will recall that agreeent said that as recovery proceeds, trade controls should be rolled back.

Recovery has certainly proceeded in the United States. The unemployment rate has dropped dramatically over the last 15 months. Nevertheless, as you mentioned, trade protectionism has risen here, and you in this body particularly know the pressures to do more.

How can that be? The answer, I would submit, goes back to the exchange rate. The United States has priced itself out of world markets. We are placing a tax of about 25 percent on our products every time we try to sell them abroad. We are subsidizing our imports to the tune of 25 percent or so when they come in from the rest of the world, and even our efficient firms cannot compete with that.

Mr. Pratt made the point very clearly. As long as that imbalance continues, and our trade deficit therefore rises to these astronomical numbers—$120, $150 billion, with no turnaround in sight at present—we are going to have not only continuing but growing trade pressures. This link between trade problems and the monetary underpinnings of those problems, despite a lot of talk, has not yet been effectively realized, either by policymakers in this city, or certainly by policymakers around the world.

INTERRELATED ISSUES ON SUMMIT AGENDA

That, with all due deference to what summits can do, is one purpose that a summit should have. That is the one occasion a year where it is not just trade ministers sitting together or finance ministers sitting together. It is heads of state with all their ministers gathered around. It is the one occasion that naturally forces people at top levels of government to look at issues together. That is why I put together a set package of proposals.

That is the format in which it is natural to consider how trade and monetary and debt problems interrelate.

If you don't do it there, you are never going to do it, and that is why I think it is such a tragedy that the summits have deteriorated into the nonevents that they have. That is my explanation, Mr. Chairman, and I think a summit does provide an opportunity to try to do something about it.

REMOVAL OF AUTOMOBILE IMPORT QUOTAS

Mr. HAMILTON. Would all of you agree that the automobile import quotas ought to come off? Maybe I should put it this way: Is there any objection to removing them? Would everybody accept that action?

I take your silence to be assent to that proposition.

Mr. GREENSPAN. I will be unsilent and say that they were a terrible mistake. The sooner we can get rid of them, the better.

I must say, however, I am not terribly hopeful.

Mr. HAMILTON. You are not hopeful?

Mr. GREENSPAN. No.

Mr. HAMILTON. I saw the other day that the Japanese want them on again. I couldn't quite understand that.

Mr. GREENSPAN. It is not all the Japanese, Mr. Chairman. The major auto assemblers who are shipping into this country are doing so in the type of economic environment which pretty much guarantees extraordinarily good profit margins on the cars that they ship in here. A large segment of the Japanese auto industry is not terribly concerned about these quotas.

There are others, the smaller producers in Japan, who obviously would like to get in, cannot, and they are most unhappy. But the presumption that there is a general view in Japan that these quotas are strictly adverse to Japan's auto industry are false. There is no doubt about it, the sooner we eliminate that, the better.

Since we have a director of one of America's major auto companies sitting at our panel, I would be interested to hear what he has to say.

Mr. PRATT. Well, I think that the reason that the Japanese might want them to stay on would be because they were afraid that without them they would get even worse action out of the U.S. Congress, and that was why they agreed to them in the first place.

Since I am an outside director, I certainly don't want to be put in the position of speaking for General Motors.

I think General Motors has taken the position generally in this that they don't like the idea of quotas. They don't like restrictions of any kind.

Speaking purely as an individual, whether or not they were a bad idea or a good idea, I have to admit I am not too sure. I suspect they did indeed forestall even worse steps that might have been taken had they not been put on, and therefore in that regard they may well have been the best of a bad series of choices that could have been made.

They were put on with the ostensible purpose of giving American industry a chance, the automobile industry, a chance to recover from a rather unusual, unique set of circumstances which put them in a very undesirable competitive posture. I think they have taken advantage of the period of time do to that, so I think it is debatable that at the time they may well have served a worthwhile series of purposes.

I think everybody feels they certainly should come off as soon as possible. With all these issues still in mind, whether now is the right time I am not sure. I believe General Motors generally takes the position that they would like to see them off.

Mr. HAMILTON. Mr. Roth.

Mr. ROTH. Thank you, Mr. Chairman.

First of all, I want to say, Mr. Chairman, I congratulate you for having these hearings, because I think it is very important, and of course very timely, and you are the only chairman in Congress where I know if you say you will start at 2 o'clock, you start exactly at 2 o'clock, don't you?

U.S. TRADE POLICY

I have been thinking about this situation especially as it relates to summitry. One of the things that I have a hard time reconciling is that we when go to the summit we don't know what we are looking for many times. For example, what is the trade policy in this country? To say that we are going to reindustrialize or revitalize our economy does not seem to me to be a trade policy.

We have had the Williams Commission. We have had the Peterson Report. We have had all kinds of blue ribbon commissions that have studied trade policy, but yet, when we sit back and say what is the United States trade policy, it is hard to grasp. If I had to list the points of our trade policy, it would be difficult to do. Maybe you gentlemen can help me out with that.

Mr. BERGSTEN. Well, there are two questions: What is it, and what should it be? Those need not be identical. I would suggest what I think it should be. It should be for the most open trading regime possible, taking due weight of the need for equitable trading conditions. I happen to believe that when other countries subsidize or dump in our market, and there is injury to us, we should retaliate sharply, not primarily because I like those retaliatory steps but because I would like to get rid of the other country's practices.

I think the record shows the United States can compete extremely effectively in an open world trading system. As recently as 1978 to 1980, U.S. exports were growing twice as fast as world trade. We improved our current account position by $60 billion in 2 years, excluding the effects of the second oil shock. We recouped a share of world markets for manufactured goods in every major sector we hadn't seen since the late 1960's. Then the dollar exchange rate rose 30–40 percent in 3 years and we priced ourselves out, but we can compete if we get our exchange rate right and have an open trading system, and I think fundamentally that ought to be the U.S. goal.

CORRECTION OF DOLLAR EXCHANGE RATE

Mr. ROTH. You know in theory, I suppose that is correct, but your first point, Mr. Bergsten, is that we have to do something about this $200 billion trade deficit, right? That is No. 1.

Mr. BERGSTEN. And to do that we need to get the dollar exchange rate back to equilibrium.

Mr. ROTH. And how are we going to do that in Congress, by working for a balanced budget?

Mr. BERGSTEN. That is the most important step. Short of that, there are other things that can be done, but that is the most important, and I would underline what everybody else has said. Keep working on that until you succeed.

Mr. ROTH. I wish we could do that today, but you know we had the budget resolution before the Congress and so on, and nothing really substantial happened, did it? I mean I was one of 50 people that voted on the Grace Commission report, but we only had 50 Congressmen voting. It would probably be unfair to ask you how we are going to balance the budget, that is supposed to be my job, and the jobs of other Congressmen, but we need 218 votes if we are going to do that in the Congress.

Quite frankly, gentlemen, the thing that really scares me in all that you have pointed out, is that we are possibly going to have a $120 billion trade deficit this year; $150 billion next year. For every billion dollars we send overseas in deficits, we lose $400 million here in our Federal Treasury in tax revenue. That means if we are going to have a $120 billion deficit we have—what—almost $55 billion added on to our deficit. So where do we go from here?

Mr. BERGSTEN. Again: keep on the deficits. Have some thoughts as to how you can put a package together. I refer to those in my statement. If you can't do that, then there are other things that you can do to work on the exchange rate problem. I mentioned one set in my testimony.

YEN-DOLLAR RELATIONSHIP

In the most important particular currency case, the yen-dollar relationship, some commitments were extracted from the Japanese last November when President Reagan visited Tokyo. Unfortunately, the implementation of those commitments has gotten completely off track.

I happen to think that the current effort that the Treasury is pushing very hard, to liberalize the Japanese capital markets, and internationalize the yen over time, are all right. But it must be very clearly understood that they may or may not help the exchange rate relationship in the short run or even in the long run. If the Japanese really liberalize their capital markets, frankly they would be taking more controls off capital outflows than off capital inflows. The net result at least for some time would be a weaker yen, not a stronger yen, and the implementation of the commitment made by the Japanese last November has been derailed mainly by dint of U.S. priorities in the implementation. It has been messed up from this side, to put it very bluntly.

There is still time to turn that around. The Japanese made a commitment, as I said, to borrow heavily abroad to bring in capital and support the yen. That is exactly what the United States did in 1978 when the dollar was in the same boat. When the dollar was weak, we announced among other things a $10 billion offshore borrowing program. We borrowed marks and francs, put then into the dollar, stopped the dollar slide cold, and in combination with other steps finally began to correct the situation.

The Japanese should do that, and they should be pushed to do that in the summit context. If that is not enough, they can be asked—and they have done it very recently—to limit capital outflow through administrative guidance. I call it the 30-phone call approach. The finance minister gets on the phone, calls the big investors and reminds them what they did after the 1980 oil shock.

ADJUSTMENT OF CAPITAL FLOWS

There are thus things to do to fiddle around with the capital flows. That is not something I advocate with any relish. It is what economists call a second-best strategy but if you all here, working with the administration, can't do the first best of getting the budget corrected, and thereby bring interest rates down, you have to go to a second best.

I think you had better do that rather than let it slide, which is current policy, because then you are going to get this massive protectionist outbreak, continued deterioration of the trade balance, and possible explosion of the debt bomb that would really bring the whole situation to grief.

THE NEED TO OPPOSE PROTECTIONISM

Mr. PRATT. I guess I would just add that I would be more conscious of, I think, Mr. Roth, the things we shouldn't do to try to tackle it, and even as a businessman, who has to compete in many cases against difficult competitive situations of the kind that have been referred to here, I know hardly any businessman who thinks the right answer is to retreat into a protectionist shell, for the very simple reason that in the long run we will all lose by that, and we are convinced of that.

We keep emphasizing that. Protectionism scares us. History makes it pretty clear where that leads, and history also makes it clear where an open and free trading system leads, and I would say that has been the policy of this Nation in large degree, and still is, and must continue to be. If we don't lead in that direction, then certainly no other nation in the world can do it.

Mr. ROTH. Dr. Greenspan?

LIKELIHOOD OF A SMALLER TRADE DEFICIT

Mr. GREENSPAN. I would just like to offer a dollar dissent here, because I think we may be overshooting. I don't agree with Fred Bergsten's $150 billion trade deficit for next year. I assume that is on the premise of either current exchange rate or higher ones.

The pull in the international trade system, even at the current $100 billion plus level is, as best I can judge, very extraordinary. I find it very difficult to envisage that with the accumulated holdings of dollars in internationally mobile portfolios at this particular point, that we can envisage a $150 billion trade deficit next year, with the concurrent huge current account deficit that would be implied and presume that the dollar will remain here, well above so-called purchasing power parities.

In other words, I would question whether that is a reasonable estimate, and I am concerned about it mainly because it is important to free up the Japanese capital accounts, which are being restricted. I am not terribly concerned which way the exchange rate goes as a consequence, although I do agree with Fred that it is quite likely the initial effect is likely to strengthen rather than weaken the yen.

MISDIRECTION OF U.S. TRADE POLICY

But I am also concerned that we may be putting too much of our thrust of trade policy in the context of a series of events which, in my judgment, are unlikely to occur. If we find, for example, that, as I indicated earlier, the dollar exchange rate starts to fall we will get much less in the way of current account deficit, I am concerned that everyone will then say the battle is over and we can then regroup. The problems of protectionism are more deep-seated, and they are likely to continue. Moreover, the long-term international financial problems which have to be resolved are going to have to be resolved in any event.

I am a little concerned about projections which I obviously can't say won't happen. But I would say the probability in my judgment is not very high that one can reconcile current exchange rate with a $150 billion deficit.

I agree with pretty much everything that Fred Bergsten has said, with the exception of his forecast.

Mr. BERGSTEN. Could I just perhaps make two comments in response?

FORECAST OF HIGH TRADE DEFICIT

Alan may well be right, but my first comment would be that even if we waved a wand and corrected the exchange rate tomorrow, and did it in a stable way, we would still have a very sizable and continuing triple digit, I would suggest, trade deficit well into 1985.

Given the lags, you don't begin to get a big turnaround in your trade balance for a year or so down the road. However, Alan is quite right that then at least the trend would be headed in the right direction, and one could point to an improvement.

CONTINUED RISE OF DOLLAR

The second point is in terms of forecasting when this exchange rate is going to turn around. I may be twice shy, having predicted at a rather earlier point that the big current account deficits even before they got to this level, would turn the exchange rate around. What, unfortunately, I see is the continuing rise of the dollar.

Dr. Greenspan is absolutely right, theoretically, as he said in his opening statement: At some point the portfolio shift will have reached a new equilibrium, and at that point, the dollar will begin to decline.

As he also said, however, nobody can know where that equilibrium level is, and we may or may not be there yet. It certainly seems in the most recent past that, as U.S. interest rates rise again, there is still some out there to be shifted into the dollar, and who knows how long that will continue?

DECLINE OF RATE OF INCREASE OF THE DOLLAR

Mr. GREENSPAN. May I make one final point?

Let's be very clear on this very important theoretical point. I am not saying that there will be a movement out of the dollar. I am merely saying that the rate of increase into it will decline.

Mr. BERGSTEN. Right.

Mr. GREENSPAN. As a consequence, if you get that, the exchange rate will fall. It is important to recognize the distinction here. I must admit I am a little concerned that we will end up with events starting to go in so-called right direction, and then all pressure to resolve many of the issues we have been talking about will just dissolve.

Mr. BERGSTEN. I fully agree with that.

GROWTH OF EUROPEAN PROTECTIONISM

Mr. ROTH. Mr. Chairman, I just have one more question. All three of our panelists have raised the red flag of protectionism, but don't you think in the pragmatic world that becomes more evident. Right now our trade with the Pacific rim is about $133 billion, with Europe $100 billion. Everything I read says that Europeans are very concerned about being highly pressured in the area of high technology and related industries. Aren't these European countries going to become more protectionist oriented?

Mr. BERGSTEN. Again, this gets back in a sense to the earlier discussion. We should be using every occasion, like a summit, like a proposed new GATT round, to try to turn that around.

It would be very bad for us if they move in that direction. I would be loathe, frankly, to sit back and say, well, inexorably they are headed in that direction.

Actually, we thought that in the early 1960's. We thought it in the early 1970's. Both times U.S. leadership entered the vacuum, proposed to reverse the trend by launching a new major effort to get trade liberalization going.

The Europeans moaned and groaned, had to be pulled along, finally were pulled along, and the tide was reversed. I don't suggest it would be easy, and indeed one of the major planks in my platform for the London Summit is to get a commitment from the Europeans to do something about their structural problems that pushed them in the direction you say, in some sense, a quid pro quo for our moving to deal with our structural problem, the budget deficit.

And so it comes back, I think, to the possibility at least of trying to use a summit or whatever tactic you have at hand to try to get international quid pro quo that can deal with the problem.

Mr. ROTH. Thank you.

Thank you, Mr. Chairman.

Mr. HAMILTON. Mr. Bonker.

EXISTENCE OF MULTIPLE INTERNATIONAL ECONOMIC PROBLEMS

Mr. BONKER. I apologize for not being here earlier, because I feel we have excellent witnesses and a timely subject to explore. I am without the benefit of having completely read your statement, Mr. Bergsten, but just quickly running over the first pages, I think you have identified the critical issues in the upcoming conference: growing protectionism, massive misalignment of exchange rates, the international debt crisis, and the severe imbalance in world economic recovery.

I think American exporters ought to be concerned about the multiple problems that exist now. The United States finds itself in this fiercely competitive global economy in which our own domestic economy is no longer sufficient to meet our growth needs.

While opportunities exist, the problems are formidable, and the question becomes how do we overcome these problems, and what can the legislative branch of government do to remove impediments, such as export controls and protectionist legislation?

What I see happening globally is a sharp contraction of available money and credit to sustain the continued economic growth worldwide. When I look over in Eastern Europe, I see many of these countries now imposing economic austerity measures in order to export more and import less to get their financial houses in order. One need only look at Europe to see the stagnation and the outflow of capital to inhibit their own economic recovery.

In addition, in the Latin American countries we have this debt crisis which persists and could severely limit our export potential to that continent. I don't know where we are going to find the currency or the credit to continue the strong economic recovery that we seem to be experiencing in this country. At the same time, and for whatever reason, all these other countries seem to be developing economic policies that will enable them to export more and import less.

RELATIONSHIP OF TRADE IMBALANCE AND INTERNATIONAL INDEBTEDNESS

It is clear that not every country can export more and import less. Somebody has got to pick up the slack, and guess who is doing it? How long can the United States continue this trade imbalance by helping other countries to recover, by being the one country to import more and export less? Is that a genuine problem, or is that just a superficial problem as we look at the global economic scene today?

Mr. Greenspan is smiling, so maybe he has a response.

Mr. GREENSPAN. My smile is not benevolent, because, Mr. Chairman, you are raising a very important question. I do not think that the issue really rests so much on the unavailability of credit in a general sense.

It is in very limited areas. One can certainly tie the extraordinary growth of the LDC countries, excluding the OPEC through the seventies, with the dramatic rise in Euro-currency credit.

My recollection was for a number of years credits to the LDCs rose 25 percent a year. One can assume that the injection of credit, was a major factor in the growth of the LDCs and as a consequence, a significant factor in, for example, the growth of U.S. export markets. The shutting down of credit, specifically for the Latin American countries for obvious reasons, coincides with a dramatic and very sharp decline in U.S. exports to Latin America.

We keep thinking of our huge trade deficit as solely an exchange rate question.

A substantial part of the deficit increase reflects the Latin American pulling back of imports for balance of payments reasons. In addition the decline in the price of oil, effected our deficit because on net balance, our exports to OPEC countries have gone down far more than our purchase of oil.

As a consequence of that, the question is what will revive trade. I cannot envision any significant net voluntary credits coming from the Eurocurrency system to the LDCs generally, and certainly nowhere, near the volumes that existed previously, and so in that sense, I think it is going to be very difficult for developing nations to grow at a pace which will enhance the expansion of world trade, and very specifically, exports from the United States.

There is, I might say, somewhat more of a pickup in Europe, and Japan, than has been implied in this conversation today, where there is no credit problem, per se. The basic underlying issues in Europe, aside from the structural issues, are also their internal budget problems.

They have some budget problems which make ours look almost handleable.

I would not argue that it is the availability of the credits, per se, but more the poor balance sheet structure of the potential borrowers, which is where the issues lie. Until that can be resolved, then sluggish trade, sluggish growth are probably going to be with us, but I would not endeavor to try to resolve this question by finding means to merely augment the creation of more international debt.

I think that is where our basic problem has been. Merely feeding more debt into the system by some government programs may resolve short-term problems, but they are not going to come to grips with what is really the very fundamental deep-seated problems which are creating the types of issues which you raise.

VALUE OF FOREIGN INVESTMENT

Mr. PRATT. Foreign investment is a very critical issue with me, Mr. Chairman, as you know, and I think that is also one of the reasons why it is important. It is one of the best ways to get further availability of funds into the countries that need it where you do not have the question of building up the debt structure even more.

It could be a far more significant contributor if we took pains to stimulate that as much as we can here, and indeed, emphasized to foreign nations the benefits they would receive from foreign investment.

PROJECTED ACCOMPLISHMENTS OF LONDON SUMMIT

Mr. BONKER. I wonder, Mr. Pratt, if you are optimistic about what may occur in London, given what happened in Williamsburg? My own sense is when we have a convening of the heads of state of the major industrial countries, especially in a political year, not much is really going to be accomplished.

I for one was not terribly impressed with the substance of the Williamsburg Summit but the public relations aspect topped all other conferences of its kind in modern times. Substantially, though, not much was accomplished.

As we approach London, we have some critical issues facing us: protectionism, export controls, the debt crisis, et cetera. Do you really think that the world leaders are prepared to address these tough questions, or are they going to avoid confrontation and gloss over the substantive issues?

We ought to confront the Japanese. Somebody ought to confront us on high interest rates and budget deficits. The French ought to be confronted for their mercenary economic ways. Contentious issues such as export controls ought to be addressed at that conference, but I imagine that the overriding sympathy will be to avoid conflict, to avoid controversy, to try to work out something that would be a grand statement that will look good on paper, but would accomplish very little.

Do you share that viewpoint, or are you more optimistic than I am?

Mr. PRATT. I mentioned before you came in, that in my judgment, I personally look at meetings like this as not the end, and the beginning, but merely another item in a continuum of relationships between nations. It seems to me we would be unrealistic to expect it to be more than that.

Therefore, we should do the most we can and achieve as much as we can. I guess if you asked me, no, I wouldn't expect world-shaking events to come out of it, but I still think the meetings are worthwhile and perhaps we can help put input into our side to enable us to be more productive this time.

Mr. BONKER. Mr. Bergsten, go ahead.

Mr. BERGSTEN. I laid out in my statement a fairly comprehensive series of steps that could be crafted if the will were there, that would use the summit to provide major progress on all these fronts.

Your question was, what is likely to happen? As best I can read the tea leaves, there is some effort to move forward in the trade area, to reverse the momentum of protectionism by at least moving toward a new negotiation and dealing with some of the immediate problems.

Now, while applauding that, one has to immediately reiterate what we said a moment ago, that solemn pledges were taken at Williamsburg to not only stop the creation of new trade barriers but also to roll back those that exist as recovery proceeds.

Even if the words are there, one still has to be a bit skeptical as to how it is going to be implemented. But on that one, at least, the intention is to try to make some progress.

On the macro-economic policy issues, export controls, direct investment measures that Mr. Pratt calls for—and, as he well knows, I have been advocating a "GATT for investment" for many years and the progress has been glacial, to put it mildly—one does not see a seizure of the moment, to put it mildly.

REASONS FOR OVERVALUED DOLLAR

Mr. HAMILTON. On the overvaluation of the dollar, why do economists keep talking about the overvaluation of the dollar, when the market sets the value of the dollar?

Mr. BERGSTEN. The market sets the value, so you have to be very clear how you define "overvaluation". I always try to be clear and say that I mean overvaluation of the dollar compared with the underlying competitive positions of the economies involved.

I don't argue that the market is irrational to set the dollar price where it was. It is responding to interest rate differentials, safe haven factors, and other things that have nothing to do with underlying competitiveness.

The exchange rate is the price that equates currencies of countries and, in my view it should therefore reflect the trading competitiveness of those countries. Therefore, the dollar is way out of whack.

That is explicitly a normative concept.

You can take the other view, which I happen to think is wrong and creates enormous problems, as we are now seeing. It is a question of what role the exchange rate should play.

Mr. GREENSPAN. Remember, there are essentially two markets for the exchanges of goods and services, properties and the like. One is the trade in goods and services currently produced, which is the issue that Fred Bergsten is raising.

The other is the extraordinary amount of transaction that occurs in securities, real estate, and a whole variety of physical assets. But there is only one exchange rate. If as we have seen in recent years, there is an extraordinary endeavor to invest in the United States to obtain dollar-denominated securities, if there is only one exchange rate, it must rise relative to its so-called competitive position with respect to the production of goods and services on a worldwide basis.

You cannot have extraordinary demand in the capital markets without driving the exchange rate above its so-called purchasing power parity.

RETRENCHMENT OF EXCHANGE RATES

Mr. HAMILTON. When do you expect to see this retrenchment in the exchange rate take place?

Mr. GREENSPAN. It depends basically on the trend of dollar-denominated interest rates. If they stabilize or even start down, I would suspect the exchange rate will at that point have peaked and start down.

The only thing keeping the exchange rate up is the continued rise in interest rates. As soon as interest rates stop rising, I think the dollar starts down. That is largely because, we are at least approaching if not already arrived at what I would call dollar saturation in internationally mobile portfolios.

CONTINUED RISE OF INTEREST RATES

Mr. HAMILTON. Is it your judgment that interest rates are not going to continue to rise?

Mr. GREENSPAN. They will continue to rise in the short run. Long-term interest rates already embody a long-term inflation rate expectation which is quite substantial. Part of the problem in the short-term interest rate structure is the effect that these very substantial borrowings on mergers, acquisitions and leveraged buyouts are creating in the short run.

They have a temporary effect of moving interest rates higher, but they will reverse later. So there are unusual factors in the market at this stage. The presumption that rates have to continue higher indefinitely through 1985, I think, is making a forecast which is pushing the numbers farther than they can be pushed.

SOLVING THE INTERNATIONAL DEBT PROBLEM

Mr. HAMILTON. Let's discuss the debt problem, and how you would tackle it. There are a lot of suggestions that are being discussed at the moment. One is to put a cap on how much the rate on a loan could rise, and if the rates go up above that cap, then add the excess to principal.

There has been a lot of talk about lowering the fees that the banks ought to charge, lowering the spreads between the prime rate and the amount above it that countries are charged.

There is talk about lengthening the grace periods, and the maturities.

There are all kinds of solutions. Mr. Bergsten, you have a solution. I refer to the fourth and fifth points that you make in your statement with regard to allocating $35 billion of special drawing rights for 1985 and another 10 million in subsequent years and also increasing the lending capability of the World Bank to solve the debt problem.

Maybe I ought to ask Mr. Greenspan and Mr. Pratt to comment on how serious the international debt problem is, and what steps would you recommend that we take to deal with it.

Mr. GREENSPAN. Mr. Chairman, it is quite serious. The fact that it continues to reemerge is, an indication of that. Capping interest rates is not a solution.

It just prevents any current rise in rates from making what is already a very difficult situation worse. It does not come to grips with what is a deep-seated issue. We have got to recognize that all of the international, especially Latin American debt problem, is not strictly a problem of illiquidity.

Were it strictly a problem of illiquidity, rescheduling debt would fully confront the problem and merely having assets which do not mature at the appropriate times is easily resolved and one can do that.

Some part of the problem reflects assets falling short of the liabilities. If that is in fact the case, all of the rescheduling is not going to close that gap.

It doesn't change assets in the slightest. What we are left with is a problem of partial insolvency. Part of the extraordinary expansion in debt, did not create income-producing assets to pay off the debt. Flight of capital which has occurred has also reduced ability of these countries to repay this debt.

Meanwhile, the cumulative interest charges continue to increase the debt aggregates, and we are in effect merely capitalizing the interest payments which clearly will not make that go away.

OPPOSITION TO DIRECT INVOLVEMENT OF U.S. GOVERNMENT

It is important to confront this question in a longer term sense. The solutions are not simple. I am not one who believes that the U.S. Government should get directly involved.

My concern, however, is that through the FDIC, the Government is already involved in the sense that through the levels of guarantees of liabilities, a goodly part of the American banking system in effect has government-guaranteed liabilities through the FDIC, and to the extent that we cannot make all of the loans of the American banking system to third-world nations viable, then in that sense, the U.S. Treasury will have a role, because it is already involved in it.

This is a very, very difficult problem. I would suggest that there probably will have to be some form of U.S. Treasury input. Imposing on the American banks, unilaterally, requirements that they cut their interest rates, or that they cut their spreads, I do not think is a realistic solution.

U.S. LIABILITY IN DEBT SITUATION

Mr. HAMILTON. Are you suggesting that the debt situation has a potentially large liability for the American taxpayer?

Mr. GREENSPAN. Yes; it does.

Mr. HAMILTON. Have you done any calculations as to what that might be?

Mr. GREENSPAN. Not directly, Mr. Chairman, because we do not know what type of problems that we are potentially confronting. All I would suggest is that what we try to do is to recognize that we have a problem and to try to minimize whatever costs to the American taxpayer will ultimately ensue.

NEED FOR EXPANDED FOREIGN EXCHANGE EARNINGS

Mr. BERGSTEN. One should conceptualize the problem in three phases. As I said way back at the outset, in passing, the only fundamental solution to the problem is to provide a world environment in which the debtor countries are able to expand their own earnings of foreign exchange rapidly enough to get back to some modicum of creditworthiness, servicing their debt, et cetera.

That means rapid world economic growth, avoidance of protectionism, et cetera. That is cardinal to the whole thing.

INCREASED ROLE OF WORLD BANK

But even when you have that, you still have a second question. How are you going to provide the ongoing flows of capital but only to finance trade as Mr. Bonker talked about, but to finance the current account deficits of developing countries? They are going to run current account deficits. It was in that connection that I suggested big increases in the role of the World Bank.

It won't cost the taxpayer a cent. There are various techniques for enabling the World Bank to expand its programs without costing the United States or any other taxpayer a penny.

Before the first oil shock, public institutions like the World Bank, and bilateral aid programs provided three-quarters of all the capital flow going to developing countries.

After the first oil shock, it reversed, much shorter maturity——

SOURCE OF MONEY FOR WORLD BANK

Mr. HAMILTON. Wait a minute. How can you raise the World Bank's contribution by 50 to 100 percent? Where does the money come from?

Mr. BERGSTEN. The World Bank is a financial intermediary. It borrows in the private capital markets and lends that money onto the borrowing countries.

The money comes from the private capital markets. The United States and other governments stand behind with guarantees, but never has a penny been drawn, and it wouldn't have to be.

Mr. BONKER. At what rates? If it is borrowing in the private sector?

Mr. BERGSTEN. It passes on substantially lower interest rates than those countries can get when borrowing from the market themselves and it lends at 20- to 25-year maturities. So you are right, it is not concessional lending, but it is at much less onerous terms.

PAST ROLE OF WORLD BANK

Mr. HAMILTON. Why hasn't the World Bank jumped into this situation? All we read is about the measures of the IMF.

Mr. BERGSTEN. Because the countries who dominate policymaking at the World Bank have not recognized the need to do so. Indeed, the main equity owners of the World Bank have been squeezing it—the have cut back on IDA, as you know—and have been restraining the capability of the World Bank to expand its programs. It should be making a big contribution without a cent of taxpayer money.

CHANGES IN BANK LENDING

There is a third dimension bank lending itself. It may have to be, as Dr. Greenspan says, that changes have to be made in the nature of the currently outstanding bank loans to the developing countries.

My own preference is to go to what are known as variable maturity loans where the current cash flow remains the same, even when interest rates rise, but you put the additional unpaid amount on at the end of the loan.

British home mortgages have followed that system, and it is a well-known financial technique.

Mr. HAMILTON. Is it like an adjustable rate mortgage?

Mr. BERGSTEN. It is a flat cash flow repayment. There is an accounting question of how much you treat as interest and how much you treat as principal, but the economic effect is to avoid any ratcheting up in the annual cash repayment. You put it on at the end.

That is adding further to the debt, and that is not what you fundamentally want. Even if you have to do that to avoid breaking lots of crockery in the short run, that is not fundamental.

It is number three in a three-tier series of responses.

Mr. HAMILTON. Mr. Greenspan, you shook your head a moment ago.

COST OF GOVERNMENT GUARANTEES TO TAXPAYERS

Mr. GREENSPAN. It is a matter of principle between us. I consider a Government guarantee the use of U.S. Government resources. The presumption that it doesn't cost the taxpayer a cent is the same issue raised with our domestic accounts relative to U.S. Treasury off-budget loans. It is wrong to says it doesn't cost the taxpayer anything. If you extend that principle indefinitely you pressure the financial markets toward accepting ever increasing amounts of Government paper with private paper and private investment being elbowed out.

It may not on the surface and immediately cost the American taxpayer anything. Ultimately, it does increase world inflation and to the extent that there are defaults, it does cost something.

I do not necessarily object to the desire to expand, but it does cost us something.

LIKELIHOOD OF WORLD ECONOMIC RECOVERY

Mr. HAMILTON. Suppose you do not get an economic recovery in the rest of the world, particularly the third world, suppose you don't get a lowering of interest rates or an increase in commodity prices upon which these countries are so dependent, what happens on this debt problem?

Your underlying assumption has been that we are going to have economic recovery, but isn't that very much in doubt?

Mr. BERGSTEN. I agree it is in doubt. We published a study last fall that laid out the parameters under which one could see his way through the debt problem. That requires steady 3 to 3.5 percent growth of the industrial countries. That would be rather unimpressive compared with most post-war recoveries, but it would be at least more than we have seen up until 1983.

On most current projections, one will certainly get that this year and in 1985 and might well get it out into 1986, too. You should not throw up your hands. There is a reasonable possibility that the stable scenario will play out, but the risks are sufficient that I also think you are quite right to ask a contingency planning question, what to do in the absence thereof?

I think, at that point, one would have to do some fairly substantial stretching out of the debt coming due, and then, too, particularly look for ways to provide additional finance, like the World Bank case. That is suboptimal, because it is building up more debt, and that is not the way out, but I really do not see any alternative under that kind of scenario than trying to get through as best one can.

Mr. HAMILTON. Mr. Roth.

ROLE OF CHAIRMAN OF THE FEDERAL RESERVE

Mr. ROTH. Thank you, Mr. Chairman. I would like to go back to the London summit for just 1 minute. Because the Europeans are so concerned about our interest rates, and because the Federal Reserve Board is so concerned about Third World and the debt in the Third World, should Paul Volker be at the President's elbow at the summit in London?

Mr. GREENSPAN. Fortunately, telecommunications are wonderful in this world and physical contiguousness is not really necessary, probably not even appropriate.

PRESENCE OF U.S. TRADE REPRESENTATIVE AT SUMMIT

Mr. ROTH. How about Bill Brock, our U.S. Trade Representative, he wasn't even at Cancun. Shouldn't he be there?

Mr. GREENSPAN. I am a little hesitant when dealing with heads of Government to have essentially independent agencies, as far as our Government is concerned, there but Bill Brock works for the President of the United States and so there are no conflicting forces.

I would hate to have the White House, Federal Reserve normal, perhaps not even bad, frictions, carried across our borders.

Mr. BERGSTEN. In the last administration, Bob Strauss, the Trade Representative, was at the center of many of the summits and I think Ambassador Strauss would tell you if you asked him that the last big trade negotiation succeeded only because of the pushes given at succeeding summits, 1977 and 1978 particularly, when he was there and where President Carter made very clear the U.S. overall priorities in getting that done.

Strauss was right there, and the other heads of state knew we had the mandate to carry it out. That is terribly important. Indeed the failure of the GATT ministerial in 1982, was largely due to the failure of top level support within his own country for Ambassador Brock.

CREATION OF DEPARTMENT OF TRADE

Mr. ROTH. Do you think we need a department of trade? Would you endorse that concept?

Mr. BERGSTEN. I think we have some problems right now in the way trade policy is being managed. One is the rivalry, not cooperation, between the two main agencies and the other is the failure to coordinate it with the monetary side. I think we need a change. Every trade issue is being dominated by the bureaucratic rivalry between the Secretary of Commerce and the U.S. Trade Representative.

That is bad for the country and should be corrected forthwith. I am afraid I don't believe a new trade department is the way to do it. Trade is an issue that brings together concerns of every major agency in this city and the lead agency concept has been demonstrated again and again in the history of Government management not to work.

I think the alternative is to strenghten the Office of the Trade Representative in the White House, give it the job you and the Congress tried to give it in the Trade Act. Put that person in front. Have him carry the President's mantle and be in charge. If you insist on that, I think it would be done.

Mr. PRATT. That is what I believe the majority of the business community supports, too.

Mr. ROTH. If you had a Cabinet-level officer heading up trade, wouldn't that give it more emphasis? A person in the Cabinet would be able to knock heads together, wouldn't it be more appropriate?

Mr. BERGSTEN. I differ with you on the facts. I don't think a Cabinet officer has as much clout as a Presidential assistant in the White House, who in a real sense, if backed by the President, can coordinate the Cabinet. Look at any number of studies of this—an effort by one Cabinet officer to coordinate other Cabinet officers does not work.

The lead agency concept does not work. It is unfortunate. One always wishes for Cabinet government to be more effective, but it is just not effective. I think it is the only effective way to coordiante an area where every different constituency is going to go to its Cabinet officer and ask him not to quit fighting their battle until he goes to the top.

Mr. GREENSPAN. I fully subscribe to Dr. Bergsten's remarks.

We talk Cabinet government, but that is not the way our system functions. There is no doubt that you need, for full support, to have that office close enough to the President and not subject to parochial blandishments of one group or another.

Mr. PRATT. I certainly agree with you and with Dr. Bergsten that the Ambassador should be at summit meetings, particularly when the issues being considered are so primarily in his area.

RATE OF THIRD WORLD ECONOMIC GROWTH

Mr. ROTH. Just one more question. Dr. Greenspan, when you answered a question earlier, you mentioned that the Third World economic growth is going to be more sluggish. Is that right?

Mr. GREENSPAN. Yes.

POSSIBILITY OF INSTABILITY IN THE THIRD WORLD

Mr. ROTH. That brings a question to mind. When Dr. Kissinger was here before us a number of weeks back, he said for the Third World countries to maintain their 1978 standard of living, they have to increase their GNP by 6 to 7 percent a year.

Looking at the tremendous population growth, Mexico going from 70 to 115 million, or Egypt, another example, 40 to 65 million, within the next 15 years or so, aren't we going to see some tremendous political, economic, and social upheavals in these countries?

Mr. GREENSPAN. I do think that there are problems, but I would be hesitant to forecast that. I will always remember the forecasts that many of us who were then in government were concerned about following the huge increase in the price of oil in 1974 and the expectations of a huge increase in unemployment in Western Europe and the presumption that that would bring with it a highly unstable and very dangerous political situation in the developed countries.

In fact, unemployment in 1975 and indeed subsequently, rose far beyond any forecasts that we even dared make at that time and social unrest and disintegration of the system clearly did not occur. So I am inclined to be a bit hesitant to draw immediate logically necessary consequences.

As Dr. Kissinger has said, there is far more than economic events, creating those problems. The issues of anticipations and a great number of other forces are involved. So while there is no doubt that per capita incomes in real terms of the developing nations will do less well than they have, as far as growth is concerned in the next 5 to 10 years than they have done in the previous decade, I would not necessarily read into that dire concerns.

Mr. HAMILTON. Mr. Bonker.

TRADE REORGANIZATION

Mr. BONKER. On trade reorganization, Mr. Bergsten, the trade reorganization bill that I have introduced takes into account your concern to keep a special White House adviser who would coordinate trade policy and really be the President's spokesman. It also achieves trade reorganization by putting that department more into a structure that would give it greater strength when it comes to commerce activity and trade activity.

I believe we have rival institutions that really inhibit our efforts to be not only clear, but more effective in our trade policy. That will be a subject for a different session of Congress, not this one.

FLOW OF FOREIGN CAPITAL INTO THE UNITED STATES

At London, I rather imagine that our European allies will be confronting the President, at least privately, on two major issues. One is this problem of foreign capital that is coming into the United States which is helpful in the short-term, at least for us by way of financing our debt and the other is export control policy which is greatly alarming the Europeans.

On that first point, Dr. Greenspan, you said that foreign capital coming into the United States to purchase dollar denominated investments has been large and is, in fact, the mirror image of the current deficit. Are you saying that the foreign inflow is equal to the size of our current deficit?

Mr. GREENSPAN. I am merely stating the numerical necessity; namely, that the balance of payments balances and that to the extent that we are in deficit on goods and services account, there has to be an equal offset in the financing area. When you have a period of a very rapid rise in the dollar, which implies a huge demand for U.S. dollar-denominated investments, the consequent upward pressure on the dollar's exchange rate reflecting that supply and demand was, and probably in this case, may well have been, a major factor forcing this huge current account deficit.

You cannot look at the current account deficit independently of the capital account. They are constantly functioning together.

FINANCING OF FEDERAL DEFICIT BY FOREIGN CAPITAL

Mr. BONKER. Would it be too simplistic to ask what percentage of our current Federal deficit is being financed by foreign capital?

Mr. GREENSPAN. It is not a question we can answer directly, in the same sense that a business cannot answer the question what part of its inventory accumulation is financed by short-term credit in the sense that you have all the liability items on one side and all of the asset items on the other. And in the same sense in the United States we have this huge amount of net credit requirements, Federal Government, business, State and local governments on the one side, domestic sources of savings and foreign sources on the other.

And you cannot match one to the other.

IMPACT OF WITHDRAWAL OF FOREIGN CAPITAL

Mr. BONKER. Are we finding ourselves in a vulnerable situation, heavily dependent on foreign sources to help manage our current deficit? If there were to be a precipitous withdrawal of foreign capital, what kind of corresponding impact would that have in our private markets and on interest rates?

Mr. GREENSPAN. Oh, a very significant effect. You don't even have to argue withdrawal of funds. You can argue for a mere slowing down of the rate of investment into this country.

If foreigners decide that they wish to reduce that rate of investment flow then our interest rates would have to rise to induce otherwise reluctant people to continue investing at the current rate.

To the extent we are at risk, I would say we are at risk on the interest side.

FLOW OF EUROPEAN CAPITAL TO UNITED STATES

Mr. BONKER. What is being said about the huge outflow and the Europeans' need to have capital expansion, capital investment and so forth. That is quite a problem for Europe.

Mr. GREENSPAN. Part of the problem is that a great deal of investment into the United States is coming here because private citizens perceive this as a good place to invest.

EUROPEAN RESTRICTION OF CAPITAL OUTFLOW

Mr. BONKER. Is it likely that in the future they will enact legislative measures to limit the outflow of their capital?

Mr. GREENSPAN. Some of them do. It is a very unfortunate thing.

Fred Bergsten raised the question of a GATT for investment, direct and otherwise, I assume. It is the same issue. In other words, if you start restricting capital flows, we will eventually run into the same problems that we get in restricting the movement of goods and services across national boundaries.

Mr. BERGSTEN. It should be added that some of the Europeans are ambivalent about the problem, as you stated it. They do deplore the loss of investment funds and particularly the pull on their interest rates that occur.

On the other hand, some of them like the undervaluation of their currencies and the competitive advantage it gives them. In most cases, the net effect is negative and certainly a fragile basis for their recovery, and therefore they should be looking for more stable underpinning.

Thinking about attitudes they will bring to the summit, however, there is some degree of ambivalence in at least some of the countries.

Mr. BONKER. Mr. Pratt, I will close with just two questions of you.

I rather imagine the Europeans will raise the question of our export control policy and how disruptive it has been between the United States and our allies.

PROTECTIONIST PRESSURES ON U.S. POLICY

I would like to have your opinion about our export control policy and this question of protectionism, which you addressed in your statement. There are many who favor a domestic content bill because of the industrial impacts in their respective districts, and others who favor it only to send the Japanese the message: If you are going to have access to our markets, we ought to have access to your markets.

It is not legislative measures that raise this specter of protectionism, as much as it is the existing practice in the Trade Act of 1974. The Export Task Force, which I chair, prints weekly a list of all of the filings before the ITC pursuant to the countervailing and antidumping procedures. It is remarkable the number of companies that are now coming to the Federal Government and asking for relief. In fact, I read a month ago that the ITC had to greatly expand its staff—everybody was doing investigative work—the clerks, the secretaries—everybody but the janitor, because they are so overloaded.

Such a situation says, No. 1, many of our U.S. industries are hurting badly, badly enough to come to the Government and do what they don't like to do—ask for help; and second, it says that obviously there are many, many countries that are subsidizing their industries, to give them a competitive edge in our market, whether it is small corporate airplanes or copper or whatever.

How can the United States stand up tall and resist protectionism in view of the widespread practice of other countries subsidization that give their companies a competitive advantage in our markets causing considerable harm to our own industries? Don't you think this is the kind of issue that ought to be addressed in London?

ENFORCEMENT OF THE GATT AND OTHER TRADE RULES

Mr. PRATT. I would answer that this way, sir: There are no simple issues here; that is pretty clear. But the only way we have any chance of keeping the system in being and the reason the system works as well as it does now is because we agreed on a set of operating rules under the GATT and in other places. And we are always having conflicting pulls against us as independent nations. But we agree to a set of rules because, in the long run, if a system is going to work we have to have a set of rules for it to work by.

So I think the rules, the existing rules, do provide for handling issues of subsidization and unfair trade practices. As the head of ECAT, I strongly believe in free trade. ECAT was created to stand in the way of increasing protectionism. But my company has used the rules to go to our Government for help in cases where the rules are being broken. We have to live by the rules we have, and we should enforce them strongly, and we should challenge our trading partners when they break them.

But that does not equate with setting new independent steps of protectionism which tend to tear the system apart. That is where I draw the difference.

PROTECTIONISM IN THE UNITED STATES

Mr. BONKER. Whenever people testify before committees, they always refer to domestic content; that is a message, if not a myth, because it is not going to be a reality. But the reality is that every day subsidies are in place to help industries in other countries, and we have our own form of subsidies. We are practicing protectionism in many different ways, again within certain guidelines; but, nonetheless, it is real.

EXPORT CONTROL POLICY

What about export control policy?

Mr. PRATT. The position of ECAT is to acknowledge the fact that, for national security and other reasons, there needs to be some controls over critical exports. On the other hand, we believe the record suggests that we have been applying them ineffectively and tried to stretch them into areas where they don't belong. And I mentioned in my statement we are tending to become, in many people's eyes, an unreliable supplier of goods. So ECAT has taken a specific position on the various issues with regard to this.

We think the law should be extended and should be improved, but should have limitations upon it, particularly when there are alternate availabilities of goods; and that, in general, as the law is extended, it should be restrained rather than given more control.

The extraterritorial issue is a particularly serious problem which should be dealt with and should not continue.

Mr. HAMILTON. Gentlemen, we have had you here for quite a while, and we appreciate it. But I do want to get your reaction to Dr. Bergsten's sixth and seventh points.

INTERNATIONAL CONFERENCES ON MONETARY SYSTEM AND TRADE

He suggests two major international conferences. One is to work out a new international monetary regime and define the synthesis between the rigidity of exchange rates and the volatility of the current regime of floating rates. That is a sizeable challenge if we head for that. And the seventh point is to move toward a new international trade negotiation, taking up the rules of the GATT, and so forth. These suggestions prompt these questions.

Are we in fact moving toward major international conferences in both of these areas? Is that the direction that we are moving worldwide?

Second, should we move in these directions? When should we act? What should the U.S. objectives be? Is it to our advantage now to push for those objectives?

I would like a little discussion on these. Can the international system stand two big conferences going on simultaneously?

Mr. BERGSTEN. I may not have been clear. I was not advocating conferences per se, but substantial moves in both those directions.

I talked about a target zone system very cryptically, here, so it is my fault. But I would start out by having the big five deputy finance ministers, who get together all the time anyway, start to devise and implement a system of that type. I wouldn't call a big conference until much later down the road.

Mr. HAMILTON. A lot of preparation has to be done first.

Mr. BERGSTEN. Yes. On trade, there are annual conferences of the GATT ministers, the trade ministers of the GATT countries. But the whole Tokyo round of trade negotiations was concluded without a ministerial meeting, let alone one of heads of state.

PRIORITY OF TRADE OR MONETARY CONFERENCE

Mr. HAMILTON. Is the trade negotiation a higher priority than the restructuring of the international monetary regime, or should they proceed on a parallel track?

Mr. BERGSTEN. Those were the two priorities I cited. To be ultimately successful, they have to proceed on parallel tracks. Unless you get the monetary side right, it is very hard to avoid this kind of seizing up of the trade system, so the two have to go more or less in parallel.

Think back to the early seventies after the breakdown of the Bretton Woods system of fixed exchange rates. There was explicit linkage between trade and money.

When Secretary Shultz was Secretary of the Treasury, he led the U.S. delegation to the Tokyo meeting in 1973 that launched the Tokyo round. Now, you might say, in light of this organizational discussion, why was the Secretary of the Treasury leading the U.S. delegation to a meeting that launched a trade negotiation? Well, linkage was recognized. Much of the trade problem had emerged out of a move to a new monetary system. There was specific linkage forced on the United States by the French at one stage, but the agreement was for parallel progress.

Now, we need to move ahead on both again. It has to proceed in parallel.

SUPPORT FOR NEW INTERNATIONAL TRADE NEGOTIATIONS

Mr. HAMILTON. Is it the administration's policy today to move toward a new international trade negotiation? Are we pushing hard for that now? Is it their policy to move toward that?

Mr. BERGSTEN. Key parts of the administration are moving as effectively as they can toward a new trade negotiation.

Mr. HAMILTON. Not on the monetary restructuring?

Mr. BERGSTEN. To the contrary.

Mr. HAMILTON. Any further comments from the panel or from my colleagues?

Gentlemen, we thank you for a most constructive and interesting session. We appreciate very much your contributions.

The subcommittees stand adjourned.

[Whereupon, at 4 p.m., the joint subcommittees adjourned, subject to the call of the Chair.]

PROSPECTS FOR THE LONDON ECONOMIC SUMMIT

WEDNESDAY, MAY 30, 1984

HOUSE OF REPRESENTATIVES, COMMITTEE ON FOREIGN AFFAIRS, SUBCOMMITTEES ON EUROPE AND THE MIDDLE EAST AND ON INTERNATIONAL ECONOMIC POLICY AND TRADE, AND JOINT ECONOMIC COMMITTEE, SUBCOMMITTEE ON ECONOMIC GOALS AND INTERGOVERNMENTAL RELATIONS,

Washington, DC.

The subcommittees met at 2:30 p.m., in room 2200, Rayburn House Office Building, Hon. Lee H. Hamilton (chairman of the Subcommittee on Europe and the Middle East and the Subcommittee on Economic Goals and Intergovernmental Relations) presiding.

Mr. HAMILTON. The meeting of the subcommittees will come to order.

The subcommittees on Europe and the Middle East and on International Economic Policy and Trade of the Committee on Foreign Affairs and the Joint Economic Committee's Subcommittee on Economic Goals and Intergovernmental Policy meet to continue their examination of the prospects for the upcoming London Economic Summit.

The London Summit, which is the 10th in a series of annual economic meetings of the leaders of the seven major industrial countries, will take place June 7 through 9.

In their first hearing on the Summit on May 14, the subcommittees heard testimony from Mr. Edmund T. Pratt, Jr., chairman and chief executive officer of Pfizer Inc.; Mr. C. Fred Bergsten, director of the Institute for International Economics; and Mr. Alan Greenspan, president, Townsend & Greenspan.

We are happy to have with us today the Honorable W. Allen Wallis, Under Secretary for Economic Affairs, Department of State.

Mr. Wallis, we look forward to your testimony and discussing this important meeting with you. You may proceed to summarize your statement.

Your entire statement will be entered into the record in full.

We are delighted to have you with us. You may proceed, sir.

STATEMENT OF HON. W. ALLEN WALLIS, UNDER SECRETARY FOR ECONOMIC AFFAIRS, DEPARTMENT OF STATE

Mr. WALLIS. Thank you very much. I am happy to have an opportunity again this year to talk with the committee before the

Summit about what our plans and expectations are there, both for the President's participation and for that of his colleagues.

Let me start with a few words of caution about what we should expect from the London Summit. London will mark the 10th economic summit. The first having taken place in Rambouillet in 1975.

If the past 10 years have taught us anything about the utility of economic summitry, the major lesson is that the public should not expect magic cures, or even band-aids to result from 3-day meetings.

Rather than attempt to design "quick-fixes" for complicated or highly specific economic problems, summitry is most useful in sketching broad strategic outlines and policy objectives for our governments to pursue in a coordinated fashion. And, perhaps most importantly, economic summits offer a unique opportunity for the heads of the world's seven largest industrial democracies to discuss mutual problems.

While foreign ministers, finance ministers, and trade ministers meet frequently to discuss their concerns, the summits provide the only annual meeting dedicated to tackling economic issues in the context of their interrelationships.

With this caveat, I should note that we enter the London Summit with the broadest basic agreement with our summit partners on economic policy questions in several years. While in the past we have differed with our summit partners on the appropriateness of various economic objectives, the President's market-oriented economic program is now widely accepted by our partners.

This change in attitude, even since last year's highly successful meeting in Williamsburg, is striking. Our partners now recognize that the President's policies have succeeded at home and that, working with the President over the past 3 years, they have forged with him a coherent strategy for sustainable, noninflationary growth, which is the broadest economic objective of all the summit participants.

Although further progress, especially in removing structural rigidities in some countries, will be slow and difficult, all now agree on its necessity and are working to achieve it.

Our two broad objectives at the London Summit next week are (1) strengthening and spreading the recovery that at Williamsburg seemed to be taking hold and now is firmly established in most of our countries; and (2) improving the implementation of the strategies outlined at Williamsburg on international trade, finance and debt. These broad objectives result in goals that are more specific.

One of the chief tasks at London will be to explore ways to sustain convergence of summit country economic performance to ensure that higher growth and lower inflation spread to the rest of the world. Real growth in the summit countries is expected to be about 4.5 percent this year, and inflation about the same.

We believe the key policies to achieve this objective are:

First, to restrain Government spending, thus allowing expansion of the private sector;

Second, to promote stable, moderate monetary growth, thus inducing lower interest rates and increasing confidence that inflation will be contained;

Third, to remove structural rigidities that are inhibiting the growth of employment and investment in some summit countries; and

Fourth, to maintain and enhance the open trading system, with special emphasis on trade with developing countries.

Previous testimony before this subcommittee has included concerns about U.S. budget deficits and the fear that they will lead to higher interest rates that could choke off recovery and reignite inflation in both industrial and developing countries. Now that both the House and Senate have acted on the President's proposals for a downpayment on the deficit, we believe that at London we can promise a reduction in our budget deficit.

We will stress at London the value of the multilateral surveillance process, initiated 2 years ago at Versailles and strengthened at Williamsburg, as a forum for continuing consultations on convergence of economic performance.

We will also point out that the large trade and current account deficits of the United States have made major contributions to growth in other countries, as their exports to our market have risen.

However, as we all know and appreciate, that situation will not last forever, so it is urgent that all countries pursue their efforts at rectifying their economic policies.

Concerning the debt problem of the developing countries, we will argue at London that all parties must continue to fulfill their responsibilities under the five-point debt strategy endorsed at Williamsburg. The debt problem will be manageable in the long run, as well as the short, if each of us does his job—debtors, creditors, commercial banks, international financial institutions and governments.

One of our main objectives at London is thus to confirm that the Williamsburg strategy of managing LDC debt problems on a flexible, case-by-case basis is working and requires no fundamental change. It is, however, true that the strategy, and especially its medium and longer-term aspects, can be strengthened and public understanding of it improved.

In our view, the medium-term aspects, which we hope to see stressed at London, comprise the following elements:

First, the need for continued adjustments by the LDC's;

Second, the need for closer coordination between the International Monetary Fund and the World Bank to facilitate the adjustment and development process;

Third, the need for developing countries to improve the climate for private investment to stimulate adjustment and growth and to acquire new inflows of foreign exchange without excessive dependence on borrowing;

Fourth, to assure that markets remain open and prospects are enhanced by new multilateral trade negotiations.

With regard to international trade, the challenge for summit leaders at London will be to consolidate the movement toward worldwide economic recovery, to promote early progress in liberalizing trade and improving the trade system, and to move forward toward new multilateral trade negotiations.

This is the message that emerged out of the OECD ministerial meeting 2 weeks ago. At that meeting, the 24 member countries agreed that a new round of multilateral trade negotiations was of the utmost importance to a strengthening of the liberal trade system.

Members urged expanded consultations with all GATT countries and gave a high priority to the GATT work program established in 1982 to lay the groundwork for the development of a consensus on such negotiations. We trust that the London Summit will reaffirm this undertaking at the highest political level.

Finally, let me mention briefly our objectives on East-West economic relations at London. Our goals in this area are simple and straightforward.

We will seek to continue to work closely with our summit partners and other allies to broaden our consensus, stemming from the Versailles Summit, on prudent economic relationships with the Soviet Bloc countries. We will urge that work underway since 1982 in such specialized organizations as the OECD, IEA, NATO, and COCOM continue to make that consensus as comprehensive as possible.

Those, Mr. Chairman, are our basic economic goals as we approach the London Summit. The leaders will doubtless, as at previous summits, also exchange views on international political issues informally during their meetings alone, primarily over meals.

At this stage, I could not comment in more detail about the subjects they may cover. I will, however, try to answer any questions you have on the economic aspects of the summit.

May I say that I have with me my deputy, Ambassador Robert Morris, who has as much to do with the preparations for the Summit as anyone, if not more.

[The prepared statement of Mr. Wallis follows:]

PREPARED STATEMENT OF HON. ALLEN WALLIS, UNDER SECRETARY OF STATE FOR ECONOMIC AFFAIRS

Mr. Chairman: I appreciate this opportunity to outline the administration's objectives at the London Economic Summit to be held June 7–9.

Let me begin with a few words of caution about what we should expect from the London Summit. London will mark the tenth economic summit. The first having taken place in Rambouillet in 1975. If the past ten years have taught us anything about the utility of economic summitry. The major lesson is that the public should not expect magic cures. Or even band-aids. To result from three-day meetings. Rather than attempt to design "quick-fixes" for complicated or highly specific economic problems. Summitry is most useful in sketching broad strategic outlines and policy objectives for our governments to pursue in a coordinated fashion. And, perhaps most importantly, economic summits offer a unique opportunity for the heads of the world's seven largest industrial democracies to discuss mutual problems. While foreign ministers, finance ministers, and trade ministers meet frequently to discuss their concerns. The summits provide the only annual meeting dedicated to tacking economic issues in the context of their interrelationships.

With this caveat, I should note that we enter the London Summit with the broadest basic agreement with our summit partners on economic policy questions in several years. While in the past we have differed with our summit partners on the appropriateness of various economic objectives. The President's market-oriented economic program is now widely accepted by our partners. This change in attitude, even since last year's highly successful meeting in Williamsburg, is striking. Our partners now recognize that the President's policies have succeeded at home and that, working with the President over the past three years, they have forged with him a coherent strategy for sustainable. Non-inflationary growth, which is the broadest economic objective of all the summit participants. Although further progress, expecially in removing structural rigidities in some countries, will be slow and difficult. All now agree on its necessity and are working to achieve it.

Our two broard objectives at the London Summit next week are: (1) strengthening and spreading the recovery that at Williamsburg seemed to be taking hold and now is firmly established in most of our countries; and (2) improving the implementation of the strategies outlined at Williamsburg on international trade, finance, and debt. These broad objectives result in goals that are more specific.

One of the chief tasks at London will be to explore ways to sustain convergence of summit country economic performance to ensure that higher growth and lower inflation spread to the rest of the world. Real growth in the summit countries is expected to be about 4.5 percent this year. And inflation about the same.

We believe the key policies to achieve this objective are:

First, to restrain government spending, thus allowing expansion of the private sector;

Second, to promote stable, moderate monetary growth, thus inducing lower interest rates and increasing confidence that inflation will be contained;

Third, to remove structural rigidities that are inhibiting the growth of employment and investment in some summit countries; and

Fourth, to maintain and enhance the open trading system, with special emphasis on trade with developing countries.

Previous testimony before this subcommittee has included concerns about U.S. budget deficits and the fear that they will lead to higher interest rates that could choke off recovery and reignite inflation in both industrial and developing countries. Now that both the House and Senate have acted on the President's proposals for a "downpayment" on the deficit, we believe that at London we can promise a reduction in our budget deficit.

We will stress at London the value of the multilateral surveillance process, initiated two years ago at Versailles and strengthened at Williamsburg, as a forum for continuing consultations on economic convergence.

We will also point out that the large trade and current account deficits of the United States have made major contributions to growth in other countries, as their exports to our market have risen. However, as we all know and appreciate, that situation will not last forever, so it is urgent that all countries pursue their efforts at rectifying their economic policies.

Concerning the debt problem of the developing countries, we will argue at London that all parties must continue to fulfill their responsibilities under the five-point debt strategy endorsed at Williamsburg. The debt problem will be manageable in the long run, as well as the short, if each of us does his job—debtors, creditors, commercial banks, international financial institutions, and governments.

One of our main objectives at London is thus to confirm that the Williamsburg strategy of managing LDC debt problems on a flexible, case-by-case basis is working and requires no fundamental change. It is, however, true that the strategy, and especially its medium- and longer-term aspects, can be strengthened and public understanding of it improved.

In our view, the medium-term aspects, which we hope to see stressed at London, comprise the following elements:

First, the need for continued adjustments by the LDC's:

Second, the need for closer coordination between the International Monetary Fund and the World Bank to facilitate the adjustment and development process;

Third, the need for developing countries to improve the climate for private investment to stimulate adjustment and growth and to acquire new inflows of foreign exchange without excessive dependence on borrowing;

Fourth, to assure that markets remain open and prospects are enhanced by new multilateral trade negotiations.

With regard to international trade, the challenge for summit leaders at London will be to consolidate the movement toward worldwide economic recovery, to promote early progress in liberalizing trade and improving the trade system, and to move forward toward new multilateral trade negotiations.

This is the message that emerged out of the OECD ministerial meeting two weeks ago. At that meeting, the 24 member countries agreed that a new round of multilateral trade negotiations was "of the utmost importance to a strengthening of the liberal trade system." Members urged expanded consultations with all Gatt countries and gave a high priority to the Gatt work program established in 1982 to lay the groundwork for the development of a consensus on such negotiations. We trust that the London Summit will reaffirm this undertaking at the highest political level.

Finally, let me mention briefly our objectives on East-West economic relations at London. Our goals in this area are simple and straightforward. We will seek to continue to work closely with our summit partners and other allies to broaden our consensus, stemming from the Versailles Summit, on prudent economic relationships with the Soviet bloc countries. We will urge that work underway since 1982 in such specialized organizations as the OECD, IEA, NATO, and COCOM continue to make that consensus as comprehensive as possible.

Those, Mr. Chairman, are our basic economic goals as we approach the London Summit. The leaders will doubtless, as at previous summits, also exchange views on international political issues informally during their meetings alone, primarily over meals. At this stage, I could not comment in more detail about the subjects they may cover. I will, however, try to answer any questions you have on the economic aspects of the summit.

Mr. HAMILTON. Thank you very much, Mr. Wallis. We are glad to have Mr. Morris with us, as well. We will begin questioning with Chairman Bonker.

DEGREE OF SUCCESS OF U.S. ECONOMIC POLICIES

Mr. BONKER. Thank you, Mr. Wallis, for your statement. We wish you the best of luck at the London conference.

I have read your statement and listened to your comments and I really have to say that I don't agree with much of what you have said to the subcommittees.

I don't believe that we are entering the London summit with the broadest basic agreement with our summit partners. I think that we are deceiving ourselves if we do not see the emerging economic realities as we approach that summit.

I am not sure that the President's market oriented economic program is widely accepted by our trade partners. While that may be the case in England. I am not sure that is the case with other participating countries.

I really don't agree that last year's Williamsburg summit meeting was highly successful. I think it was a good public relations effort at glossing over some of the problems that exist among member nations.

I am not prepared to agree that we can recognize that the President's policies have succeeeded at home. I think the jury is still out, and we won't really know for another few years whether those policies have truly promoted economic expansion and growth.

In the short term the statistics bear out that statement. I am not sure what the long term will say about his economic policies. But, in any case, as we approach the London summit, I wonder whether countries are going to agree about monetary policy as it exists today, particularly the currency imbalances. While I read in the paper today that the administration has done a pretty good job in negotiating with the Japanese in an effort to internationalize the yen, beyond that, the strength of the dollar continues to be a plague upon American exporters.

Protectionism is still a problem that needs to be dealt with at the summit so as to strengthen our collective resolve to resist the temptation of protectionism.

The question of subsidies shall persist how we deal with the problem of other countries dumping or subsidizing their industries, giving them not only a competitive advantage in the world market, but even within our own market. One need only look at the tremendous numbers of filings before the International Trade Commission to realize the problem of subsidization—increasing numbers of companies feel that other countries are indeed subsidizing their industries which results in injury to our own domestic industries.

Export control policy continues to be a persistent problem, and all of the Europeans with whom I have met, and perhaps Mr. Hamilton since he is our resident expert on European policy, stress problems of the extraterratorial reach of our foreign policy controls. What we are attempting to achieve through Cocom has certainly left a sour and bitter taste in the mouths of many of our European allies.

Finally, the issue of trade services is an emerging question which in the past has not been covered by GATT, but certainly needs to be confronted.

CONSENSUS ON U.S. ECONOMIC POLICIES

I guess my question, Mr. Wallis, is whether we are approaching the London conference with this idea of consensus among all the countries on the President's economic policies, and thus present basically a public relations forum in which the seven leaders are going to put forth the very best possible image, because it always brings political benefits at home, or whether we are willing to seriously address the many economic problems that exist in the world today.

Are we going to recognize these problems or go in and say that the President's economic policies are indeed successful and are to be emulated by all other member nations.

Mr. WALLIS. Well, now, the point of view you express is somewhat different than the one I expressed, quite different. I didn't realize you were going to make so many points all at once, or I would have listed them, because most of the ones saying you disagreed with me, I would disagree with you, and I would counter by bringing out my evidence.

The broad point you raise is the degree to which there is an agreement on the basis of what economic policy ought to be, and that is very, very striking, as you travel around the world, and indeed, not just in the summit countries.

Everywhere you now hear people talking about liberalization, decentralization, the necessity of reducing the scope of government, of diminishing governemnt regulations, government intervention, of controlling government expenditures.

In India last year I had somebody quoting Adam Smith to me. While I didn't think the quote was quite right, I thought it was rather interesting they are thinking that way.

Mr. BONKER. Mr. Wallis, is there agreement that the interest rates in America today have a profound influence in international economic matters?

Mr. WALLIS. I haven't come yet to that part of your remarks. I am talking now about the earlier part of your remarks, the basic question of whether there is agreement on really basic fundamentals.

And there, I think, there just certainly is. Even a socialist country like France is talking in very much the same terms as President Reagan or Prime Minister Thatcher or the other leaders. They are all very much in accord on the fundamental principles.

Now, of course, there are some differences. What would be the point of getting together if all they came to do was simply congratulate each other and be "yes" men, and the point, in general at a summit meeting there is a sense in which they do not really discuss the really important issues, because they are in total agreement on them.

They will not discuss issues like whether people should be put in jail without a hearing, whether they should have the right to express their opinions freely, because there is no disagreement, no use talking about that kind of subject.

Similarly, on economic policy they will not be discussing these basic issues, except certain ones like structuralization.

Now, when they get around to what is the state of affairs in the world today, which is one of the things they will try to do, how strong is the recovery, what are its weaknesses, what are the dangers we see ahead, sure enough interest rates and the fact that they are rising currently is one of the problems.

But there, again, you will have an agreement. All seven of those people are going to be in agreement that interest rates are too high, that rising interest rates——

IMPACT OF HIGH U.S. INTEREST RATES

Mr. BONKER. Interest rates in America are too high. They are certainly not too high in Japan.

Mr. WALLIS. Whether they are made in America is a complicated question in economic analysis which I cannot go into today.

Mr. BONKER. It seems to me the Europeans are concerned primarily by the magnitude of foreign investment in the United States, investments drawn here in part by our high interest rates. That has to be a source of concern for Europe.

Mr. WALLIS. They do a lot of scapegoating, I must say. There are a large number of factors that account for the high interest rates in the United States today.

One of them certainly is the strength of our recovery, that there is great demand for investment now because the economic recovery is going very well here.

There are a variety of others, which, as I said, I guess I better not attempt to go into the substance of all these issues here.

But at any rate, we don't really accept the argument that the dificit is what causes the high interest rates, although we are very strongly opposed to the deficit.

CAUSES OF HIGH INTEREST RATES

Mr. BONKER. What do you see are the other contributing factors to high interest rates?

Mr. WALLIS. I think expectations of inflation are an important factor. You may say, well, why would people expect inflation when it has been under control for a couple of years.

I think they look at the record. The United States has essentially eliminated inflation four or five times since the Second World War, and each item it has been followed by an even bigger inflation than the one eliminated.

HIGH INTEREST RATES AND FOREIGN INVESTMENTS

Mr. BONKER. Would high interest rates necessarily draw foreign investments? It seems to me we are in an ideal situation when we have low inflation and high interest rates.

Mr. WALLIS. High interest rates will draw foreign investment. If they are higher here than elsewhere, some investment will flow here. It flows here for a great many reasons.

The returns on investment are better here than in other countries. The prospects for political stability and security are better here than anywhere in the world, the so-called safe haven effect, that anybody in the world that has capital wishes they had it here, and tries to move it in here for a variety of reasons.

So there are a lot of factors that contribute to the high interest rates. There is no doubt that the high interest rates are a problem.

Mr. BONKER. You don't think that will be an issue raised by our European friends?

Mr. WALLIS. No; I was saying that will be one of the things we all talk about, because that is one of the things we all see as a problem in the economy today, all seven countries, eight if you count the EC, because here are eight participants.

EXPORT CONTROLS AND EXTRATERRITORIALITY

Mr. BONKER. What about export control policy? Virtually everybody I have talked to in Europe is concerned about our export control policy, the extraterritorial reach of our export control laws. You don't see that as an issue to be raised?

Mr. WALLIS. I think there may be some discussion of that. You are right, there is a great deal of concern about that issue. I do not think—you mentioned COCOM.

I think that is one area where it has worked out pretty well, where the countries get together and agree on what controls should be exerted.

I think the problems come more in other types of controls, where there is not mutual cooperation and agreeing on what will be controlled.

There is concern about that. We have concern about that, too. And about activities on the parts of other countries that have extraterritorial effects on us.

I don't think that probably will come in for a great deal of discussion there, mainly because there is a lot of work going on at lower levels, much more technical detailed levels on those issues.

Mr. BONKER. I might add, most of the work going on within the administration is to tighten controls, is to make it more difficult for American exporters to place a greater burden upon other companies that do business with America.

So if we are moving in any direction at all it is one that is going to upset them even more.

Mr. WALLIS. The work I was referring to is work going on with other countries to minimize the difficulties and frictions and misunderstandings that arise out of so-called conflict—basically it is conflicts of jurisdiction.

It is an arguable point sometimes whether it is extraterritoriality or not. But there is a great deal of work done. It has to be handled differently for different types of problems.

Antitrust, criminal actions, security actions, drug control, control of military equipment—all of those things are being handled differently.

What we are doing is trying to work in concrete detail with other countries and work out procedures that will minimize the troubles.

Another range of problems that I know you are very much involved in I have not touched on.

Mr. HAMILTON. Mr. Winn.

Mr. WINN. Thank you, Mr. Chairman.

Thank you, Mr. Wallis.

PREPARATIONS FOR LONDON SUMMIT

I think on page 3 of your testimony you covered pretty succinctly the information, some of the information that my colleague from Washington referred to, in your second point. You said "one of the chief tasks at London will be to explore ways to sustain convergence of summit country economic performance," and so on.

And No. 2, "to promote stable, moderate monetary regrowth, thus inducing lower interest rates and increasing confidence that inflation will be contained."

Obviously this is going to be one of the issues that will be discussed over there.

Let me get a little background, if I may.

In preparing for these summit talks, what do the various people do other than the discussions that take place on the ministerial level. The subject matters are proposed, each country puts forth something in advance.

Because you are sure not going to cover it all in a 2-day period of time. Could you tell us that?

Mr. WALLIS. Yes, I would be glad to try to describe the process.

Mr. WINN. Just briefly.

Mr. WALLIS. Yes. I may want to turn to Ambassador Morris because he does the most of this than anybody. Each of the eight participants has what is called his personal representative who works on the planning in advance, the PR's. As you know they are referred to as sherpas, since they are supposed to guide the leaders to the summit.

And each sherpa has two colleagues, two associates—one finance person, and one foreign policy person, usually somebody from the Ministry of Foreign Affairs, and somebody from the Ministry of Financial Affairs—a team of three. And then, of course, they are backed up with, as we are within our own Government, by a much larger group that works on the summit.

There is a summit team at the White House. But the sherpas are the central point. And they meet beginning in the late fall. They have a preliminary meeting at the conclusion of the previous summit.

But they begin to meet in the late fall and talk about the general structure of the summit, things like where it will be, when, how much time will there be, how long will it go on, and find out at that preliminary meeting what subjects each person thinks his principal will want to introduce.

Prior to that first meeting, each of us has a meeting with his prime minister or president or chancellor, in one case, to get guidance on what topics they would like to have brought up at the summit.

Then they get together and put all these down. They tend to overlap. They are very close.

So then they start working at later meetings on what will each country say about that, what would you like—they will ask us, what would we like to see come out as a final statement?

And we will try to put down what we now think the President would like to see at that stage. And the others will indicate that kind of thing—well, they are not totally consistent. Mr. Bonker brought out they don't come there in total agreement.

So then there gets to be work back and forth. And sometimes it results in working groups being set up to try to reduce differences, or sometimes the summit itself when it meets will decide there are areas they cannot agree on, and they therefore better do some intensive work before the next summit.

That is about the way it goes.

RELEASE OF FINAL STATEMENT

Until the Williamsburg Summit, until President Reagan changed it. It used to be that they wrote the final statement beginning along about March, and by the time they got to the summit the final statement, telling what they said, had already been written.

And President Reagan said when he went to his first meeting he was astonished that they opened the meeting by looking at a document that purported to tell what they had said, when they had not yet said anything, so the rest of the meeting consisted of discussing that document.

He didn't want that. He wanted a meeting where they discussed things substantively. So he abolished the prenegotiated communique, and we really did not do any preparation of the communique until after the first day, and we worked all night after the first day's meeting.

The British are following very much the same pattern at this summit. In almost every respect they are copying the innovations President Reagan made for Williamsburg, because Williamsburg is generally regarded in all these countries as having been an extremely successful summit meeting.

DEGREE OF CONSENSUS AT SUMMITS

Mr. WINN. As I remember the Williamsburg conference, basically all of the leaders were in agreement on the problems that we all faced from an economic standpoint. There were no great disagreements, no leaders of any of those countries were going to go down there and come away from there being embarrassed.

And I think we all understand that. There were some disagreements and some of those disagreements were brought forth in outside press interviews, either prior to or right after the Williamsburg conference.

But it was no big deal. I think I remember that it was the French—Mitterrand—who spoke out later on disagreements at Williamsburg.

But my point is——

Mr. WALLIS. After Versailles there was a great deal of that. But I don't recall any after——

Mr. WINN. There was a little bit after Williamsburg, too, if I remember correctly.

Well, my point is that there is room for disagreement. But nobody is going to try to embarrass anybody else at a conference of that type.

UNEMPLOYMENT AND EUROPEAN ECONOMIC RECOVERY

Let me go on to touch on several things that you did not touch on.

One, I am the cochairman of the U.S. Delegation which meets with the European Parliament Delegation twice a year. Trade, of course, is one of the big discussions that we have in every meeting.

Unemployment in Germany and other European countries is another one. You did not touch on that. Do you touch on that?

You must consider that when you are talking about the economy, because it is certainly tied in.

Mr. WALLIS. Yes. I think there will be heavy emphasis on that, and it will come under words like structural adjustment.

The Europeans are tremendously impressed with what has developed in the United States economy. They are impressed not just by our recovery. They have a recovery, too, not as strong. Canada is almost as strong.

Mr. WINN. Doesn't their recovery usually follow ours?

Mr. WALLIS. Not necessarily always. But this time they are lagging behind us. But the important thing is we are getting a substantial reduction in unemployment and we are getting a big creation of new jobs, a quarter of a million last month alone.

They are getting none of that. They have no more jobs in Europe now than they did 12 years ago. Unemployment has risen every year for the last 12 years.

Canada, although it has almost as good a recovery as we have, has made very little dent in its unemployment problem. So all these other countries are enormously impressed with the United States performance, not just in its recovery, but in building employment opportunities.

And they attribute that, whether correctly or not, I don't attempt to say, it is certainly an important factor—they attribute it to what they call flexibility and mobility and lack of rigidity and structural things being fixed rigidly and structurally.

And so they are all concentrating on the idea that the major problem in the world economies today is to eliminate structural rigidity, as they call it.

So there definitely will be attention to the unemployment problem. It is the rest of them that are most concerned about it. We are concerned about it.

But our concern is nothing like theirs, where nothing is happening.

Mr. WINN. Well, it is the highest in history in West Germany.

Mr. WALLIS. They are getting some recovery, but no reduction in unemployment. While our unemployment is too high, at least it is coming down.

ECONOMIC RELATIONS WITH SOVIET UNION

Mr. WINN. Let me ask one last question. On page 7, you talked about the goals that are simple and straightforward. And you mentioned several things.

One, you said, on prudent economic relationships with the Soviet bloc countries. Embellish that a little bit, will you?

What do you mean by that, and what exact subject matters are discussed? Can you discuss those in open session?

Mr. WALLIS. Yes; I can. I think there won't be much discussion of that at the summit for the simple reason that a general increasing consensus has been developed through work at the organizations I listed there, the Organization for Economic Cooperation and Development, the International Energy Agency, NATO, and so on.

But the real point is that we want to have trade with the Eastern bloc, and with the Soviet Union, to the extent that it is mutually advantageous, that it should be carried on, except if our trade is contributing to their strategic advantage, thereby undermining our security, and thereby causing us to spend more and more money on defense—then it is very foolish for us to contribute to that. And while we may forgo a little profit by not doing that kind of trade, we also forgo a whole lot of expense in defending against what they build up.

So what we are saying there is that the trade ought to be prudent, carried on as far as you prudently can without jeopardizing your security. And that is where some of the friction that Congressman Bonker raises, as to where is the line between what jeopardizes your security and what doesn't.

Mr. WINN. Thank you very much.

Thank you, Mr. Chairman.

Mr. HAMILTON. Mrs. Holt.

SUPPORT OF U.S. ECONOMIC POLICY

Mrs. HOLT. Thank you, Mr. Chairman.

I certainly feel that you, Mr. Wallis, have outlined very well the efforts that the administration is making to improve our economic situation. And I agree with them wholeheartedly, even though my colleague from Washington doesn't.

I think we have demonstrated that this is the way to move, to start stable economic long-term growth without the ups and downs that we have had over the past years.

I had the opportunity recently to meet with a panel in Europe, European Community members, and there each one had to take a swipe at the United States. They wanted us to reduce our deficit, to bring our interest rates down, to spend more for defense, have a weaker dollar, do more for the Third World nations, and the reasons that they gave for not being able to do all of those things was that they had political problems.

So I am sure that you will run into the same kind of thing. But then when each finance minister talked about what he was doing in his country, it sounded as if they were patterning themselves absolutely after the Reagan economic plan or Mrs. Thatcher's plan.

So I think that we all are working toward trying to develop an economic recovery, and that we are moving in the right direction.

DISCUSSION OF TRADE AT LONDON SUMMIT

My concern is recently before the Joint Economic Committee we had some testimony about our trade policies. Several witnesses testified that we ought to subsidize more in this country, we ought to have a whole new institutional development for trade.

And then one witness who was a former director of GATT said he felt we had everything in place to do the job if we would use it, if we would enforce GATT, if we really would speed up the judgment of cases that were involved, if we really would try to act on them, that we could solve many of our differences in trade policy.

Do you feel that this will be brought up or will this be discussed? How do you feel about that?

Mr. WALLIS. I think there definitely will be extensive discussion of the trade issue. This is one of the issues where there is less than complete agreement. Everybody agrees that we do need to free up our markets, and that world trade is probably—the growth of world trade since the Second World War probably has more to do with the unprecedented prosperity of the recent 40 years, the last 40 years than any other one factor.

But there are these protectionist devices coming in, and there are different ones, many of them different ones than GATT deals with.

INADEQUACY OF GATT REGULATIONS

Mrs. HOLT. Yes; But if we just enforced the regulations, the agreements we have today, wouldn't we overcome all of this protectionist tendency.

Mr. WALLIS. I am afraid not. I think it would help if we enforced them all. GATT doesn't make any restriction on subsidies, for example, hardly any, doesn't deal with the problem we have with European agriculture. They are subsidizing agricultural exports heavily, and Europe is producing a lot of things that it makes absolutely no sense for them to be producing.

People don't believe it when you try to tell them Europe has become one of the largest wheat exporters in the world, or that they are exporting chickens in huge volume in the Middle East.

Well, they would not be—England is exporting barley for the first time since the corn laws were repealed in the 1840s, because of the subsidies involved in the European agricultural policy.

GATT doesn't deal with that.

SUBSIDIES FOR U.S. EXPORTS

Mrs. HOLT. Yet when we subsidized our grain shipments to Egypt, there was a hue and cry from France.

Mr. WALLIS. We do very little of that. We subsidize some things and we store them. We don't dump them on the world markets.

And we occasionally take a well selected market where there is reason, as in Egypt's case to think they couldn't have bought it anyway, they didn't have the funds, so it did not harm our competitors. There have been one or two where we have deliberately, as we say, fired a shot across the bow, sold things where it did harm competitors to get their attention to the fact, see they don't like it and we don't like it either.

But there are major problems there. And the results is the strong feeling that there needs to be what is referred to in the international language that gets pretty complicated, as multinational trade negotiations, usually called MTN. Sometimes you will hear it said as a new round of trade negotiations, like the Dillon round, the Kennedy round, the Tokyo round, and so on.

NEED TO ENFORCE EXISTING REGULATIONS

Mrs. HOLT. That was the point I was making. The testimony we had is if we would enforce what we have today we could be in far better position rather than do as we usually do here in the Congress; when we want to reform something we add another layer of bureaucracy and don't bother to enforce what we have that really would work.

So I would strongly urge you to try to express the view that we do need to enforce those regulations that we have at the present time.

NECESSARY MEASURES BEYOND THE GATT

Mr. WALLIS. Well, we do in the GATT.

Bill Brock, Ambassador Brock, we do try to get the GATT to work better. But we also feel that a lot more is needed than just what GATT can do. Both what you say, that we would be a lot better off if we could make the GATT work better, but beyond that we really need a lot more.

We need to cover trade in services, need to cover the subsidies issue, need to cover quotas and physical restraints. Sometimes what passes as health standards are nothing but restrictive devices. All of those things need to be dealt with—in addition to what the GATT has tried to do.

We have pretty well eliminated the tariff problem.

Mrs. HOLT. Thank you.

Mr. HAMILTON. Mr. Bereuter.

NEW ROUND OF TRADE TALKS

Mr. BEREUTER. Thank you for your testimony today.

Two weeks ago at the OECD Ministerial, the 24 member countries I understand agreed that a new round of multilaterial trade negotiations was "of the utmost importance to a strengthening of a liberal trade system".

The Williamsburg testimony I recall gave priority to consideration of what we should have a new round. And I would ask therefore first, has the administration decided on the need for a new trade round?

Mr. WALLIS. We feel that a new trade round is highly desirable, very important for opening up world markets. I know that the President will be arguing that position with his colleagues.

And we know that many of the others will be supporting it. The issue really will not be should there be one. It will be more like when should it be—is it too soon, should it be delayed for a year or two.

We think it should not be delayed because once you decide to do it, we will urge that a decision be made. But once you decide, it will take quite a while to do it.

PARTICIPATION OF U.S. TRADE REPRESENTATIVE

Mr. BEREUTER. If that is our position—I am glad to have that clarification, I hoped that might be the response—and if discussion about a new round will be one of the centerpieces or prime items at the London Summit, wouldn't it be appropriate to have Ambassador Brock there to show the United States commitment to the preparation for a new round?

Mr. WALLIS. The question of participation in the summit is always a complicated one. Basically the summit is a meeting of the heads of Government.

In their plenary sessions each has two other ministers with him—his finance minister and his foreign minister. And we have problems.

There are occasions when the Secretary of Commerce would be appropriate, when the special trade representative would be appropriate. The Germans and the Japanese have worse problems because they have coalition governments and members of one party don't want members of the other party there unless they are always along.

So there is the issue of how Landsdorf in Germany and the Miti ministers from Japan, these are always touchy issues. But it always been held rigidly to three.

Mr. BEREUTER. I realize that. But I hope some consideration can be given to that arrangement.

Mr. WALLIS. They participate extensively in the preparations. While we have this three man team, we have co-opted nonofficially a member of STR Bill Brock's staff, who has met with us, the U.S. delegation, in all our preparatory work.

INCREASE IN PROTECTIONISM

Mr. BEREUTER. Last year at the Williamsburg summit participants committed themselves to halting protectionism. And yet Japan has maintained an elaborate system of trade restrictions, particularly on high technology.

Something that catches my attention—current EC consideration of restrictions on corn, gluten and other corn meal products. I think it is fair to conclude that protectionism has worsened since June of 1983.

CAUSES OF U.S. PROTECTIONISM

I would like your opinion. Why have protectionist forces in the United States increased during a period of time when we have an economic recovery? And in part, I am asking you to comment upon actions of the Congress itself, when we pass, for example, domestic content legislation in the House. But I am not exclusively pointing to that as an example.

Mr. WALLIS. Well, let me say first the general feeling of the people preparing for this summit is that those commitments have not been satisfactorily carried out that you read from. As to why they haven't, I think you would be a far better judge of that than I am. I think it is basically these questions of trade are domestic, they are not really international issues, they are domestic issues. If one group in this country wants to get the better of another group in this country, so instead of letting some group in this country buy what they would like to buy, the other group wants to force it be bought from them and use the power of law to bring that about.

In other words, it becomes a political question, not an economic one as to who has the power to prevent people who he would like to have as customers from buying a product. I think you would be a better judge than I would.

I would like to make one remark, I agree with you, I think you are right, that protectionism has been growing but when people challenge me as to what is my evidence, I don't have any. There are always protectionist pressures. They always point out to me there have always been every year, and I think it is very hard to quantify. Just the same, I think it seems to me the pressures are stronger.

AGRICULTURAL TRADE PROBLEMS WITH EUROPEAN COMMUNITY

Mr. BEREUTER. I have just one more observation to share based upon something Mrs. Holt brought up. I was one of the congressional observers to the November 1982 GATT Ministerial in Geneva. I think almost all of us there had a particular interest in agricultural commodities of some kind and we were sent there in some ways to sort of beat on the table ahead of time with the Japanese and the European Economic Community. We came away so frustrated at the lack of significant gains except that the issues of agricultural export subsidies would be considered in a study. I think most members who have an interest in the area applauded the sale of the million metric tons of wheat flour to Egypt as a specific shot across the bow of the French frigate.

It was aimed directly at France with intention. I don't want to back away from the perception that I think was here at the congressional level to suggest that it was anything else but a very specific attempt to send a message to the French. I had the hope and the feeling that that was the intention of the administration as well.

Mr. WALLIS. That was what I had in mind when I referred to the shot across the bow.

Mr. BEREUTER. Thank you. Thank you, Mr. Chairman.

PRIORITY OF DEBT PROBLEM AT SUMMIT

Mr. Hamilton. Mr. Secretary, in looking over your key policies to achieve your objectives, which you list on page 3, the absence of any policy dealing with international debt problems struck me. We had testimony as I think you know from outside witnesses a few weeks ago, one of the things that impressed me in their testimony was their deep concern about the international debt problem.

I think I recall that Dr. Greenspan said that he thought it was the most serious single threat to the international economic system today, and he talked of it more in terms of being an insolvency problem than a liquidity problem.

So I am struck by the fact that you don't list the debt problem among your key policies although you do mention it later in your statement. However, you reaffirm the view that a case-by-case basis is the way to handle international indebtedness rather than through more fundamental changes.

Before I ask you to comment on that generally, I just throw in this additional comment, that it seems to me that the Federal Reserve has a somewhat different approach on the question of debt than does the administration, a difference in the sense that they express more concern about the seriousness of the problem and are talking about some fundamental changes in the way we ought to deal with that.

So part of the question I am raising is whether there is a split, between the administration and the Fed on the seriousness of the international debt problem. Another part of the question is why you don't list the international debt problem as one of the key policy objectives at the summit?

Mr. Wallis. Let me clarify that last first. At the top of page 3, I say one of the two chief tasks will be one, to bring about convergence of economic performance. Then on page 5, the middle of the page, one of our main objectives will be to confirm the debt strategies. As the two main objectives there, one on the economic performance of the world, economic welfare and the other on the debt problem.

FEDERAL RESERVE AND ADMINISTRATION POLICIES ON DEBT ISSUE

On the question of, is there a split between the Fed and the Administration, not that I know of. I wonder when you refer to the Fed if you are thinking about that conference that the New York Federal Reserve Bank had in which most of the statements that attracted the news were simply made by outside speakers at the conference?

Mr. Hamilton. Yes; I was thinking of that same conference where they recommended that the real interest rate on the debt be separated from the inflationary component. But I think Mr. Volcker has spoken, has he not, in terms of a cap. The administration has not, and I just have the sense that the Federal Reserve are more deeply concerned about the international debt problem than the administration is.

Mr. Wallis. No, I certainly don't think they are at all. We are the ones that have been bearing the brunt of that problem and the Treasury, particularly, and Under Secretary. There was a statement without the source being given in the newspapers, but an official backgrounder was held I think at the White House last Friday, in which there was indicated that the issue of things like capitalizing the interest beyond a certain level, that the administration's attitude is that is strictly a matter between the debtor and creditors, we are not debtors or creditors in those cases so it is not up to us to tell them what to do, and the statement was made that we are interested if they want to get together and work out something, that is fine.

Mr. HAMILTON. But that reflects a difference in your analysis of the priorities or the urgency of the problem. You are saying in effect you can work it out by having the debtor and creditor get together. The Fed is saying that the problem is so serious that you are really going to have to fundamentally change the way you approach it.

Mr. WALLIS. What our statements reflect is that those banks are private banks, not Government banks, and the Fed is a Government bank, but the banks that are talked about for capitalizing interest are private banks, so we are saying the Government cannot try to run the private banks. The Government has been very active in all of the beginning with the Mexican problem in August of 1982, the administration has been extremely active. The debt problem is one that we think we have the feeling is under control and the five-point policy outlined in Williamsburg which in fact was in effect before Williamsburg is working but everybody is nervous all the time.

GOVERNMENT INTERVENTION WITH PRIVATE BANKS

Mr. HAMILTON. You say the Government doesn't step in with regard to private banks, but the Government didn't hesitate to step in in the instance of the Continental Illinois case. They certainly stepped in there and not only assured deposits up to $100,000 but said the Government was going to ensure all deposits and that we are not going to let Continental collapse. That is a case where the Government, this administration, intervened very heavily in the private banking system.

I don't want to argue about whether that was a wise or unwise decision, I haven't sorted all that out in my own mind yet, but you certainly jumped into the private marketplace.

Mr. WALLIS. Well, the point I was making earlier is that we don't try to manage the private banks so that——

Mr. HAMILTON. Just save them.

Mr. WALLIS. Well, that is what the FDIC was established for.

Mr. HAMILTON. To save private banks when they get in trouble?

Mr. WALLIS. Depositors.

Mr. HAMILTON. They only save the big ones.

Mr. WALLIS. No, no, FDIC? Oh, no, they have lots of small banks.

Mr. HAMILTON. If a small bank in southern Indiana got in trouble and had a run on its deposits, my guess is that the FDIC wouldn't act and assure all the depositors that their deposits were going to be fully covered.

Mr. WALLIS. I am not up on any detail there but I think we can find a dozen cases in the last dozen months where they have done exactly that. Little ones don't make the headlines. If you are watching that sort of thing you do see them listed all the time, little banks that the FDIC has taken over, forced a merger, otherwise saved depositors up to a certain, depositors up to a certain sum, $100,000.

Mr. HAMILTON. I think you will find that the FDIC has let about 30 small banks go under, Mr. Secretary, and there has in effect been a double standard in the case of Continental. I know that is a complicated question.

Mr. WALLIS. Outside of my sphere.

ADMINISTRATION POLICY ON INTERNATIONAL INDEBTEDNESS

Mr. HAMILTON. It is not in your field. I assume that in regard to the international debt problem, the administration rejects the various proposals that have been made to separate the real interests from the inflationary components, the various insurance schemes that have been put forward, and the caps that have been proposed. It is the administration's view that each debt situation has to be worked out individually on a case-by-case basis.

Mr. WALLIS. The latter statement is true, we haven't taken a position on the caps, we haven't rejected them or——

ROLE OF WORLD BANK

Mr. HAMILTON. Do you see a greater role for the World Bank in the debt situation at all? Should it provide more resources to debtor countries?

Mr. WALLIS. On the whole, we think there ought to be a separation there on balance of payments probably between the IMF and the World Bank, but we do think—I think there will be some discussion of this at the Summit probably as to whether the World Bank couldn't be more supportive of the kinds of changes that the IMF brings about.

Usually when the IMF moves in, it is because these countries are having problems with debt, it is almost invariably that they have extremely bad domestic economic policies. Other countries with the same problems have nothing, have not had to turn to the IMF and we feel that the World Bank in making its development loans could pay more attention to the quality of the economic policies within the countries to which it makes the loans.

Mr. HAMILTON. Do you see the need for additional World Bank resources?

Mr. WALLIS. Not at the present time. I have forgotten when the present—May 1986, that the present capital replenishment runs out. Do you have the date for that?

STATEMENT OF ROBERT J. MORRIS, DEPUTY TO THE UNDER SECRETARY FOR ECONOMIC AFFAIRS, DEPARTMENT OF STATE

Mr. MORRIS. For the selective capital increase, the administration is putting up a bill on that.

IMPORTANCE OF STABLE MONETARY GROWTH

Mr. HAMILTON. Let me ask also with regard to one of the policies you state on page 3, you are relating to money growth or monetary growth. You say you believe one of the key policies to achieve the objective of higher growth and lower inflation is to promote stable and moderate monetary growth, thus inducing lower interest rates.

Now, do you think that is the present Federal policy?

Our interest rates are going up, not coming down.

Mr. WALLIS. Yes. I don't think you can judge simply from that, can't evaluate the Federal policy simply from that because they are going up. You might say their policy is keeping them from going up more or you could say that is what causes them to go up. And I won't attempt to pass any judgment on that.

The point to this proposition is that expectations of inflation develop because of higher interest rates. It has also been argued by some of the technical people that study these things in minute, complicated detail that volatility in the money supply given a certain average rate of growth over a year or 2-year period, that if there is volatility around that average that that will make interest rates higher than if there had been steady growth.

INCREASE IN INTEREST RATES

Mr. HAMILTON. The point that strikes me is that when you talk about one of the key policies being a stable moderate monetary growth which will induce lower interest rates, that is one of our objectives for the Summit. We are going to encourage the other countries to do that.

Look at what is happening in our country. Interest rates are going up.

Mr. HAMILTON. We don't come with clean hands then on that argument to the Summit, do we?

Mr. WALLIS. Of course, they are going up in the other countries, too, but they are rising worldwide. Rates won't go up much in one country without going up in the others.

SURVEILLANCE PROCESS FOR SUMMIT COUNTRIES

Since the Versailles Summit, there has been the so-called surveillance process. There has been a reference to here where the finance ministers or actually deputies of the five SDR countries; that is, all Summit countries except Italy and Canada, meet periodically with the Director of the IMF and evaluate each other.

First, they describe what their policies are and what has been coming of it and what their aims and intentions are. And then they evaluate each others performance and the Director of IMF in effect grades them good, bad or indifferent—not quite that simple. He passes judgment on them and makes criticism of their policies and makes suggestions for improvement.

CONVERGENCE OF ECONOMIC PERFORMANCE

An objective, when that was launched was to get a greater convergence in the economic performance of these various countries so that exchange rates would be more stable; that when you have wide difference in rates of inflation, then you get exchange rates moving and also to get more stability in exchange rates.

Since that process was then strengthened at Williamsburg and it is being strengthened still further, it has proved fairly effective, the participants feel, and there has in fact been on the record a substantial convergence of the rates of inflation in these countries and downward. They have all moved down and come closer together.

Mr. HAMILTON. Mr. Bonker.

PROTECTIONISM IN THE UNITED STATES

Mr. BONKER. Mr. Wallis, let's briefly go over the Williamsburg text. We won't dwell on it, but the first point concerned appropriate monetary and budgetary policies. We have already discussed that area and I think both the legislative and executive branches can take equal blame for our inability to deal more effectively with those problems.

We agreed to pursue closer consultation of policies affecting exchange markets and marketing conditions and I will assume that we are meeting our commitment there.

In point No. 3, we committed ourselves to halt protectionism by dismantling trade barriers and consulting with appropriate existing fora on ways to implement and monitor this commitment. I have no doubt about this administration's commitment to free and fair trade. And I have worked closely with your colleagues in the executive branch to bring about such a trade policy. But the fact of the matter when it comes to steel, textiles, motorcycles, and machine tools, is that this administration really has been protectionist oriented in many of these vital areas.

What do you say when you consult with our allies to whom we have a strong commitment here on resisting the temptation of protectionism and yet in major areas we are in effect protectionist in our policies?

Mr. WALLIS. The fact that they say very little about those subjects because they are so much more vulnerable than we are that they don't care to invite our comments.

Mr. BONKER. Is this a charade? We have a document here in which we say that we commit ourselves to halt protectionism and dismantle trade barriers. What has this administration done with respect to trade barriers?

Mr. WALLIS. Well——

Mr. BONKER. Other than Brock's statement about voluntary restraint on quotas on automobiles?

Mr. WALLIS. To mention a number of protectionist actions that have been taken, if you compare that with the number we have declined to take, the record looks quite a lot better. There have been many more that we have declined than we have taken.

The point here, however, I mentioned earlier, I think it was in respone to Mr. Bereuter's question, that there is a feeling in the Summit preparations, at any rate, that the Summit leaders have to face up to the fact that that particular commitment has not been fulfilled to any appreciable extent.

We have the feeling it is simply——

COMMITMENT TO HALT PROTECTIONISM

Mr. BONKER. Can we acknowledge next time around rather than just glossing over these things and saying we commit ourselves to resisting protectionism and we are all for free trade and so forth—to say the protectionist is a problem and that member nations ought to resist the temptation?

Mr. WALLIS. When they said we commit ourselves to halt protectionism, did that convey to you any impression they might consider protectionism a problem that ought to be halted?

Mr. BONKER. Then, I think we have to acknowledge that protectionism is a way of life which we must resist. But, let's not dwell on that.

Mr. WALLIS. Let me comment on one thing. I think one of the sentences we have is that when you deal with these things one item at a time, let's say motorcycles, the motorcycle issue comes up. To those people to whom it makes any difference, it makes an awful lot of difference. And they can bring a lot of political clout to bear.

To the rest of the public it makes very little difference.

Mr. BONKER. I understand.

Mr. WALLIS. So it has a chance of getting through. One by one these protectionist measures can be taken, but if you can come in with a comprehensive program and say we are going to get rid of all of that stuff, then the people that got the benefit from the motorcycles begin to see if they got that benefit, they get so much benefit from the 150 things that might be changed, that you can get their support.

So that actually becomes easier to do these things on a broad comprehensive basis than it is to do them one item at a time.

Mr. BONKER. Well, I would suggest at the next Summit that we also look at the problem of subsidies and dumping because the numerous findings before the ITC, which are considerable indicate the magnitude of the problem. That says a lot about what is happening in the world economy today. While I am not unrealistic, nor am I idealistic about free trade, because I know it doesn't exist, I do think that we ought to deal with these problems realistically. To say that we are for lower interest rates and against protectionism is really a safe noncontroversial thing to say. To deal with these issues in a fundamental and effective way is entirely something else.

U.S. COMMITMENT TO DEVELOPMENT ASSISTANCE

One other point, then I will relinquish my time. In the Williamsburg Summit, point No. 6, recognizes the problems of LDC's in particular in view of the huge inducements of many nations, and suggests that one way to deal with that is to increase bilateral economic assistance, development assistance to poorer countries and for food and energy production bought bilaterally and through appropriate international institutions.

We reaffirmed our commitments to provide agreed funding levels for the International Development Association, IDA, the World Bank. If the administration is to receive a failing grade anywhere, it is for its lack of support for IDA. Again, a fundamental commitment was made at the Williamsburg conference. This is very explicit language and yet when the chips are down, this administration came up woefully short of its commitment to adequate funding levels.

INTERNATIONAL DEVELOPMENT ASSOCIATION FUNDING

Mr. WALLIS. I think you are confused on that. We made good on that commitment. That refers to IDA-6, a commitment made by the Carter administration which they didn't fulfill or come anywhere near fulfilling. When this administration came in they didn't like it. They felt they were stuck with the commitment of the U.S. Government and pulled out the stops to manage to get that through Congress although it took them a long time.

Mr. BONKER. Let's talk about specifics. It seems to me the Carter people were committed to almost a billion dollars over a 3-year period and the Reagan Administation dropped it to——

Mr. WALLIS. You are talking about IDA-7 now.

Mr. BONKER. IDA-6 and IDA-7 are essentially related. The fact is that the financial commitment is much less.

Mr. WALLIS. The commitment you referred to as IDA-6 in this Williamsburg thing, that was fulfilled completely.

Mr. BONKER. Well, then, the spirit of the commitment isn't being fulfilled in IDA-7.

Mr. WALLIS. We think the appropriation for IDA-7 is fully adequate. That was an issue as to how much money they can use effectively, and we went into that and came to the conclusion that the $9 billion would be adequate for their purposes. That is a long way from all the funds available for international development aid.

ROLE OF SECURITY ASSISTANCE

Mr. BONKER. What about bilateral assistance? We preside over the foreign aid bill and most of our bilateral assistance is going by way of military aid to these countries. Do you really consider security assistance as part of bilateral programs to developing countries?

Mr. WALLIS. I don't have the figures in mind on that. Certainly a lot of the international aid is concentrated on certain countries and also involves a substantial part. That is not what we normally think of the military aid when we think about international aid.

AID TO SUB-SAHARAN AFRICA

We think about aid to countries that are impoverished. Right now we are very much conerned, as you probably know, about Sub-Saharan Africa, because apart from their problems, they now have a big drought and we recently had the President of Botswana here and he and his staff told us, and I checked this later, that 90 percent of their food crop has been lost.

They are down to 10 percent. Fortunately that economy has been an extremely well-run one and they had devices. They are not starving. They have had a lot of help from us, but they have also been able to manage their affairs in such a way that they have been able to make sacrifices of other things and purchase food, but that has prevailed through a good deal of Africa and the President has recommended a half a billion dollar program for Sub-Saharan Africa.

WITHDRAWAL OF FOREIGN DEPOSITS FROM U.S. BANKS

Mr. BONKER. In closing, I would like to state that I agree with Chairman Hamilton's concern about what is happening to banking institutions. The problem with Continental has been the rapid or precipitous withdrawal of foreign investments in that bank. And while Europeans may feel that the LDC indebtedness problem is essentially an American problem because it is essentially American banks, these loans over the years—could well trigger a crisis in that institution, which is going to have real impact globally.

Again, I think it is a problem that has to be dealt with at the London summit. I know there are concerns about the level of foreign investment, but, on the other hand, to have countries rapidly pull out of their deposits in a major bank like Continental could precipitate a real financial crisis. I think it is a very tenuous and potentially dangerous situation, and I hope that it is going to be dealt with somewhere.

Mr. WALLIS. It is being dealt with, and I feel a lot better about it than I did a year ago. That is not, however, the kind of technical question that can be dealt with effectively at the summit. The best they can do, most effective thing they could do, is get reports from their finance ministers, which they will do, and give them instructions on methods of dealing with the problem.

BANK LENDING POLICIES TO DEVELOPING COUNTRIES

With regard to the private banks, one thing you want to remember, it won't be so many years ago that people in your position would have been criticizing the private banks for not providing enough money for the developing countries. That is where they put their money, was in large part in the developing countries. At a time when it looked like good investments, some of those developing countries did not use the funds very effectively. They did not——

Mr. BONKER. Excuse me. I would have to take some issue with that because this money went not necessarily to starving countries in Africa, but it went to the LDC's, and primarily Latin America and probably some Asian countries that I wouldn't put into the same category as the developing countries. But that doesn't excuse the banks for their lending practices. I know they had a lot of petrodollars to recycle, but nonetheless banks should retain conservative lending practices.

I think anybody who has looked closely at what they have done over the past 15–20 years, both with respect to LDC's and in terms of investments for loans for energy production, realizes that something of an imperative at the time—but nonetheless, the banking institutions are vital to our economic well-being. While you may not share my concern, I think we are at a very delicate stage and if a few of these larger banks have nonperforming loans and precipitous withdrawals of major deposits, I think we could have a real crisis on our hands.

Mr. WALLIS. Of course, I do share your concern. I think anybody following it has to. But I am not in any position to defend the private banks nor, for that matter, to accept or verify some of the factual assertions you have made. I simply don't know whether they are correct or not. It is not a field I have gone into.

I don't know, for example, what proportion of the loans to Latin America are from American banks and what proportion from non-American banks. I would be surprised, though, if your statement is—I think your statement is almost certainly correct. At least half of it came from American banks; well over half of it.

Mr. HAMILTON. Mr. Winn.

Mr. WINN. Thank you, Mr. Chairman.

Let me change the subject matter just a little bit.

GAP BETWEEN EUROPEAN AND UNITED STATES AND JAPANESE INDUSTRIES

How seriously, in your judgment, is the gap that many Europeans see between their industries and those of the United States and Japan?

Mr. WALLIS. Well, I think the point I mentioned earlier, that they are concerned about the rigidities, are valid. We have mentioned here two things separately that, in fact, I think are related. I mentioned earlier the European program of subsidizing agricultural production.

Mr. WINN. Yes.

Mr. WALLIS. And we mentioned the feeling that there needs to be structural readjustment to develop modern industry.

ROLE OF EUROPEAN SUBSIDIES

Well, there—in effect, those subsidies—we look at them as subsidies that may take away markets that really are rightfully ours. That is where we are more efficient producers. But they could be looked at in other ways. They are subsidizing people to stay where they are—not to make the adjustments that they need.

They don't seem to see the connection there that as long as they maintain those subsidy programs, try to prevent the declining industries from declining, trying to maintain employment at the same level it has always been, in the same places for the same activities—as long as they do that, they are simply not going to keep up with a country like ours.

Mr. WINN. Yes. But in discussions with the Europeans it is pretty obvious—was pretty obvious to our delegation in the last few years, particularly when subsidies become a big issue—that a lot of those subsidies, such as agriculture subsidies, were to try to keep the people where they were and keep them employed. Obviously, it was a political decision, very political.

Mr. WALLIS. Well, an unwise one.

Mr. WINN. The problem was, a lot of farmers like we have here—the farmers are going to the big cities thinking that is where the jobs and big money might be, and the employment.

Mr. WALLIS. Well, here both things have happened. Industry has gone to the country.

Mr. WINN. That is right.

Mr. WALLIS. And States like Iowa that you think of as typical farm States got more industry than they have got farming.

Mr. WINN. Well, my State of Kansas has got a lot of export farms out there.

Mr. WALLIS. North Carolina; many of these States.

Both have happened here. Industries moved to where the people were, and people have moved to where the industry was. And we have flexibility in a way that they don't.

POSSIBLE INWARD TURN BY EUROPE

Mr. WINN. Do you think that Europe might turn increasingly inward as a result of the fears of Asian competition and probable dominance?

Mr. WALLIS. I wouldn't have any way of judging that. It is certainly a danger, and it is reflected in these protectionist sentiments that they have. They are afraid to open up world markets because they think they would lose.

You can see why they think they would lose if they don't allow for the fact in that kind of competitive situation they would become far more efficient. That is, if now they are protected and they don't have to become more efficient, the Government subsidizes them to stay where they are and see that they get the same incomes. But if they were thrown into a competition more directly with the rest of the world, I think they would in fact become just as efficient as we are, or the Japanese. If they had the same kind of economic institutions that we have, they would have no reason to doubt they would be every bit as efficient. After all, they are the same people as here.

Mr. WINN. Well, it is interesting in retrospect to see how competitive French wines are now after the California and I suppose New York wines really made a dent in their market. And now there is a big move to try to get French wines into the United States at a better price.

Mr. WALLIS. Yes.

Mr. WINN. Interesting.

ACCOMPLISHMENTS OF SUMMITS

Now for a different question: How much is accomplished behind the scenes? I think all of us have some reservations or some questions about the formality of having the leaders get together, which I think is a good idea. But, behind the scenes, when the Secretaries and their spokesmen are getting together, is there much accomplished there, or quite a bit, or nothing?

Mr. WALLIS. I think you have put your finger on one of the probably bigger single advantages to summits and a sort of thing that leads people to say they were soporific and didn't generate any news and didn't do anything but put out platitudes. So, in fact, at Williamsburg this was one of the innovations that President Reagan made for running summits.

Over half of the total time there, the heads were all alone by themselves; nobody, not even their ministers, there. And during those sessions, they have a different kind of candid, frank discussion than they otherwise would have.

Mr. WINN. Was that off the record?

Mr. WALLIS. Yes.

Mr. WINN. No court reporter or anybody?

Mr. WALLIS. One of the first dinners, when it became apparent that they were going to want a statement made, the President personally took notes, and those notes were turned over to the Secretary of State. Then he was told to draft a statement that says what these notes say they wanted said. So they literally had no notetakers or anybody else. They had interpreters, because there are five languages at these.

Mr. WINN. So when you are saying that there is probably a lot more accomplished in the way of communications——

Mr. WALLIS. Well——

Mr. WINN [continuing]. Other than what we read in the paper, or——

Mr. WALLIS. Yes.

In addition, you mentioned the finance ministers and the foreign minister. They are there. And when the heads are meeting alone, they can also be meeting alone; and then beyond that these preparatory sessions in effect amount to a lot of exchange. That is, we get there and each of us has talked to his chief before he went. And so what we say isn't our personal opinion at all; it reflects the official opinion of our—in my case, the President—or the Prime Minister or the Chancellor, or whatever it is.

That also is a kind of preliminary exploration. So when they come together, their conversation is much more effective. They don't do a lot of thrashing around trying to explore the territory and find out who stands where. They know when they got there pretty well what their views were and are able to converge on the point of difference.

I have said myself a number of times, more than half-seriously, that if these people could get off by themselves on a weekend house party, like the house parties other people have, with no press hanging around and a lot of ministers hanging around, and have a genuine informal 2 or 3 days' free and easy give and take, that would be even more useful than the summits with their formal agenda and their communiques afterward, and so on.

ROLE OF PRESS AT SUMMITS

Mr. WINN. I think if I were covering it for the press, I would think those candid communiques and everything that are preagreed upon would be pretty dull news.

Do they try to go around behind the scenes and get separate interviews and pick up separate information and even make an attempt maybe to show there is a division of opinion, or difference?

Mr. WALLIS. Well, they certainly do. They try. But they don't have direct access. At Williamsburg, they were at the college, which was half a mile away. So anybody that wanted to talk with them had to go out from the summit from the Williamsburg proper and over there. And they simply weren't allowed inside Williamsburg proper.

At London, the meetings will be in Lancaster House, and the press will be kept a half a mile away or so, 10 minutes—they say

10 minutes. That will keep them from having that kind of generation of gossip and have remarks that are remarks from people who aren't fully informed.

Of course, they are always trying to find something—one person used this word, and another used this word.

Mr. WINN. With that format, unless they are trying to get something different, I suppose they might as well all get it off the wire services and not even go cover the event.

Mr. WALLIS. That is what——

Mr. WINN. Sounds like Dullsville to me.

Mr. WALLIS. That is what we tried to tell them before Williamsburg.

Mr. WINN. Not with all the leaders there. They are going to be there one way or the other.

Thank you very much.

Mr. HAMILTON. Mr. Bereuter.

Mr. BEREUTER. Thank you, Mr. Chairman.

IDA FUNDING

IDA was mentioned before, aid to Sub-Sahara, Africa. As ranking member of the Banking Subcommittee responsible for IDA authorization, I would like to give you a report. We passed from the subcommittee with unanimous vote the requested IDA authorization. It is now stalled by the chairman of the full committee.

It seems last year, we passed a housing program related to rental housing—HUD developed the formula—and by some quirk of the formula, Providence, RI is not eligible for the program. So the IDA authorization is held hostage until Providence manages to get some money, along with some other cities, and it will entitle some impoverished communities such as Brookline, MA and Newton, MA also to receive a substantial share of the money. So that is where our wonderful IDA authorization bill is right now.

Unless you think I am too partisan, let's take a look at what happened in the other body, controlled by Republicans, with the supplemental aid bill for Sub-Sahara, Africa, a simple little bill introduced on February 8 or 9. The $50 million increased to $90 million by the time they got through Christmas treeing it with locks and dams and the history of the U.S. Senate. The last I looked it was $1.3 billion, and last week, we finally got to this urgent supplemental food assistance bill for Sub-Sahara, Africa.

So I would think that perhaps a few fingers ought to be pointed right back at the Congress—both Houses and the leadership on both sides of the aisle—for dealing like this with critical authorization appropriations matters. Sorry for the lecture, but I am pretty frustrated with the situation with respect to IDA-7 right.

Mr. WALLIS. We try to explain those things to the other countries and they always act as if nothing like that ever happened in their country, but of course it does in any democratic government, and they understand it perfectly well.

Mr. BONKER. Is it not true that other country's commitments are geared to the level of our——

Mr. WALLIS. They don't have to be and they had said they wouldn't go above the $750 million a year. They would put in some additional, but they didn't.

COST OF EUROPEAN COMMUNITY SUBSIDIES

Mr. BEREUTER. Let me ask a final question. We hear lots of groaning in Europe today with the finance ministers and the exchequers about what the export subsidies are doing to them over there. Some of us keep wondering how long they can maintain that level of subsidy, and I gather part of the disturbance right now with Mrs. Thatcher's government has to do with that subject, and the old bargain struck between the Germans and the French about putting this whole thing together, and industrial and agricultural products. Is it under severe duress now or are we likely to see them finally admitting they cannot continue this level of subsidy?

Mr. WALLIS. It is definitely our impression that they can't. Something like 70 percent of the total budget of the EC goes to these agricultural subsidies, and they are making major frictions among the different countries, and there is a feeling that if we can keep our temper long enough, the reforms on agricultural policy will be forced by financial reasons.

REFORMS IN EUROPEAN COMMUNITY

They have started to try to come to grips with this problem in the EC Commission. Some of the measures they are taking as a partial attempt to come to grips with it are ones that we are, to say the least, disapproving of. For example, this reference—was it you who referred to corn gluten earlier?

Mr. BEREUTER. Yes.

Mr. WALLIS. That comes about as part of their attempt to reform. They want to reform at our expense. But we are certainly going to make a major resistance to that and have made that clear to them.

EUROPEAN SUGAR PRICES AND CARIBBEAN BASIN

Mr. BEREUTER. I hope one subject that you will be able to raise with some of our European allies just with respect to the Caribbean Basin, is that their agricultural trade policies, have a devastating effect from time to time on the Caribbean. We can put millions of dollars of aid into the Caribbean Basin but all the Europeans have to do is do what they did two years ago with their sugar prices and their sugar export policy, and absolutely devastate these one and two export nations of the Caribbean, and I hope you will remind them, not too gently, that they have done great damage to the Caribbean Basin in the last 2 years.

Mr. WALLIS. Their restrictions on textile imports also are very damaging to the Caribbean.

Mr. BEREUTER. Thank you.

Thank you, Mr. Chairman.

TIMING OF NEW TRADE ROUND NEGOTIATIONS

Mr. HAMILTON. Mr. Secretary, I just wanted to get clear. That you favor a new round of trade talk?

Mr. WALLIS. Yes.

Mr. HAMILTON. Sooner than later is how I think you put it.

Mr. WALLIS. When I say I do, the administration does.

Mr. HAMILTON. You will be pushing at the summit for an early round of trade talks?

Mr. WALLIS. We would like to see a decision made to do it by the end of next year.

TALKS ON INTERNATIONAL MONETARY SYSTEM

Mr. HAMILTON. But you do not favor talks on restructuring the monetary system, as some economists have called for?

Mr. WALLIS. No, I wouldn't say that. The Williamsburg summit—I wonder if I can find the exact language there—says that we have invited ministers of finance in consultation with the Managing Director of IMF, to define the conditions for improving the international monetary system and to consider the part which in due course might be played in this process by high level international monetary conference. That work was instituted at Williamsburg by the finance ministers is in progress, and as I referred to earlier, the fact is they will have a report they say by the middle of the year.

Mr. HAMILTON. This year?

Mr. WALLIS. Middle of next year.

Mr. HAMILTON. 1985?

Mr. WALLIS. Yes.

Mr. HAMILTON. So we are moving then toward a major meeting on restructuring the monetary system.

Mr. WALLIS. No, we won't know whether we are or aren't until after we see the results of the finance ministers, but I do know they put out a communique after their last meeting in Rome about 2 weeks ago or 1 week ago, and I know from that that they are converging pretty much on the idea that the problem is to make the existing system work better rather than to put in new institutions or restructure them, but improve their operations.

MAJOR ISSUE AT LONDON SUMMIT

Mr. HAMILTON. What issue do you think will dominate the headlines at the summit?

Mr. WALLIS. Well, if any big news event occurs between now and then that will probably dominate it. Something of that sort. When anything of that sort has happened before a summit, they have discussed it and put out statements. You remember last year before the summit the Russians made some kind of threat against Western Europe. As a result there was a statement put out before the Economic Summit got going on——

Mr. HAMILTON. Absent that kind of event, what would you expect to be the big headlines?

Mr. WALLIS. I don't know. I think that the subjects discussed will be the ones I mentioned, and I don't know which one the press will decide are least unnewsworthy.

Mr. HAMILTON. What do you think?

Mr. WALLIS. Trade, I think if there is a definite recommendation a decision should be made on a new trade round, that those who watch those things will recognize that is an important step, but it isn't going to affect anything in the real world for several years.

DISCUSSION OF TERRORISM

Mr. HAMILTON. Is it possible that things like terrorism, for example, might come up?

Mr. WALLIS. That could be one. I don't know what the political subjects would be. That could be one of them.

POLISH DEBT AND REPAYMENT TO U.S. GOVERNMENT

Mr. HAMILTON. Now, if I may go back to an old issue for a moment. I want to talk briefly about the Polish debt problem. We asked for some material from the State Department about its status, and the department has indicated to us that since the imposition of martial law in Poland in 1981, the Government of Poland has paid $4.7 billion in net payments to private banks. About 10 percent of that came to U.S. banks. But in that same time period, the U.S. Government has received only about $14½ million back from Poland on its outstanding loans. And in that period of time, the U.S. Government has paid $887 million to private banks on Polish loan guarantees.

Now, the question is why are the private banks getting these huge back payments from the Poles while the U.S. Government is getting next to nothing?

Mr. WALLIS. Well, I am not really prepared to discuss that issue at all. I haven't looked into that Polish debt problem for probably a month or two, because of the various things going on.

Of course, I do know why the money is paid, because the Federal Government guaranteed the loans and the loans defaulted, so they are obligated to pay, but I am sure you knew that, too.

COST OF POLISH DEBT TO UNITED STATES

Mr. HAMILTON. Well, I am just concerned that the American taxpayer is assuming such an enormous liability, almost $1 billion, while private banks are doing pretty well. They are getting their money back. Poland is paying the private banks but Poland is not paying us, and the American taxpayer is getting stung with $1 billion bill.

Mr. WALLIS. Of the $14 million you cite, I haven't any idea what would be the total amount that could be collected in that period, what basis to judge that against.

Mr. HAMILTON. It seems to me like Poland has made the judgment that they are going to pay back the private banks because they thereby hope to get new trade credits, which they have done and have gotten, but that they are not going to pay back the official creditors because they have made the correct judgment we weren't going to extend any additional credit.

Mr. WALLIS. Well, as I say, I am absolutely not up on that, but isn't that partly that the rescheduling of that debt hasn't been completed?

Mr. HAMILTON. That is by our choice. It looks to me like we are not making a very good choice.

Mr. WALLIS. Well, I know that that has been a matter of considerable discussion.

ADMINISTRATION CONCERN ABOUT POLISH DEBT

Mr. HAMILTON. Let me observe every time I bring this up, no matter in what forum and with what witnesses, the witness doesn't know anything about it. You are the Under Secretary for Economic Affairs, Mr. Wallis. I talked to the Secretary for European Affairs. He doesn't know anything about it.

Mr. WALLIS. Any of us can find out easily enough.

Mr. HAMILTON. What concerns me is your lack of concern, your lack of involvement in the issue. I am just bringing it up for your attention. I know that you did not anticipate this. I brought it up toward the end, but I am getting increasingly concerned about it and I would hope that since I have raised the question repeatedly that you would begin to look at it more carefully and raise it in your list of priorities. I know you have got a lot of them, but this seems to me to be a pretty serious matter.

Mr. WALLIS. There is a Deputy Assistant Secretary in whom I have a lot of confidence who is watching that and I am sure if I asked her, she could tell me in 2 minutes the answer to what you discussed.

Mr. HAMILTON. It is not a question of a Deputy Assistant Secretary knowing what the facts are. I am sure there are those who do. It is a question of raising it sufficiently to a policy level so that we begin to deal with the problem.

Mr. WALLIS. Oh, yes.

Mr. HAMILTON. I am concerned with this gross difference between the way the Poles have treated the private banks here and the way they have treated the U.S. Government.

Mr. WALLIS. I thought what you were asking was why is it that way.

Mr. HAMILTON. I think I see what Poland has done, but the one that is really getting stuck in the end is the American taxpayer.

With that happy note, Mr. Secretary, we will conclude the hearings. Thank you very much.

Mr. WALLIS. Thank you.

[Whereupon, at 4:10 p.m., the subcommittees adjourned.]

APPENDIX 1

Current Policy No. 579

Looking Toward London: Ten Years of Economic Summitry

May 23, 1984

United States Department of State
Bureau of Public Affairs
Washington, D.C.

Following is an address by Allen Wallis, Under Secretary for Economic Affairs, before the American Association of Exporters and Importers, New York, May 23, 1984.

When I accepted the invitation to be your keynote speaker, I realized that I would appear on the eve of an important event, the 10th annual economic summit meeting of the heads of state and government of the seven major industrialized countries: the United States, Canada, Japan, the United Kingdom, the Federal Republic of Germany, France, and Italy.

The first economic summit, which did not include Canada or Italy, was held in Rambouillet, France, in 1975. I doubt that many people predicted then that Rambouillet would lead to yearly meetings of the leaders of the seven largest free-world economies to discuss mutual economic concerns. Certainly one of the thoughts most remote from my mind then was that I would become involved in the 9th and 10th summits. One of my first assignments when I came to Washington in July 1982 was to serve as the President's personal representative in preparing for the Williamsburg economic summit. That meeting was highly successful, thanks to the major part the President personally took in the preparations and above all to his splendid presiding at the actual sessions. For the past several months, I have been increasingly absorbed in preparing for the London summit, which will be held June 7-9. In fact, I returned only yesterday from Chevening, near London, where the personal representatives met for 2 days in their final preparatory session.

I did not realize until recently that my speech today would be near the anniversary of another historic event of particular significance to this meeting and to National Trade Week. Fifty years ago, Secretary of State Cordell Hull shepherded through the Congress the seminal Reciprocal Trade Agreements Act. Coming 4 years after the Smoot-Hawley Tariff Act had devastated world trade, and a year after the United States had "torpedoed" the London economic conference, the Reciprocal Trade Agreements Act was the first major step in the emergence of the United States into global economic leadership. It meant that the United States was beginning to shift from extreme protectionism toward assertive, forward-looking efforts to liberalize world trade. The act symbolized Hull's strong belief, which he had voiced as a congressman during the First World War, that "unhampered trade dovetails with peace; high tariffs, trade barriers, and unfair economic competition with war."

A half century later, the world economy has changed dramatically. It is more complex. Yet the essential goal of the Reciprocal Trade Agreements Act—trade liberalization—remains one of the central objectives of the United States as we approach the 10th economic summit. Just as Hull argued that beggar-thy-neighbor trade policies begat the conflict of World War I, we today are firmly convinced that trade liberalization and a coordinated approach to related economic issues are vital to Western solidarity. In the decades following Hull's stewardship, we have learned collectively that there can be no secure peace without economic harmony.

It was this kind of thinking that led former French President Giscard d'Estaing to call the first summit meeting at Rambouillet, and this is why it is so vital today to continue regular consultations at the highest levels of Western governments on issues that are basic to peace and prosperity—issues such as growth, trade, finance, money, development, and economic security. Less than 2 weeks ago, Ambassador Brock, the U.S. Trade Representative, convoked a highly useful meeting of many of his main counterparts to let their hair down and to vet the problems facing the multilateral trade system. Last week, Secretary of the Treasury Regan met with 10 other finance ministers for a comparable purpose relating to international finance. But the value of economic summits is that they go beyond discussion of any single subject.

The summits afford leaders an opportunity to take account of the interrelationships among the various aspects of economic policy. Bilateral meetings can accomplish part of this function. Bilateral issues, however, tend to be relatively sharply defined. In an interdependent world, economic issues are more complex and multilateral. Leaders, not their staffs, must ultimately make the hard choices on economic policy that affect not only their electorates but also millions of people outside their borders. It is valuable for them to hear directly from their counterparts other, sometimes conflicting, ideas on how best to approach mutual problems.

Just as important is the fact that economic summits allow the heads of government an unusual opportunity to get a better sense of each other's larger priorities, perceptions, prejudices, and policies. While there is an abundance of opportunities each year for trade and finance ministers to meet, the annual summits provide the only regular occasion for the major Western heads of government to confer on economic issues.

Evolution of the Summits

The main topic of my talk today is our principal goals and objectives for the London summit. Before I outline them, however, I will set the stage by sketching the evolution of summits since President Reagan took office.

Ottawa in 1981 was President Reagan's first summit and, therefore, his first opportunity to explain his domestic economic policies to his summit colleagues. Already in place was much of his program to promote sustainable, market-oriented, noninflationary growth. The key components of this program were, as they are today, to reduce government spending; to change the tax code in ways that provide incentives for individuals to work, to save, and to invest; to reduce government regulation; and to achieve stable and moderate growth in the money supply. At the time, the President's strong emphasis on stopping inflation and on shifting resources and their management away from government and into private control was seen by some as being at best on the fringes of respectable economic policy. Thus, at Ottawa the President was received politely but skeptically.

The President also used the opportunity to highlight his concerns about the relationship between economic relations with Eastern countries and Western security. Finally, at Ottawa the President gave a preview of the approach he was to articulate more fully at Cancun later that year on managing the relationship between developed and less developed economies.

At Versailles in 1982, the heads of government were faced with a somber economic tableau—falling output, rising unemployment, and high interest rates. The sole bright spot was lower inflation in the United States. Concern about exchange rates led to agreement to develop a framework in which the five countries with special responsibilities for the international monetary and financial systems—namely the United States, Japan, the F.R.G., the United Kingdom, and France—could consult more effectively about the effects of their domestic economic policies on the international economy. A study of the historical record of exchange rates was also launched. Finally, Versailles highlighted further the pressing need for greater consensus on East-West economic issues.

By the time of Williamsburg, developments in the American economy had already begun to show the success of the economic policies President Reagan had first championed at Ottawa 2 years earlier. The summit leaders expressed confidence that economic recovery was becoming a reality, with the United States in the lead. They defined a strategy by which, through a more open trade and financial system, they could grapple effectively with the legacies from the 1970s of inflation, unemployment, and debt. They agreed on ways to promote greater convergence of economic performance, accepting thereby the conclusion from the study of exchange rates that economic convergence was essential for stability of exchange markets. At Williamsburg, the cry for massive government intervention intended to control exchange markets was muted though not quite stilled. On East-West economic issues, the leaders pointed to a new consensus based on work carried out in institutions such as the Organization for Economic Cooperation and Development, the North Atlantic Treaty Organization, and the International Energy Agency. Finally, stressing the interrelationships among growth, trade, and finance, the leaders agreed on the components of a strategy for managing international debt and for promoting a more open trade system. These components included immediate actions as well as others that would be considered for the medium term, such as a new round of multilateral trade negotiations.

With this background on the evolution of the last three summits, let me turn to a discussion of our goals and objectives for the next summit at London.

U.S. Objectives

The United States will pursue two principal objectives at the London summit:

First, to confirm that economic recovery—not just in the United States but in other summit countries—has taken hold firmly and that we need to recommit ourselves collectively to policies that will ensure that growth will be sustained, will not become inflationary, and will spread to the rest of the world;

Second, to build on the strategy outlined at Williamsburg for managing international trade and financial problems and to translate that strategy into a concrete program of action.

In a sense, London will be a transition summit, marking the passage from a period in which the task was to lay solid domestic foundations for growth to one in which our nations together, building on agreements at Williamsburg, can further shape their vision of the future of the international economic system. Since the beginning of his Administration, the President has argued that the foundation of a well-functioning international economy must be policies in each of the major countries to reduce inflation and to expand the scope for individual initiative. The thrust of his message has been that the proper role of government must be to remove domestic economic rigidities in order to facilitate, not frustrate, adjustment to changing circumstances, thus creating new jobs and a durable prosperity.

In contrast to the situation at Ottawa, at Versailles, and even to some extent at Williamsburg, the President's message and, indeed, his economic program are now more widely accepted among our summit partners. The change in attitude of some summit countries is striking indeed. Our partners now recognize that the President's policies have succeeded and that, through his contribution to the past three summits, he has forged with them a coherent strategy for sustainable, noninflationary growth that is bringing our nations out of the recessionary trough of the early 1980s. Although further reduction in market rigidities in many countries will be slow and painful, all now agree on its necessity and are working to achieve it. Thus, the London summit will provide an opportunity to review and to take satisfaction from our achievements during the President's first term, stressing the consistency and continuity of purpose that has characterized the President's approach to both domestic and international economic problems.

But the London summit will be more than a summary or recitation of past successes. Because summit leaders will start their discussions already basically agreed on the problems they face and on the objectives of their respective national economic policies, London offers the additional and unique opportunity for leaders to look beyond current problems and to develop further a strategy that will consolidate economic recovery and advance our objectives of more open world markets.

Our two broad objectives at London, then, are strengthening and spreading recovery, and progress on international trade, finance, and debt. Let me translate these broad objectives into more specific goals.

We expect that one of the main subjects discussed at London will be the economic situation and the outlook for world recovery. There has been a broad convergence of the economic performances of summit countries toward faster growth and lower inflation. Summit countries grew on the average of 2.4% in 1983. This contrasts with 0.4% in 1982 and 4.5% forecast for 1984. Summit-country inflation was 6.8% in 1982, 4.3% in 1983, and is forecast to be 4.6% this year. Continued non-inflationary expansion in summit countries is essential to spur similar growth in other industrialized countries as well as in the less developed countries.

Thus, one of our chief tasks at London is to explore ways to sustain this convergence of summit-country economic performance and to ensure that higher growth and lower inflation spread to the rest of the world. We believe the key elements of our action plan should be:

First, to restrain government spending, thus allowing expansion of the private sector;

Second, to promote stable, moderate monetary growth, thus inducing lower interest rates and increasing confidence that inflation will be contained;

Third, to remove structural rigidities that are inhibiting the growth of employment in some summit countries; and

Fourth, to maintain and enhance the open trading system in order to foster economic growth, particularly in the developing world.

Concerns will undoubtedly be voiced about U.S. budget deficits and the fear that they will cause higher interest rates that could choke off recovery and reignite inflation in both industrial and developing nations. With action now taken in both the House and Senate on the President's proposals for a "downpayment" on the deficit, we believe we can promise real action in the near future to reduce budget deficits. We will point again to the multilateral surveillance process, initiated at Versailles and strengthened at Williamsburg, as a forum for continuing consultations on convergence. We will also point out that the sizeable trade and current account deficits of the United States have made major contributions to growth in other countries as their exports to our market have risen. However, that situation will not last forever, so it is urgent that all countries pursue their adjustment efforts.

As regards the developing countries with severe debt problems, all parties must continue to fulfill their responsibilities under the five-point debt strategy endorsed at Williamsburg. The problem will be manageable in the long run, as well as the short, if each of us does his job.

Our objective at London is to confirm that our strategy for managing LDC debt problems on a flexible, case-by-case basis is working and requires no fundamental change. This strategy has worked successfully to promote adjustment efforts in debtor countries and has checked serious disruption of the international trade, finance, and monetary systems.

We believe this strategy is appropriate for the medium as well as the short term. There have been several suggestions recently that our strategy lacks a medium- to long-term component. In fact, it has both. We believe the London summit will offer an opportunity to expand and clarify the medium-term aspects of the strategy agreed to at Williamsburg. We will stress four major elements:

- The need for continued adjustments by debtor countries with the support of the IMF [International Monetary Fund] and lending by commercial banks;
- The need to expand trade between developed and developing countries to promote growth in both and to assure that heavy debtors will be able to earn foreign exchange to service their debts and to justify increased commercial bank lending in the years ahead;
- The need for developing countries to stimulate increased foreign direct investment to redress the imbalance between debt and equity in their external finances and to attract the financial, technological, and management resources they need to exploit future export opportunities; and
- The need for closer coordination between the International Monetary Fund and the World Bank in order to make the role of the Bank more consistent with that of the IMF in promoting adjustment in developing countries, and in strengthening the Bank's contribution to longer term development.

With respect to international trade, the challenge for summit leaders at London will be to consolidate the movement toward worldwide economic recovery, to promote early progress in liberalizing trade and improving the trade system, and to move forward toward new multilateral trade negotiations to achieve more comprehensive liberalization.

At the OECD [Organization for Economic Cooperation and Development] ministerial meeting last week, member countries agreed that a new round of multilateral trade negotiations is "of the utmost importance to a strengthening of the liberal trade system." They urged expanded consultations with all GATT [General Agreement on Tariffs and Trade] countries and gave a high priority to the GATT work program established in 1982 to lay the groundwork for the development of a consensus on such negotiations. We hope the summit will give a real impetus at the highest political level to this undertaking. The liberalization that such negotiations can achieve is essential in order to consolidate the future success of the strategies for domestic growth on which our countries are now embarked.

Finally, our objectives on East-West economic relations at London are simple and straightforward. We will seek to continue to work closely with our summit partners and other allies to broaden our consensus on prudent economic relationships with the Soviet Union and the countries of Eastern Europe. We will urge that work underway since 1982 in such specialized organizations as the OECD, IEA, COCOM [Coordinating Committee for Multilateral Security Export Controls] and NATO continues in order to make that consensus as comprehensive as possible.

In spite of the length with which I have described U.S. goals and objectives at London and the issues we expect to tackle collectively, you most definitely should not get an impression that we expect major breakthroughs at London that will make headlines in *The Wall Street Journal*, *The New York Times*, or the *Journal of Commerce*. For at least three reasons, I expect this not to occur.

First, if the problems discussed at London were susceptible to easy answers and quick fixes, there would be no reason for the summit. The issues with which the summit leaders wrestle are complex. Only long-term approaches provide real solutions, and long-term approaches are complicated and difficult. Those who expect blinding revelations and facile cures for the world's economic ills will be disappointed—not only in June at London but perpetually everywhere.

In a repetition of the atmosphere introduced by President Reagan at Williamsburg, we expect that summit leaders at London will discuss these longer term approaches in an informal, flexible manner without the rigidly structured agenda and prenegotiated communique of most summits before Williamsburg. Earlier summits focused on detailed means to coordinate macroeconomic policies, reflecting a view that the route to sustained growth lay in internationally concerted manipulation of demand—so-called "fine tuning." These efforts were disappointing and may have contributed to the instability that only now is being brought under control. While our new approach to summitry may produce fewer headlines, it seems to me eminently more prudent and constructive.

The second reason that headline hunters will be disappointed is that disagreements make the best headlines. As summit economies expand, scapegoating diminishes; nevertheless, I expect the stories from London to focus on expressions of concern about interest rates, deficits, and debt crises. I urge that you not be misled if that happens. Expressions of concern, which indeed we all share, do not necessarily mean disagreement or disarray. While there will not be agreement on every issue, I will be surprised if there is significant disagreement on an issue of major importance. So I suggest that you look beyond the headlines, read carefully the statements that are issued, and draw your own conclusions.

Finally, I anticipate that no startling news will come out of London because the news deals with the present but the summit deals with the future. The real test of the London summit's success will be reflected not in next month's headlines but in the months that follow; not in what the leaders say at London but in what they do in the months and years ahead when the United States and our summit partners seek to implement domestically and internationally the policies sketched at London. We have come a long way, individually and collectively, in the 50 years since the Reciprocal Trade Agreements Act, but there is still a long way to go. London, like its predecessor summits, will mark another, and I believe a significant, milestone on our journey. ■

Published by the United States Department of State • Bureau of Public Affairs
Office of Public Communication • Editorial Division • Washington, D.C. • May 1984
Editor: Colleen Sussman •

APPENDIX 2

Biographies of Witnesses

Edmund T. Pratt, Jr.

Edmund T. Pratt, Jr. is the chairman of the board and chief executive officer of Pfizer Inc. Mr. Pratt joined Pfizer as controller in 1964. He moved to Pfizer International in 1967 as operations vice president and became chairman of the board and president of Pfizer International in 1969. Mr. Pratt was elected to the board and executive committee of Pfizer Inc. in 1969, and he was named president in 1971 and chairman of the board and chief executive officer in 1972.

He began his business career with International Business Machines Corporation and was controller of IBM World Trade Corporation from 1958 to 1962. During the Kennedy Administration he served as assistant Secretary of the Army for Financial Management.

Born in Savannah, Georgia in 1927 he was graduated Phi Beta Kappa and magna com laude from Duke University in 1947 with a B.S. degree in electrical engineering. He received an M.B.A. degree from the Wharton School of Commerce and Finance, University of Pennsylvania, in 1949. Mr. Pratt served in the U.S. Navy during World War II and the Korean War.

Mr. Pratt is a director of General Motors Corporation, International Paper Company, The Chase Manhattan Corporation, and The Chase Manhattan Bank, N.A. He is chairman of the Emergency Committee for American Trade, Chairman of the Advisory Committee on Trade Negotiations, and a member of the President's Export Council. Mr. Pratt serves on the Policy Committee of the Business Roundtable and is a member of the Business Council.

He is a trustee Duke University and a member of the board of overseers of the Wharton School of Commerce and Finance.

Mr. Pratt is vice chairman of the New York State Business Council and chairman of the United Way of Tri-State. He is a member of the board of the New York Chamber of Commerce and Industry, the New York Economic Development Council, the New York City Partnership and the Japan Society, a trustee of the Committee for Economic Development and the United States Council of the International Chamber of Commerce, and a member of the National Industrial Advisory Council of Opportunities Industrialization Centers of America.

Mr. Pratt and his wife, Jeanette, live in Port Washington, New York.

Alan Greenspan

Dr. Alan Greenspan is chairman and President of Townsend-Greenspan & Co., Inc., an economic consulting firm in New York City. He previously had held this position from 1954 to 1974.

From August, 1974 to January, 1977 he served as Chairman of the President's Council of Economic Advisers in Washington under President Ford.

Current Associations: Member President Reagan's Economic Policy Advisory Board; member President's Foreign Intelligence Advisory Board; member of Time Magazine's Board of Economists; Senior Adviser to the Brookings Panel on Economic Activity; Adjunct Professor of Economics, Graduate School of Business Administration, New York University; Member Board of Overseers, Hoover Institution (at Stanford University); Consultant: Congressional Budget Office, Federal Reserve Board.

Corporate Directorships: Aluminum Company of America (ALCOA); American Broadcasting Companies, Inc.; Automatic Data Processing Inc.; General Foods Corporation; J. P. Morgan & Co., Inc.; Morgan Guaranty Trust Company of New York; Mobil Corporation.

Memerships: Council on Foreign Relations, Director; Conference of Business Economists (past Chairman); National Association of Business Economists (past

President (1970) and Fellow); National Economists club (Washington, D.C.) (past Director); Trilateral Commission, Executive Committee.

Past Presidential Appointments: The National Commission On Social Security Reform (Chairman) (1981–1983); Commission on Financial Structure and Regulation (1970–1971); Commission on an All-Volunteer Armed Force (1969–1970); Task Force on Economic Growth (1969).

Awards: Joint recipient, with Dr. Arthur Burns and William Simon, of the Thomas Jefferson Award for the Greatest Public Service Performed by an elected or appointed official. Presented by the American Institute for Public Service (1976), Recipient of the Public Service Award. Presented by Claremont Men's College (1977), Recipient of the Distinguished Alumni Award, Graduate School of Business Administration, New York University (1978).

Honorary degree, Doctor of Commercial Science, Pace University (1981), as well as many others.

Background: B.S. summa cum laude, M.A., Ph.D., New York University advanced graduate study; Columbia University.

Born—New York City, March 6, 1926.

C. Fred Bergsten

1. C. Fred Bergsten is Director of the Institute for International Economics, created in late 1981 as the first research institution in the United States devoted to international economic policy issues. The Institute is now averaging about one publication per month on international economic, monetary and trade topics. In addition, it hosts an active series of discussion meetings on a wide range of international economic issues.

2. Dr. Bergsten was Assistant Secretary of the Treasury for International Affairs during 1977–81, and also functioned as Under Secretary for Monetary Affairs during the last year of that period. In those capacities he had responsibility for a wide range of US policies in the international monetary, trade, investment and development areas.

3. During 1969–71, Dr. Bergsten served as Assistant for International Economic Affairs to Dr. Henry Kissinger on the Senior Staff of the National Security Council.

4. Dr. Bergsten has been a senior fellow at the Brookings Institution (1972–76), Carnegie Endowment for International Peace (1981) and Council on Foreign Relations (1967–68).

5. He has authored twelve books, ten monographs and over sixty articles on international economic issues. His books include: American Multinationals and American Interests (1978), The Dilemmas of the Dollar: The Economics and Politics of US International Monetary Policy (1976), Toward a New World Trade Policy (1975), World Politics and International Economics (1975), and five volumes of his collected essays including The United States in the World Economy (1983). His articles have appeared in such journals as the American Economic Review, Journal of International Economics, Foreign Affairs and Foreign Policy.

6. Dr. Bergsten has received the Exceptional Service Award of the Treasury Department and the Meritorious Honor Award of the Department of State. He is listed in Who's Who in the World, Who's Who in America, Five Thousand Personalities of the World and Two Thousand Notable Americans.

7. Dr. Bergsten testifies frequently before a wide range of Congressional committees and appears often on such television programs as the McNeil-Lehrer Report, David Brinkley's Journal and the networks' evening news reports. He is quoted widely in the quality press (including the New York Times, Washington Post and Wall Street Journal and is a popular public speaker, having recently addressed the Business Council, International Monetary Conference, National Press Club and other leading groups in the United States and abroad.

8. Dr. Bergsten received his M.A., M.A.L.D. and Ph.D. degrees at the Fletcher School of Law and Diplomacy. He received his A.B. from Central Methodist College in Missouri.

W. Allen Wallis

Since September 1982, Mr. W. Allen Wallis has been serving as Under Secretary of State for Economic Affairs, having been nominated by the President in July 1982.

A native of Philadelphia, Mr. Wallis' prior career included serving as Chancellor of the University of Rochester (1962 to 1982). From 1946 to 1962 he was at the University of Chicago as Professor of Statistics and Economics, Chairman of the Statistics Department, and Dean of the Graduate School of Business.

Mr. Wallis served in the Federal Government as Special Assistant to President Eisenhower and Executive Vice Chairman of the Cabinet Committee on Price Stability for Economic Growth from 1959 to 1961. He was a member of the President's Commission on an All-Volunteer Force, 1970-74; and the Corporation for Public Broadcasting, 1975-78, serving as Chairman in 1977 and 1978. In addition. Mr. Wallis was the Chairman of the President's Commission on Federal Statistics, 1970-71, and Chairman of the Statutory Advisory Council on Social Security, 1974-75.

Mr. Wallis graduated from the University of Minnesota in 1932. In addition, he studied economics on the graduate level at the University of Minnesota, the University of Chicago, and Columbia University from 1932-36. He is the author of some ten books and monographs and has had published numerous scholarly articles on economics and public and international policy.

He is married to the former Anne Armstrong and has two children.

O